STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

GTE North Incorporated and GTE South Incorporated	:	
Joint petition for the Commission to ascertain, determine and fix proper and adequate rates of depreciation of certain of the several classes of properties of the Joint Petitioners.	:	**97-0355**

ORDER

By the Commission:

I. PROCEDURAL HISTORY

On August 1, 1997, GTE North Incorporated ("GTE North") and GTE South Incorporated ("GTE South") (collectively hereinafter referred to as "GTE") filed a joint petition with the Illinois Commerce Commission ("Commission") requesting approval of proposed depreciation rates for certain classes of properties.

Petitions to intervene in this proceeding were filed by AT&T Communications of Illinois, Inc. ("AT&T") and Illinois Bell Telephone Company ("IBT"). AT&T's petition to intervene was granted by the Hearing Examiner. IBT's petition to intervene is granted.

Pursuant to proper legal notice, a prehearing conference was held in this matter before a duly authorized Hearing Examiner of the Commission at its offices in Springfield, Illinois on August 22, 1997. An evidentiary hearing was held on January 21, 1998. At the evidentiary hearing, appearances were entered by counsel on behalf of GTE, AT&T and Commission Staff. The following witnesses presented testimony in this proceeding: Anthony J. Flesch, GTE's Staff Manager-Capital Recovery, on behalf of GTE; Michael J. Majoros, Jr., Vice President of Snavely King Majoros O'Connor & Lee, Inc., on behalf of GTE; and Harvey G. Nelson, an Economic Analyst in the Commission's Telecommunications Division, on behalf of Commission Staff ("Staff"). At the conclusion of the hearing on January 21, 1998, the record was marked "Heard and Taken."

Initial and reply briefs were filed by GTE, AT&T and Staff.

The Hearing Examiner's proposed order was served on the parties. AT&T filed a brief on exceptions. Reply briefs on exceptions were filed by GTE and Staff. These filings have been considered by the Commission in reaching the conclusions herein.

II. THE PARTIES' PROPOSED DERECIATION RATES

A. Overview

GTE proposes changes to the depreciation rates for eight accounts. The current depreciation rates for those accounts, and the depreciation rates (%) proposed by GTE, AT&T and Staff are as follows:

For GTE North:

Account No.	Description	Current Rate	GTE	AT&T	Staff
2212	Digital Switching Equipment	6.6	10.0	7.6	6.9
2232	Circuit Equipment	10.0	11.5	6.6	9.2
2421.1	Aerial Cable Metallic	7.3	15.1	7.2	11.3
2421.2	Aerial Cable Non-Metallic	5.5	5.9	5.9	5.9
2422.1	Underground Cable Metallic	6.3	15.8	7.0	11.3
2422.2	Underground Cable Non-metallic	5.2	6.5	5.2	6.1
2423.1	Buried Cable Metallic	4.8	10.4	5.1	7.2
2423.2	Buried Cable Non-metallic	4.4	5.6	5.2	5.2

For GTE South:

Account No.	Description	Current Rate	GTE	AT&T	Staff
2212	Digital Switching Equipment	6.9	7.5	5.4	6.3
2232	Circuit Equipment	9.2	11.2	6.2	9.0
2421.1	Aerial Cable Metallic	6.3	15.4	7.4	11.5
2421.2	Aerial Cable Non-metallic	6.3	6.6	6.6	6.6
2422.1	Underground Cable Metallic	3.5	15.2	6.8	10.8
2422.2	Underground Cable Non-metallic	3.5	6.2	4.8	5.9
2423.1	Buried Cable Metallic	4.3	8.8	4.3	6.1
2423.2	Buried Cable Non-metallic	4.3	6.2	5.5	5.7

B. GTE's Proposed Depreciation Rates

1. Reasons Given by GTE for its Proposed Depreciation Rates

GTE notes that regulatory bodies have traditionally evaluated the following three factors in determining depreciation rates: (1) physical factors (e.g., wear and tear, decay, action of the elements and accidents); (2) functional factors (e.g., inadequacy, obsolescence, changes in art and technology, changes in demand, requirements of public authorities and management discretion); and (3) contingent factors (e.g., casualties or disasters, and extraordinary obsolescence). (GTE Ex. 1.00, pp. 3-4)

GTE contends that in light of the changing technology and the evolving competitive market, detailed analysis of mortality data is no longer a viable tool for setting depreciation rates. GTE indicates that the determination of proper depreciation rates must reflect a transition from heavily weighted historical analysis to forecasts more heavily weighted towards the impact of the changing telecommunications environment. GTE asserts that economic lives should be used to set its depreciation rates since they reflect factors in today's evolving competitive marketplace. Economic life measures the time period over which an asset will produce a positive revenue stream such that the present value is equal to the original cost of the asset. (Id., pp. 5-6)

GTE emphasizes that competition is growing in its Illinois service area. GTE indicates that more than 20 potential competitors have filed applications for authority to provide resold or facilities-based local exchange service in its Illinois service area. (GTE Ex. 3.00, p. 4)

GTE proposes changes in depreciation rates for the eight accounts that include the assets that are most impacted by the effects of technological change and competition. GTE's estimated economic lives for those assets are: copper cable - 15 years; digital switching - 10 years; circuit equipment - 8 years; and fiber cable - 20 years. The economic life is the total life expectancy at age zero. GTE's estimated economic remaining lives for those assets are: copper cable - 6 years; digital switching - 6 years; circuit equipment - 4 years; and fiber cable - 15 years. The remaining life is the length of time the asset will produce a positive net revenue stream beyond a given age. The remaining life calculation for a group of assets recognizes that some of the useful life has been consumed in prior periods. (GTE Ex. 1.00, pp. 7-8)

GTE used the remaining life formula, (100 - Future Net Salvage - Reserve Ratio) / Remaining Life, to develop its proposed depreciation rates. The proposed depreciation rates used the currently prescribed regulatory Future Net Salvage. The depreciation reserve ratio was updated to reflect actual year-end balances. The currently prescribed regulatory remaining life was replaced by GTE's estimated economic remaining life. (Id., p.8)

GTE requests that its proposed depreciation rates be approved with an effective date of January 1, 1998. (Initial brief, p. 2) Approval of GTE's proposed depreciation rates would increase the composite depreciation rates for the total depreciable plant of GTE North and GTE South from 6.1% to 9.6%, and from 5.8% to 8.4%, respectively. If the proposed depreciation rates had been in effect in 1997, the depreciation expense for GTE North and GTE South would have increased by $59,362,000 and $2,568,000, respectively. (GTE Ex. 2.00, pp. 11 and 13)

GTE asserts that the reasonableness of the depreciation rates in its study is demonstrated by their comparison to the results of other studies and the present pattern and trends of the depreciation rates of competitors and other telecommunications companies. GTE relied on studies prepared by Technology Futures, Inc. ("TFI") that depict industry trends. GTE witness Flesch testified that TFI is an independent corporation that since 1984 has utilized substitution analysis in technology forecasting and strategic planning for several industries, including the telecommunications industry. He indicated that substitution analysis is used to project remaining lives for plant investment when technological change is causing a shortening of asset lives. Mr. Flesch testified that the technological substitution model used by TFI is superior to the mortality models used under regulation without competition. He stated that TFI's model uses data from many sources, including regulatory reports such as those provided in the Automated Reporting Management Information System. He indicated that data from GTE and numerous other providers is utilized. He noted that TFI's studies address the appropriate lives for outside plant cable, central office switching and circuit equipment. GTE emphasizes that its proposed lives are generally at the higher end of TFI's ranges. (GTE Ex. 1.00, pp. 11-15; Initial brief, pp. 10-12)

GTE notes that its proposed economic lives are not as short as those used by AT&T. (GTE Ex. 1.00, p. 23) GTE further notes that its proposed composite depreciation rates are generally lower than the rates of its competitors, and that its proposed economic lives are comparable to those of the Regional Bell Operating Companies. (Id., pp. 22 and 24; Initial brief, p. 12)

2. AT&T's Criticism of GTE's Proposed Depreciation Rates

AT&T indicates that in the pending GTE total element long-run incremental cost ("TELRIC") case, GTE's forward-looking economic costs will be determined. AT&T states that the determination of forward-looking costs requires the use of economic depreciation lives. AT&T asserts that GTE's proposed lives, however, are not forward-looking economic lives. AT&T contends that GTE's proposed lives are a composite of the following sources: (1) the lives recommended in national studies conducted by TFI, which are not Illinois-specific and are not part of the record; (2) the financial reporting lives that GTE and other telecommunications carriers have reported to the Securities and Exchange Commission ("SEC"), and (3) the Federal Communications Commission ("FCC") prescriptions for plant in the cable television industry. (Initial brief, pp. 2-3)

AT&T asserts that the TFI studies cannot be a basis for the Commission's findings in this case. AT&T emphasizes that the studies are not in the record and that GTE witness Flesch did not know the assumptions upon which the studies were based. AT&T notes that the TFI studies were funding by local exchange companies, including GTE. (Tr. 48) Therefore, AT&T concludes that it is not surprising that GTE's economic life proposals for the different plant and equipment at issue all fall within the TFI recommended ranges. (Initial brief, pp. 13-14) AT&T also asserts that GTE presented no evidence that TFI's assumptions regarding technology changes hold true for GTE's Illinois operations and will shorten the lives of GTE's Illinois assets. (Id, pp. 11-12, 14)

AT&T witness Majoros testified that TFI's plant replacement predictions are not holding true. He noted that GTE is proposing to reduce the projected lives for its metallic cable accounts to 15 years. He stated that the basis for this proposal is TFI's prediction that digital loop carrier systems requiring feeder cable systems will serve 23 percent of all access bins by the year 200, 50 percent by 2004, and 90 percent by 2010. He indicated that the basic driver for this technology change is the provision of broadband services. His Schedule 12 compared the retirements of metallic cable implicit in the TFI forecast to GTE-Illinois' actual retirements for calendar years 1994, 1995 and 1996. TFI's forecast implies retirements of $47.5 million during that three-year period, while GTE's actual retirements were $18.3 million. (AT&T Ex. 1.0, pp. 24-25)

AT&T contends that financial reporting lives do not reflect a forward-looking analysis of the expected economic lives and should not be used to set the TELRIC prices in a competitive marketplace. AT&T indicates that financial reporting lives reflect the generally accepted accounting principles' bias toward conservatism, which leans toward shorter lives. AT&T asserts that the unreasonableness of GTE's proposal is demonstrated by the fact that the conservative financial reporting lives are nearly identical to GTE's proposed lives. (Initial brief, p. 17)

AT&T notes that GTE witness Flesch compared GTE's proposed lives to the FCC's prescribed lives for outside plant for the cable industry. AT&T emphasizes that Mr. Flesch did not know the assumptions used by the cable industry in determining the depreciation rates that it proposed to the FCC. (Initial brief, p. 18)

AT&T disagrees with GTE's contention that the shorter depreciation lives proposed by GTE are necessitated by the evolving competitive environment and technology changes. AT&T contends that GTE failed to present any evidence that it faces any competition in the local exchange market. AT&T notes that Mr. Flesch could not identify any competitor that is providing local exchange service in GTE's Illinois local exchange territory. (Tr. 24-26) AT&T further asserts that even if competition did exist, the economic lives of GTE's network assets may not be effected. AT&T emphasizes that the resale and use of unbundled network element combinations by competitors necessarily involves the continued use of GTE's network. With regard to technology changes, AT&T asserts that Mr. Flesch failed to identify one new technology that will shorten GTE's depreciation lives. (Initial brief, pp. 9-12)

Finally, AT&T indicates that the lives adopted by the Commission in the Ameritech TELRIC case (Second Interim Order, Docket Nos. 96-0486/96-0569 Cons., February 17, 1998) are, on average, 40% longer than the lives recommended by GTE in the instant proceeding. AT&T concludes that since GTE faces significantly less competition than Ameritech and both companies face the same changes in technology, it makes no sense to adopt drastically shorter lives for GTE than for Ameritech. (Reply brief, p. 2)

3. GTE's Response

GTE asserts that it faces competition in its Illinois service area, citing again that more than 20 potential competitors are seeking or have been granted authority to offer local exchange services in its service area. (Reply brief, p. 4)

GTE contends that its depreciation proposal is Illinois-specific. GTE states that AT&T erroneously argues that GTE's proposal is simply a mirror of the studies conducted by TFI. GTE emphasizes that TFI's studies were one of several benchmarks for GTE's own analysis. (Id., pp. 4-5)

C. AT&T's Proposed Depreciation Rates

1. Reasons Given by AT&T for its Proposed Depreciation Rates

AT&T proposes that the depreciation rates adopted by the Commission for both GTE North and GTE South be based on the projection lives prescribed by the FCC for GTE North in 1994. As shown in GTE Late-Filed Exhibit 4, AT&T's proposed lives result in composite depreciation rates for GTE North and GTE South of 6.0% and 5.2%, respectively, compared to their existing composite depreciation rates of 6.1% and 5.8%. If AT&T's proposed depreciation rates had been in effect in 1997, the depreciation expense for GTE North and GTE South would have decreased by $1,899,000 and $491,000, respectively.

AT&T asserts that the FCC's prescribed lives are forward-looking. AT&T witness Majoros testified that over a decade ago, the FCC directed its staff to place less emphasis on historic data in estimating productive lives, and pay closer attention to company plans, technological developments and other future-oriented analyses. He noted that the FCC recently reaffirmed its forward-looking orientation in connection with the simplification of its depreciation prescription practices. He indicated that the FCC prescribed a range of projection lives that could be selected by carriers for prescription on a streamlined basis. He stated that these ranges were based upon statistical studies that included detailed analysis of each carrier's most recent retirement patterns and plans and the current technological developments and trends. He pointed to the rise in the depreciation reserve levels in the industry as an indicator that the FCC's prescribed lives are forward-looking. He noted that the composite reserve level for all local exchange carriers providing full

financial reports to the FCC rose from 18.7% in 1980 to an historic high of 47.1% in 1996. (AT&T Ex. 1.0, pp. 8-11)

Mr. Majoros compared GTE North-Illinois' actual lives and retirement patterns in its most recent depreciation rate study filed with the FCC to the FCC's prescribed lives and retirement patterns for four of the accounts at issue in this proceeding. AT&T notes that the FCC's prescribed lives are significantly shorter (18%, on average) and that the FCC's prescribed retirement patterns are much more accelerated. AT&T concludes that this comparison further demonstrates that the FCC's prescribed lives are forward-looking. (Id, p. 13; Initial brief, pp. 7-8)

Mr. Majoros testified that GTE's exhibits in the instant proceeding show Illinois intrastate reserve ratios as of December 31, 1996 for GTE North and GTE South of 48% and 54%, respectively. He concluded that these reserve ratios indicate that the lives prescribed by the Commission have been forward-looking. (AT&T Ex. 1.0, pp. 12-13)

2. GTE's and Staff's Criticisms of AT&T's Proposed Depreciation Rates

GTE contends that AT&T's proposed depreciation rates are unreasonable. GTE states that AT&T's proposal is not based on any analysis of GTE's Illinois demographic and competitive environment, and gives no weight to the changes in technology and competition since GTE's last depreciation prescription case. GTE asserts that AT&T's proposal relies only on the outdated and archaic national averages established by the FCC. GTE notes that the FCC indicated in its Order 97-157 adopted May 7, 1997, that it intended shortly to issue a notice of proposed rulemaking to further examine its depreciation rules. (GTE Ex. 3.00, p. 10)

Similarly, Staff states that the FCC'S prescribed lives recommended by AT&T are outdated and do not reflect the competitive atmosphere faced by GTE in Illinois and current technological advancements. Staff indicates that the FCC's prescribed lives were established in January of 1995 and based on information from an even earlier time period, all of which were prior to the 1996 Telecommunications Act. (Initial brief, p. 9)

3. AT&T's Response

AT&T contends that there has been no change in the level of competition that GTE now faces in comparison to that which existed in January of 1995, the last date on which the FCC prescribed lives for GTE's accounts. AT&T again asserts that GTE does not face any competition in its Illinois local exchange service area. AT&T states that GTE has failed to present evidence which demonstrates that technology changes are impacting the lives of its Illinois assets. (Reply brief, pp. 3-4)

AT&T contends that the acceptance of its proposed depreciation rates would be consistent with the Commission's determination on depreciation rates in Ameritech's

TELRIC docket. AT&T points out that the Commission adopted the FCC's prescribed lives for Ameritech which were adopted by the FCC in January of 1996. Like the FCC's prescribed lives for GTE recommended by AT&T, the FCC's prescribed lives for Ameritech were based on an analysis conducted prior to the adoption of the 1996 Telecommunications Act. AT&T emphasizes that the Commission concluded in Ameritech's TELRIC docket (Second Interim Order, Docket Nos. 96-0486/96-0569 Cons., February 19, 1998, pp. 28-29) as follows:

> We believe that the projection lives and future net salvage percentages underlying the depreciation rates prescribed for Ameritech Illinois by the FCC as set forth in the FCC's annual depreciation rates should be used in the TELRIC calculations. (FCC 96-22 adopted January 25, 1996) They reflect the most recent credible and comprehensive evaluation of depreciation in the record. We are persuaded by Mr. Majoros' testimony that the FCC projected lives are reasonably forward-looking. We note that the FCC has stated that they are based on a detailed analysis of each carrier's most recent retirement patterns, the carrier's plans, and current technological developments.

(AT&T Reply brief, pp. 4 and 6)

C. Staff's Proposed Depreciation Rates

1. Reasons Given By Staff for its Proposed Depreciation Rates

Staff witness Nelson sponsored Staff's proposed depreciation rates, average remaining lives and future net salvage for GTE North and GTE South's circuit equipment, copper cable, fiber cable and digital switch accounts. Staff's proposed depreciation rates use longer average remaining lives than those recommended by GTE for those accounts. Staff's proposal results in composite depreciation rates for GTE North and GTE South of 7.2% and 6.7%, respectively, compared to their existing composite depreciation rates of 6.1% and 5.8%. If Staff's proposed rates had been in effect in 1997, the depreciation expense for GTE North and GTE South would have increased by $18,893,000 and $872,000, respectively. (Staff Ex. 1.0, Schedules 1, 2 and 3)

Staff indicates that the average remaining lives used to calculate its proposed depreciation rates reflect the impact of the demographic and competitive characteristics of GTE North's and GTE South's Illinois service areas on their physical assets. Mr. Nelson testified that GTE serves small cities and suburban areas in Illinois that provide services to insurance companies, manufacturers, educational institutions and the agricultural community. He concluded that the majority of GTE's Illinois service areas have stable economic conditions and population that normally do not attract competitive telecommunications carriers and telecommunications services beyond the basic services. (Staff Ex. 1.0, p. 4)

Mr. Nelson testified that the demographic and competitive characteristics of GTE's Illinois service areas have resulted in GTE not pursuing an accelerated central office and outside plant capital improvement program. He noted, for example, that GTE is the last local exchange carrier in Illinois using non-digital, electromechanical switches. He stated that GTE anticipates that its non-digital switches will all be converted to digital switches by the end of 1998. He noted that GTE North's modernization program began in 1993 when its Dongola central office was converted to digital switching technology. He indicated that the recent additions of new switching and transmission facilities have a positive effect on the average remaining lives of such facilities. Staff indicates that the longer lives ultimately result in lower depreciation rates. (Staff Ex. 1.0, pp. 5-7; Initial brief, pp. 6-7)

2. AT&T's Criticism of Staff's Proposed Depreciation Rates

AT&T states that Staff's recommended depreciation rates would allow GTE to shorten drastically its economic lives for the eight accounts at issue. AT&T indicates that the demographic and competitive characteristics of GTE's service areas and GTE's modernization program do not support Staff's conclusion that GTE's lives should be shortened.

AT&T asserts that the record indicates that GTE has not faced and will not face any competition in its service territory. AT&T contends that even if competition did exist, there would be little impact on the economic life of GTE's bottleneck facilities since competitors would still have to use GTE's network. (Initial brief, pp. 10 and 18)

In response, Staff indicates that at least 65 telecommunications providers have been granted certificates to provide both facilities-based and resold services within GTE's Illinois services area and at least 25 providers have pending applications to provide such services. Therefore, Staff concludes that competition is on the forefront of GTE's service areas and must be considered in setting its depreciation rates. Staff also disagrees with AT&T's assertion that competition would not have much impact on the economic life of GTE's facilities. Staff indicates that many competitors will not be resellers. Staff notes that approximately 39 companies have been certificated to provide facilities-based service within GTE's service area. Staff further states that GTE's use of its network facilities for provision of services to its own customers will differ from its use for providing services to resellers. (Reply brief, pp. 3-4)

AT&T also contends that GTE's "modernization program" is irrelevant to the determination of forward-looking economic lives for use in TELRIC proceedings. AT&T states that in a TELRIC proceeding, it is assumed that the carrier will have already deployed the least-cost, most efficient and currently available technology. AT&T indicates that the Commission must then determine the economic life of the carrier's assets. AT&T concludes that the fact that GTE's embedded network is outdated and needs to be updated is no reason to allow GTE shorten its forward-looking economic lives. (Initial brief, p. 19)

In response, Staff indicates that it did not shorten GTE's "forward-looking economic lives" to reflect the notion that GTE's network was outdated and needed to be updated. Staff states that it considered GTE's installation of new digital switches and transmission facilities between 1993 and the present time and determined that the average remaining lives for those accounts should be longer and the resulting depreciation rates lower due to the modernization program. (Reply brief, pp. 4-5)

AT&T also asserts that Staff's position in the instant proceeding is contrary to its recommendations in the Ameritech TELRIC case. AT&T points out that Staff testified in the Ameritech TELRIC case that the depreciation lives set by the Commission for Ameritech in 1993 were forward-looking economic lives and, therefore, concluded that there was no reason to shorten Ameritech's economic lives. AT&T contends that Staff has failed to explain why a similar conclusion should not hold true for GTE, which faces the same technology changes as Ameritech and faces significantly less competition. (Initial brief, p. 20)

In response, Staff states that its recommendations for GTE are not contradicted by its position in the Ameritech TELRIC case, where it proposed that the Commission adopt the depreciation rates for Ameritech set in Docket No. 92-0448 (alternative regulation plan). Staff states that its recommendation in the Ameritech TELRIC case was based on its belief that Ameritech's demand forecast for unbundled network elements showed that Ameritech's plant would neither be obsolete or inadequate due to competition and that the 1993 depreciation rates were forward-looking. Staff notes that the Commission rejected its proposal to use the 1993 depreciation rates because they were "somewhat outdated and [did] not adequately reflect consideration of more recent marketplace and regulatory developments which may have had some impact on economic lives." (Second Interim Order, Dockets 96-0486/96-0569 Cons., p. 28) Staff indicates that its recommendations for GTE recognize the changes in the environment in which GTE provides service that have occurred after GTE's depreciation rates were prescribed in 1993. (Reply brief, pp. 5-6)

3. GTE's Compromise Proposal

While GTE's primary position is that its proposed depreciation rates be approved, GTE proposes as a compromise that Staff's proposed depreciation rates be approved, except for Staff's proposed depreciation rate for GTE North's digital switching account. GTE witness Flesch testified that Staff's recommendations for GTE's circuit equipment, copper cable and fiber cable accounts are reasonable.

Staff recommends a 6.9% depreciation rate for GTE North's digital switching account. In contrast, GTE's primary position is that a 10% depreciation rate be adopted for that account. As a compromise, GTE recommends an 8.8% depreciation rate for the digital switching account of GTE North. The modification of Staff's proposal to reflect the 8.8% depreciation rate produces a composite depreciation rate of 7.6% for GTE North. If the compromise proposal had been in effect in 1997, the depreciation expense for GTE North would have increased by a total of $26,253,000. (GTE Ex. AJF-1, attached to GTE

Ex. 3.00) This amount is $7,360,000 greater than the increase resulting from Staff's proposal. (GTE Ex. 3.00, p. 9)

GTE notes that Staff's recommended depreciation rate of 6.9% for GTE North's digital switching account is based on an average remaining life of 9.1 years. GTE contends that the average remaining life of 9.1 years is too conservative when compared to the lives recommended or approved for the same account in other jurisdictions. GTE's compromise proposal reflects the same remaining life, 7.2 years, for the digital switching accounts of GTE North and GTE South. GTE notes that for all accounts, except the digital switching accounts, Staff has proposed the same remaining lives for GTE North and GTE South. GTE concludes that since the operating characteristics of the two companies are similar, it is logical that the shorter life of 7.2 years assigned to the smaller company (GTE South) be adopted for the larger company (GTE North), whose service area is more susceptible to competition. (GTE Ex. 3.00, pp. 6-9)

Staff concludes that GTE's compromise proposal should be rejected. Staff contends that different remaining lives for the digital switching accounts of GTE North and GTE South are warranted in light of the history of their operations since 1986. Staff notes that GTE South initiated the installation of digital switches in 1986. Mr. Nelson testified that GTE South has four electromechanical switches and 43 digital switches, 25 of which have been installed since 1990. (Tr. 119). In contrast, GTE North's installation of digital switches is part of its modernization program which did not begin until 1993. (Staff Ex. 1.0, p. 7) Therefore, Staff concludes that GTE North's digital equipment is newer than that of GTE South and, therefore, has longer average remaining lives. (Reply brief, p. 8)

III. COMMISSION'S ANALYSIS AND CONCLUSION

The parties agree that forward-looking economic lives should be used to set the depreciation rates for GTE. The Commission agrees with this approach and concludes that such lives should reflect the impact of the demographic and competitive characteristics of GTE North's and GTE South's Illinois service areas on their respective physical assets.

The Commission determines that Staff's proposed depreciation rates appropriately reflect these characteristics and should be adopted. Staff analyzed the extent of existing and expected future competition in the Illinois service areas of GTE North and GTE South. Staff noted that the demographic and competitive characteristics of GTE's Illinois service areas have impacted the pace at which GTE's central office and outside plant capital improvement program has proceeded. Staff's proposal recognizes that the recent additions of new switching facilities and transmission facilities have had a positive impact on the remaining lives of such facilities for GTE.

The Commission rejects GTE'S compromise proposal which proposes an 8.8% depreciation rate for GTE North's digital switching account, rather than the 6.9% depreciation rate recommended by Staff. GTE's compromise would reflect the same average remaining life, 7.2 years, for the digital switching accounts of GTE North and GTE

South. Staff appropriately determined that a longer average remaining life of 9.1 years should be used for the digital switching account of GTE North. Staff recognized that GTE South's installation of digital switches has occurred at an earlier time frame than that of GTE North. The longer average remaining life of GTE North's digital equipment reflects the fact that its digital equipment is newer than that of GTE South.

The Commission concludes that GTE's primary proposal should be rejected. GTE's recommended depreciation rates do not reflect the specific demographic and competitive characteristics of the Illinois service areas of GTE North and South to the extent that Staff's proposed depreciation rates do. While GTE relied on TFI's studies that depict industry trends, GTE failed to present evidence that TFI's assumptions regarding technology changes hold true for GTE's Illinois operations.

The Commission further concludes that the depreciation rates proposed by AT&T, which reflect the FCC's prescribed lives established in January of 1995, should be rejected. AT&T's proposal relies on outdated national averages established by the FCC and fails to reflect an analysis of the demographic and competitive characteristics of the Illinois service areas of GTE North and GTE South.

IV. FINDINGS AND ORDERING PARAGRAPHS

The Commission, having considered the entire record and being fully advised in the premises, is of the opinion and finds that:

(1) GTE North Incorporated and GTE South Incorporated are telecommunications carriers within the meaning of Section 13-202 of the Public Utilities Act that provide local exchange and interexchange telecommunications services within the State of Illinois;

(2) the Commission has jurisdiction over GTE North Incorporated and GTE South Incorporated and the subject matter of this proceeding;

(3) the recitals of fact and conclusions reached in the prefatory portion of this order are supported by the evidence of record and are hereby adopted as findings of fact;

(4) Commission Staff's proposed depreciation rates for GTE North Incorporated and GTE South Incorporated, set forth on page 2 of this order, are reasonable and in the public interest and should be approved.

IT IS THEREFORE ORDERED that the depreciation rates recommended by Commission Staff, set forth on page 2 of this order, are approved and GTE North Incorporated and GTE South Incorporated are authorized and directed to place said rates in effect as of January 1, 1998, for their Illinois operations.

IT IS FURTHER ORDERED that subject to the provisions of Section 10-113 of the Public Utilities Act and 83 Ill. Adm. Code 200.800, this Order is final; it is not subject to the Administrative Review Law.

By order of the Commission this 10th day of September, 1998.

(SIGNED) RICHARD L. MATHIAS

Chairman

(S E A L)