Dr. John Lacey
Depreciation

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

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In the Matter of Petition of WorldCom, Inc. Pursuant to Section 252(e)(5) of the Communications Act for Expedited Preemption of the Jurisdiction of the Virginia State Corporation Commission Regarding Interconnection Disputes with Verizon Virginia Inc., and for Expedited Arbitration	)	CC Docket No. 00-218
In the Matter of Petition of Cox Virginia Telecom, Inc., etc.	)	CC Docket No. 00-249
In the Matter of Petition of AT&T Communications of Virginia Inc., etc.	)	CC Docket No. 00-251

VERIZON VIRGINIA INC.

REBUTTAL TESTIMONY OF DR. JOHN LACEY ON DEPRECIATION INPUTS

(PUBLIC VERSION)

August 27, 2001

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I. INTRODUCTION AND SUMMARY
(JDPL Issues II-1-a; II-1-c; II-2-a; II-2-c)

Q. What is your name and address?

A. My name is Dr. John M. Lacey. I am Professor of Accountancy and Ernst & Young Research Fellow at California State University, Long Beach. My address is 7 Poppy Trail, Rolling Hills, CA 90274. I filed direct testimony in this proceeding on July 31, 2001.

Q. What is the purpose of your rebuttal testimony?

A. The purpose of this rebuttal testimony is to respond to Mr. Lee's claim that Verizon VA's increasing depreciation reserve demonstrates that AT&T/WorldCom's proposed depreciation lives are forward-looking. Verizon witness Allen Sovereign also responds to Mr. Lee's proposed depreciation lives.

Q. Please summarize your testimony.

A. Mr. Lee's claim that because Verizon VA's depreciation reserve has increased since 1994, the Commission prescribed depreciation lives are adequate and forward looking is flawed. Verizon VA's depreciation reserve is increasing simply because Verizon VA has been changing its mix of assets and the age of the assets has increased (relative to their projected lives). Contrary to Mr. Lee's assertion, this fact does not mean that the depreciation lives prescribed by the Commission are forward-looking and appropriate for pricing unbundled network elements ("UNEs").

II. VERIZON VA'S INCREASING DEPRECIATION RESERVE DOES NOT SUPPORT AT&T/WORLDCOM'S PROPOSED DEPRECIATION LIVES. (JDPL ISSUES II-1-a; II-1-c; II-2-a; II-2-c)

Q. Do you agree with Mr. Lee's claims that Verizon VA's increasing depreciation reserve levels provides empirical evidence that AT&T/WorldCom's proposed depreciation lives are forward-looking? (Lee at 5-8).

A. No. Mr. Lee's attempt to use depreciation reserve levels to justify his proposed depreciation lives is off base. Mr. Lee makes much of the fact that Verizon VA's depreciation reserves are increasing. But this increase is to be expected and says nothing about whether AT&T/WorldCom's proposed lives are forward-looking. In fact, one would expect Verizon VA's reserve levels to have been even greater if proper forward-looking depreciation lives had been used.

Q. Please briefly explain Mr. Lee's reasoning.

A. Mr. Lee attempts to show through an example that the depreciation reserve would remain constant if depreciation lives were not forward-looking. Then, using the same simplistic and wholly unrealistic example, he attempts to show that using shorter depreciation lives would mean an increase in the accrual rate that would lead to an improper increase in the reserve balance.

Specifically, Mr. Lee assumes in his example that the average age of assets remains constant (9 years in his example), that the average total life of

assets remains constant (27 years in his example), and that replacements exactly equal retirements. In such a hypothetical, simple and unlikely model, the percentage of depreciation reserve would remain constant over time.

Q. Do you agree with Mr. Lee's analysis?

A. No. Mr. Lee's analysis is flawed for at least three reasons. First, Mr. Lee ignores that as the age of the assets increases, both the amount of depreciation reserve and the percentage of depreciation reserve increases. This result is true in a simple model or in the real world, whether or not depreciation lives are forward-looking.

Second, Mr. Lee also ignores that the depreciation reserve will grow if the company changes its asset mix and begins adding new assets that have a shorter life than the older assets that are in place and continuing to be depreciated. Because the average total life of the new assets is shorter, the total depreciation reserve and the percentage of depreciation reserve begin to grow faster after the asset mix changes than before. This result is also true whether depreciation lives are forward-looking or not.

Third, Mr. Lee further suggests in his model that the cause of an increase in the depreciation reserve is shorter asset depreciation lives. He describes an increased "accrual rate," which is simply another way to describe a shorter depreciation life. It is true that a shorter life would lead to a higher depreciation reserve, but it is only one of several potential causes. The important fact here –

and one that destroys Mr. Lee's analysis – is that the prescribed lives for Verizon Virginia did ***not*** change during the time that Mr. Lee describes the increase in the depreciation reserve.

Q. Can you illustrate how the depreciation reserve increases as the age of the asset increases?

A. Yes. For example, assume that a company purchases a machine for $1,000 and expects to use it for ten years and then discard it. The depreciation expense every year is computed to be $100 per year ($1,000 divided by 10 years). In this example, 10% of the machine's cost is depreciated each year because the life is 10 years (1/10=10% per year).

The depreciation reserve is the accumulation of the depreciation taken to date. The depreciation reserve at the end of the first year is $100, or 10% of the cost of the machine because 10% of the machine's life has passed. At the end of the second year, the depreciation reserve is $200, or 20% of the cost of the machine because 20% of the machine's life has passed. By the end of the fifth year, the depreciation reserve is $500, or 50% of the cost of the machine because 50% of the machine's life has passed. The fact that the depreciation reserve is growing is simply a result of the machine getting older. By the end of the tenth year, the depreciation reserve is $1,000, or 100% of the cost of the machine, because the machine's entire cost was charged to depreciation expense over its life.

Q. Does the fact that the depreciation reserve is growing mean that the depreciation life is forward-looking?

A. No. The example above is a simple hypothetical with a made-up asset life. I made no assumption that the depreciation lives are forward-looking – in fact, the example does not even identify the asset. Thus, the example demonstrates that depreciation reserves increase as the asset increases regardless of the depreciation life assumed.

Q. Can you illustrate how the depreciation reserve increases as the asset mix changes?

A. Yes. For example, assume, as above, that a company purchases a machine for $1,000 and expects to use it for ten years and then discard it. The depreciation expense every year is computed to be $100 per year ($1,000 divided by 10 years). In this example, 10% of the machine's cost is depreciated each year because the life is 10 years (1/10=10% per year). By the end of the second year the depreciation reserve balance is $200, or 20% machine's cost.

Assume that at the beginning of the third year a second machine is purchased for $1,000, but that the second machine is expected to be used for only five years and then discarded. For the second machine with the shorter life, the depreciation expense every year is computed to be $200 per year ($1,000 divided by 5 years).

The depreciation reserve grows by $300 per year ($100 from the first machine and $200 from the second machine) so by the end of the sixth year it is $1400 ($600 from the original machine, because six years of its life has passed, plus $800 from the second machine because four years of its life has passed.) The depreciation reserve by the end of the sixth year is 70% ($1,400 of reserve divided by $2,000 cost) instead of the 60% it would have been if the new, shorter-lived asset had not been added.

Q. Does Mr. Lee's depreciation reserve analysis contain other flaws?

A. Yes. Mr. Lee assumes that just because Verizon VA's depreciation reserve is growing, it must be adequate, and therefore existing Commission-prescribed lives must also be adequate. He is mistaken.

Mr. Lee, for example, ignores that the useful life of a machine may change during the time of its use. The change may result from physical, technological, or economic factors (such as increased competition). A change in the life of an asset may mean that the associated depreciation reserve is inadequate, even though it has grown.

Assume in the first example with a single machine that technology and competitive market changes require the company to reassess the expected life of the machine at the beginning of the fourth year. The depreciation reserve balance

at the end of the third year is $300 ($100 per year for 3 years). The depreciation reserve percentage is 30% ($300 depreciation reserve divided by the $1,000 cost of the machine) because 30% of the machine's life had passed by the end of the third year. Assume further that the new expected life of the machine at the beginning of the fourth year, based upon the new information about technology and competition, is a total of six years instead of ten years. Based upon the new information, 50% of the machine's life has passed by the beginning of the fourth year (3 years out of the total 6 year life has passed), so the balance in the depreciation reserve account should be 50% of the machine's cost or $500 ($1,000 multiplied times 50%).

Even though the balance in the depreciation reserve account grew from $100 at the end of the first year to $300 at the end of the third year, the balance in the depreciation reserve is too low at the beginning of the fourth year because technology changes and competition have reduced the machine's useful life.

Q. Mr. Lee states that depreciation reserve level grew from 32.9 percent in 1992 to 49.6 percent in 2000, while the plant reserve amount grew by 60 percent. (Lee at 8.) Does that mean that the depreciation reserve is adequate?

A. No. As discussed above, Mr. Lee argues that the fact that Verizon VA's depreciation reserve level for the plant grew means that an appropriate forward-looking life has been used, or that the depreciation reserve is adequate. As illustrated in the examples above, this is simply not true. Indeed, there is reason

1 to believe that Verizon VA's current depreciation reserve is not growing enough
2 and is therefore inadequate.
3
4 For example, based upon the implied age[1] of Verizon Virginia's plant at
5 the end of 2000, if the minimum life in the Commission's range of depreciable
6 lives had been used to compute depreciation reserve instead of the prescribed
7 Virginia lives, Verizon VA's percentage of depreciation reserve would have been
8 approximately 56% by the end of 2000 instead of 49.6%.[2] This means that if
9 Verizon had consistently used the minimum life in the Commission's range of
10 depreciable lives instead of the prescribed Virginia lives, the implied depreciation
11 reserve would have been greater by approximately $460 million by the end of
12 2000 than it was using the Virginia prescribed lives. If Verizon VA's GAAP
13 lives had been used to compute the depreciation reserve instead of the prescribed
14 Virginia lives, its percentage of depreciation reserve for 2000 would have been
15 even greater (approximately 67%).[3]

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[1] The implied average age for each asset category is computed by multiplying the percentage of the depreciation taken to date for that asset category times the Virginia prescribed life for that asset category. The implied average age for all assets is the weighted average of the implied asset life for each category. The weight used in computing the average is end-of-year plant adjusted for salvage. The percentage of depreciation taken to date is the end-of-year depreciation reserve divided by end-of-year plant adjusted for salvage.

[2] The reserve percentage using the minimum life in the Commission's range of depreciable lives is computed first for each asset category by multiplying the implied age as a percentage of the FCC minimum life times end of year plant adjusted for salvage to compute the implied depreciation reserve amount for the FCC minimum lives. The sum of the implied depreciation reserve is then divided by the end-of-year plant adjusted for salvage to obtain the estimated reserve percentage.

[3] The reserve percentage using GAAP depreciable lives is computed first for each asset category by multiplying the implied age as a percentage of GAAP life times end of year plant adjusted for salvage to compute the implied depreciation reserve amount for GAAP lives. The sum of the implied depreciation reserve is then divided by the end-of-year plant adjusted for salvage to get the estimated reserve percentage.

1 **Q. How does Verizon Virginia's 67% implied depreciation reserve percentage,**
2 **computed based on its GAAP lives, compare to the depreciation reserve**
3 **percentage AT&T has computed using its GAAP lives?**
4 A. It is the same. Using its GAAP lives, AT&T computed a depreciation reserve
5 percentage for 2000 of **[BEGIN AT&T PROPRIETARY]** XXX **[END AT&T**
6 **PROPRIETARY]**.[4]
7
8 **Q. Did AT&T's reserve percentages increase during the 90s?**
9 A. Yes. AT&T's depreciation reserve percentage increased from **[BEGIN AT&T**
10 **PROPRIETARY]** XXX in 1990 to XXX in 2000 **[END AT&T**
11 **PROPRIETARY]**.[5]
12
13 **III. CONCLUSION**
14 **(JDPL ISSUES II-1-a; II-1-c; II-2-a; II-2-c)**
15
16 **Q. Please summarize your conclusions.**
17 A. The fact that Verizon VA's depreciation reserve has been increasing does not
18 provide empirical evidence that the 1994 Commission-prescribed lives are
19 forward-looking and appropriate for pricing UNEs. Mr. Lee's analysis is simply
20 wrong and is in direct conflict with basic depreciation concepts.
21
22 As I stated in my direct testimony, the Commission should adopt Verizon
23 VA's proposed depreciation lives, which are the same lives Verizon VA uses for

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[4] AT&T Response to Verizon VA Set IV, No. 8.

[5] AT&T Response to Verizon VA Set IV, No. 8.

1 its financial reporting and are based on GAAP principles. AT&T/WorldCom's
2 proposed lives, which are the lives the Commission prescribed in 1993 and 1994,
3 are outdated by many years and do not reflect the current and future state of
4 competition in Virginia or the changing technological environment.
5
6 **Q. Does this conclude your rebuttal testimony?**
7 A. Yes.

Declaration of John Lacey

I declare under penalty of perjury that the foregoing is true and correct. Executed this 23rd day of August , 2001.

John Lacey

Allen Sovereign
Depreciaion

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VERIZON VIRGINIA INC.

REBUTTAL TESTIMONY OF ALLEN SOVEREIGN ON DEPRECIATION INPUTS

AUGUST 27, 2001

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1 **I. INTRODUCTION AND SUMMARY**
2 **(JDPL Issues II-1-a; II-1-c; II-2-a; II-2-c)**
3
4 **Q. Please state your name, address and present position.**

5 A. My name is Allen E. Sovereign. My business address 600 Hidden Ridge, Irving,
6 Texas 75039. I am employed by Verizon Consolidated Services Inc. as Group
7 Manager-Capital Recovery. I submitted direct testimony in this proceeding on
8 July 31, 2001.
9
10 **Q. What is the purpose of your rebuttal testimony?**

11 A. The purpose of this rebuttal testimony is to respond to the depreciation inputs
12 proposed by Mr. Richard Lee on behalf of AT&T and WorldCom.
13
14 **Q. What depreciation inputs do AT&T and WorldCom recommend in this**
15 **proceeding?**

16 A. Mr. Lee recommends the outdated projection lives and future net salvage values
17 last prescribed by the FCC in 1994 (based on information gathered prior to 1994)
18 for Verizon Virginia Inc. ("Verizon VA").
19
20 **Q. What are Verizon VA's proposed depreciation inputs?**

21 A. As I explained in my direct testimony, Verizon VA is proposing the same
22 depreciation inputs it uses for financial accounting purposes. As Dr. John Lacey
23

1 explained, these lives comply with Generally Accepted Accounting Principles
2 ("GAAP").[1]
3
4 **Q. Please summarize your testimony.**
5 A. The 1994 Commission-prescribed lives proposed by AT&T/WorldCom are based
6 on data gathered prior to 1994 and are therefore outdated. Indeed, the
7 Commission itself has significantly ***shortened*** its recommended ranges of
8 depreciation lives for telecommunications assets since 1994. None of these
9 changes are reflected in AT&T/WorldCom's proposed depreciation lives.
10
11 The Commission's rules require that UNE prices reflect forward-looking
12 costs. As Dr. Lacey and I both explained in our direct testimony, the
13 Commission's 1994 prescribed lives do not appropriately reflect forward-looking
14 factors such as the current and future state of competition in Virginia and
15 technological innovations. (Mr. West also discusses in his direct testimony the
16 state of competition in Virginia and the technology being developed to replace
17 Verizon VA's network.)
18
19 The Commission should therefore adopt Verizon VA's proposed
20 depreciation inputs, which are the same inputs Verizon VA uses for financial
21 reporting purposes.

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[1] See Direct Testimony of Dr. John Lacey, submitted on July 31, 2001.

II. AT&T/WORLDCOM'S PROPOSED DEPRECIATION LIVES ARE OUTDATED AND DO NOT REFLECT FORWARD-LOOKING FACTORS SUCH AS COMPETITION AND CHANGING TECHNOLOGY. (JDPL Issues II-1-a; II-1-c; II-2-a; II-2-c)

Q. Has the Commission stated that its past prescribed depreciation inputs should be used to price unbundled network elements?

A. No. In fact, the Commission has explicitly stated that commissions do ***not*** have to use its prescribed lives in pricing of unbundled network elements ("UNEs"). The Commission, for example, held in the SBC Kansas/Oklahoma 271 proceeding: "We have never stated that states should be precluded from setting depreciation rates that differ from the Commission's, and do not do so here."[2]

In addition, in its Supreme Court reply brief filed in *Verizon Communications, Inc. v. FCC*, the Commission explained that depreciation lives calculated pursuant to TELRIC principles must account for technological change and competition: "[D]epreciation lives under TELRIC must accommodate[] reasonable economic assumptions about future technological advances and the effect those advances will have on the value of current assets."[3]

Importantly, in its reply brief, the Commission again emphasized that state

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[2] *In re Joint Application by SBC Communications Inc., Southwestern Bell Telephone Company, and Southwestern Bell Communications Services, Inc. d/b/a Southwestern Bell Long Distance for Provision of In-Region, InterLATA Services in Kansas and Oklahoma*, CC Docket No 00-217, Memorandum Opinion and Order (rel. Jan. 22, 2001) at ¶ 76.

[3] Reply Brief for Petitioners United States and the FCC, *Verizon Communications, Inc. et al. v. FCC*

commissions are not required to use historical depreciation lives, holding that these lives only provide a starting point for determining UNE prices:

> Among their many options, state commissions could . . . adopt accelerated depreciation schedules that provide faster recovery of incumbents' forward-looking costs at the beginning of the relevant period than at the end . . . . *The incumbents are . . . incorrect in asserting that TELRIC requires state commissions to retain the depreciation schedules* . . . that were set under prior historical cost-ratemaking schedules. . . . Although the FCC stated that existing determinations provide a "reasonable starting point for TELRIC calculations," the FCC was merely offering tentative guidance.[4]

Q. In your opinion, do the lives recommended by Mr. Lee represent forward looking economic costs?

A. No. The lives prescribed by the FCC in 1994 -- prior to the passage of the 1996 Telecommunications Act -- are outdated and could not have contemplated all the changes that have occurred in the telecommunications industry in general, and in Virginia specifically, such as increasing competition and technological innovations, both of which shorten the useful life of Verizon VA's assets. These factors are discussed in my direct testimony, and the direct testimony of Dr. Lacey and Mr. West.

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et al. (Nos. 00-551, 00-555, 00-587, 00-590, and 00-602) at 10.

[4] *Id.* at 11 (emphasis added).

1 **Q. Has the Commission recognized that the depreciation lives for**
2 **telecommunications assets have become shorter since 1994?**
3 A. Yes. The Commission itself has significantly ***shortened*** its recommended
4 depreciation inputs since 1994. The Commission, for example, shortened its
5 recommended range of depreciation lives in 1995, and again in 1999.
6 AT&T/WorldCom completely ignore these changes.
7
8 **Q. Please explain the purpose of the Commission's depreciation ranges?**
9 A. The Commission's ranges are a span of asset depreciation lives established to
10 simplify the depreciation rate setting process. The Commission determined that
11 establishing "Basic Factor Ranges" was more desirable than requiring ILECs to
12 prepare traditional historical depreciation studies because ranges provide
13 simplification, savings, and flexibility.[5] The ILEC generally could choose any
14 depreciation lives within the range.
15
16 The Basic Factor Ranges were determined by averaging the then current
17 prescriptions and applying a distribution mean. Because the depreciation rates for
18 all ILECs were reviewed on a three-year cycle, the prescriptions used as a basis to
19 determine the 1994 ranges were based on data for years prior to 1994.
20
21

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[5] *In the Matter of Simplification of the Depreciation Prescription Process*, CC Docket 92-296, FCC 93-452 (Oct. 20, 1993).

Q. Was Verizon VA granted permission in 1994 to use the shorter lives in the Commission's 1994 ranges?

A. Yes. During Verizon VA's 1994 depreciation proceeding, Verizon VA requested and was granted permission to use the shortest lives in the Commission's 1994 ranges. The following chart compares the current Commission prescribed lives with the low end of the Commission's 1994 ranges.

Projection Lives (Years)

Account	FCC Range[6]	FCC Prescribed
Motor Vehicles	7.5	7.5
Other Work Equipment	12	12
Furniture	15	15
Underground Cable Metallic	25	25
Fiber Cable	25	25
Conduit Systems	50	50

The Commission, however, had not established ranges for all assets in 1994.

Q. Are Verizon VA's current Commission-prescribed lives for the remaining assets (not included in the 1994 ranges) the same as the shortest lives in Commission ranges established in 1995 and 1999?

A. No. The Commission prescribed lives for the remaining assets not included in the 1994 ranges are ***longer*** than the shortest lives in the Commission's 1995 and 1999 ranges.

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[6] *In the Matter of Simplification of the Depreciation Prescription Process*, CC Docket 92-296, FCC 94-174, Second Report and Order (June 8, 1994).

Projection Lives (Years)

Account	Short end of FCC Range[7/]	FCC Prescribed
Digital Switching Equipment[8/]	12	17.5
Circuit Equipment - Digital	11	11.5
Poles	25	30
Aerial Cable Metallic	20	23
Buried Cable Metallic	20	21

Q. Is it your opinion that if the 1995 and 1999 ranges were available to Verizon Virginia in 1994, current Commission-prescribed lives would be at the short end of the Basic Factor Range?

A. Yes. Because the Commission approved lives for Verizon VA at the short end of the 1994 ranges, it follows that it would have approved lives at the short end of the 1995 ranges for accounts not included in the 1994 ranges. Through using the simplified approach, Commission would certainly have prescribed Verizon VA lives at the short end of the ranges.

7/ *In the Matter of Simplification of the Depreciation Prescription Process*, CC Docket 92-296, FCC 95-181, Third Report and Order (adopted May 2, 1995).

8/ *In the Matter of 1998 Biennial Regulatory Review -- Review of Depreciation Requirements for Incumbent Local Exchange Carriers*, CC Docket 98-137; In the Matter of United States Telephone Association's Petition for Forbearance from Depreciation Regulation of Price Cap Local Exchange Carriers, ASD98-91, FCC 99-397 (adopted Dec. 17, 1999), ¶ 13.

1 **Q. Are the lives recommended by witness Lee the shortest lives within the**

2 **Commission current ranges?**

3 A. No. In fact, some accounts have lives that are ***longer*** than the longest life in the

4 current Commission ranges, and some are near top of the range (the longest life).

5 For example, the Commission range for Operator Systems is 8-12 years, and

6 AT&T recommends 15 years.[9]

7

8 **Q. Has the Commission prescribed lives that are at the short end of the current**

9 **Commission ranges in other proceedings?**

10 A. Yes. The Commission's recent prescriptions in other proceedings have been at

11 the short end of the Commission's ranges. For example, the Commission recently

12 prescribed the shortest lives in the Commission ranges for affiliates of Verizon

13 VA in Washington, Oregon, Idaho, and Hawaii for rates effective January 1,

14 2000[10], and in the former GTE territories of Ohio and Virginia for rates effective

15 January 1, 1999.[11]

16

17

18

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[9] See Attachment 6, page 1 of Mr. Lee's direct testimony.

[10] *In the Matter of The Revised Percentages of Depreciation pursuant to the Communications Act of 1934, as amended for: Verizon Hawaii, Incorporated, and Verizon Northwest, Incorporated*, CC Docket No. ASD 00-36, FCC 00-306 (Aug. 17, 2000).

[11] *In the Matter of The Revised Percentages of Depreciation pursuant to the Communications Act of 1934, as amended for: GTE North, Incorporated, and GTE South, Incorporated*, FCC 99-369 (Nov. 23, 1999).

Q. What is Verizon VA's current Commission prescribed life for the digital switching account?

The life prescribed in 1994 for Verizon VA's digital switching account is 17.5 years, even though the shortest life in the Commission's current range for that account is 12 years. Notably, the Commission has approved a life of 10.5 years for digital switching for Verizon VA's former GTE entity. (Verizon VA is proposing 10 years in this proceeding.)

Q. Has the Commission shortened the prescribed life for Buried Metallic Cable

The lives for Buried Metallic Cable were reduced to the shortest life in the Commission's current range.

Comparison of Copper Cable lives

State	Company Proposed	Current Prescription	Prior Prescription
Ohio	15	20	22
Virginia (f. GTE)	15	20	22
Hawaii[12/]	15	20	24
Idaho	15	20	22
Oregon	15	20	24
Washington	15	20	23

Verizon VA's prescribed life in 1994 for Buried Metallic Cable was 21 years, and for Aerial Metallic Cable was 23 years. As the above table demonstrates, both of these lives are longer than the lives recently approved by the Commission.

[12/] Due to the difficult terrain in Hawaii, Aerial Cable was used as the copper comparison account. There is virtually no buried copper cable investment in Hawaii.

Q. How do lives recommended by Verizon VA, AT&T, and WorldCom compare to the shortest lives in the current Commission ranges?

A. The following table contrasts several of the lives recommended by AT&T and Verizon with the shortest lives in the Commission ranges. AT&T and WorldCom's recommendations do not account for the Commission's current ranges, and in particular, fail to recognize that the Commission has reduced the projection life for the Digital Switching Account to 12 years.

Projection Lives (Years)

Account	Verizon Proposed	Low end of FCC Range	AT&T/WorldCom Proposed
ESS Digital	10	12	17.5
Circuit Equipment	9	11	11.5
Aerial Cable Metallic	17	20	23

Q. Is it your position that the Commission should adopt the lowest lives in its current range of depreciation inputs?

A. No. The current FCC ranges are still too high and do not reflect TELRIC principles. These ranges were determined as part of establishing depreciation rates for interstate accounting purposes, not in a proceeding to determine UNE prices. Unlike UNE price setting proceedings, interstate accounting proceedings

do not use TELRIC methodology, do not focus on forward-looking costs, and do not assume a competitive market. Thus, even assuming that the Commission's recent depreciation ranges were correct for that purpose – which, as a general matter, they are not – these ranges are not appropriate for setting UNE prices. Verizon VA has pointed out that the Commission's current ranges are significantly shorter than the lives prescribed in 1994 only to demonstrate that AT&T and WorldCom's proposal to use lives prescribed in ***1994*** should plainly be rejected.

Q. Please respond to Mr. Lee's claim that numerous state commissions, including the Virginia Commission, have adopted the Commission-prescribed depreciation lives in determining UNE prices and have rejected the ILECs' recommended financial reporting lives (Lee at 8-14).

A. The Commission should disregard the rulings of other state commissions that have attempted to interpret and apply the Commission-prescribed depreciation lives to determine UNE prices.

In any event, Mr. Lee's citations to other commission rulings are incomplete and outdated. Mr. Lee ignores that several states have recommended the financial reporting lives recommended by Verizon VA's affiliates. Other states have rejected the Commission's prescribed lives and have adopted their own shorter lives.

1

2 For example, in 1997, the Missouri Public Service Commission adopted

3 GTE's financial reporting lives, noting that its "goal has been to recommend

4 depreciation rates based on parameters that GTE is likely to experience for

5 financial purposes so as to fully recover its long run capital costs in a timely

6 fashion."[13/]

7

8 In 1998, the Michigan Public Service Commission likewise approved the

9 use of financial reporting economic lives, holding that in its view "GTE's

10 proposed asset lives are largely consistent with a forward-looking approach and

11 are reasonable," and further found "AT&T/MCI's proposal to be insufficiently

12 forward looking for purposes of a TELRIC study."[14/] GTE had proposed its

13 financial reporting, or GAAP, lives.

14

15 Notably, some of the lives adopted in the Michigan proceeding are shorter

16 than the lives proposed in this docket. For example, the Michigan Commission

17 adopted a 8-year depreciation life for Circuit Equipment. Verizon VA has

18 proposed 9 years in this proceeding. Similarly, the Michigan Commission

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[13/] *In the Matter of AT&T Communications of the Southwest, Inc.'s Petition for Arbitration Pursuant to Section 252(b) of the Telecommunications Act of 1996 to Establish an Interconnection Agreement Between AT&T Communications of the Southwest, Inc. and GTE Midwest Incorporated*, Docket No. TO-97-63, Final Arbitration Order at 76 (Missouri P.S.C., Aug. 20, 1997).

[14/] *In the Matter on the Commission's Own Motion to Consider the Total Service Long Run Incremental Costs and to Determine the Prices of Unbundled Network Elements, Interconnection Services, Resold Services, and Basic Local Exchange Services for GTE North*, Docket No. U-11281, Opinion and Order at 28 (Mich. P.S.C., Feb. 25, 1998).

1 adopted a copper cable life of 15 years, compared to the 17-year life proposed by
2 Verizon VA in this proceeding. For Digital Switching, the Michigan commission
3 adopted a life of 10 years, which is the same as Verizon VA's proposal in this
4 docket. Other state commissions have similarly rejected the CLECs' proposed
5 depreciation lives.[15]
6
7 Finally, Mr. Lee's citations to the state commission rulings in the former
8 Bell Atlantic regions are irrelevant. In those cases, Verizon proposed an entirely
9 different method of calculating depreciation lives than it is proposing in this
10 proceeding – Verizon VA's financial reporting, or GAAP, lives. Thus, the state
11 commissions in those proceeding faced a different choice of depreciation inputs
12 than presented to the Commission in this proceeding.[16]

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[15] *See, e.g., Rulemaking on the Commission's Own Motion to Govern Open Access to Bottleneck Services and Establish a Framework for Network Architecture Development of Dominant Carrier Networks; Investigation on the Commission's Own Motion into Open Access and Network Architecture Development of Dominant Carrier Networks, Decision No. 96-08-021* (California Public Utilities Commission, Aug. 2, 1996) at 79 ("We agree with Pacific that the schedules formally adopted in the represcription proceeding 'reflect the previous paradigm of the regulated monopoly environment,' and so are difficult to justify in a cost study that looks forward to an environment in which there is local exchange competition. We also see little merit in the Coalition's original suggestion that we use FCC schedules. These schedules also reflect 'the previous paradigm'; moreover, they are based on different assumptions and applied in different ways than our own.").

[16] Mr. Lee misstates the decision of the Pennsylvania Utilities Commission. (Lee at 9, n. 16.) In fact, in the 1997 Pennsylvania proceeding Mr. Lee references, the Pennsylvania Commission rejected AT&T/MCI's proposal to use FCC prescribed lives from 1995 in favor of lives advocated by Bell-Atlantic Pennsylvania. The Pennsylvania Commission noted that it found "more merit in the analysis of future economic conditions than past prescribed lives and [thus decided to] adopt the lives proposed by Bell because they appear to be consistent with Bell's expected position in a competitive market." The Pennsylvania Commission noted that its policy in ratemaking proceedings has been to adopt forward-looking lives rather than those used for accounting purposes.

III. CONCLUSION
(JDPL Issues II-1-a; II-1-c; II-2-a; II-2-c)

Q. Please summarize your conclusions regarding AT&T/WorldCom's proposed depreciation lives.

A. Mr. Lee's proposed depreciation inputs, prescribed in ***1994***, are outdated and do not reflect forward-looking costs. His proposals do not account for the significant pace of competition and technological innovation that is taking place in Virginia and is expected to continue in the future.

In stark contrast, Verizon VA's recommended depreciation lives comply with the requirement to use forward-looking costs by using depreciation lives that reflect the current and future telecommunications environment. Indeed, the Commission itself has recognized that the depreciation lives for certain telecommunications assets have been decreasing since 1994.

Q. Does this conclude your rebuttal testimony?

A. Yes.

Declaration of Allen Sovereign

I declare under penalty of perjury that the foregoing is true and correct. Executed this

24 day of August, 2001.

Allen Sovereign