

-- BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH --

In the Matter of Changing the Depreciation)
Lives and Rates of US WEST COMMUNI-)
CATIONS, INC.)

DOCKET NO. 97-049-16

REPORT AND ORDER

ISSUED: June 16, 1998

SHORT TITLE

1997 Depreciation Rates

SYNOPSIS

The Commission herein Orders a decrease in the projected lives and remaining lives of plant accounts resulting in an increase in depreciation rates. The depreciation rates are determined using plant balances as of January 1, 1997, and are to be used in booking depreciation expense beginning January 1, 1997.

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APPEARANCES:

Lori Noda For Division of Public Utilities

Assistant Attorney General

Salt Lake City, Utah

Gregory Monson " U S West Communications, Inc.

Attorney at Law

Stoel, Rives, Boley, Jones & Grey

Salt Lake City, Utah

Richard S. Wolters " AT&T of the Mountain States, Inc.

Attorney at Law

Denver, Colorado

I. PROCEDURAL HISTORY

On June 2, 1997, the Division of Public Utilities ("Division") filed a petition with the Public Service Commission ("Commission") requesting approval of changes to the depreciation lives and rates of US West Communications, Inc.'s ("Company" or "USWC") investments used in Utah intrastate operations. The Commission issued a Notice of Formal Agency Action and Notice of Scheduling Conference on July 7, 1997, providing notice of a conference to be held August 5, 1997, to determine the schedule for the Docket. On July 25, AT&T Communications of the Mountain States, Inc. ("AT&T") filed a petition to intervene. On August 5, the Commission issued an order granting intervention to AT&T.

On August 5, 1997, a Scheduling Conference was held in which the Commission adopted a schedule for the filing of testimony and set a hearing for October 20, 1997. On August 8, 1997, the Company filed its response to the Division's request for agency action. On August 25, the Commission issued its scheduling order. On September 25, the Exchange Carriers of Utah ("ECU") filed a petition to intervene.

At the October 20, 1997 hearing, the Commission agreed to take administrative notice of certain testimony in Docket No. 97-049-08, the Company's general rate case, at the request of AT&T and supplemented by the Company. On January 30, 1998, the Commission entered a slip order opinion, informing the parties of the Commission's resolution of the disputed matters. That slip opinion provided the Commission's numerical values for the remaining or projected lives for the disputed plant accounts for use in calculating 1997 depreciation expense.

II. BACKGROUND

USWC's depreciation lives and rates were changed by this Commission's Report and Order issued April 4, 1996, in Docket No. 95-049-22, using January 1, 1995 investment and depreciation information. Depreciation rates were last changed by the Report and Order issued September 30, 1996, in Docket No. 96-049-18, as a technical update using January 1, 1996 investment information.

On January 21, 1997, the Federal Communications Commission ("FCC") and the Company negotiated an agreement to change lives and rates for the interstate portion of the Company's investments. The Division did not agree that these lives and rates would be appropriate for the intrastate portion of investments due to differences of opinion about the projected lives for the Aerial and Underground Metallic Cable, Digital Switching, and Digital Circuit accounts. The

Division advocates shorter lives than those which the FCC adopted.

III. POSITIONS OF THE PARTIES

The current projected lives and those proposed by the Division are presented by plant category in the following table :

Plant Class or Subclass of Current Division

Acct # Plant Category Projected Life Projected Life

2112	Motor Vehicles	9.0	9.5
2114	Special Purpose Vehicles	14.0	14.0
2115	Garage Work Equipment	14.0	14.0
2116	Other Work Equipment	14.0	14.0
2121	Buildings	42.0	40.0
2122	Furniture	15.0	15.0
2123.1	Office Equipment	10.0	10.0
2123.2	Company Communications Equipment	6.0	6.0
2124	General Purpose Computers	6.0	6.0
2211	Analog Switching Equipment	1997.2	4.0
2212	Digital Switching Equipment	16.0	13.0
2220	Operator Systems	8.0	8.0
2231	Radio Systems	15.0	15.0
2232	Circuit DDS	7.0	7.0
2232	Circuit Digital	11.0	10.0
2232	Circuit Analog	7.0	4.0
2351	Public Tel. Termination Equipment	7.0	7.0
2362	Other Terminal Equipment	7.0	7.0
2411	Pole Lines	25.0	25.0
2421	Aerial Cable - Metallic	20.0	18.0
2421	Aerial Cable - NonMetallic	25.0	25.0
2422	Underground Cable - Metallic	25.0	23.0
2422	Underground Cable - NonMetallic	25.0	25.0
2423	Buried Cable - Metallic	26.0	20.0

2423 Buried Cable - NonMetallic 25.0 25.0

2424 Submarine Cable - Metallic 25.0 25.0

2424 Submarine Cable - NonMetallic 0.0 0.0

2426 Intrabuilding Cable - Metallic 19.0 19.0

2426 Intrabuilding Cable - NonMetallic 25.0 25.0

2431 Aerial Wire 8.5 8.5

2441 Conduit Systems 60.0 60.0

The Company and the Division have reached agreement on all lives and depreciation rates except the remaining life for analog switching equipment, and, depending on the disposition of the Division's differential depreciation proposal, the projected lives for Digital Switching Equipment and Buried Metallic Cable.

A. Differential Depreciation for Digital Switching Equipment and Buried Metallic Cable Accounts

1. Position of the Division

The current projected lives for Digital Switching is 16 years, and Buried Metallic Cable is 26 years. The Division recommends that these lives continue to be used to develop depreciation expense in basic residential dial tone line service cost studies and for Universal Service purposes. It further recommends that shorter projected lives of 13 years for Digital Switching and 20 years for Buried Metallic Cable should be used to determine general revenue requirement for all other services and features, and for the prices of unbundled network elements.

The Division argues that using the current projected lives of the digital switching and buried cable-metallic accounts to develop basic residential local exchange services costs will protect this class of customers from inappropriately bearing a higher cost of service associated with the Company's new and enhanced services, competitive interconnection, and network restructuring. The Division views its support for reduction of the projected lives -- if the resulting expense increases are not assigned to basic residential phone service -- as a forward-looking action driven by service needs unrelated to residential telephone service.

The Division argues that the new lives, net salvage values, and depreciation rates should be applied to the intrastate portion of all investments booked as of January 1, 1997, and all subsequent investments, with continued technical updates. The effective date for the FCC's previously ordered depreciation rate changes for the interstate portion is January 1, 1997.

2. Position of the Company

The Company argues that the Division's differential depreciation proposal for digital switching and buried metallic cable is outside the scope of this proceeding because it is a pricing issue rather than one related to the consumption of capital and the prescription of depreciation rates which reflect it. Ever higher data transmission speed no longer is exclusively the requirement of business customers, states the Company; further, it is a demand that will necessitate replacement of existing buried metallic cable and digital switching investment. The Company argues there is no reason to believe that residential customers do not share responsibility for consuming this capital. Customers who subscribe to basic residential service consume capital as that capital is affected by changes in technology generally, according to the Company. Therefore, it testifies, the Division's notion that there is something called "plain old telephone service" which is immune from technological changes in the industry is not credible.

B. Analog Switching Equipment Account

1. Position of the Division

The Division proposes to realign the projected and remaining lives of the analog switching equipment account with the current schedule of final retirements. It states that annual intrastate technical updates have produced high depreciation rates in order to assure that adequate reserves are booked when equipment is retired. As a result, the reserve account for the remaining analog switching equipment investment is in excess of 85 percent. This, argues the Division, allows for a decrease in the 1997 intrastate depreciation rate from 28.2 percent to 9.8 percent. The Division notes that USWC has not replaced four analog switching offices previously scheduled to be replaced in 1997 to 1998, and it has deferred replacement of four offices scheduled for replacement in 1998 to 2000. According to the Division, these deferments transfer over \$23 million that was previously planned for years 1997 and 1998 to years 1999 and 2000, with the result that past actions to accelerate depreciation of the analog switching account have been overly generous. The 1996 technical update resulted in a 28.2 percent depreciation rate for this account in anticipation of the accelerated replacements then scheduled for 1997 and 1998. Therefore, the Division advocates changing the projected lives for this account from 1998.3 to 4 years, and the average remaining life from 1.8 to 2.8 years, yielding a depreciation rate of 6.3 percent. The Division testifies that this will allow full capital recovery of this account, including net salvage in the year 2000.

2. Position of the Company

The Company proposes an average year of final retirement of 1998.6 years based on its plans to consolidate or replace each switch.

IV. DISCUSSION, FINDINGS, AND CONCLUSIONS

Due to the agreement of the Division and the Company on the depreciation rates and remaining lives for almost all of the Company's plant investment accounts, we must resolve only two disputed matters in order to determine the depreciation rates to be used by the Company effective January 1, 1997. The first is the remaining life and depreciation rate for the analog switching equipment account. The second is the Division's proposal to use two different depreciation rate and remaining life schemes for the buried metallic cable account and digital switching accounts. The Division's differential depreciation schemes would be used in determining depreciation levels for basic residential services and for all other services. A third dispute arises if we reject the Division's differential depreciation proposal, because we then must determine the depreciation rate for the buried metallic cable and digital switching accounts.

A. ANALOG SWITCHING EQUIPMENT

Through past reviews, updates and orders, the regulatory regime in Utah has continually accelerated the depreciation rate for analog switching equipment. The issue in this Docket is the proper length of the remaining life for analog switching equipment. We are persuaded to adopt the Division's position.

We view the Company's proposed remaining life to be too accelerated in light of the nature of the services it provides and will provide with the equipment. This is particularly true in consideration of the Company's actual retirement, replacement and removal of analog switching equipment. The record shows that the Company's actual replacement of equipment has lagged the planned replacement of equipment used to develop the depreciation studies we have relied upon to reach depreciation decisions in past orders. The Division maintains that the Company's unilateral decision to defer actual replacement of eight analog switches that were to occur in 1997, 1998, 1999, and beyond has resulted in an excess depreciation expense in 1996 of approximately \$11,000,000. We conclude that the Division's proposal better reflects the time during which the analog switching plant will continue to be used, and thus is the most appropriate remaining life estimate.

B. DIFFERENTIAL DEPRECIATION AND

DIGITAL SWITCHING AND BURIED METALLIC CABLE

The Division testifies that while various services may be provided by utility plant and equipment, a decision to replace a particular piece of equipment may be based on the requirement generated by some of the services only or by plans to offer entirely new services. This is the basis for its differential depreciation proposal. The Company opposes differential depreciation. It argues that (1) residential customers increasingly demand higher speed transmission, not just voice grade service; (2) technological advances permitting higher transmission speed, the emergence of the Internet, and other new telecommunications demands do not arise solely from large business customers but are simply part of the continuing evolution of the integrated network; (3) new switching and transmission technologies benefit all customers, just as similar advances have in the past; (4) if USWC fails to continually upgrade its network in order to provide services customers demand, it will lose business to competitive providers; and (5) the Division's position rests on a fiction that plant has one life for basic residential service and another for all other services, when in reality the integrated network uses the same equipment to provide all services.

As indicated in our Order in Docket No. 95-049-22, we were interested in exploring the concept of differential depreciation. In the meantime, the Company's last general rate case under traditional rate-base, rate-of-return regulation was completed in Docket No. 97-049-08. Our final order therein was issued December 4, 1997. Henceforth, prices for USWC's services are frozen for a three-year period, following which future price changes will be based on price-cap indexes.

This change in regulatory regime is recent and its implications undeveloped. Thus, at this time we can only speculate whether we will be called upon in the future to determine depreciation rates. If not, differential depreciation is a moot issue. But the structure of price-cap regulation has yet to be determined. A likely feature of a price cap, however, is the ability to change the cap to reflect changes beyond management's control. The issue of depreciation may be argued in this context. Thus, depreciation decisions may remain important from a pricing standpoint. It is also true that depreciation studies will continue to be necessary for reporting Company earnings.

It would appear prudent, therefore, to decide the differential depreciation issue directly. On this record, we find that the Company's arguments are persuasive and we conclude that current developments in telecommunications appear to benefit all customers, including basic residential service subscribers. Therefore, we reject the differential depreciation proposal. Though we do not adopt it on this record, further ahead we may find cause to reconsider the concept.

The Division and the Company do not agree on the projected lives and derived depreciation rates for the digital switching and the buried metallic cable accounts. We conclude that the Company's proposal must be rejected because the projected lives advocated would be too short. Though we encourage the Company to deploy advanced services to Utah customers, its argument for the low end of the range is based on an overly optimistic view of the rapidity with which this equipment will be replaced and advanced services will be deployed. Existing Utah retirement or replacement data does not support this estimate.

The record in this docket shows that digital switching equipment has a projected life estimated to be between 10 and 17 years. Our most recent decision sets this life at 16 years, a number within the range. We now believe, however, that this should be reduced. The Division has presented reasonable argument and evidence for a projected life between 13 and 16 years, even though developed in the context of its differential depreciation proposal. We do not adopt differential depreciation but we can derive an estimate from that range. Noting that the Company and the FCC have agreed that 14.5 years should be used for interstate purposes, we conclude that 14.5 years is a reasonable estimate of the projected life of digital switching equipment for intrastate purposes as well.

Our conclusion for buried metallic cable is similar. The actual and anticipated introduction of more advanced technology in the telecommunications infrastructure and the actual and anticipated introduction of additional and more advanced services lead us to conclude that our previous estimate of the projected life of the Company's buried metallic cable should be shortened. We do not agree with the Company's view of how quickly this plant will be replaced. This is especially the case when considering the replacement of buried metallic cable in the Company's network and the actual and anticipated availability of services (services which require plant other than buried metallic cable) to the Company's residential customers. The Division presented a range of 20 to 26 years for this plant. Because we have rejected the

differential depreciation proposal, our determination of a single value for the remaining life of buried cable must consider the demands placed on this plant by the mix of residential services as well as other services. We conclude that 24 years is a reasonable estimate of the projected life for buried metallic cable.

V. ORDER

Based upon our consideration of the evidence and argument presented in this Docket, we order:

1. The depreciation schedule (remaining lives, salvage values and depreciation rates) contained in Division Exhibit R2 are approved, with the exception of account 2212, digital switching equipment, and account 2423, buried metallic cable, as determined hereafter.
2. The remaining life for account 2211, Analog Switching Equipment, shall be 2.8 years.
3. The projected life for account 2212, digital switching equipment, shall be 14.5 years. The depreciation rate shall be adjusted accordingly.
4. The projected life for account 2423, buried metallic cable, shall be 24 years. The depreciation rate shall be adjusted accordingly.
5. The differential depreciation proposal is rejected.
6. The effective date for the use of and implementation of the depreciation schedule approved herein shall be January 1, 1997.
7. The Division and the Company shall continue to prepare and submit annual technical updates to the Company's depreciation schedule.

DATED at Salt Lake City, Utah, this 16th day of June, 1998.

/s/ Stephen F. Mecham, Chairman

(SEAL) /s/ Constance B. White, Commissioner

/s/ Clark D. Jones, Commissioner

Attest:

/s/ Julie Orchard

Commission Secretary