ALJ/PAB/dk

Mailed

DEC 28 1990

Decision 90-12-116 December 27, 1990

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of Pacific Bell, (U-1001-C), a corporation, for approval of changes to capital depreciation rates.	Application 90-06-061 (Filed June 29, 1990)
In the matter of the application of GTE California Incorporated, (U-1002-C), a corporation, for approval of 1991 depreciation rates.	Application 90-06-062 (Filed June 29, 1990)

Gregory L. Castle and Daniel J. Mc Carthy, for Pacific Bell; Robert N. Herrera and Kenneth K. Okel, Attorneys at Law, for GTE California Incorporated; applicants.

Carrington Phillip, Attorney at Law, for California Cable Television Association; Thomas J. Long and Joel R. Singer, Attorneys at Law, for Toward Utility Rate Normalization; protestants.

Randolph W. Deutsch, Attorney at Law, for AT&T Communications, interested party.

Rufus G. Thayer, Attorney at Law, for the Division of Ratepayer Advocates.

Decision 90-12-116 December 27, 1990

I N D E X

OPINION

On June 29, 1990, Pacific Bell (Pacific) and GTE California, Inc. (GTEC) filed separate applications to adjust their respective capital depreciation accounts effective January 1, 1991. The applications were filed pursuant to Decision (D.) 89-10-031, the Phase II decision in the telecommunications regulatory framework proceedings, which requires annual applications for approval of represcription or technical update of depreciation accounts to be effective on January 1 of the following year. (At p. 183 and Ordering Paragraph 6, p. 391.)

In its depreciation accrual accounts, Pacific initially proposed a net reduction in depreciation accrual of $36.906 million. This is comprised of a decrease of $52.930 million for its technical update of all accounts, a decrease of $39 million for fully depreciated step-by-step and crossbar equipment (including an allowance for the cost of removal), and an increase of $55.024 million due to the represcription of seven equipment categories.

In its depreciation accrual accounts, GTEC initially proposed a net reduction to depreciation accruals is $7.287 million. This is comprised of a decrease of $10.391 million for its technical update (including adjustments for inside wire amortization), and an increase of $3.104 million due to represcription of its underground metallic cable account.

Applicants requested ex parte approval of the applications. Applicants request no change in rates as a result of these adjustments because such rate changes are prohibited under the Phase II decision unless extraordinary. (D.89-10-031, pp. 182 and 183.)

On August 2, 1990, Division of Ratepayer Advocates (DRA) filed its reports evaluating the applications. DRA agrees with applicants' proposed technical updates, Pacific's revisions based

upon the 1991 retirement of step-by-step and crossbar equipment and GTEC's amortization of inside wire equipment. However, DRA disagrees with the proposed represcription for the requested switching and interoffice copper cable accounts of both applicants. Based upon a review of applicants' supporting data, the recent retirement patterns and its judgement on the future replacement of interoffice copper cable[1] and represcribed switching equipment, DRA predicts projection lives for these disputed categories of equipment which are slightly longer than those requested by applicants. Based upon its longer projection lives, DRA recommends a net depreciation accrual reduction of $58.852 million for Pacific and $12.94 million for GTEC. DRA agreed to applicants' requests for ex parte approval of the applications.

The California Cable Television Association (CCTA) and Toward Utility Rate Normalization (TURN) protested ex parte approval of these applications and requested a hearing. CCTA alleged that the basis for the proposed adjustments in both applications is inadequate. CCTA subsequently filed numerous pleadings. On August 22, 1990, CCTA filed replies to DRA's recommendations. On September 19, 1990, CCTA filed motions to compel applicants to produce certain documents to which Pacific and GTEC responded on October 1 and 5, 1990. TURN also protested ex parte approval of the applications and asserted that the offsetting of the reduced depreciation expense by new represcription expenses is an inappropriate "whittling away" of income which would be shared by the ratepayer under the new telecommunications regulatory framework.

---

1 We refer collectively to Pacific's aerial cable (interoffice metallic), underground cable (interoffice metallic), buried cable (interoffice metallic) accounts, and GTEC's metallic underground cable accounts.

Prehearing Conference was held on September 21, 1990. Consolidation of the two applications, the position of the parties, CCTA's motions and tentative hearing dates, if needed, were discussed. GTEC indicated its willingness to stipulate to DRA's recommendations for projection lives for metallic underground cable, the only item DRA disputed in its application. AT&T Communications, Inc. appeared and indicated an intent to monitor the proceeding.

On October 15, 1990, the assigned Administrative Law Judge (ALJ) issued an oral ruling on the requests for hearing, consolidation of the two applications, motions to compel the production of documents, and set hearing dates. CCTA's request for further discovery was granted. The oral ruling was subsequently confirmed in writing. The two applications were consolidated, the the motions were denied, the requests for a hearing were granted, and the orally agreed hearing schedule was set.

On November 6 and 7, 1990, evidentiary hearings were held in San Francisco. The applicants, DRA, and CCTA presented witnesses and TURN participated in cross-examination. At the evidentiary hearing, Pacific stipulated to DRA's recommendations for longer projection lives of prescribed switching and interoffice copper cable equipment.

Concurrent briefs were filed on November 16, 1990.

The Proposed Decision of ALJ Bennett was filed on November 27, 1990. Comments were duly filed. We address TURN's comments below.

Pacific's Application

Pacific summarizes its application as one prompted and encouraged by the Commission's new regulatory direction in telecommunications. Pacific cites D.89-10-031, p. 91, the new regulatory framework decision, to show the Commission's encouragement of technological advance as an important method of reducing costs and prices in the long run and a method which produces new and better services which contribute to the well being of consumers and the economy as a whole. Pacific quotes the portion of the decision which states that Pacific's replacement of

electro-mechanical and electronic switches and associated analog carrier interoffice facilities is an important and necessary step fully consistent with the Commission's commitment to maintain and improve telecommunications service in California so that all ratepayers can participate fully in the Information Age." (Ibid. p. 210.)

With the new regulatory framework decision as background, Pacific professes support for the Commission's goals and commitment to achieving these goals by incorporating into its network appropriate advances in technology. However, Pacific asserts that as new technologies are introduced into the network, older technologies are replaced, sometimes before the older technologies have reached the end of their previously prescribed service lives. According to Pacific, this reduction in the life cycle of older technologies by the placement of new technologies requires that the service lives of the older technologies be shortened.

In addition, Pacific alleges that the technological and competitive forces operating in the 1990's are dramatic and significant in the area of capital recovery. Pacific contends that the advance of technology, coupled with the competitive pressures to operate more efficiently, results in a shortening of the lives of all investments. Pacific contends that it is planning for the transition of its network from an analog/copper to a fiber/digital infrastructure to respond to technology advances and competitive forces.

In analyzing the capital recovery requirements for step-by-step and crossbar switching equipment which will be fully depreciated in 1991, Pacific proposes to reduce the currently ordered depreciation schedule for this equipment by $12 million and $27 million, respectively.

Pacific proposes a technical update of depreciation rates for all other categories of plant. The technical update captures changes in asset consumption, remaining lives, and shifts in the

depreciation reserve occurring since the previous represcription of depreciation rates. The technical update process first calculates updated remaining lives for the categories of plant being updated. This is mathematically accomplished by Pacific by using the categories, survivor curves and projection lives prescribed in its most recent depreciation study and the age distribution of assets as of the study date, which is January 1, 1990. The updated remaining life, current depreciation reserve percentage and future net salvage from the 1990 depreciation study are used in the authorized straight-line, remaining life depreciation rate formula to determine the technically updated depreciation rates requested.

Pacific analyses its plant accounts and concludes that seven categories of plant are outmoded and in need of represcription. Pacific's proposes total increases in depreciation expense of $55.024 million caused by its requested represcription. The seven categories of plant which are represcribed are: analog electronic switching, operator systems crossbar, digital circuit (other), analog circuit (other), aerial cable (interoffice metallic), underground cable (interoffice metallic), and buried cable (interoffice metallic). In its application, Pacific describes and provides its justification for represcribing each of these categories of plant. Pacific's justification includes investment statistics, retirement history, future expectations of technological changes, a study procedure, and a summary statement for each category of represcribed plant. Pacific provides in its application the statistical data generated by the application of authorized straight-line remaining life depreciation methodologies used to calculate its proposed remaining lives. Pacific uses the

currently authorized depreciation formula[2] and parameters in calculating its proposed depreciation accrual.

In the category of analog electronic switching, Pacific includes central office switching equipment which uses stored program controlled (SPC) technology to switch calls through an analog network controlled by a specialized computer. Pacific indicates it has recently accelerated the replacement of small analog electronic switches. Pacific plans to replace all small analog and 1EASS switches by the end of 1995 as the next generation of switching is introduced or as enhancements to the existing digital switches make replacement economical. Pacific has placed no new analog switching systems in service since 1984. Pacific contends that analog switching equipment cost more initially and to maintain. In addition, Pacific finds it is difficult to expand or update this equipment with new hardware or software. In 1989, Pacific retired 11 analog SPC switches. Thus, based on current projections, Pacific expects to have all such switches retired by 2006. In order to achieve complete capital recovery by that date, Pacific proposes a reduction in the current 16 year projection life to 12.8 years.

In the category of interoffice metallic cable (aerial, underground, and buried), Pacific includes transmission facilities between central offices. Pacific contends optical fiber has replaced copper as the growth medium for these cable facilities. Pacific contends since 1984, the addition of fiber cable has exceeded additions using copper cable for both trunk and toll facilities. Pacific asserts the retirements of copper cable have been greater than copper cable additions. Because fiber is

---

2 Technical Update Dep. Rate = $\frac{100\% - (\text{Depreciation Reserve \%}) - (\text{Future Net Savage \%})}{\text{Updated Remaining Life}}$

cheaper, has greater capacity, security, and reliability and is used in new technologies, Pacific predicts that all interoffice copper cable will be replaced with fiber by the year 2000. In order to fully recover its investment in copper cable by this year, Pacific proposes projection lives of 8.9 years for aerial cable, 10.6 years for underground cable, and 13.2 years for buried cable.

Pacific includes in the category of equipment, analog circuit-other, analog transmission, and signaling equipment used to provide interoffice message and special service circuits. This consists of voice frequency and signaling equipment, analog carrier, transmission test and support equipment. Pacific contends that analog circuit equipment compared to digital equipment is slower, has lower capacities, requires more on-site labor to maintain, and is often either no longer manufactured or is difficult to obtain. Therefore, Pacific considers this equipment uneconomical and indicates that it also has a decreasing demand for this type of equipment. These factors will result in Pacific retiring this equipment by the year 2006. Pacific's proposed projection life for this equipment is 8.4 years to completely recover its investment.

In the category, digital circuit equipment-other, Pacific includes an assortment of digital technologies used for the transmission of information over communications channels. Channel banks convert analog voice signals to digital signals. In Pacific's opinion, such conversion equipment is no longer needed when electro-mechanical switches and analog SPC switches are replaced by digital switches and as special service circuits migrate to end-to-end switched digital service. Pacific asserts that T carrier line and multiplexing equipment is generally located in manholes along the cable route, making it expensive to install and maintain. Pacific contends that today, current generation fiber is replacing vintage fiber equipment. Pacific expects the flexibility and speed of the newest development in fiber,

Synchronous Optical Network (SONET) systems will economically justify increasing deployment of synchronous equipment for growth purposes from 1991 to 2000. At that time, Pacific expects retirements will significantly increase as SONET replaces the current generation of digital circuit equipment. Therefore, Pacific plans to be 100% SONET compatible by 2007 and proposes a projection life of 10.2 years for digital circuit-other equipment.

Pacific includes in the category, operator systems-crossbar, equipment used to provide directory assistance which will undergo network modernization starting in 1991. At that time Pacific will retire or replace the crossbar automatic call distributors and directory assistance system computers. Pacific indicates that the manufacturer has already discontinued making this system. Pacific has scheduled this entire modernization project for completion by 1993. To attain complete capital recovery by this date, Pacific proposes projection lives of 7.6 years for operator crossbar systems and 5.5 years for operator systems network support systems.

While Pacific recommends new projection lives for the above seven categories of plant, it retains the other currently prescribed depreciation parameters. The intrastate depreciation rates currently in effect for Pacific were ordered by the Commission in Resolution No. 13030 on November 23, 1988. In 1991, Pacific indicates it will participate in represcription of depreciation rates with the Federal Communication Commission (FCC) when an in-depth depreciation study will be prepared for the remaining categories of plant. Pacific intends to use that study as the basis for its 1991 capital depreciation application filing with this Commission.

GTEC's Application

GTEC requests approval of a new composite depreciation rate of 7.94% which is a reduction from the rate of 8.05% adopted in 1990. The proposed new rate results in approximately a

$7.287 million decrease in annual depreciation expense based on 1989 end-of-year plant balances. This net reduction is a result of a $10.391 million reduction to customer premises inside wire amortization and a $3.104 million increase in expenses due to represcription of GTEC's underground metallic cable account.

GTEC also requests permission to amortize its embedded investment in certain equipment and furniture, including minor tools costing from $200 to $500, in accordance with the decision issued in FCC Docket No. 87-135, adopted October 24, 1989. GTEC does not propose to separate this amortization amount for depreciation rate determination because there exists only a negligible difference in the depreciation expense that would be booked using the FCC 8-year amortization versus using the Commission-approved remaining lives.

In its application, GTEC explained how it developed its 1991 depreciation rates. The application is based upon a 1990 study which involved a review of all capital plant accounts. The study consists of primarily an update of rates and remaining lives to reflect accounting activity during the 1989 calendar year. The main focus of the study was on the remaining lives of plant investments which are most susceptible, in GTEC's opinion, to technological changes in the network.

GTEC divides physical plant accounts into the categories of general support, central office equipment, and outside plant for analysis.

GTEC performed a technical update of general support accounts which includes motor vehicles, special purpose vehicles, garage work equipment, other work equipment, buildings, furniture, office support equipment, general purpose computers, public telephone equipment, and other terminating equipment.

GTEC divided central office equipment into various categories for review. In GTEC's opinion, the existing service lives of its radio and both analog and digital switching equipment

has not changed. However, GTEC adjusts the lives of other sub-categories of central office equipment based upon the remaining lives of similar equipment, industry-wide forecasts of remaining lives, and the service life history of existing equipment.

GTEC performed a technical update and limited represcription of its telephone plant in 1989 under our pre-existing advice letter procedure. (Resolution No. T-13050, issued February 24, 1989.) The following year we authorized GTEC's represcription of all straight-line remaining lives of its telephone plant. (Resolution No. T-14042, issued January 24, 1990.) Therefore, in this proceeding, for the majority of outside plant accounts, GTEC does not believe that one additional year of activity has significantly changed the plant lives, with the exception of fiber optic cable substitution for copper.

GTEC contends that technology forecasting studies, industry projections, manufacturing reports, economic forecasts, local network engineering, and planning studies lead it to conclude that all of the copper in its network will be replaced by fiber optics by the year 2020. According to GTEC, these independent studies indicate that the average remaining life for all copper cable is approximately 14 to 15 years. GTEC asserts that these projections are supported by the experience in its network of: (1) the installation of fiber facilities for interoffice trunking, which is now well beyond the half way mark; (2) increased installations of remote switching units served by fiber, replacing feeder cable; and, (3) tests of fiber to the home in California and throughout the world.

GTEC believes with the advent of increased competition in the telecommunications marketplace and rapid technological advancements in fiber facilities which have resulted in steadily declining costs for such facilities, a major replacement program can be expected in the near future. Based on this information,

GTEC assigned similar remaining life projections to all of its copper cable accounts to achieve full recovery of its investment in copper facilities prior to retirement. GTEC recommends that the current projected life of 23 years for interoffice metallic underground cable be revised to 20 years.

On cross-examination, GTEC's witness, Carl R. Lanterman, explained that its application was prepared under authorized Commission depreciation guidelines which describe the methodologies to be used for historical data and life analysis of plant.

DRA's Position

DRA filed a report for each application presenting its recommendations. In summary, after analysis of each application, including the supporting data, DRA recommends a higher net reduction of depreciation accrual than that proposed by applicants, $58.852 million for Pacific and $12.94 million for GTEC.

DRA's witness, Ramesh Joshi, confirms that applicants' proposed technical updates are based upon authorized depreciation parameters and methodology. Joshi verifies that unless depreciation accruals for Pacific's step-by-step and crossbar equipment are adjusted, the total investment in this electromechanical equipment would be recovered before the retirement of the equipment. Joshi supports GTEC's treatment of inside wire amortization. However, Joshi recommends adjustments in applicants' proposed represcription.

Joshi, an expert in depreciation for 7 years, explained the depreciation parameters involved in any depreciation proceeding. According to Joshi, depreciation parameters are average remaining life, future net salvage, and depreciation reserve. Depreciation rates are based on these parameters. DRA and applicants differ over the average remaining lives of Pacific's represcribed plant accounts as follows:

Central Office Equipment	Projection Life Current	Pacific	DRA
1. Analog Electro Switching	16.00	12.80	13.20
2. Operator Systems Crossbar	12.30	7.60	7.60
3. Digital Circuit - Other	10.50	10.20	10.20
4. Analog Circuit - Other	10.50	8.40	9.00
Outside Plant			
5. Aerial Cable - Interoffice Metallic	12	8.90	12.00
6. Underground Cable - Interoffice Metallic	20	10.60	12.00
7. Buried Cable - Interoffice Metallic	19	13.20	14.00

DRA recommends that GTEC's proposed projection life of 20 years for underground metallic cable be extended to 21.5 years.

Thus, the basis of DRA's higher reduction in depreciation accruals is its recommendations for longer projection lives than those proposed.

Joshi explains that represcription of depreciation rates is performed to reflect any change in the total projection life, future net salvage and/or retirement pattern due to technological changes and growth of telephone plant. In his analysis of applicants' proposed represcription, Joshi indicates that the Commission's reliance on technological advance reducing costs and prices in the long run and its encouragement of implementing such advances in order to produce new and better services may only be achieved if all future replacement decisions are supported by proper economic analysis.

Joshi believes and reflects in its recommendations that the advance of technology as well as competitive pressures to operate more efficiently are shortening the lives of analog switching equipment and interoffice copper cable. However, in Joshi's judgment, the impact is modest and not substantial as Pacific and GTEC contend.

In Joshi's opinion, the replacement of copper by optical fiber is becoming economical due to the advancement of technology. The reduced cost of electronics at the transmitting and receiving ends allows an increased flow of traffic on the fiber optic cables. Thus, as the cost of the electronics is spread over larger volumes of traffic, replacement of copper by fiber in the interoffice environment is rapidly becoming economical. Among the three categories of interoffice cable categories, Joshi believes underground cable is used in urban areas and is being rapidly replaced by fiber cable. Joshi reflects in his recommendations his opinion of the rate at which the replacement of copper will occur.

In addition, Joshi compares and relies on Pacific's actual retirements of copper cable and retirement projections for the past 3 years to derive new projected lives for its interoffice copper cable accounts. Joshi indicates that its analysis of Pacific's represcription is based upon the operating environment within California.

Joshi uses the same basic philosophy described above to review and analyze GTEC's proposed represcription. In recommending a longer projection life for metallic cable than GTEC proposes, Joshi includes GTEC's retirement projections to derive its recommendation.

At the evidentiary hearing in response to questions by the assigned ALJ, Joshi testified that applicants showing in this proceeding is no different that those in the past and that recommendations in depreciation proceedings are based upon an expert's judgement.

During the evidentiary hearing, Pacific stipulated to DRA's recommended projection lives.

CCTA's Position

During the evidentiary hearing, CCTA presented two witnesses, Kelly W. Curenton and Yvette Smiley Smith.

Curenton, a utility consultant with 9 years experience in the utility regulatory field, analyzed Pacific's application to determine if the requested depreciation changes are substantiated and properly assignable to the ratepayer. Curenton used as a guide in his evaluation the standard for depreciation charges contained in the Uniform System of Accounts issued by the FCC for Class A and Class B telephone companies. This publication requires that depreciation charges be computed by applying the composite annual percentage rate considered applicable to the original cost of each class of depreciable plant owned or used which are based on the estimated service values and service lives developed by a study of the company's history, experience, and such engineering and other information available regarding prospective future conditions.

Curenton testified that he was unable to obtain the necessary "economic studies" to determine if the basis of future conditions was properly included in Pacific's depreciation study. Curenton explained that these studies are needed when obsolescence is a factor alleged to cause accelerated retirement. In Curenton's opinion, these studies will indicate whether the retirement is based on management's desire to engage in new services or other reasons. Should the motivation for accelerated retirement be management policy, Curenton asserts that the ratepayer should not pay the accelerated costs. Curenton contends that setting depreciation lives is a balance between past service life indications, mortality dispersions, and future conditions.

Curenton criticizes Pacific's use of the life cycle analysis technique in its represcription because this method, in Curenton's opinion, relies little, if at all, on past mortality experience of equipment. Since Pacific uses this method in concluding that represcription is needed, Curenton believes that future expectations are a dominant, and possibly the only force, driving the replacement programs of Pacific. Curenton asserts that a review of the economic studies justifying retirement and

replacement of equipment is mandatory. Otherwise, Curenton believes the Commission is relying solely on Pacific's judgement of future lives.

In addition, Curenton views represcription as a step necessary for the ultimate installation of broadband fiber into the local communication network between the company interoffice and customer premises.

Curenton believes under such circumstances, a regulated monopoly could decide to retire any of its plant at any time to replace it with new technology without economic justification. Thus, without justification, the ratepayer would finance retirement even if the replacement plant is designed to cultivate future revenue sources which may not be apparent at this time.

Curenton points out that existing fiber cable in Pacific's network is miniscule compared to existing copper cable. In addition, Curenton estimates that of the 203,761 miles of fiber presently employed in Pacific's network, 25,862 miles are equipped with electronics. Therefore, over 85% of the fiber installed in Pacific's 1989 return was not capable of carrying intelligence.

Curenton recommends that the Commission deny Pacific's requested represcription until guidelines are established clarifying the appropriate method of obtaining data and quantifying the amounts of depreciation expense allocable to non-telephone operations. Curenton proposes that these guidelines be used for the three-way FCC represcription which will occur in 1991.

Curenton testified that GTEC's written testimony indicated that retirements were driven in part by certain "revenue opportunities" for business and residential services due to the replacement of copper by fiber optics. Curenton asserts that GTEC's narrative also mentioned a site-by-site economic selection process for feeder cable. Curenton contends that GTEC admits that the increased depreciation accruals in underground cable accounts

can be attributed, in part, to the plan to enter into the cable television market.

Assuming that this entry into non-telephone markets is a driver of GTEC's requested represcription, Curenton recommends that GTEC's represcription be denied until guidance by the Commission is given for the proper treatment of depreciation expense caused by entry into non-telephone related services. After such standards are set, Curenton recommends revision of GTEC's depreciation accounts to separate non-telephone and telephone depreciation accruals on a going forward basis.

Smith, a certified public accountant with 17 years experience and an expert witness in numerous utility proceedings, testified that Pacific has not supplied the necessary data to support its represcription and that the potential reduction in sharable earnings of the proposed represcription is significant. Smith recommends that both applicants' requests for represcription be denied as being unsubstantiated, adverse to the public interest and inviting cross-subsidization.

Smith contends that although applicants mention the price cap mechanism, they do not recognize the operation of the second mechanism, sharable earnings. Smith asserts that the earnings mechanism was included to balance the risks, insure that ratepayers receive a portion of the benefits from incentive regulation, preserve strong efficiency incentives, and protect both ratepayer and shareholder from risks that the indexing mechanism may significantly under- or over-estimate reasonable cost levels.

TURN's Position

TURN believes applicants must include justification for its accelerated retirement of plant by identifying the services causing the acceleration. TURN indicates that although such studies are included in a prudency review (which is the applicants' characterization of CCTA's request for economic studies), when reviewed in a depreciation proceeding, the inquiry would be the

reason for the retirement, not the prudency of the investment. TURN believes that the absence of retirement studies to justify accelerated depreciation will invite the use of monopoly rates to subsidize below-the-line service and diminish the potential earnings to be shared with ratepayers.

In its Comments on the Proposed Decision, TURN clarifies that it's position in this proceeding is not to recommend broad economic studies, therefore, its position is distinguishable from that of CCTA. However, where TURN's argument in support of its position is the same as that of CCTA, both are appropriately discussed together below.

Discussion

Both procedural and substantive issues are raised in this first depreciation proceeding under the new regulatory framework. In the interest of clarity, we discuss these issues separately.

A. Procedural Issues

We support the assigned ALJ's ruling to liberally construe Rule 8.4 of the Commission's Rules of Practice and Procedure, our protest rule, in order to allow CCTA and TURN an opportunity to be heard because this is the first depreciation proceeding under our new regulatory framework, and given the pending status of our follow-up monitoring and regulatory forum proceedings, discussed below. However, now having this first experience behind us, we must reiterate that our intent for annual depreciation proceedings is to follow standard application procedures in our Rules of Practice and Procedure.

In D.89-10-031, we ordered Pacific and GTEC to file applications for technical update and represcription by June 30 of each year. We indicated that accounting changes would be effective by January 1 of the following year. In order to meet this schedule, we must adhere to the general requirements of Rule 8.4. Rule 8.4 requires that specific facts be alleged in a protest. Where a protest does not comply with Rule 8.4, we are under no

obligation to hold a hearing and may grant the application by ex parte order." (Rule 8.2.)

In future depreciation proceedings, in order to ascertain the specific facts required by Rule 8.4, it is imperative that potential protestants proceed with informal and formal discovery, if any, upon the filing of the application. This discovery requirement increases the application review period under the new regulatory framework since depreciation accrual adjustments under the previous regulation were accomplished under our advice letter procedures requiring a protest to be filed within 20 days after the filing of an advice letter.

The applications in this proceeding were filed on June 29; CCTA's protest in Pacific and GTEC's applications were filed on July 17 and 30, respectively; DRA's responses were filed on August 2. DRA's responses prompted protests by TURN filed on August 6 and responses by CCTA filed on August 22 and 24. On August 7 and 10, GTEC replied to the protests and on September 19, CCTA filed motions to compel applicants to produce documents. On October 1 and 5, Pacific and GTEC responded to CCTA's motions.

In the future, applications for depreciation accrual adjustments shall continue to provide supporting data in the application. Should informal or formal discovery be required, we expect an applicant to continue to fully cooperate in order to expedite this process. Conducting discovery in a timely manner will avoid what has occurred in this proceeding, a flurry of pleadings, some of which were filed after the 30-day protest period had run.

Technically, there are no provisions in our rules that require us to consider pleadings filed after the protest period has ended. Therefore, we are under no obligation to consider, for example, replies to protests or discovery motions, in our deliberation on a protest and request for hearing. We did so this year because of the extenuating circumstances discussed above and

the lack of specific procedures surrounding the depreciation application. However, in future depreciation proceedings, in order to proceed judiciously, pleadings filed beyond the 30-day protest period shall not be accepted unless accompanied by a motion to accept the pleading. This motion would contain, at a minimum, a description of the need for the pleading, the reasons why the pleading could not be filed within the 30-day protest period and the impact of granting the motion on our desire to render a decision by the end of the year.

In its Comments on the Proposed Decision, TURN approves of all the above proposed procedures except the requirement of a motion to accompany pleadings filed beyond the protest period. If the term "pleadings" includes discovery motions, TURN believes this requirement is an additional burden to a protestant and may encourage applicants to intentionally delay responses to data requests in order to activate this additional requirement. TURN believes that the Commission's concern for prompt discovery is clear and that additional language stating that it is less inclined to grant motions to compel discovery where discovery is not timely would serve the same purpose as the requirement of an additional motion.

In response to this comment, this requirement is not solely based upon our concerns for timely discovery. Our concern for timely discovery is addressed by our statements above. Our concern in requiring a motion to accompany pleadings tendered for filing after the 30-day protest period is excessive pleadings. We recite above the various types of pleadings filed in this proceeding beyond the 30-day protest period, including discovery motions. We intend that all such pleadings in future proceedings be subject to this requirement. We do not agree that this requirement creates an incentive for applicants to delay discovery, especially given our express request for timely discovery above.

The requirement, as Pacific points out in its reply to TURN's comments, applies to any pleading from any party.

In its closing brief, GTEC requests that future proceedings exclude the type of evidence and argument that CCTA and TURN present in this proceeding, namely, evidence and argument addressing the appropriate standard of review in depreciation matters. We decline to make such a finding because the depreciation methodology under which we derive our findings and conclusions within the new regulatory framework cannot be treated differently than any other methodology regardless of the type of regulation. Criticism of any underlying methodology is obviously relevant and subject to challenge in depreciation proceedings. However, it is our policy not to annually review methodology once it is authorized unless persuasive facts are presented to do so.

DRA suggests that such challenges belong in our Open Forum Investigation (I.) 90-02-047. To make such a finding would be inappropriate prejudging of future protests. Protests in depreciation proceedings must be decided on a case-by-case basis. This year we clarify the methodology to be used in future depreciation proceedings, below. Next year our monitoring program and follow-up phases of regulatory flexibility should be in place. Therefore, we can only observe now that we are implementing steps which will add to our working knowledge of the new regulation each year. This knowledge will undoubtedly guide our deliberations on disputed issues in future depreciation proceedings.

B. Substantive Issues

Turning to substantive issues, the record in this proceeding indicates no dispute over applicants' requested reductions in depreciation accruals for technical updates, Pacific's retirement of step-by-step and crossbar equipment and GTEC's adjustment for inside wire amortization. DRA indicates that it has carefully reviewed these revisions and gives justifiable reasons for recommending its approval. The formula and parameters surrounding the technical updates are the same as those authorized in 1988. Pacific's accrual for step-by-step and crossbar equipment will over-recover the investment unless it is adjusted. GTEC's proposed treatment of inside wire amortization meets the Commission and FCC requirements. Therefore, we find these revisions to Pacific and GTEC depreciation accruals reasonable and will adopt them.

The dispute in this proceeding is over applicants' proposed represcription. We specifically ordered applicants to annually propose technical update or represcription. Thus, the applications are not inappropriate because they include represcription. Applicants base their recommendations regarding represcription on authorized Commission depreciation methodology and analysis. DRA has carefully reviewed the applications and recommends adjustments to applicants' proposed projection lives. Applicants' stipulated to DRA's recommended revisions during the proceeding.

Protestants argue that economic cost studies to retire and/or replace plant in the future or specific retirement studies are needed now to prevent alleged harmful cross-subsidies and diminishing the ratepayer's potential sharable earnings. CCTA recognizes that the Commission does not know whether applicants have generated a rate of return to require that earnings be shared. Yet protestants argue that the lack of these studies may allow the "whittling away" of potential sharable earnings. CCTA believes

such studies will show a significant reliance on future non-monopoly telephone investment which is currently motivating applicants to request accelerated depreciation schedules. Protestants believe this present motivation by future investments may be a substantial factor in these applications, even though they provide no analysis of applicants' supporting data. Because retirement or economic studies to justify the projected retirement of copper cable and replacement with fiber were not performed, TURN and CCTA argue that applicants' showing is inadequate and the represcription requests should be denied. CCTA requests that the represcription request be reviewed in the triennial FCC represcription proceeding next year. However, DRA testified that no additional economic studies are required for triennial FCC represcription.

We find CCTA's arguments fraught with speculation about existing and future state and federal regulatory policy, technical potentials, the possibility of an overall economic study, and the reliability of an economic study performed so far ahead of actual deployment. Applicants point out that they are presently prohibited from providing certain services, such as cable television. GTEC asserts that its network of fiber is too extensive to perform one economic study to presently justify future retirement and replacement decisions and that any exact retirement dates given may change. Applicants emphasize that copper cable is only replaced at the end of its useful life and the purpose of this proceeding is to establish that useful life in order to recover the existing investment. GTEC describes a capital investment decision as one focusing on the new investment, not the existing investment it is replacing, if any.

TURN's requirement of identifying specific existing services which will be modified or replaced by future services may be impossible to meet. Applicants' justification for accelerating

depreciation is a change in technology which will prompt services that may be unidentifiable now.

Moreover, in order to agree with protestants, we must believe that the flexible regulatory framework recently established will not operate as anticipated. We do not believe this to be the case. Pacific and GTEC defend their respective showings based upon the operation of safeguards we placed within the new regulatory framework, naming specifically the price caps, prohibition of rate changes pursuant to depreciation adjustments, monitoring, and future cost justification requirements for new services. We agree that the regulatory framework includes protection against exactly the motivation which protestants fear.

In this first depreciation proceeding for Pacific and GTEC since we adopted the new regulatory framework in D.89-10-031, it is appropriate to clarify the intent of these annual reviews as well as the applicable standard for review within the context of the new regulation.

The basic policy decisions we made in D.89-10-031 regarding utility investment and expenses are very clear. All monopoly rates and rate ceilings for Category II services will be adjusted each year by the price cap index, modified as necessary by appropriate exogenous or "Z" factors. The price cap index will not include changes in utility investments or expenses; in fact, Pacific and GTEC are precluded from applying to increase rates based upon the cost of investments or expenses, except for those specifically allowed as "Z" factors. We also have in place a version of the FCC Part 64(a) allocation methodology to separate above-the-line costs, revenues, and investments from below-the-line cost, revenues, and investments. Ratepayers are, therefore, shielded from the effects of inprudent or excessive investment or expenditures as well as cross-subsidy, and the Commission will not conduct prudency or reasonableness reviews. By these provisions,

the utilities are given a strong incentive to minimize cost and invest only where it is cost-effective.

In addition to these protective provisions and the beneficial incentives they create, comprehensive monitoring provisions will observe directly whether cross-subsidy or other undesirable activities are occurring, and the Commission will investigate if monitoring results indicate that substantial problems may exist.

We recognize that the sharing mechanism does give a possible incentive for the utilities to increase expenses periodically in order to reduce sharing, but such actions would also reduce investor earnings. In the context of the entire regulatory framework, adverse incentives potentially created by sharing earnings do not outweigh the benefits to ratepayers offered by the program as a whole. Ratepayers are only directly at risk under our framework if utility earnings fall below a lower level, currently an 8.25% rate of return, for two consecutive years. In such a case, the utility may request an increase in rates, which CCTA witness, Smith, points out. However, we would hesitate to approve such a request if evidence showed that imprudent investment or improper cross-subsidies were a substantial cause of the low earnings.

In this context and supporting modernization of the network in the interest of ratepayers and shareholders, we singled out depreciation expense as an item that we wished to review and approve annually. Our stated objective was to avoid excessive depreciation expense that might reduce sharable earnings. However, in discussing the "whittling away" of sharable earnings, we specifically referred to requests for ratemaking adjustments. (D.89-10-031, p. 355, Finding of Fact 53.) We do not agree that a credit on a ratepayer's bill generated by earnings shared which reduces the total charge is a "ratemaking adjustment", as TURN

argues. Thus, applicants make no request for rate changes in this proceeding.

We did not intend to apply the new regulatory framework to all expenses except depreciation, then conduct the equivalent of an annual rate case for depreciation. Instead, we intend the annual depreciation review as an opportunity to verify the consistency of the utilities' depreciation rates when viewed against reliable industry standards, as we have in the past. Our particular concern is tied to the importance of depreciation in the overall expenses of the utility, as well as the controversies over the alleged need to rapidly accelerate depreciation schedules to compensate for allegedly inadequate previous depreciation rates. A utility decision to accelerate depreciation rates is one we should review for its reasonableness, even though it would have no direct impact on rates. Where we find the proposed acceleration of depreciation rates excessive and outside reliable standards, it must be denied. However, the evidence in this proceeding does not support such a conclusion.

Applicants presented evidence in this proceeding which is routinely relied upon to prescribe projection lives. DRA confirmed this fact. CCTA and TURN did not challenge the supporting documentation that was presented by applicants. They argue that additional evidence should be required.

It is possible that accelerated depreciation rates could make some investment decisions economic that would not have been economic otherwise. In such a case, Pacific and/or GTEC might invest in fiber that could position them better to compete with cable firms if they are authorized by law to enter this business. As described above, ratepayers would be at minimal risk under such circumstances. Competitors such as cable firms, on the other hand, would reasonably be concerned about competition from the local exchange companies (LEC) which may be based upon greater efficiencies. However, as long as monopoly-side rates cannot be

increased to cover competitive-side cross-subsidies, and as long as below-cost pricing does not take place for LEC competitive services, both of which our safeguards should prevent, we should not be concerned about the speculative effects of depreciation rate changes on future investment decisions. CCTA's interest in Pacific's and GTEC's capital budgeting and investment review processes is misplaced in a proceeding designed only to verify that utility depreciation expense rates bear some reasonable relationship to the remaining useful lives of their plant.

We reiterate that Pacific and GTEC must file an application to deploy fiber optics beyond the feeder, that is, in a manner that could create the infrastructure technically needed to offer cable television service. We included this provision in D.89-10-031 at the urging of CCTA, which represented that this protection would meet its legitimate concerns regarding an opportunity to review investment decisions that might directly affect their industry. This requirement applies whether or not the other legal restrictions now barring telephone utilities from providing cable television service are lifted.

In addition, our open forum I.90-02-047, exists to address anticompetitive conduct and other competitive concerns. This proceeding allows parties other than Pacific and GTEC to petition the Commission to investigate a number of issues, including, violation by Pacific or GTEC of Commission policies, such as our policy goal of avoidance of cross-subsidy and anti-competitive behavior. This proceeding also specifically allows parties to bring unresolved auditing or cost allocation problems to our attention by an appropriate petition so we can address these issues prior to and apart from the annual sharable earnings review.

We are also in the process of establishing an ongoing monitoring program for oversight of the new regulatory framework. This monitoring program will include reports on a variety of topics, including several measures under the goals of encouragement

of technological advance, full utilization of the local exchange network, and avoidance of cross-subsidies and anti-competitive behavior. The open forum procedure specifically allows parties to file a petition, as a result of review of data or reports gathered in the monitoring process, to review the adherence to the Commission's monitoring goals established in D.89-10-031.

Accordingly, we conclude that Pacific and GTEC have adequately demonstrated that their proposed 1991 depreciation rates, as amended by the stipulations to DRA's recommendations, are reasonable. We accept DRA's recommended adjustments to the applications because they reflect an approach to depreciation acceleration which places more reliance on our historical experience.

Findings of Fact

1. In separate applications, Pacific, and GTEC request accounting adjustments effective January 1, 1991 to respective depreciation accrual accounts for the technical update of all plant accounts and represcription of specific accounts.

2. Pacific proposes a net reduction in its depreciation accrual of $36.906 million comprised of: a decrease of $39 million for fully depreciated step-by-step and crossbar equipment; a decrease of $52.930 million for the technical update of all plant; and, an increase of $55.024 million due to the represcription of seven categories of plant.

3. GTEC proposes a net reduction in its depreciation accrual of $7.287 million comprised of: a decrease of $10.391 million for its technical update of plant; and, an increase of $3.104 million for represcription of its underground metallic cable account.

4. DRA recommends that the projection lives used in the requested represcription be adjusted to calculate a net reduction in depreciation accrual for 1991 of $58.852 million for Pacific and $12.94 million for GTEC. In its analysis of projection lives, DRA relies on historical analysis of plant accounts and authorized

Commission methodology in deriving the average remaining life of the prescribed equipment. DRA's recommendations are reasonable.

5. Applicants stipulate to DRA's recommendations.

6. CCTA and TURN oppose the proposed prescription in both applications.

7. CCTA and TURN contend that there is insufficient evidence upon which to grant the application because applicants do not provide additional studies to justify their projected retirement and replacement dates.

8. CCTA and TURN do not otherwise challenge the applications or supporting data.

9. The evidence and argument supporting CCTA's request to deny the applications involves speculation about the existing regulatory framework and future state and federal regulation, the possibility that economic studies can be performed and the reliability of such studies. TURN's request to identify specific services to justify accelerated depreciation may be impossible.

10. Applicants and DRA use authorized Commission depreciation methodology to support the respective prescription requests and recommendations.

11. The granting of applicants' requested adjustments to depreciation accrual, as amended by DRA, will not change applicants' rates.

Conclusions of Law

1. Applicants' requested adjustments to depreciation accrual, as amended by DRA, should be approved for accounting purposes in 1991.

2. The granting of applicants' requested adjustments to depreciation accrual, as amended by DRA, will not change applicants' rates.

3. This decision should be effective immediately.

O R D E R

IT IS ORDERED that:

1. Pacific Bell is authorized to adopt the depreciation accounting changes proposed in its application, as amended by Division of Ratepayer Advocates (DRA), for the calendar year 1991 as contained in Appendix A.

2. GTE California, Inc. is authorized to adopt the depreciation accounting changes proposed in its application, as amended by DRA, for the calendar year 1991 as contained in Appendix B.

This order is effective today.

Dated December 27, 1990, at San Francisco, California.

G. MITCHELL WILK
President
FREDERICK R. DUDA
STANLEY W. HULETT
JOHN B. OHANIAN
PATRICIA M. ECKERT
Commissioners

I CERTIFY THAT THIS DECISION WAS APPROVED BY THE ABOVE COMMISSIONERS TODAY

NEAL J. SHULMAN, Executive Director

APPENDIX A
PACIFIC BELL
1991 ACCRUALS AT AUTHORIZED RATES

ACCOUNT NUMBER	CLASS OR SUBCLASS OF PLANT	1-1-90 INVESTMENT $	RATES %	ACCRUALS $	AUTH. OTHER ADJ. $	TOTAL ACCRUALS $
2112	MOTOR VEHICLES	261,192	9.9	26,452		26,452
2114	SPECIAL PURPOSE VEHICLES	1,680	4.2	71		71
2115	GARAGE WORK EQUIPMENT	11,304	10.6	1,198		1,198
2116	OTHER WORK EQUIPMENT	118,515	7.3	8,652		8,652
2121	BUILDINGS	1,694,938	2.0	33,899		33,899
2122	FURNITURE	109,225	4.8	5,243		5,243
2123.1	OFFICE SUPPORT EQUIPMENT	43,697	9.0	3,879		3,879
2123.2	COMPANY COMMUN EQUIPMENT	128,430	17.7	22,732		22,732
2124	GEN PURPOSE COMPUTERS	1,245,203	11.2	139,463		139,463
2211	ANALOG ELECT SWITCH	2,681,883	7.4	198,459	49,889	248,348
2212	DIGITAL ELECT SWITCH	1,634,645	4.3	72,861	-35,344	108,205
2215.1	STEP BY STEP	111,529	@		10,000	10,000
2215.2	CROSSBAR	100,388	@		26,000	26,000
2220.2	OPERATOR SYS-CROSSBAR	85,122	11.0	9,363		9,363
2220.3	OPERATOR SYS-OTHER	37,732	6.7	2,528	909	3,437
2231	RADIO SYSTEMS	91,873	7.3	6,707		6,707
2232.11	DIGITAL DATA SYSTEMS	154,114	9.1	14,024		14,024
2232.12	DIGITAL CIRCUIT-OTHER	2,104,290	7.8	164,135	45,717	209,852
2232.2	ANALOG CIRCUIT-OTHER	1,404,305	6.9	89,383	18,141	107,524
2351	PUBLIC TEL TERM EQUIPMENT	151,390	8.1	12,263		12,263
2362	OTHER TERMINAL EQUIPMENT	217,291	12.6	27,379		27,379
2411	POLES	447,819	6.1	27,317		27,317
2421.1	AERIAL CABLE-EXCHANGE	1,699,089	5.3	89,922		89,922
2421.2	AERIAL CABLE-INTEROFFICE	20,897	11.6	2,424		2,424
2422.1	UNDERGROUND CABLE-EXCHANGE	2,110,379	4.5	98,027		98,027
2422.2	UNDERGROUND CABLE-INTEROFC	501,614	8.2	41,116		41,116
2423.1	BURIED CABLE-EXCHANGE	1,308,595	4.1	56,684		56,684
2423.2	BURIED CABLE-INTEROFFICE	112,556	9.2	10,355		10,355
2424	SUBMARINE CABLE	11,261	5.0	563		563
2426	INTRABUILDING NETWORK CABL	542,402	6.0	32,544		32,544
2431	AERIAL WIRE	31,221	12.9	4,028		4,028
2441	UNDERGROUND CONDUIT	1,826,219	2.4	43,877		43,877
	TOTALS	20,891,791		1,245,068	186,000	1,431,068

@ SPECIAL SCHEDULE
B ORDERED IN RESOLUTION NO. 13030

(END OF APPENDIX A)

APPENDIX B
GTE CALIFORNIA
1991 ACCRUALS AT AUTHORIZED RATES

ACCOUNT NO. FCC	CLASS OF PLANT	ACTUAL 12-31-89 PLT BAL $	RATES %	AUTHORIZED ACCRUALS $
2112.00	MOTOR VEHICLE	108034	5.79%	6255
2115.00	GARAGE WORK EQUIPMENT	87083	6.20%	5399
2121.00	BUILDINGS	545711	3.19%	17408
2122.00	FURNITURE	48399	4.12%	1994
2123.00	OFFICE SUPPORT EQUIPMENT	117805	11.61%	13677
2124.00	GENERAL PURPOSE COMPUTERS	120991	24.76%	29885
2211.00	ANALOG SWITCHING EQUIP.	449181	19.34%	86872
2211.10	ANALOG SWITCHING - BTO	2802	20.00%	560
2212.00	DIGITAL SWITCHING EQUIP.	1001906	6.88%	68931
2212.10	DIGITAL SWITCHING - BTO	98039	20.00%	19608
2220.00	OPERATOR SYSTEMS	18932	5.77%	1092
2231.00	RADIO	41310	8.32%	3437
2232.10	CIRCUIT EQUIPMENT - ANALOG	71319	22.16%	15761
2232.21	CIRCUIT EQUIPMENT - DIGITAL	761268	10.20%	77649
2232.23	CIRCUIT EQUIPMENT - LIGHTWT	62634	10.10%	6326
2351.00	PUBLIC TELE EQUIP - COIN	39888	8.41%	3354
2362.00	BCTE,PAID CHIN, & OTE TELE EQU	39473	12.26%	4839
2411.00	POLES	112884	5.23%	5904
2421.10	METALLIC CABLE - AERIAL	748284	6.52%	48788
2421.20	NON-METALLIC CABLE - AERIAL	463	5.33%	25
2422.10	METALLIC CABLE - UNDERGROUND	974593	5.83%	56815
2422.20	NON-METALLIC CABLE - UNDERGROU	33788	4.09%	1379
2423.10	METALLIC CABLE - BURIED	570816	5.62%	32035
2423.20	NON-METALLIC CABLE - BURIED	325	4.77%	16
2424.00	METALLIC CABLE - SUBMARINE	884	5.79%	51
2426.00	INTRABUILDING CABLE - NTWK	7395	3.25%	240
2431.00	AERIAL WIRE	9587	6.45%	618
2441.00	CONDUIT SYSTEMS	512424	2.02%	10351
	SUB-TOTAL (EXCL. CPIN)	6585274	7.89%	519319
2321.00	STA. CONN. - INSIDE WIRE	415652	7.56%	31174
	TOTAL ALL ACCOUNTS	7000926		550493
	COMPOSITE RATE		7.86%	

*NOTE: TOTAL DOES NOT INCLUDE ACCOUNT 2215, WHICH WILL BE FULLY RETIRED BY 12-31-90.

(END OF APPENDIX B)