

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Investigation Into)
Pricing of Unbundled Network)
Elements) Docket 990649-TP

DIRECT TESTIMONY OF

ALLEN E. SOVEREIGN

On Behalf of

VERIZON FLORIDA INC.

SUBJECT: DEPRECIATION

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DIRECT TESTIMONY OF ALLEN E. SOVEREIGN

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME, ADDRESS AND PRESENT POSITION.

A. My name is Allen E. Sovereign. My business address is 1420 East Rochelle Blvd., Irving, Texas 75039. I am employed by Verizon as Group Manager-Capital Recovery.

Q. PLEASE BRIEFLY DESCRIBE YOUR EDUCATIONAL BACKGROUND.

A. I received a Bachelor of Science Degree in Electrical Engineering from Michigan Technological University, Houghton, Michigan, in 1971. I received a Master of Science Degree in Business Administration from Indiana University, Bloomington, Indiana, in 1980. I have attended courses in depreciation and life analysis provided by Depreciation Programs, Inc., of Kalamazoo, Michigan. I have also attended and instructed basic and advanced GTE courses in depreciation life analysis. I am a Senior Member of the Society of Depreciation Professionals.

Q. PLEASE BRIEFLY DESCRIBE YOUR WORK EXPERIENCE WITH VERIZON.

A. I have worked for Verizon, and the former GTE Companies, for 25

1 years, with 18 of those years in the depreciation study area. I have
2 held various positions in Engineering and Construction, Capital
3 Budgeting, Marketing, and Product Development. I was named to my
4 current position in February 1994.

5

6 **Q. WHAT ARE YOUR RESPONSIBILITIES IN YOUR CURRENT**
7 **POSITION?**

8 A. I am responsible for the preparation, filing and resolution of capital
9 recovery studies and the determination of economic lives for Verizon.

10

11 **Q. HAVE YOU PREVIOUSLY TESTIFIED IN FLORIDA?**

12 A. Yes.

13

14 **Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE ANY OTHER**
15 **REGULATORY BODIES?**

16 A. Yes, I have also testified before state utility commissions in South
17 Carolina, Texas, New Mexico, Arkansas, California, Washington,
18 Idaho, Illinois, Indiana, Nebraska, Pennsylvania, Michigan, Virginia,
19 Kentucky, Nevada, Iowa, and Hawaii.

20

21 **Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY?**

22 A. The purpose of this testimony is to respond to Issue 7b in this
23 proceeding, regarding the appropriate depreciation lives and future
24 net salvages to be used in the unbundled network element ("UNE")
25 cost studies Verizon Florida Inc. ("Verizon" or "Company") has

1 submitted in this proceeding.

2

3 **Q. WHAT DEPRECIATION INPUTS DID VERIZON USE IN ITS COST**
4 **STUDIES?**

5 A. Verizon used the forward-looking economic lives and future net
6 salvages recommended in this testimony. A complete list of Verizon's
7 proposed depreciation lives and future net salvage percentages is
8 attached as Exhibit AES-1.

9

10 **Q. PLEASE SUMMARIZE YOUR DIRECT TESTIMONY.**

11 A. The Florida Public Service Commission ("FPSC") should approve the
12 economic depreciation inputs Verizon used in its cost studies. Like the
13 cost study methodology prescribed for use in this proceeding,
14 Verizon's depreciation inputs are forward-looking. This forward-
15 looking approach produces a more accurate estimate of assets'
16 economic lives than an outdated, historical approach.

17

18 When all local exchange companies were monopoly providers,
19 regulators could defer capital recovery without affecting the ability of
20 the regulated company to recover its investments. With the advent of
21 local competition, regulators no longer have the luxury of postponing
22 capital recovery in the rate-setting process. The changing
23 telecommunications environment must be taken into consideration
24 when determining the proper recovery period of an asset. The
25 methodology described in my testimony considers these

1 A. Economic lives are generally shorter than prescribed asset lives.

2

3 **Q. WHY ARE ECONOMIC LIVES SHORTER THAN PRESCRIBED**
4 **LIVES?**

5 A. Historically, regulatory commissions prescribed asset lives under the
6 assumption that there would be little or no competition and that
7 technological innovation would continue at its traditional pace. The
8 Telecommunications Act of 1996 ("Act") is intended to spur a new
9 competitive environment that invalidates that basic assumption.

10

11 As previously discussed, the economic life of an asset is the period
12 of time over which that asset is used to provide economic value. Both
13 increased competition and technological change shorten the period
14 over which an asset will provide economic value. In a world where
15 Verizon was sole provider, depreciation rates were based upon
16 artificially long asset lives. By basing depreciation rates on long asset
17 lives, the depreciation rates were lower, and the period of time over
18 which the asset was depreciated was longer. These longer
19 depreciation lives helped state commissions to keep consumer prices
20 artificially low. Today's market environment reduces the length of
21 time over which Verizon can recover its investment in an asset and
22 renders unsustainable the use of artificially long asset lives in
23 calculating depreciation rates.

24

25 **Q. WHEN ESTIMATING ECONOMIC LIVES, IS IT POSSIBLE TO USE**

1 **TRADITIONAL LIFE ESTIMATION TECHNIQUES?**

2 A. No. Traditional life estimation techniques are used to predict an
3 asset's *physical* life, but not its *economic* life. The physical life of an
4 asset ends upon that asset's retirement. Economic lives, however,
5 can be affected when no retirements are evident. For example,
6 assume Verizon has a 1,200 pair cable that has been used to provide
7 service to 1,000 customers in the pre-1996 single-provider
8 environment. Next, assume that in the post-1996 industry, only 500
9 pairs of the 1,200 pair cable are being used (*i.e.*, providing service to
10 customers and economic value to Verizon) as a result of 500
11 customers leaving for competitors' networks. Retirement-based
12 analysis (*i.e.*, the traditional physical life estimation technique)
13 assumes that all plant in service has economic life. However, under
14 this scenario, only 50% of the originally utilized investment actually
15 has economic life. The economic life of the asset is severely affected
16 by competition, but there are no associated retirements of the asset.

17
18 **Q. HAS THE FLORIDA PUBLIC SERVICE COMMISSION FOLLOWED**
19 **THE TRADITIONAL METHOD FOR SETTING DEPRECIATION**
20 **LIVES?**

21 A. Historically, the FPSC followed the traditional method for setting
22 depreciation rates. However, since January 1996, Verizon has been
23 permitted to set depreciation rates that reflect competitive and
24 technological advancements in the marketplace. Verizon uses the
25 same depreciation inputs for FPSC regulatory purposes that it uses

1 for financial reporting purposes, and those are the same inputs I
2 recommend here.

3

4 **Q. WHAT DID THE FPSC RECOMMEND THE LAST TIME IT**
5 **PRESCRIBED DEPRECIATION INPUTS?**

6 A. As previously stated, the FPSC no longer prescribes depreciation
7 inputs for Verizon for regulatory reporting purposes. The last time it
8 did so was in Docket 920284-TL, in 1992. The Commission did,
9 however, recommend depreciation inputs in its 1998 proceeding to
10 determine the cost of basic local service for purposes of establishing
11 a universal service fund mechanism. (Docket 980696-TP). The chart
12 below compares the FPSC-ordered depreciation lives in Docket
13 980696-TP with the depreciation lives Verizon uses in its cost studies
14 for the major technology-sensitive accounts. A complete comparison
15 of all accounts is attached as Exhibit AES-2.

16 A Comparison of FPSC-Ordered and Verizon's Proposed Depreciation Lives

	FPSC	Verizon
	<u>Ordered</u>	<u>Proposed</u>
Digital Switching Equipment	13	10
Circuit Equipment	8	9
Copper Cable		
Aerial	18	15
Underground	23	15
Buried	18	15

1	Fiber Cable		
2	Aerial	20	20
3	Underground	20	20
4	Buried	20	20

5 As the chart illustrates, the FPSC accepted Verizon's lives in some of
6 the major technology-sensitive accounts, but ordered somewhat
7 longer lives in others.

8
9 Establishing the proper economic lives for these assets is critical to
10 determining economic depreciation in a forward-looking cost study.
11 Economic lives of other assets are used in Verizon's cost studies, but
12 the changes in those assets' economic lives (e.g., motor vehicles) as
13 compared to the prescribed lives are extremely small and have little
14 impact on the depreciation rates for those assets.

15

16 **Q. DID THE FPSC RECENTLY APPROVE DEPRECIATION INPUTS**
17 **FOR BELL SOUTH IN THIS DOCKET?**

18 A. Yes. On April 18, 2001, the FPSC approved its Staff's recommended
19 depreciation inputs. The inputs for the technology-sensitive network
20 accounts were similar to those ordered in the USF docket discussed
21 above. The chart below compares the FPSC-approved depreciation
22 lives for BellSouth with the depreciation lives Verizon uses in its cost
23 studies for the major technology-sensitive accounts. A complete
24 comparison of all accounts is attached as Exhibit AES-2.

25

1 A Comparison of FPSC-Recommended and Verizon's Proposed Depreciation Lives

2		FPSC	Verizon
3		Approved	<u>Proposed</u>
4	Digital Switching Equipment	13	10
5			
6	Digital Circuit Equipment	9	9
7	Copper Cable		
8	Aerial	18	15
9	Underground	23	15
10	Buried	18	15
11	Fiber Cable		
12	Aerial	20	20
13	Underground	20	20
14	Buried	20	20

15

16 As the chart shows, the depreciation lives the FPSC approved for
17 BellSouth's fiber accounts and those ordered for the large local
18 exchange companies in the USF docket are the same. Verizon
19 recommends the same 20-year life for these fiber cable accounts in
20 this proceeding, so there should be no question about its
21 reasonableness.

22

23 There are differences between Verizon's recommendations and the
24 lives approved for BellSouth in certain other areas—principally, the
25 Digital Switching and Copper Cable accounts. Verizon's

1 recommendations for these accounts more accurately reflect the
2 competitive and technological conditions of the highly competitive
3 Tampa Bay area in which Verizon operates, as discussed further in
4 this testimony.

5

6

7 **III. COMPETITION AND TECHNOLOGICAL INNOVATION REQUIRE**

8

THE USE OF ECONOMIC LIVES

9

10 **Q. WHAT FACTORS SHOULD THE COMMISSION CONSIDER IN**
11 **APPROVING DEPRECIATION INPUTS FOR THE COST MODEL?**

12 A. The two most important factors that must be considered in
13 establishing the economic value of Verizon's assets are: (1)
14 technological innovation and (2) impact of competition.

15

16 **Q. WHAT TECHNOLOGICAL INNOVATIONS WERE CONSIDERED IN**
17 **ESTABLISHING VERIZON'S ECONOMIC LIVES?**

18 A. Competitive carriers are utilizing a number of alternative technologies
19 to provide telecommunications service that completely bypass the
20 ILEC's existing wireline network. These technologies include wireless
21 local loops, cable lines, and electric lines. Prior to the passage of the
22 1996 Telecommunications Act, depreciation analysis consisted
23 primarily of mortality analysis with only slight adjustments for
24 technological change. Now, the rapid pace of advancement in
25 technological innovations must be recognized in establishing the

1 economic value of Verizon's assets.

2

3 **Q. WHAT KINDS OF COMPETITIVE DEVELOPMENTS WERE**
4 **CONSIDERED IN ESTABLISHING VERIZON'S ECONOMIC LIVES?**

5 A. Verizon witness Jacobson details these developments in his Direct
6 Testimony. As he points out, Florida will continue to be a particularly
7 attractive market for entry by alternative competitive local exchange
8 carriers. There were well over 400 certificated carriers as of April
9 2001. Over 600 collocations are complete, with an additional 85
10 collocation agreements pending, in Verizon central offices. ALECs
11 have deployed over 80 voice switches and 11 wireless switches in
12 Verizon's operating territory. At this pace, ALECs will soon have
13 almost as many switches as Verizon.

14

15 The FPSC's December 2000 Report on Competition in
16 Telecommunications Markets in Florida likewise noted the competitive
17 strides ALECs have made and continue to make. The Commission's
18 own statistics (based on ALECs' self-reported data) demonstrate the
19 acceleration of competitive activity in Verizon's territory, particularly
20 in the business market. This trend will only become more pronounced,
21 as more and more competitors enter the market.

22

23 For example, Level 3 Communications, Inc. launched services in
24 February 2000 in the Orlando and Tampa metropolitan areas. The
25 company is targeting business customers for services such as private

1 lines, Internet access, and dark fiber. Florida Digital Networks, a
2 facilities-based ALEC headquartered in Orlando and focussing on the
3 business segment, has completed construction of fiber optic networks
4 in Tampa, among other areas. Most of Verizon's competitors are,
5 understandably, targeting the most lucrative business customers.

6
7 The increased trend toward facilities-based competition that has been
8 evident here is consistent with developments nationwide. According
9 to the February 2000 report of the national Association for Local
10 Telecommunications Services (ALTS), 333 of the over 375 ALECs in
11 operation across the United States own or control and operate some
12 of their own facilities. When the report was published over a year
13 ago, Intermedia Communications, headquartered in Verizon's Tampa
14 area, had over 60% of its lines on its own switches, and Allegiance
15 and Nextlink had over 80% on their own switches. ICG had over 50%
16 of its lines on its own network and an additional 28% on-switch.
17 (ALTS 2000 Report at 4). In addition, ALTS reports that CLECs have
18 invested \$56 billion in infrastructure since 1997. (ALTS, "The State
19 of Local Competition 2001," February 2001.)

20

21 **Q. HAVE YOU ALSO CONSIDERED THE THREAT OF BYPASS BY**
22 **EMERGING TECHNOLOGIES SUCH AS WIRELESS LOCAL LOOP**
23 **TECHNOLOGIES?**

24 A. Yes. In this regard, for instance, AT&T and MCI WorldCom have both
25 conducted trials of fixed wireless local loop technology and

1 announced that this technology would soon be available nationwide.
2 Other companies, including Winstar and Teligent, are currently
3 offering a fixed wireless alternative to local landline service in the
4 Tampa area.

5

6 **Q. HAVE THE REGIONAL BELL OPERATING COMPANIES (RBOCS)**
7 **EXPRESSED INTEREST IN COMPETING IN VERIZON'S**
8 **OPERATING TERRITORY?**

9 A. Yes. On June 2, 1999, the PSC granted SBC's application for
10 certification to provide local service in Florida. SBC had announced
11 that it would begin offering local service in 30 of the nation's top
12 markets, including Tampa, outside of its franchise territories.

13

14 Since October 1998, BellSouth has offered wireless service in the
15 Tampa Bay area. Its prices and bundled packages for wireless local
16 and long distance service, including paging and calling features,
17 represent direct competition to Verizon's wireline services, and there
18 can be little doubt that its wireless marketing ideally positions it to
19 successfully move into the wireline market.

20

21 **Q. DO OTHER CELLULAR PROVIDERS POSE A THREAT TO**
22 **VERIZON'S WIRELINE NETWORK?**

23 A. Yes. Prices and packages for wireless plans are becoming
24 increasingly competitive with wireline plans and are being marketed
25 as an alternative to the wireline network. For example, Alltel offers a

1 \$59.95 monthly calling plan that provides unlimited local calling both
2 to and within the four-county area including Pinellas, Hillsborough,
3 Pasco and Polk counties. A subscriber using this plan as a
4 replacement for their home service would not only get the benefit of
5 being mobile within this four-county area, but would also avoid the toll
6 and/or extended calling service charges that they would otherwise
7 incur for wireline service.

8
9 A national survey conducted by the Yankee Group indicates that the
10 number of consumers relying solely on their mobile phones is on the
11 rise. Yankee Group analyst Mark Lowenstein predicts that traffic on
12 U.S. wireless networks will skyrocket from 105 billion minutes in 1998
13 to 554 billion minutes in 2004 (“More Using Cell than Home Phones,”
14 USA Today, July 28, 1999 at 1A.).

15

16 **IV. VERIZON PROPERLY WEIGHS ALL RELEVANT FACTORS IN**
17 **DETERMINING ECONOMIC LIVES.**

18

19 **Q. WHAT METHOD DOES VERIZON USE TO DETERMINE THE**
20 **ECONOMIC LIFE OF AN ASSET?**

21 **A.** When estimating economic lives, Verizon (a) evaluates the criteria that
22 are used to establish the retirement lives of assets as a guideline for
23 estimating economic lives, (b) considers industry benchmark
24 comparisons, and (c) considers the effect the evolving competitive
25 market will have on the economic lives of many of Verizon’s assets.

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**Q. WILL YOU PLEASE EXPLAIN THE USE OF THESE FACTORS
IN MORE DETAIL?**

A. Verizon first considers the National Association of Regulatory Utility Commissioners' description of factors that cause property to be retired. (Public Utility Depreciation Practices, National Association of Regulatory Utility Commissioners (NARUC), 1996, at 15).

These include:

1. Physical Factors
 - a. Wear and tear
 - b. Decay or deterioration
 - c. Action of the elements and accidents
2. Functional Factors
 - a. Inadequacy
 - b. Obsolescence
 - c. Changes in art and technology
 - d. Changes in demand
 - e. Requirements of Public Authorities
 - f. Management discretion
3. Contingent Factors
 - a. Casualties or disasters
 - b. Extraordinary obsolescence

Verizon believes these same factors can be used to help estimate an asset's economic life expectancy by allocating the appropriate

1 weighting to each factor. That is, Verizon uses the NARUC factors as
2 a guideline for choosing economic lives of certain assets, but only
3 after allocating proper weighting to those factors that reflect the
4 significant roles competition and technological change play in
5 determining an asset's economic life.

6
7 Specifically, the "Functional Factors" (Part 2 of the NARUC factors)
8 are sensitive to competition and technological change and are given
9 substantially greater weight when Verizon considers the NARUC
10 criteria in establishing the economic lives of Verizon's assets. As I
11 explained above, the effects of competition and technological change
12 on an asset's economic life must be properly considered when
13 determining competitive market asset lives. It has long been
14 recognized in the industry that traditional methods for determining
15 lives for accounts most affected by technology and competition are
16 inadequate. Most Commissions, including this one, have thus seen
17 it fit to make adjustments to the physical life indications produced by
18 historical mortality analysis.

19

20 **Q. WHAT OTHER GUIDES DO YOU USE IN ESTABLISHING ASSET**
21 **LIVES?**

22 A. To help quantify our professional judgment as to the appropriate lives
23 for telephone plant, Verizon also benchmarks against competitors,
24 such as AT&T, MCI Worldcom, and cable television providers, and
25 considers industry studies performed by Technology Futures Inc.

1 ("TFI").

2

3 **Q. PLEASE EXPLAIN WHY BENCHMARKING IS USEFUL AND**
4 **APPROPRIATE.**

5 A. We believe that benchmarking affords an excellent example of the
6 reasonableness of Verizon's recommended depreciation lives. As we
7 transition to a competitive environment, we should be treated the same
8 as our competitors with respect to setting depreciation rates.
9 Competitors' depreciation rates are not reviewed or approved by any
10 regulatory body, and are a good guide to reasonable practices in a
11 competitive market.

12

13 **Q. WHAT DID YOU DETERMINE USING BENCHMARK**
14 **COMPARISONS WITH AT&T?**

15 A. Comparing the economic lives proposed by Verizon to the lives AT&T
16 uses affords an excellent example of how reasonable Verizon's
17 recommendations are. AT&T's 1999 annual report states that the
18 useful life of communications and network equipment ranges from 3 to
19 15 years. The useful life of other equipment ranges from 3 to 7 years.
20 The useful life of buildings and improvements ranges from 10 to 40
21 years. Verizon's recommended lives are not as short as AT&T's. In
22 comparison, Verizon's recommendation for network equipment ranges
23 from 9 to 50 years. My testimony also recommends 5 to 15 years for
24 Other Equipment, and 35 years for buildings.

25

1 **Q. WHAT WAS DETERMINED BY THE COMPARISON WITH MCI**
2 **WORLD.COM?**

3 A. MCI WorldCom's 1996 annual report stated that the weighted average
4 depreciable life of the assets comprising the communications system
5 in service approximates 10 years. Furniture, fixtures and equipment
6 are depreciated over a weighted average life of 6 years. Buildings are
7 depreciated using lives of up to 35 years. In comparison, Verizon's
8 recommendation for equipment that comprises the communication
9 system ranges from 9 to 50 years. My testimony recommends 5 to 15
10 years for furniture, fixtures and equipment, and 35 years for buildings.

11

12 In 1998, MCI WorldCom again shortened the lives of its
13 communications facilities from approximately 10 years to 9 years,
14 stating that the company periodically reviews and adjusts the useful
15 lives assigned to fixed assets to ensure that depreciation charges
16 provide appropriate recovery of capital costs over the estimated
17 physical and technological lives of the assets. The weighted average
18 of depreciable life of the assets comprising the communications
19 system in service approximates nine years.

20

21 **Q. WHAT WAS DETERMINED BY THE COMPARISONS TO LIVES**
22 **USED BY THE CABLE TELEVISION (CATV) OPERATORS?**

23 A. Verizon's lives are not as short as the lives used by CATV operators.
24 The FCC adopted a flexible range of lives to be used by CATV
25 operators seeking to justify depreciation rates in cost of service filings.

1 The useful lives adopted by the FCC for distribution facilities were from
2 10 to 15 years. This range was developed from a statistical analysis
3 of lives used by CATV operators for their own facilities. The 15-year
4 economic life for copper cable and the 20-year life for fiber cable
5 calculated selected by Verizon are not as short as the lives within the
6 FCC-allowed range for CATV distribution facilities. Additionally, the
7 lives proposed by Verizon for support assets such as office furniture
8 and equipment, vehicles, and buildings are reasonable when
9 compared to the FCC-allowed ranges for CATV operators. The FCC
10 CATV range for office furniture and equipment is 9-11 years, which
11 compares favorably to Verizon's proposal of 10 - 15 years for these
12 accounts. The FCC range for vehicles and equipment is 3-7 years,
13 which is shorter than Verizon's proposal of 8-12 years. The FCC
14 range for buildings is 18-33 years, which is shorter than Verizon's
15 proposal of 35 years. (FCC MM Docket No. 93-215, Implementation of
16 Sections of the Cable Television Consumer Protection and Competition Act
17 of 1992: Rate Regulation and FCC CS Docket No. 94-28, Adoption of a
18 Uniform Accounting System for Provision of Regulated Cable Service,
19 Second Report and Order, First Order on Reconsideration, and Further
20 Notice of Proposed Rulemaking, January 26, 1996).

21

22 **Q. HAVE ANY OTHER COMMISSIONS DETERMINED THAT**
23 **BENCHMARKING IS A VIABLE METHOD TO ASSESS THE**
24 **REASONABLENESS OF VERIZON'S PROPOSED LIVES?**

25 A. Yes. The Missouri Public Service Commission commented on

1 benchmarking for purposes of establishing depreciation rates to be
2 utilized in Verizon's TELRIC cost studies as follows:

3 Staff believes that benchmarking GTE TELRIC rates against
4 those booked for financial purposes of likely competitors and
5 other companies using similar technologies is appropriate and
6 is the best method to determine if GTE's TELRIC rates pass the
7 muster of reasonableness.

8

9 (Case No. TO-97-63, Missouri Public Service Commission, Final
10 Arbitration Order, July 31, 1997 ("Missouri Order"), Attachment C at
11 77).

12

13 The Missouri Staff chose 19 of the largest IXC, CATV, cellular, CAP,
14 and PCS companies to benchmark against and found that the
15 depreciation rates used to calculate GTE TELRIC costs were at the
16 bottom or second from the bottom of the list and were significantly
17 lower than several companies in similar industries, concluding that
18 "This is the most significant factor to Staff's belief that GTE's proposed
19 depreciation rates are reasonable." (Missouri Order, Attachment C at
20 79).

21

22 **Q. HAVE ANY ALECS PROVIDED INFORMATION IN THIS DOCKET**
23 **THAT CONFIRMS THE REASONABLENESS OF VERIZON'S**
24 **PROPOSED LIVES?**

25 A. Yes. A number of ALECs responded to BellSouth's discovery requests

1 in its phase of this docket. For example, Florida Digital Network
2 confirmed that it owned or operated switches and cable in Florida to
3 provide telephone exchange services. It stated that the life it uses for
4 switches is 10 years, which is the same as Verizon recommends; and
5 15 years for cable, which is the same as Verizon's recommended 15
6 years for copper cable and shorter than Verizon's recommended 20
7 years for fiber cable. It also listed lives for support equipment which
8 ranged from 5–10 years, which were generally shorter or the same as
9 Verizon's recommendations of 5–15 years for similar equipment.
10 (BellSouth Hearing, Ex. 33.)

11
12 Intermedia Communications also responded to BellSouth
13 interrogatories (BellSouth Hearing, Ex. 35). Intermedia stated that it
14 uses a 7-year life for switches, which is the much shorter than
15 Verizon's recommendation of 10 years; and 20 years for fiber cable,
16 which is the same as Verizon's recommended 20 year. It also listed
17 lives for telecommunication equipment and furniture and fixtures which
18 ranged from 2–7 years, which is shorter than Verizon's
19 recommendations of 5– 5 years for similar equipment.

20
21 In its responses (BellSouth Hearing, Ex. 36), Rhythms Links admitted
22 that that it owns or operates digital circuit equipment used to provide
23 digital subscriber line services in Florida. It uses a 5-year life for digital
24 circuit equipment, which is much shorter than Verizon's
25 recommendation of 9 years. Its lives for equipment and furniture

1 ranged from 3–7 years, which are also shorter than Verizon's
2 recommendations of 5–15 years for similar equipment.

3

4 Time Warner Telecom of Florida also owns or operates facilities to
5 provide telephone exchange services in Florida. It uses a 10-year life
6 for switches was 10 years, which is the same as Verizon recommends;
7 and 15 years for fiber cable, which is shorter than Verizon's proposed
8 20 years. For vehicles and other equipment, Time Warner's lives
9 range from 3 – 10 years, which are generally shorter or the same as
10 Verizon's recommendations of 5–15 years for similar equipment.
11 (BellSouth Hearing, Ex. 36.)

12

13 This information provides further evidence that Verizon's
14 recommendations are reasonable and should be accepted in this
15 proceeding.

16

17 **Q. PLEASE EXPLAIN VERIZON'S USE OF THE INDUSTRY STUDIES**
18 **PERFORMED BY TECHNOLOGY FUTURES INC. (TFI).**

19 A. TFI forecasts the remaining lives for certain assets when technological
20 change is driving the shortening of asset lives. To quantify this
21 technological change, TFI uses a model to analyze remaining
22 economic lives using patterns of technological substitution observed
23 in the communications industry, as well as other industries. The
24 industry studies conducted by TFI forecast the combined effects that
25 competition and technological change will have on an asset's

1 remaining useful life. The studies generally project shorter lives than
2 traditionally prescribed by most Commissions. Verizon uses the TFI
3 lives as a reasonableness benchmark comparison with the lives used
4 by other companies, both regulated and non-regulated, with similar
5 types of telecommunications assets.

6

7 **Q. WHAT DO THE TFI STUDIES RECOMMEND VERIZON USE AS**
8 **ECONOMIC LIVES FOR ITS ASSETS?**

9 A. Verizon's recommendations here are in line with TFI's recommended
10 economic life ranges, as shown by the following chart. (*Transforming*
11 *the Local Exchange Network: Analyses and Forecasts of Technology*
12 *Change*, Larry K. Vanston, Ray L. Hodges, and Adrian J. Poitras, 2d Ed.
13 1997, Technology Futures, Inc., at 33).

14

15 A Comparison of The TFI Ranges with Verizon's Proposed Economic Lives

16		TFI	Verizon
17		<u>Ranges</u>	<u>Economic</u>
18	Digital Switching Equipment	9-12	10
19	Circuit Equipment	6-9	9
20	Copper Cable	14-20	15
21	Fiber Cable	20	20

22

23 TFI specifically addresses the appropriate lives to be used for outside
24 plant cable, central office switching, and circuit equipment accounts,
25 as these accounts report equipment that are most affected by changes

1 in competition and technology.

2

3 **V. VERIZON'S ECONOMIC LIVES HAVE BEEN ENDORSED BY**

4 **OTHER STATE REGULATORY COMMISSIONS**

5

6 **Q. HAS ANY OTHER REGULATORY BODY APPROVED THE**
7 **ECONOMIC LIVES PRESENTED HERE?**

8 A. Yes. In 1996, the California Public Utilities Commission ("CPUC")
9 endorsed the use of the same economic lives presented here except
10 that they approved a 14 year life for copper cable, one year less than
11 requested here. The CPUC concluded that the economic lives used
12 by GTE and Pacific Bell for external financial reporting were the
13 appropriate forward-looking lives for cost studies. The CPUC rejected
14 the suggestion made by AT&T and others that FCC-prescribed lives
15 are forward-looking, stating:

16 We agree with Pacific that the schedules formally adopted in
17 the represcription proceeding reflect the previous paradigm of
18 the regulated monopoly environment, and so are difficult to
19 justify in a cost study that looks forward to an environment in
20 which there is local exchange competition. We also see little
21 merit in the Coalition's original suggestion that we use FCC
22 schedules. These schedules also reflect the previous
23 paradigm; moreover, they are based on different assumptions
24 and applied in different ways than our own. It also seems to be
25 the case, however, that Pacific is now using these schedules

1 in financial reports it is required to file, and thus for purposes
2 of these cost studies, the schedules also appear consistent
3 with generally accepted accounting principles. The schedules
4 also appear realistic for a firm having to operate in a
5 competitive environment, as Pacific will soon have to do.
6 Accordingly, we will approve their use in this proceeding.

7

8 (California Public Utilities Commission Decision No. D.96-08-021,
9 August 2, 1996, in Rule Making R.93-04-003, I.93-04-002).

10

11 In 1997, the Missouri Public Service Commission, likewise, adopted
12 the same economic lives proposed in this case, stating:

13 Staff's goal has been to recommend depreciation rates based
14 on parameters that GTE is likely to experience for financial
15 purposes so as to fully recover its long run capital costs in a
16 timely fashion.

17

18 (Missouri Order, Attachment C at 76.)

19

20 In 1998, the Michigan Commission approved GTE's use of economic
21 lives:

22 GTE proposes to reduce its asset lives in accordance with
23 their economic lives....The Staff's view is that GTE's
24 proposed asset lives are largely consistent with a forward-
25 looking approach and are reasonable....The Commission

1 finds that GTE's proposal related to depreciation is
2 appropriate for TSLRIC purposes....The Commission further
3 finds AT&T/MCI's proposal to be insufficiently forward
4 looking for purposes of a TSLRIC study.

5

6 (Michigan Docket No. U-11281, Feb. 25, 1998 Order, Section d).

7

8

VI. CONCLUSION

9

10 **Q. PLEASE SUMMARIZE YOUR DIRECT TESTIMONY.**

11 A. Traditional historical methods of establishing depreciation lives are not
12 forward-looking. The economic lives used in Verizon's cost studies
13 are properly based on a forward-looking approach. Verizon's
14 proposed rates are reasonable in comparison to the financial
15 reporting lives of competitive telecommunications providers, including
16 those in this docket, and should be approved by this Commission for
17 use in establishing permanent UNE rates.

18

19 **Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

20 A. Yes.

21

22

23

24

25

Verizon Recommended Depreciation Lives and Salvage Values

USOA ACCT	ACCOUNT DESCRIPTION	VERIZON LIFE YEARS	VERIZON SALVAGE %
2112	Motor Vehicles	8	15
2113	Aircraft	8	50
2114	Special Purpose Vehicles	12	0
2115	Garage Work Eq	12	0
2116	Other Work Eq	12	0
2121	Buildings	35	0
2122	Furniture	15	0
2123.1	Office Support Eq	10	0
2123.2	Company Communications Eq	8	0
2124	General Purpose Computers	5	0
2212	Digital Electronic Switching	10	2
2220	Operator Systems	10	0
2231	Radio Systems	5	0
2232	Circuit Eq	9	2
2362	Other Terminal Eq	7	0
2411	Poles	30	-75
2421.1	Aerial Cable Metallic	15	-10
2421.2	Aerial Cable NonMetallic	20	-10
2422.1	Underground Cable Metallic	15	-10
2422.2	Underground Cable NonMetallic	20	-10
2423.1	Buried Cable Metallic	15	-5
2423.2	Buried Cable NonMetallic	20	-5
2424.1	Submarine Cable Metallic	15	-10
2424.2	Submarine Cable NonMetallic	20	-10
2425.1	Deep Sea Cable Metallic	15	-10
2425.2	Deep Sea Cable NonMetallic	20	-10
2426.1	Intrabuilding Cable Metallic	15	-15
2426.2	Intrabuilding Cable NonMetallic	20	-10
2431	Aerial Wire	15	-5
2441	Conduit Systems	50	-10
2690	Network Software	3	0

Comparison of Verizon Recommended Depreciation Lives and Salvage Values with Commission-Ordered Depreciation Lives and Salvage Values in Docket No. 980696-TP, Order No. PSC-99-0068-FOF-TP, Table V-A(3); and Docket 990649-TP 4/6/01 Table 7a & 7b FPSC Approved for BellSouth

USOA ACCT	ACCOUNT DESCRIPTION	990649-TP	990649-TP	980696-TP	990649-TP	990649-TP	980696-TP
		2001 UNE VERIZON Proposed LIFE YEARS	2001 UNE FPSC Proposed LIFE YEARS	1998 USF FPSC Approved LIFE YEARS	2001 UNE VERIZON Proposed SALVAGE %	2001 UNE FPSC Proposed SALVAGE %	1998 USF FPSC Approved SALVAGE %
2112	Motor Vehicles	8.0	8.0	7.5	15	16	1
2113	Aircraft	8.0	na	5.0	50		0
2114	Special Purpose Vehicles	12.0	7.0	7.0	0	0	0
2115	Garage Work Eq	12.0	12.0	12.0	0	0	0
2116	Other Work Eq	12.0	15.0	12.0	0	0	0
2121	Buildings	35.0	45.0	40.0	0	0	0
2122	Furniture	15.0	15.0	11.0	0	10	10
2123.1	Office Support Eq	10.0	11.5	10.0	0	5	0
2123.2	Company Communications Eq	8.0	7.0	7.0	0	10	10
2124	General Purpose Computers	5.0	4.5	5.0	0	2	0
2212	Digital Electronic Switching	10.0	13.0	13.0	2	0	0
2220	Operator Systems	10.0	10.0	10.0	0	0	0
2231	Radio Systems	5.0	9.0	9.0	0	-5	0
2232	Circuit	9.0	*7.5/8/9	8.0	2	2	0
2362	Other Terminal Eq	7.0	na	6.0	0	na	0
2411	Poles	30.0	36.0	30.0	-75	-55	-75
2421.1	Aerial Cable Metallic	15.0	18.0	18.0	-10	-14	-35
2421.2	Aerial Cable NonMetallic	20.0	20.0	20.0	-10	-14	-35
2422.1	Underground Cable Metallic	15.0	23.0	23.0	-10	-8	-10
2422.2	Underground Cable NonMetallic	20.0	20.0	20.0	-10	-8	-10
2423.1	Buried Cable Metallic	15.0	18.0	18.0	-5	-7	-10
2423.2	Buried Cable NonMetallic	20.0	20.0	20.0	-5	-7	-10
2424.1	Submarine Cable Metallic	15.0	18.0	18.0	-10	-5	-5
2424.2	Submarine Cable NonMetallic	20.0	20.0	20.0	-10	-5	-5
2425.1	Deep Sea Cable Metallic	15.0	na	na	-10	na	na
2425.2	Deep Sea Cable NonMetallic	20.0	na	na	-10	na	na
2426.1	Intrabuilding Cable Metallic	15.0	20.0	20.0	-15	-10	-10
2426.2	Intrabuilding Cable NonMetallic	20.0	20.0	20.0	-10	-10	-10
2431	Aerial Wire	15.0	na	na	-5	na	na
2441	Conduit Systems	50.0	55.0	50.0	-10	-10	-10

* Note The FPSC recommended different lives for categories of Circuit Equipment: Digital 9, DDS 8, Analog 7.5, in Docket 990649-TP for BellSouth

In USF Docket 980696-TP the FPSC approved a combined life for Circuit Equipment.

Verizon recommends a combined life for Circuit Equipment in this proceeding, since Verizon typically studies this account on a combined basis