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

In the Matter of

The Prescription of Revised Percentages of)
Depreciation pursuant to the Communications)
Act of 1934, as amended for:

AT&T Alascom, Inc.
Contel of California, Inc.
GTE South, Incorporated
GTE Southwest, Incorporated
New England Telephone Company
Southern New England Telephone Company
Southwestern Bell Telephone Company
U S WEST Communications, Inc.

MEMORANDUM OPINION AND ORDER

Adopted: December 19, 1996 **Released:** December 20, 1996

By the Commission: Commissioner Chong issuing a statement.

I. INTRODUCTION

1. In this Memorandum Opinion and Order, we prescribe depreciation rates for seven local exchange carriers and AT&T Alascom, Inc. ("Alascom").' The prescribed depreciation rates are based on our analysis of the depreciation studies filed by the carriers, our consultations with various state commission staffs, and a review of the comments.

2. We will commence in the near future a comprehensive review of our depreciation rules. We recognize that these rules may need to be reexamined in light of the Telecommunications Act of 1996.[2] We also note that the *1996 Act* amended the Communications

Conte! of California, Inc. ("Contel"); GTE South, Incorporated ("GTE South"); GTE Southwest, Incorporated ("GTE Southwest"); New England Telephone Company; Southern New England Telephone Company ("SNET"); Southwestern Bell Telephone Company ("Southwestern Bell"); and U S WEST Communications ("U S WEST").

[2] Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) ("1996 Act").

Act of 1934 to no longer require the Commission to prescribe depreciation rates but to permit the Commission to do so. We prescribe new depreciation rates for these carriers pending our comprehensive review.

3. Before enactment of the *1996 Act*, Section 220(b) of the *Act* stated that "(t)he Commission *shall prescribe* ... depreciation." (emphasis added)[3] The *1996 Act*, however, changed the requirement that the "Commission shall prescribe" to "the Commission may prescribe." The phrase "as it determines to be appropriate" was also added. The amended statute now provides that:

> The Commission *may* prescribe for such carriers *as it determines to be appropriate*, the classes of property for which depreciation charges may be properly included under operating expenses, and the percentages of depreciation which shall be charged with respect to each of such classes of property, classifying the carriers as it may deem proper for this purpose (emphasis added).[4]

The Commission will consider the implementation of this statutory change in the forthcoming comprehensive review of our depreciation rules. The current proceeding was conducted under, and is governed by, the rules that were enacted under the previous statutory provision. Since those rules have not yet been amended, they remain in effect and govern this proceeding.

II. BACKGROUND

4. Under the Communications Act of 1934, as amended, the Commission may prescribe depreciation rates that are used to compute depreciation expense for communications common carriers.' In accordance with our rules, depreciation rates are prescribed to depreciate fully the carriers' investments on a straight-line basis over the life of the associated plant.[6] In order to accomplish this, we use the following formula:

$$\text{Depreciation rate} = \frac{100\% - \text{accumulated depreciation }\% - \text{future net salvage }\%}{\text{average remaining life}}$$

[3] 47 U.S.C. § 220(b).

° Id.

[5] 47 U.S.C. §§ 151 <u>et seq.</u>

[6] See 47 C.F.R. § 32.2000(g)(2).

Both the average remaining life and the future net salvage factors are based upon estimates,' that require periodic review to ensure their reasonableness.

5. In prescribing depreciation rates, we review two types of studies: full studies and annual update studies. It has been our practice to review full studies of each major local exchange carrier every three years.' Carriers' full studies include data related to their recent plant retirements and plans for future plant additions and retirements, along with their preliminary depreciation proposals. State commissions are encouraged to provide proposals and many do. The Common Carrier Bureau ("Bureau") then independently analyzes carriers' depreciation data and proposals and prepares its own preliminary proposals that are then forwarded to the state commissions and the carriers. Representatives from the Bureau, the state commissions and the carriers jointly discuss the various proposals. At the conclusion of those discussions, the Bureau makes its recommendations to the carriers and the state commission staffs.

6. At the completion of those discussions, the carriers formally file with the Commission proposed depreciation rates pursuant to Section 43.43(b)(1) and (b)(2) that may or may not be consistent with the Bureau's recommendations.[9] The Bureau places its recommended depreciation rates on public notice to allow interested parties, including the carriers, an opportunity to comment. The Commission then adopts revised depreciation rates after giving full consideration to the comments and the record that has been developed in the proceeding.

7. Carriers are permitted to file studies on an annual basis in order to update their depreciation rates during the two-year period between full studies. Carriers can choose to have their annual update studies reviewed under one of the following procedures: (1) carriers can update their calculations based upon the life and salvage estimates that underlie the Commission's most recent depreciation prescription order; or (2) carriers can select life and salvage factors

[7] As the formula above indicates, the depreciation rate for an account is a function of the associated plant's average remaining life, future net salvage estimates and the actual accumulated depreciation ratio. The average remaining life is the average of the future life expectancy of the various items in a particular plant account. The future net salvage is the estimated gross salvage of the plant less the estimated cost of removal. The accumulated depreciation ratio is the ratio of the accumulated depreciation to the related plant. The accumulated depreciation account represents the part of a plant account that has been depreciated. See 47 C.F.R. § 32.2000(g)(2)(ii).

Based on our triennial schedule, we review each year full studies submitted by one-third of the carriers for which we prescribe depreciation rates.

° 47 C.F.R. §§ 43.43(b)(1) and (b)(2).

within the ranges established by the Commission[1°] provided that the proposals are consistent with the carriers' operations."

8. In accordance with our triennial schedule, six of the eight carriers listed in this order submitted full studies proposing revised depreciation rates based upon their revised estimates of the average remaining life, future net salvage, and updated actual accumulated depreciation ratios:[2] These six carriers filed depreciation studies under the Commission's new depreciation procedures, which enable them to use projection life and future net salvage factors based upon the ranges established by the Commission:[3] Two carriers submitted studies using annual update procedures." Following the procedures described above, the Bureau proposed rates in a Public Notice released August 7, 1996." GTE Service Corporation ("GTE") filed comments on its three full study companies and United Utilities, Inc. ("United Utilities") filed comments on Alascom's annual update proposals. The State of South Carolina Department of Consumer Affairs ("Consumer Advocate") and the Virginia State Corporation Commission Staff ("Virginia Staff') filed reply comments in response to GTE's comments.

HI DISCUSSION

9. Full Studies With respect to the full studies filed by New England Telephone Company, SNET, and U S WEST, on a triennial basis, we note that the life and salvage factors underlying the rates in the Public Notice are derived from thorough analysis and discussion. As

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[1°] See Simplification of the Depreciation Prescription Process, Report and Order, 8 FCC Rcd 8025 (1993) (Depreciation Simplification Order), petitions for recon. pending; see also, Second Report and Order, 9 FCC Rcd 3206 (1994); Third Report and Order, 10 FCC Rcd 8442 (1995). In those proceedings, the Commission adopted streamlined depreciation procedures and established ranges for the underlying factors that are used to compute depreciation rates for plant categories.

" The requirement that a new depreciation rate be consistent with a carrier's operation is designed to assure that carriers do not arbitrarily select life and salvage estimates simply because they are within the prescribed ranges. A carrier's proposed factors are found to be consistent with its operation if the proposed depreciation rate results in a straight-line depreciation of the service value over the remaining life of the plant. Service value is defined as the difference between the net book cost of a class or subclass of plant and its estimated net salvage. See 47 C.F.R. § 32.2000(g)(2Xii). Generally, such findings are made for each account by analyzing the mix of assets in the carrier's account, studying historical retirement data, and considering expected retirements and additions to the account based on the carrier's construction and modernization plans.

[12] The carriers that submitted full studies are: Contel; GTE South; GTE Southwest; New England Telephone Company; SNET; and U S WEST.

" See n.10, supra.

" The carriers that submitted annual update studies are Alascom and Southwestern Bell.

[is] Comments Invited On Depreciation Rate Prescriptions Proposed for Domestic Telephone Carriers, 11 FCC Rcd 9131 (1990) (Public Notice).

described above, the carriers' proposals are based on detailed depreciation studies. The Bureau has reviewed and analyzed these studies and discussed them with carrier representatives and various state commission staffs. In addition, the Bureau has verified the depreciation rate computations to ensure that the proposed rates are consistent with the life and salvage factors recommended by the Bureau, as well as the methods required under the Commission's rules." Moreover, we note that the proposed rates were placed on public notice and no party objected to the rates of those three carriers. We conclude, therefore, that these proposed depreciation rates are consistent with our depreciation policies and are adequately supported by the carriers' underlying studies. Accordingly, we prescribe the rates as shown in the Appendix.

10. With regard to the full studies of the three GTE companies, Contel," GTE South, and GTE Southwest, the life and salvage factors underlying the rates in the Public Notice are different than the rates proposed by the GTE companies. Our discussion of the GTE issues are detailed below.

11. The Consumer Advocate of the State of South Carolina stated that it supports the interstate depreciation rates proposed by the FCC staff for the state. Further, it stated that there has been no deregulation of intrastate depreciation rates in South Carolina. The Virginia Staff stated that GTE is still a fully-regulated entity in Virginia and will have intrastate depreciation rates prescribed in the traditional fashion. The Consumer Advocate stated that its office as well as the staff of the South Carolina Public Service Commission and the FCC staff were prepared to negotiate acceptable rates but GTE South refused to negotiate. The Virginia Staff noted a similar refusal to negotiate.

12. GTE opposed the depreciation rates proposed by the Bureau, but offered no specific criticism of the methods used to develop those rates. Furthermore, GTE's comments provided no support for the depreciation rates it proposed. We find that the depreciation rates developed by the Bureau are consistent with our depreciation policies and the rates are within the ranges established in our Depreciation Simplification Order." Moreover, the Bureau used the same procedures for determining the proposed depreciation rates for the GTE companies that it used in determining the depreciation rates for the other carriers to which no opposition was lodged, and GTE has provided no justification for departing from those procedures. We therefore adopt the rates proposed by the Bureau as shown in the Appendix.

13. Annual Updates Southwestern Bell submitted an annual update study based on the Commission's streamlined procedures. We reviewed Southwestern Bell's proposal and determined that the carrier computed the rates in accordance with our established procedures.

[16] See n. 6, supra.

[17] The California Public Utilities Commission approved the acquisition and merger of Contel with GTE in April 1996.

" Supra, n. 10.