

ORIGINAL

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Investigation into Pricing)
of Unbundled Network Elements,)
Phase II)

DOCKET 990649-TP

REBUTTAL TESTIMONY OF

ALLEN E. SOVEREIGN

On Behalf of

GTE Florida Incorporated

SUBJECT: DEPRECIATION

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FPSC-RECORDS/REPORTING

1 A. No. The ALEC witnesses recommend that this Commission use the
2 projection lives and future net salvage values the FCC prescribed for GTE
3 in 1995. These prescriptions are seriously outdated. They were adopted
4 before the market-opening Telecommunications Act of 1996 ("Act") was
5 even passed. The level of competitive activity in the local marketplace will
6 have a direct effect on the determination of what depreciation inputs are
7 appropriate for pricing UNEs. In 1995, there were no certified ALECs in
8 GTE's territory. Today, there are over 365 companies holding statewide
9 ALEC certification; 125 of these have executed interconnection, unbundling,
10 and/or resale contracts with GTE. My Direct Testimony reviews in detail the
11 degree of competitive entry in GTE's serving area, all of which has occurred
12 since 1995. (Sovereign DT at 8-13.) The bottom line is that Florida has
13 been and will continue to be one of the most attractive markets for entry by
14 competitive local exchange carriers.

15
16 The ALEC witnesses would have the Commission ignore this very relevant
17 and significant fact in favor of a default to federal depreciation rates
18 developed for a marketplace that looks nothing like today's. Reviewing
19 witness Majoros' historical charts and graphs recalls the depreciation
20 analysis of a regulated monopoly franchise in the pre-Telecommunications
21 Act of 1996 environment. Mr. Majoros' conclusions could only be credible
22 if one assumes, contrary to facts, that GTE retains an exclusive monopoly
23 franchise and that the future will be exactly like the past. An approach based
24 on these assumptions is patently inappropriate.

25

1 **Q. HAVE AT&T AND MCI WORLDCOM THEMSELVES BECOME**
2 **LOCAL COMPETITORS?**

3 A. Yes. AT&T and MCI Worldcom are spending billions of dollars to bypass the
4 ILECs' networks. In this regard, AT&T has undertaken an approach of
5 buying cable television companies. It has publicly declared that it will offer
6 local phone service via cable TV wires, either on its own or in partnership
7 with others, and via fixed wireless technology. AT&T affiliate TCG, formerly
8 Teleport, is a facilities-based competitor to the ILECs in Florida. MCI
9 Worldcom is also investing in its own fixed wireless technology to bypass
10 the LEC network.

11
12 In AT&T's announcement outlining its refocused strategy, AT&T Chairman
13 C. Michael Armstrong stated in a company press release in January of
14 1998, "Local service for consumers and businesses remains a top priority
15 for AT&T, as a key part of its strategy to offer end-to-end communications
16 services." Since that announcement, AT&T has completed a merger with
17 cable giant, TCI, and stated explicitly that their intent was to bypass the
18 ILECs and control the access to customers. AT&T announced plans to
19 speed its upgrades of TCI's cable systems to handle all-in-one packages
20 including local phone services. (AP Headlines, January 8, 1999. AT&T
21 Speeds Local Service Effort.) Finally, in January 1999, AT&T announced
22 that it had reached agreement with five cable companies to offer advanced
23 communications services, including local telephone services.

24
25 This bypass strategy is highlighted in the following quote from a recent

1 AT&T internet website article titled "Angel Takes Flight." ["Angel Takes
2 Flight," <http://www.att.com/technology/features/0005fixedwireless.html>]. "By
3 eliminating the copper-wire connection necessary for land-line
4 communications, fixed wireless literally cuts the cord between the traditional
5 central office or switching center and a consumer's home." This same
6 article illustrates the linkage of the extensive cable network purchased over
7 the last months with the fixed wireless technology: "The goal is to bring
8 fixed wireless service everywhere AT&T Cable Services is not."

9
10 Since these companies are obviously pursuing a bypass strategy, and since
11 they cannot build facilities to supply the entire market immediately, it is
12 logical that they would only want to purchase UNEs from the ILECs on an
13 interim basis. It follows, then, that the economic life of the ILEC's facilities
14 will be seriously diminished. It is completely self-serving for AT&T and MCI
15 Worldcom to recommend outdated depreciation lives that are unreasonably
16 long. If the Commission orders unduly long lives for cost model inputs, the
17 ALECs' cost of providing service through the purchase of UNEs will be
18 considerably less. AT&T and MCI Worldcom will thus have the best of both
19 worlds, able to obtain UNEs at prices substantially below their economic
20 value, while completing their own networks to bypass the ILECs.

21

22 **Q. HAS THIS COMMISSION DEVELOPED ANY DEPRECIATION INPUTS ON**
23 **ITS OWN IN THE POST-1995 TIME PERIOD?**

24 A. Yes. Although this Commission no longer prescribes depreciation rates for
25 purposes of the ILECs' financial reporting, it did determine depreciation

1 inputs for use in modeling the cost of basic local service in Docket number
2 980696-TP. The decision in that docket was issued in January of 1999.
3 The ALEC witnesses completely ignore it.

4
5 In this docket, GTE recommends that the Commission use the rates in
6 Docket 980696-TP as a starting point, with appropriate adjustments. As I
7 discussed in my Direct Testimony, the rapid pace of competitive evolution
8 in Florida warrants further shortening of some depreciation inputs. Exhibit
9 AES-2, attached to my Direct Testimony, compares GTE's recommended
10 depreciation inputs in this docket with the FPSC-ordered depreciation inputs
11 in Docket No. 980696-TP. Certainly that comparison is a much more useful
12 tool for the Commission than Mr. Majoros' enumeration of FCC inputs from
13 1995, (Majoros Ex. MJM-10 at 4.)

14

15 **Q. AT&T STATES THAT ITS DEPRECIATION LIVES ARE NOT AN**
16 **APPROPRIATE BENCHMARK FOR ESTABLISHING THE ILECS'**
17 **DEPRECIATION LIVES. DO YOU AGREE?**

18 A. No. While Mr. Majoros admits that AT&T and the ILECs use the same kind
19 of plant, AT&T seems to believe that comparisons with its depreciation
20 practices are inappropriate because the plant is put to different use.
21 (Majoros DT at 17.) Mr. Majoros could possibly have had an argument,
22 albeit a weak one, prior to the passage of the Act, when AT&T and MCI
23 WorldCom were only providers of long distance service. Long distance is
24 simply the provision of a voice communication over a longer distance than
25 a local call. However, as Mr. Majoros is aware, many companies led by

1 both AT&T and MCI WorldCom are continuing to invest heavily in alternative
2 facilities, both wireless and cable, as adjuncts to existing facilities in the
3 provision of local telephone service. This heavy investing by AT&T is the
4 implementation of its stated strategy to control access to the customer for
5 a broad selection of services including local service. In order for GTE to
6 remain competitive in the expanding telecommunications market, existing
7 facilities must deliver the wide array of services offered by the competition,
8 including AT&T and MCI WorldCom.

9
10 In discovery, GTE asked AT&T for specific information regarding the
11 depreciation inputs it uses for facilities that are primarily local, such as those
12 operated by their local affiliate TCG, fixed wireless, and CATV. AT&T has
13 refused to reply, claiming that the information is irrelevant. However, on
14 AT&T's web page, in an article titled "The AT&T Worldwide Intelligent
15 Network – Facts and Figures 2000," they state that 10,000 out of 53,000
16 route miles of fiber optic cable support local telephone service. GTE
17 suggests the Commission ask AT&T and MCI Worldcom to provide the
18 depreciation lives, salvage values, and rates for each of their accounts, so
19 that it has an additional, useful data point to consider in evaluating the
20 ILECs' proposed depreciation inputs. Nevertheless, as I stated in my Direct
21 Testimony, it is possible to get a good idea of these companies' depreciation
22 practices from their annual reports. These reports reveal that the lives
23 AT&T and MCI Worldcom use are generally shorter than those used by
24 GTE.

25

1 **Q. FCC WITNESS BARTA CLAIMS THAT THE ILECS' DEPRECIATION**
2 **RESERVE LEVELS SHOW THAT THE FCC'S DEPRECIATION RATES**
3 **ARE APPROPRIATE. (Barta DT at 11.) HOW DO YOU RESPOND TO**
4 **THIS CLAIM?**

5 A. Mr. Barta states that GTE's depreciation reserve had reached 68.64% in
6 1999, thus exceeding the growth in its plant-in-service balance. Mr. Barta
7 argues that this is evidence that the FCC lives result in properly forward-
8 looking economic depreciation rates. (Barta DT at 11.)

9
10 While I disagree with Mr. Barta's conclusion about the propriety of using
11 FCC depreciation rates in this proceeding, I do concur in his apparent view
12 that the reserve for depreciable plant should be in the range of 70%.
13 Unfortunately, it is not. Witness Barta has incorrectly calculated GTE's
14 reserve. It is actually 48.9%, as calculated by Mr. Majoros from GTE's
15 ARMIS reports (Majoros DT at 12 and Ex. MJM-5 at 2.) Because Mr. Barta's
16 calculation of GTE's depreciation reserve is significantly misstated, his
17 conclusion about the reasonableness of the FCC's depreciation rates is
18 unfounded.

19
20 **Q. SUPRA WITNESS BENTLEY URGES THE COMMISSION TO SET RATES**
21 **BASED UPON "STANDARD ACCOUNTING PRACTICES AS EMBODIED**
22 **BY THE GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP)."**
23 **(BENTLEY DT AT 4-5.) DO YOU AGREE?**

24 A. While I disagree with Ms. Bentley's cryptic comment that GTE is somehow
25 using "non-standard accounting methods" to derive depreciation lives that

1 do not reflect "true" useful asset lives ((Bentley DT at 4), I certainly do
2 agree that it would be appropriate to use depreciation inputs that accord with
3 GAAP. In fact, GTE is recommending the same depreciation factors in this
4 proceeding that it uses for financial reporting purposes. Reputable
5 independent accounting firms regularly audit these depreciation factors to
6 assure their compliance with GAAP.

7

8 **Q. PLEASE SUMMARIZE YOUR REBUTTAL TESTIMONY.**

9 A. The Commission should approve the economic depreciation inputs GTE has
10 recommended and used in its cost studies. Like the cost study methodology
11 prescribed for use in this proceeding, GTE's depreciation inputs are forward-
12 looking. This forward-looking approach more accurately estimates an
13 asset's economic life than the outdated, historical approach suggested by
14 the ALECs. Rather than merely adopt the FCC's 1995 depreciation factors,
15 as the ALECs recommend, the FPSC should use as a starting point its own
16 depreciation analysis performed in Docket 980696-TP in 1999. In this
17 regard, GTE urges the Commission to consider the continuing rapid pace
18 of competition and to modify certain of its depreciation factors, as GTE has
19 recommended.

20

21 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

22 A. Yes.

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24

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