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**BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON**

UM 840

In the Matter of the Petition of GTE)	
NORTHWEST INCORPORATED to)	
Determine Appropriate Rates of)	ORDER
Depreciation for Several Classes of its)	
Depreciable Property.)	

DISPOSITION: NEW DEPRECIATION RATES ESTABLISHED

On February 14, 1997, GTE Northwest Incorporated (GTE) filed a petition requesting an order authorizing it to adopt revised depreciation rates for some of its Oregon utility assets.

AT&T Communications of the Pacific Northwest, Inc. (AT&T) filed a petition to intervene on May 23, 1997, and on June 6, 1997, GTE filed an objection to the petition to intervene. On June 16, 1997, AT&T replied to GTE's objection. On June 18, 1997, Lowell Bergen, an Administrative Law Judge for the Commission, issued a ruling allowing AT&T to intervene as a party. On September 23, 1997, AT&T filed a notice of its withdrawal from the proceeding.

A procedural conference and a hearing were scheduled, and notice served on the parties. Administrative Law Judge Bergen presided over the conference on May 7, 1997, and the hearing on November 4, 1997. The following appearances were entered:

Tim Williamson and John A. Rogovin, Attorneys at Law

For GTE

Paul A. Graham, Assistant Attorney General

For the Commission's Staff

GTE requests shorter assumed lives of assets listed in eight of its equipment accounts. Those accounts contain information about GTE's equipment most affected by technological advancements and competition. Granting the request would increase GTE's Oregon annual depreciation expense by \$31.7 million, an increase of 56 percent, and would give GTE a composite depreciation rate of 10.1 percent. These numbers refer to total Oregon investments, which include intrastate and interstate operations. Approximately 75 percent of GTE's operations in Oregon are attributable to intrastate operations regulated by the Commission. GTE requests that the changes to its depreciation rates be given retroactive effect to January 1, 1997.

The Commission's Staff recommends that the depreciation rates for the eight accounts for which GTE proposes changes be increased, but not to the level requested by GTE. Staff recommends an increase of approximately \$5.8 million, incorporating a composite depreciation rate of 7.1 percent.

Agreement

GTE and Staff agree on a number of issues. They agree that the lives used in setting depreciation rates should be forward-looking life estimates reflecting the most current available sources for estimating the remaining life of assets. They agree on the appropriate depreciation rates for 18 other GTE accounts for which Staff proposed depreciation rates. They also agree that the changed depreciation rates should be given a January 1, 1997, effective date.

The Commission adopts the depreciation rates recommended by Staff for the 18 accounts and decides to make the new depreciation rates effective as of January 1, 1997. The remainder of this order addresses the areas of dispute between the parties.

ASSET SERVICE LIFE PROJECTIONS

The following table shows the differences between the current and proposed years of Average Remaining Lives of assets recorded in the disputed eight technology accounts:

<u>Account Description</u>	<u>Current</u>	<u>Proposed</u>
Digital Switching Equipment	9.6	6
Digital Circuit Equipment	5.8	4
Aerial Cable Metallic	12.8	6
Aerial Cable Non-Metallic	18.1	15
Underground Cable Metallic	17.3	6
Underground Cable Non-Metallic	17.8	15
Buried Cable Metallic	13.9	6
Buried Cable Non-Metallic	18	15

GTE's Contentions

GTE contends that the advent of competition into the local exchange market and the rapid changes resulting from technological advances demand that a new regulatory paradigm be established to determine depreciation rates for incumbent local exchange carriers (ILECs). The federal Telecommunications Act of 1996 and other events have opened the telecommunications industry to competition. The possibility of losing customers to competitors heightens the need for GTE to completely depreciate assets during the time they are producing revenue because full recovery of asset depreciation is not assured in a competitive market. GTE is particularly concerned about the loss of business customers.

In GTE's view, the historical method of depreciating assets based on their retirement from service no longer is appropriate. Depreciation should now be viewed from the standpoint of the ability of the assets to generate revenue in the future – their economic usefulness. The depreciation rates of currently used assets should be increased because of the impacts of technologically superior assets, even though the older assets remain in use. GTE considered several factors in deciding what depreciation rates to request, including a comparison with the depreciation rates of other companies, but considers the effects of technological change and competition to be the main factors to consider.

GTE supported its request for accelerated depreciation rates by presenting a study performed by Technology Futures, Inc. (TFI). The study estimates the rates of likely substitution of new technology for old technology. GTE argues that this substitution analysis is the appropriate guideline for computing depreciation rates in this new environment. Substitution analysis recognizes that as new technology becomes available, the economic life of assets using the old technology, that is, their ability to generate revenues in excess of costs, is diminished even though not physically retired from service. TFI has found that the rate of substitution is very similar from one type of technology to another. The study has found that the substitution of the old technology by the new technology starts out slowly when first available. But as the new technology becomes recognized and garners between 10 percent to 20 percent of the market, the pace of

substitution increases substantially. The TFI study relied on by GTE was published in 1995 and updated in 1997. The study used industry data gathered from a variety of sources but did not utilize data from GTE's Oregon operations. However, Dr. Vanston, who sponsored the study, analyzed GTE's operations in Oregon, and suggests that GTE is leading the industry, not lagging behind it.

GTE also compares its depreciation rates with those of other companies. Included in the comparison are interexchange carriers whose depreciation rates are not regulated, cable television companies, cellular companies, and the regional Bell operating companies. GTE's proposed depreciation rates are within the range of rates GTE presented for comparison.

Staff's Contentions

Staff contends that the competitive market envisioned by GTE does not now exist, and will not exist for some considerable time. The telecommunications market today has competitive and noncompetitive sectors. Appropriate depreciation rates should reflect both sectors of the market, and historical analysis provides a good method of tracking the transition from regulated pricing to competitive market pricing. Older technology is available at reasonable prices, and the option to subscribe to services requiring advanced technology is not available to all customers.

Staff argues that the substitution model used by GTE does not address the important issue of the retirement of existing plant, but only looks at the rate at which one technology captures capacity from another. It fails to account for alternative uses of older technology. Staff discounts the value of GTE's comparison of its depreciation rates with those used by other companies and argues that the other companies are not similar enough in corporate structure and business circumstances to make a meaningful comparison.

Staff performed its own study and analysis of depreciation rates for GTE's assets. Staff personnel reviewed historical GTE data showing when assets were placed into service, yearly and ending balances, and salvage information. Staff combined that data with TFI projections and Oregon plant design and budget growth projections of GTE, and developed its recommended schedule of depreciation rates. Its recommendation is therefore forward-looking, but based on historical information.

The following table shows the differences between the GTE-proposed economic lives and the Staff-recommended asset service life projections of assets recorded in the disputed accounts:

<u>Account Description</u>	<u>Staff</u>	<u>GTE</u>
Digital Switching Equipment	14	10
Circuit Equipment	10	08
Aerial Cable Metallic	20	15
Aerial Cable Non-Metallic	25	20
Underground Cable Metallic	20	15
Underground Cable Non-Metallic	25	20
Buried Cable Metallic	20	15
Buried Cable Non-Metallic	25	20

Commission Discussion

By definition and business practice, depreciation accounting allocates the cost of investment in an asset used to provide service over the useful life of the asset. Equipment costs should be allocated in proportion to the consumption of service capacity. The customers who use the services of an asset should pay for the costs incurred to make use of the asset. Prior or subsequent customers should not be expected to pay those costs. The costs are charged to operating

expenses during an accounting interval, such as a year. Of necessity, this depreciation mechanism requires an estimate of an asset's total life and its remaining life. The goal is to be as accurate as possible in forecasting the rate at which it will lose its useful life.

GTE sees technological change and competition combining to cause eight categories of its assets to quickly lose their ability to generate revenue in the future. It requests that we look at the ability of those assets to generate future revenues rather than look at their retirement from service. Staff believes the impact of competition and technological progress will be further in the future than envisioned by GTE in this docket.

We are not at this time convinced that the traditional method of establishing depreciation rates for ILECs should be replaced by another method. Technological change in the telecommunications industry has occurred rapidly in the past few years. The opening of what was once a highly regulated industry to competition will have enormous impacts on the industry. However, as of now, and probably for a considerable time into the future, ILECs will continue to enjoy the benefits of being the established local phone company. Traditional regulatory oversight, including the setting of rates and quality standards for services, will be required until the industry is far more competitive than it is now. GTE is losing customers to new competitors, but there was no showing that the competitors are making significant inroads into GTE's customer base. Nor was there a showing that the customer loss is causing or likely to cause in the near future any diminution in the utilization of GTE's existing equipment.

GTE did not demonstrate, through budget projections or otherwise, that it is embarking on a significantly increased program to take advantage of new technology. It appears that GTE's capital improvement program now and its plans for the next few years continue historical patterns and do not reflect a significant substitution of new technology for old in GTE's Oregon territory.

When technologically superior equipment becomes available, it does not automatically cause the retirement of the old equipment. The old equipment usually remains in service, and is frequently integrated into the new technology. It is still used and useful to the utility company. Eventually the old equipment will be retired, but we believe it will be retired at a slower rate than envisioned by GTE.

Our task in this proceeding is to establish reasonable and fair depreciation rates for GTE's Oregon assets. Looking at depreciation rates of other companies can be helpful. However, as is frequently the case, the companies presented for comparison are quite different from the company under study. There are differences in capital structure between companies, sometimes even when they are performing similar services. Some companies in a similar business are far more capital-intensive than others. Additional differences are apparent for companies whose depreciation rates are unregulated. The information about the depreciation rates of other companies submitted by GTE is relevant, but not persuasive.

We believe that Staff's estimates of the lives of GTE's assets will be closer to what actually occurs than GTE's estimates. Staff's estimates therefore more closely match depreciation expense with the customers benefiting from the reduction in value of those assets.

CONCLUSIONS

GTE has demonstrated that its depreciation rates should be revised. Staff's estimates of appropriate depreciation rates for GTE's assets are the most persuasive evidence presented in this proceeding, and should be adopted. The revised depreciation rates should be considered effective as of January 1, 1997.

ORDER

IT IS ORDERED that:

1. GTE is authorized to depreciate its assets according to the rates displayed on Appendix A to this order;
2. The revised depreciation rates are deemed effective as of January 1, 1997;
3. GTE shall, within 30 days of the date of this order, file with the Commission depreciation rates for each of its asset accounts. The rates shall comply with the rates

listed on Appendix A to this order.

Made, entered, and effective _____.

Ron Eachus
Chairman

Roger Hamilton
Commissioner

Joan H. Smith
Commissioner

A party may request rehearing or reconsideration of this order pursuant to ORS 756.561. A request for rehearing or reconsideration must be filed with the Commission within 60 days of the date of service of this order. The request must comply with the requirements of OAR 860-014-0095. A copy of any such request must also be served on each party to the proceeding as provided by OAR 860-013-0070. A party may appeal this order to a court pursuant to ORS 756.580.

