

THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS

Before Commissioners: Jim Robinson, Chairman
 F.S. Jack Alexander
 Rachel C. Lipman

In the Matter of a Common)
Depreciation Schedule for Small) Docket No. 188,681-U
Independent Telephone Companies)
in Kansas.)

ORDER

NOW, the above-captioned matter comes before the State Corporation Commission of the State of Kansas (Commission). Having examined its files and records, and being duly advised in the premises, the Commission finds as follows:

1. On June 24, 1993, Commission Staff (Staff) provided the Commission with a recommended streamlined process for the determination of depreciation rates and proposed submitting the modifications to the industry and interested parties for comment.

2. On August 27, 1993, the Commission issued an Order initiating a comment period concerning Staff's proposed streamlined process for the determination of depreciation rates. The Order indicated comments would only be accepted in written form through and including September 30, 1993.

3. The Commission received comments from Southwestern Bell Telephone Company (SWBT), Independent Telecommunications Group, Columbus et. al, (Columbus), and Blue Valley, et. al, (Blue Valley). The Commission also received reply comments from SWBT and Columbus.

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UTILITIES DIVISION

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4. On December 21, 1993, the Commission issued an Order adopting Staff's proposed depreciation schedule, retroactive to January 1, 1993.

5. On January 7, 1994, SWBT filed a Petition for Reconsideration, or in the Alternative for Clarification stating as follows:

I) Making SWBT Subject to Higher Access Charges from all Independent Local Exchange Companies (ILECs) on a Retroactive Basis is Unfair.

A) SWBT was a party to the Access Stipulation entered into by all the ILECs in Kansas in 1990. SWBT agreed to allow ILECs to file expedited rate cases which would recover increased expenses, including increased depreciation expenses. SWBT expected these increases would evolve as they have in the past, through the filing of depreciation studies and rate case proceedings. SWBT did not anticipate a common depreciation schedule like the one adopted by the Commission in its December 21, 1993 Order.

B) The common schedule encourages industry-wide increases in depreciation expenses of an unprecedented magnitude. SWBT states that 31 of the 35 small ILECs in Kansas have already filed for increased depreciation rates to be effective in 1993. Staff has recommended that the ILECs be given the highest allowable rate within the range.

C) By making the changes retroactive to January 1, 1993, SWBT argues the Commission's Order changed the rules during

the Stipulation's effective period without allowing SWBT an opportunity to prevent the increased access costs that will likely result from the increase in depreciation rates. It also allows the ILECs to increase their access charges in 1994 to recover increased 1993 depreciation expenses. Therefore, if SWBT and the ILECs choose to negotiate a new access agreement when the present one expires at the end of 1994, the higher access rates will already be established.

D) SWBT stated the Commission has dramatically changed those assumptions and thereby unfairly changed the basis of SWBT's agreement with the ILECs. If the Commission had made January 1, 1994, the effective date, the ILECs could only seek higher access charges reflecting the ILEC's higher 1994 depreciation costs in 1995. Therefore, SWBT requested the Commission reconsider its Order in this docket and make the effective date of the depreciation schedule January 1, 1994.

II. The Commission Should Order that a Similar Depreciation Simplification Process be Developed for Larger ILECs.

A) SWBT stated the Commission's approval of a simplification process is very timely now, as the Commission and the Federal Communications Commission are focusing on this vital issue. SWBT submitted that neither Staff nor any other commentators in this docket identified any substantial reasons why SWBT should not also have this type of regulatory relief, claiming its ratepayers deserve to receive the same benefits from reduced

regulation and improved efficiency that the smaller ILEC's ratepayers will have. Therefore, SWBT requested that the Commission issue its Order directing Staff to file a recommended simplified depreciation process for SWBT, including reserve parity, within 90 days.

III. Clarification of Certain Items.

A) SWBT requested clarification of the following items: SWBT noted staff's statement in its initial proposed Depreciation Schedule attached to the August 27, 1993 Order establishing a comment period in this docket, "[c]ompanies should determine a depreciation rate taking into account the service life and salvage of the account." SWBT noted that staff's December 3, 1993 memorandum on this matter stated that "[c]ompanies should use depreciation rates which reflect its plans and operations. If the information available to staff indicated otherwise, the company will be required to use appropriate depreciation rates." Accordingly, SWBT requested that the Order be clarified to state that the small ILECs must be prepared to show, upon request from any interested party or the Commission, that a requested rate is appropriate and not simply selected because it is within the ranges on the common schedule.

B) SWBT stated that Staff's memorandum of December 3, 1993, provides that if an ILEC requests rates that are outside the ranges, or if an ILEC asks for more than one rate change in a given year, that the ILEC will be required to supply formal

depreciation studies as in the past. SWBT asserted that the December 21, 1993 Order does not explicitly adopt all of Staff's recommendations. SWBT requests that this recommendation be specifically adopted and applied to the 18 ILECs that had filed for new rates before the December 21, 1993 Order was entered.

C) Finally, SWBT asserted the December 21, 1993 Order provides that ILECs are not required to change their rates to bring them into line with the schedule, but may if they so choose. SWBT contended that the open-ended provision could have the unintended effect of allowing an ILEC to have overall depreciation rates that are higher than the overall rates reflected by the common schedule. SWBT noted that this can occur because several ILECs have depreciation rates that are already above the ranges. To counter this problem, SWBT requested that the Commission clarify the Order to require any ILEC that seeks to increase any rate that is within the range to also bring any of its present rates that are above the ranges to within their respective ranges.

6. On January 7, 1994, Blue Valley filed a Petition for Reconsideration. In support of its petition, Blue Valley stated it believes that an error was made by Staff in using historical depreciation rates to arrive at a range of rates for today's environment. Blue Valley contended that the present circumstances of regulations, competition, and rapid technological explosion strip away the antiquated methodology for establishing depreciation rates. Computer bases equipment, such as general computers and digital switching equipment, no longer have a long

stable life of service. Blue Valley noted that consumer demand for the latest available technology prevents hardware life alone to be used for depreciation rates.

7. Blue Valley recommended a two-tier system for determining the range for depreciation; the first tier should cover the more stable assets as used by Staff, and the second tier should apply to the technological sensitive assets of computer based equipment such as digital switching. Blue Valley asserted that because of the rapid obsolescence of analog and electromechanical switching brought on by the digital technology, the depreciation rates for these accounts should be elevated.

8. Blue Valley further recommended the Commission raise the upper level of depreciation rates for technology driven accounts as follows:

<u>Account</u>	<u>Present Upper Rate</u>	<u>Proposed Rate</u>
2124 Gen. Purpose Computer	14.30	20.00
2211 Analog Switch	9.92	15.00
2212 Digital Switch	7.72	10.00
2215 Electro Switch	9.34	10.00

9. On January 10, 1994, Columbus filed a Petition for Limited Reconsideration. Columbus stated it seeks reconsideration specifically regarding the upper limit of approved depreciation rate ranges for those categories of telephone utility property which are computer-based or which are technological antecedents of such equipment. In support of its petition, Columbus asserted that one of the greatest tasks of the ILECs is meeting the

requirement that telecommunications service be provided in a modern and efficient manner. Columbus indicated that such need in itself is reasonable, but the expense of doing so is adversely affected by the rate at which required equipment must be modernized or wholly replaced.

10. Columbus indicated that computer technology in office equipment is subject to technological obsolescence which renders the mechanical useful life of such equipment practically meaningless. Columbus noted that continued rapid development of new software necessary to provide efficient management services creates a requirement for office computers with ever greater memory, speed and functionality. Columbus contended that the period of time in which such equipment is of full value to an efficiently operated telecommunications utility becomes shorter and shorter.

11. Columbus maintained that the main premise for institution of this docket and these proceedings is the disparate cost to small companies of engaging in the prior formal depreciation determination process. Columbus stated that although the Commission's Order grants the authority for any LEC to seek additional depreciation through the formal procedure previously existing, clearly no new relief is provided by the mere maintenance of such a burdensome alternative method. Columbus expressed that the new procedure may render determination of reasonable rates of depreciation comparatively more expensive rather than less so. There is no benefit to the LECs in making

formal application for increased depreciation rates on many categories of equipment. Columbus noted that the result is that individual formal applications for increased depreciation rates on property subject to technological obsolescence must be filed for a smaller total value of property. Columbus contended that this should contain reasonable depreciation rates on computer-based property through the newly available simplified procedure.

12. Columbus asserted that if rural Kansas is to have an on ramp to the information superhighway it is essential that continuing modernization be encouraged rather than discouraged. Columbus contended that reconsideration of the maximum allowed depreciation rate under the procedure ordered by the Commission December 21, 1993, would provide the opportunity for such encouragement to be afforded in a tangible fashion. Further, Columbus expressed that those LECs would be more able to modernize if such companies were not burdened by the knowledge that they would face either inadequate depreciation rates or the substantial expense and uncertainty of formal application under previously existing procedures. Columbus maintained that such an order would minimize the burdens to LECs, to their customers and to the taxpayers of Kansas resulting from disproportionately expensive and expensive formal application proceedings.

13. On January 21, 1994, the Commissioners received a memorandum from Staff recommending clarification of the December 21, 1993 Order and that reconsideration was not warranted.

14. Staff states one of the mechanisms to balance the

concerns of the parties is the option for a company to request approval of a depreciation rate outside of the established range. Requests for outside the range must be accompanied by supporting documentation consistent with past depreciation review policies. Staff believes the common schedule should be updated periodically to allow the ranges to reflect trends in technology. The update should be made at the end of the first quarter of each calendar year, incorporating the independent telephone company depreciation rates which have been granted in the preceding year (including those rates within and outside of the ranges). The goal of the common schedule is to enhance the companies' ability to implement appropriate rates that reflect and enhance their modernization plans.

15. The SWBT argument that the ILECs be require to provide supporting data for rates requested within the established ranges is against the intent of this proceeding. The basic premise of this proceeding was to develop a schedule of rates in which any rate requested within the range would be considered reasonable without requiring additional information. At the same time this is one of the reasons Staff does not believe increasing the upper range without supporting data, as the ILECs suggested, is appropriate.

16. Staff believes a streamlined depreciation schedule for SWBT is timely. However, SWBT's proposal, which incorporates reserve parity and warrants consideration in the TeleKansas docket, should not be addressed in this proceeding.

17. Staff further recommended the Commission to continue the requirement that ILECs make formal filings to request changes to rates, even for proposed rates which are within the established ranges. The new common schedule concept is something the Commission, Staff and telecommunications industry need to become familiar with. It is important to maintain current requirements during this period of adjustment. However, Staff recommended the Commission may wish to re-evaluate this situation at a later time.

18. Regarding Blue Valley's request to implement a two-tier system, Staff believes this to be somewhat premature and perhaps unnecessary at this time. After experiencing how the common schedule has worked, the Commission may desire to revisit this proposal.

19. Staff strongly objects to SWBT's request to reconsider the effective date of the common schedule, January 1, 1993, stating that the State's average depreciation rates for ILECs were severely out-dated. Even if the Commission were to reconsider the effective date as SWBT desires, it would not impact future access in the manner in which SWBT describes in its petition for reconsideration.

FINDINGS AND CONCLUSIONS

20. The Commission finds it has jurisdiction for purposes of determining the issues in this proceeding and expects the ILECs to propose depreciation rates which are appropriate to their company.

21. The Commission finds that any request of a depreciation rate outside the established range should be accompanied by

quarter results of the common schedule so this issue may be revisited later this year.

26. The Commission further finds that it is reasonable to review the possibility of raising the upper limits of the ranges of depreciation rates following the 1994 first quarter update.

27. The Commission further finds that the petition for reconsideration filed by SWBT, Blue Valley, and Columbus should be denied. The December 21, 1993 Order is clarified as set forth in this Order.

IS, THEREFORE, BY THE COMMISSION ORDERED THAT:

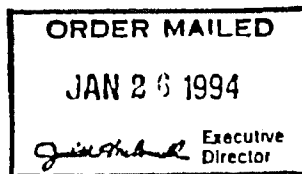
The December 21, 1993, Order adopting the depreciation schedule, retroactive to January 1, 1993 is affirmed and clarified as set forth in this order. The petitions for reconsideration are hereby denied as set forth in this Order.

The Commission retains jurisdiction over the subject matter and the parties for the purpose of entering such further order or orders as it may deem necessary.

BY THE COMMISSION IT IS SO ORDERED.

Robinson, Chmn.; Alexander, Com.; Lipman, Com.

Dated: JAN 26 1994



JUDITH McCONNELL
EXECUTIVE DIRECTOR

MLC

MEMORANDUM
UTILITIES DIVISION

TO: Chairman Robinson
Commissioner Alexander
Commissioner Lipman

FROM: Karen Matson-Flaming
Panchali Das

DATE: January 21, 1994

RE: Docket No. 188,681-U

BACKGROUND:

On December 21, 1993, the Kansas Corporation Commission (Commission) issued an order which established a streamlined process for the filing and determination of depreciation rates for small independent local telephone companies.

On January 7, 1994, Southwestern Bell Telephone Company (SWBT) filed a Petition for Reconsideration. Also on January 7, 1994, Blue Valley et. al. filed a Petition for Reconsideration. On January 10, 1994, Columbus et. al. filed a Petition for Reconsideration

STAFF RESPONSE AND RECOMMENDATION:

In general, staff believes there is some merit to the concerns expressed by the parties in this matter. However, the streamlined depreciation process has several mechanisms which, staff believes, compensates and allows for the parties' concerns to be addressed. Staff does not believe reconsideration is warranted, although the Commission may wish to provide additional clarification.

One of the mechanisms that staff believes balances the concerns of the parties is the option for a company to request approval of a depreciation rate outside of the established range. The option provides the relief the independent companies (Blue Valley et al, and Columbus, et al) desire while addressing SWBT's concerns that independent companies not be provided carte blanche to book extremely aggressive depreciation rates without adequate Commission review.

It is important that requests for rates outside the ranges be accompanied by supporting documentation consistent with past depreciation review policies. The information considered by the Commission has not always been historical, and in fact, often includes forward-looking data. This burden of proof has not changed. However, it is also important that the common schedule be updated periodically so that the ranges will reflect trends in technology. The goal of the common schedule is to enhance the companies' ability to implement appropriate rates that reflect and enhance their modernization plans.

Staff recommends the common schedule be updated at the end of the first quarter of each calendar year, incorporating the independent telephone company depreciation rates which have been granted in the proceeding year (including those rates within and outside of the ranges). This

updating will enhance the common schedule's reliability and flexibility.

Staff believes the suggestion of SWBT, that the ILECs be required to provide supporting data even for rates requested within the established ranges, runs counter to the intent of this proceeding. The basic premise was to develop a schedule of rates in which any rate requested within the range would be considered reasonable, without additional information being required. This is also one of the reasons staff does not believe simply increasing the upper range without supporting data, as the independent companies would suggest, is appropriate either.

Staff would expect the ILECs to propose depreciation rates which are appropriate to their company. Staff believes the Commission should expressly note its jurisdiction regarding this matter and its ability to investigate the appropriateness of ALL rates, upon its own motion, or in a rate case or similar proceeding.

Staff believes consideration of a streamlined depreciation schedule for SWBT is timely; however, staff firmly believes SWBT's proposal which incorporates reserve parity, warrants consideration in the TeleKansas docket and should not be addressed in this proceeding.

The Commission's order also continued the requirement that ILEC must make formal filings to request changes to rates, even for proposed rates which are within the established ranges. It has been argued that this process should also be streamlined to a letter of notification rather than a formal filing. Staff believes it important to continue with the existing filing requirements while the Commission, staff and the industry becomes familiar with the common schedule concept. Staff recommends the Commission continue to require formal filings, however, the Commission may wish to re-evaluate this situation at a later time.

In the same vein, staff considers the request by Blue Valley et al to implement a two-tier system to be somewhat premature and perhaps unnecessary, although the Commission and staff may wish to consider such a concept if experience with the common schedule demonstrates a change is warranted.

Finally, SWBT has stated its desire to use the ILEC depreciation expense as a negotiating tool in the next access proceeding and has requested the Commission reconsider the effective date of the common schedule (January 1, 1993). Staff strongly objects to such a reconsideration. Staff proposed implementation of a common schedule because this state's average depreciation rates for independent companies were severely out-dated. This is a policy matter which affects independent companies accounting records. SWBT has some potential exposure in Access, if an independent company should file for an expedited access proceeding in this last year of the access plan. However, even if the Commission were to reconsider the effective date as SWBT desires, it would not impact future access in the manner in which SWBT describes. Authorized depreciation expense is a pro forma adjustment that would be taken into consideration in any revenue requirement calculation since it is a known and measurable event that will affect future costs. Furthermore, this is not a policy to be reconsidered because SWBT wants to bargain with an ILEC's authorized depreciation expense in another matter. Staff believes such a request to be highly inappropriate

cc: Don Low Shirley Sicilian Brian Moline Judith McConnell
Martha Cooper Stacey Boyles Dana Bradbury Gene Heitsch