Exhibit No. T-_____ (TLS-1T)
Docket No. UT-040520
Witness: Thomas L. Spinks

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Petition of Verizon Northwest, Inc., for Approval of Revised Depreciation Rates	DOCKET NO. UT-040520

TESTIMONY OF

THOMAS L. SPINKS

STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

February 2, 2005

Q. Please state your name and business address.

A. My name is Thomas Spinks; my business address is 1300 South Evergreen Park Drive Southwest, P.O. Box 47250, Olympia, Washington 98504. My e-mail address is tspinks@wutc.wa.gov.

Q. By whom are you employed and in what capacity?

A. I am employed by the Washington Utilities and Transportation Commission as a Regulatory Consultant.

Q. What are your education and experience qualifications?

A. My qualifications are provided as Exhibit TLS-2.

Q. What are your qualifications to testify as a depreciation expert?

A. I have worked in the depreciation field analyzing depreciation studies and providing Staff recommended depreciation parameters since 1982. I have attended the series of six weeklong depreciation-training courses from Depreciation Programs Inc. and attended numerous seminars on depreciation topics. I have represented state commission Staff in three-way meetings since 1983 and have analyzed depreciation studies and provided

parameter recommendations for well over one hundred gas, electric and telephone companies. I have provided expert witness testimony in several contested depreciation cases and am a member of the NARUC Staff Subcommittee on Technology and Depreciation.

Q. What is the purpose of Staff's testimony?

A. On December 6, 2004, Verizon Northwest Inc. filed testimony in this docket requesting that the Commission revise depreciation rates based on adopting the lives used for the purpose of reporting financial information to investors. The purpose of my testimony is to respond to the company testimony and to recommend appropriate depreciation parameters that the Commission should authorize for regulatory ratemaking.

Q. Please summarize the Staff's recommendations.

A. Staff recommends that the Commission deny Verizon's petition to adopt GAAP lives for regulatory purposes, and authorize the depreciation parameters and rates shown in Exhibit TLS-3. Staff recommends an overall increase in depreciation rates from 6.5 percent to 6.8 percent. As a result, overall depreciation expenses would increase by $7.7 million. Staff will

update its estimated revenue requirement in Docket UT-040788, the Verizon rate case to include my recommended level of depreciation expense.

Q. Is the company's request to use financial reporting depreciation parameters being considered in another docket?

A. Yes. In Docket UT-023003, the generic cost docket, Verizon proposed that the Commission adopt the same depreciation lives as it is proposing in this proceeding. Staff filed testimony in that proceeding opposing the proposal and the matter is currently under consideration by the Commission.

Q. The Verizon testimony discusses depreciation processes and methods used in Washington. (Ex._(AJF-1T), pp.6-8) Does Staff agree with Mr. Flesch's characterization of the processes and methods used in Washington?

A. Mr. Flesch's representations are accurate but incomplete. In order to provide the Commission with a more comprehensive understanding of depreciation, I will provide a background section that describes depreciation more completely.

Background

Q. What is a depreciation rate?

A. In order for industry to bring about the production of goods and services in the economy, companies must make capital investments to purchase plant and equipment with which to produce the goods and services. When the plant and equipment used in production are expected to be used in more than one accounting period, the investment is capitalized and depreciated over time. A depreciation rate determines how much of the capitalized investment is allocated over each accounting period.

Q. What is the importance of depreciation rates?

A. Depreciation rates are important to investors, analysts, management, shareholders and customers for many reasons. In heavily capitalized industries like public utilities, depreciation expense is one of the largest single categories of expense so there is concern that financial reports of the company accurately reflect the financial standing of the company. Depreciation rates are also important to the managers of companies because depreciation expense is often the largest single source of cash flow generation. Cash flow is important in both the day-to-day operations of companies as well as in determining the need for external financing. Finally,

depreciation rates are important to the customers of public utilities who must pay the company the costs of providing utility services including depreciation expenses. Because of the potential for depreciation rates to be used as a device to manipulate the financial picture of a company, or to be used to produce cash flow and reduce financing needs, or to create rates that cause customers to pay more or less than a proper amount for their services, the determination of proper depreciation rates and methods has always been important to companies and regulatory agencies. Federal regulatory bodies such as the STB, FERC and FCC, as well as a number of state commissions have separate depreciation branches devoted to the determination of proper depreciation rates. Specialized schools exist which teach how to analyze data and determine depreciation parameters. The National Association of Regulatory Utility Commissioners convened a subcommittee on depreciation for many years and professional associations exist for the advancement of the science of depreciation. In short, the determination of proper depreciation rates has always been an important part of sound public utility regulation.

Q. How is a depreciation rate calculated?

A. A depreciation rate is calculated by first selecting the depreciation method, procedure and technique for the calculation. There are straight-line and accelerated methods, broad group, vintage group and equal life group procedures, and whole life and remaining life techniques. After determining the appropriate method, procedure and technique, the life, salvage and mortality dispersion parameters are determined for use in the calculation of the rate. The parameters are determined from analysis of existing plant data and/or a combination of existing data analysis and judgments about future expectations regarding the parameters under study. The selected parameters are then combined with the method, procedure and technique to calculate the depreciation rate.

Q. What methods, procedures and techniques are currently used in Washington State?

A. In this state, companies use the straight-line method, broad group, vintage group, or equal life group procedures and whole life or remaining life techniques for calculating depreciation rates.

Q. How have depreciation rates been set and revised by the Commission in the past?

A. RCW 80.04.350 authorizes the Commission to set depreciation rates for regulated public utilities. The Commission has long used an informal process for setting depreciation rates for public utilities that negated the need for adversarial hearings. That process begins with a petition by a company for revisions to its depreciation rates. The company submits a depreciation study; Staff analyzes the study, obtains additional information as necessary, may perform analysis of its own, and makes recommendations to the company regarding the proposal or study. The company and Staff then meet and reach agreement regarding the proposal. The Staff then prepares a memorandum for the Commission explaining the changes and recommending approval of the revised rates. The Commission, if it agrees, approves the rates. In the case of Qwest and Verizon, the depreciation parameters had been determined in concert with the FCC Staff and company, while the methods, procedures and techniques ultimately depend on approval from the state commission. Neither Verizon nor Qwest have asked the FCC to revise depreciation rates in the last five years.

Q. Why has Verizon not requested the FCC to revise depreciation rates?

A. In CC Docket No. 98-137, the FCC adopted ranges of projection lives and future net salvage for plant accounts. Verizon adopted the lowest FCC life and salvage parameters from the ranges for interstate accounting purposes and unless or until the FCC revises the ranges, would have no reason to ask the FCC to represcribe depreciation rates.

Q. How do the FCC ranges compare to Verizon's currently prescribed lives in Washington?

A. The table below shows the FCC range and the currently prescribed life for the digital switch, circuit and metallic cable plant accounts.

Table 1. Comparison of FCC ranges with Washington Current Lives

Account	FCC range (yrs.)	Washington life (yrs.)
Digital Switch	12 to 18	16.5
Circuit Equip.	11 to 13	11.4
Aerial Cable	20 to 26	21
U.G. Cable	25 to 30	25
Buried Cable	20 to 26	23

Evaluation of Verizon's Petition

Q. What is the basis for Verizon's request to revise depreciation rates?

A. Verizon witness, Mr. Flesch, states that depreciation rates need to be revised because of the following: 1) The depreciation reserve is not adequate; 2) developments since the last represcription need to be taken into account; 3) today's business environment and; 4) technological advancements. (Ex.__AJF-1T, p.8, lines 11-16.)

Q. What evidence has been provided to support the assertion that the depreciation reserve is not adequate?

A. Verizon's assertion that the depreciation reserve is inadequate is based on a comparison of depreciation reserve levels with neighboring states, the FCC, and GAAP. (Ex.__AJF-1T, p. 9, line 8 – p. 10, line 2.)

Q. Does a comparison of the depreciation reserve levels of neighboring states, the interstate (FCC) reserve levels or the GAAP depreciation reserve levels provide any support for the Company's claims?

A. No, as explained later in my testimony, the simple comparison of depreciation reserve levels does not provide any meaningful information and is not an appropriate basis for changing depreciation parameters.

Q. On what basis can the Washington depreciation reserve level be deemed inadequate?

A. The depreciation reserve level is considered to be inadequate when the actual depreciation reserve level is compared to the theoretical depreciation level and the comparison shows that the actual depreciation reserve is in the range of 3 to 5 percent less than the theoretical reserve level.

Q. What is the theoretical depreciation reserve?

A. The theoretical depreciation reserve is the reserve level that should exist given the age, service life, salvage and mortality dispersion parameters for the plant in question. For instance, if a plant account consisted of a single motor vehicle with an expected life of 10 years and the vehicle is five years old and no salvage is expected, its theoretical reserve is 50 percent.

Q. Has Staff compared the theoretical reserve with the actual reserve for Verizon plant and equipment in Washington?

A. Yes. The theoretical reserve for Verizon plant and equipment in Washington is 41.8 percent. The actual reserve is 43.3 percent, which is higher than the theoretical reserve. Thus, Verizon's current depreciation reserve in Washington is clearly adequate given the current depreciation parameters.

The importance of this fact cannot be overstated because Verizon's policy witness in this case, Mr. Danner, appears to rely on Mr. Flesch's assertions regarding an inadequate depreciation reserve as a premise for his testimony.

Q. What developments since the last represcription does Mr. Flesch identify that need to be taken into account in this represcription?

A. Mr. Flesch does not identify any Washington specific developments that need to be addressed in this represcription. His testimony does assert that a number of general assumptions are considered in developing proposed depreciation lives including current network modernization strategies, the likely future impact of technology, regulatory commitments, state demographics and traditional wear and tear. (Ex.__AJF-1T, p.14, lines 16-22.) I address these considerations later in my testimony.

Q. Does Mr. Flesch subsequently explain in his testimony what he means by the term "today's business environment"?

A. No.

Q. What technological advancements does Mr. Flesch discuss in the testimony?

A. Mr. Flesch discusses packet switching as a replacement for digital switching, the need to upgrade circuit equipment, and the replacement of copper with fiber cable. (Ex.__AJF-1T, pp. 13-15.) In addition, Mr. Flesch relies upon a 2001 Technology Futures Inc. (TFI) study forecast that supports his life proposals for Digital Switching and Circuit Equipment. I discuss these items later my testimony.

Q. Mr. Flesch states, "Unless the Commission changes its depreciation practices and approves the depreciation rates I recommend herein and in my study, Verizon NW will be denied the opportunity for full recovery of its capital investment in Washington." (Ex.__AJF-1T, p. 9, lines 3-6.) Please comment.

A. Verizon has been and is recovering its investment in Washington for the plant and equipment used to provide regulated service. As the comparison of actual and theoretical reserves illustrates, the depreciation parameters prescribed by the Commission provides a pace of capital recovery that is almost exactly on target. By contrast, Mr. Flesch's proposal results in excessive capital recovery and front-loads the recovery of long-term investments during the time while Verizon still maintains market power and the ability to raise prices without losing market share. This front-loading

approach would permit Verizon ultimately to recover much more than its investment and a reasonable return on that investment.

Q. Please explain how excessive or front-loaded deprecation ultimately leads to over-recovery of investment.

A. In a world of perpetual regulation, front-loading as Verizon is proposing here would simply shift the timing of capital recovery without changing the ultimate amount recovered. Depreciation expense is overstated in the early time periods, but this causes depreciation expenses to be lower in later time periods. Front-loading shifts the burden of capital recovery from future customers to current customers. That is not at all the situation when a company's market power is declining over time and it stops being subject to economic regulation. A company that successfully front loads its depreciation expense can raise its rates while it still has market power and is subject to regulation, but once regulation ends it is not required to lower its rates as the investment is fully recovered. Verizon is not entitled to full recovery of assets used today in regulation that will also be used to provide service in a deregulated environment in the future. Indeed, there is potential for overly permissive policies toward capital recovery to load the competitive dice in favor of incumbents who will compete in the future with

CLECs that must build their networks from scratch without any prospect of having an opportunity to recover their capital investment.

Q. Mr. Flesch discusses "benchmarking" its proposed depreciation lives with the depreciation lives used by CATV and CLEC providers as well as the TFI studies in order to validate its proposed lives. (Ex.__AJF-1T, pp.16-22.) Does Staff agree that this Commission should use benchmarking to validate Verizon's proposed lives?

A. Benchmarking can be a useful tool when there is limited or no information to otherwise guide the Commission in determining proper service lives for Verizon's Washington plant. In this case, though, Verizon has provided a depreciation study specific to Washington state intrastate plant and equipment. The study, along with additional information obtained by Staff through data request responses, provides the information necessary to properly estimate service lives for Verizon's Washington depreciable plant. Hence, benchmarking Washington lives with the lives used by other industries or companies is neither necessary nor appropriate in this case.

Q. Do the depreciation life and reserve comparisons between Verizon, other states, CATV and CLECs provide any meaningful information?

A. No. The life comparisons with CLECs and CATV simply show that different depreciation lives are used for different purposes or under different conditions. The depreciation reserve level always differs when the depreciation lives and methods differ. The comparisons with other states are not meaningful because they do not adjust for geographic and demographic factors, retirement rates, the average age of the plant and other factors that result in different lives and reserve levels between states. Thus the comparison of lives and reserve levels presented by Verizon is an "apples to oranges" comparison. Verizon's presentation of highly selective data from a few other states and unregulated companies is simply designed to support its position that Washington's lives and the reserve level are too low for their liking. Such comparisons, however, do not provide the Commission with any rational basis for changing Verizon's depreciation rates.

Q. Has Verizon used studies from TFI to support their proposed lives in past proceedings?

A. Yes, in Docket UT-961632 Verizon's predecessor GTE-NW filed a similar petition supported by TFI studies. In denying the petition, the Commission stated the following regarding the TFI studies:

"The TFI studies on which GTE relies for revising service lives of eight categories of plant are not an adequate basis for revising those lives. The studies are generic to the industry. They are not GTE-Washington specific. The model does not use any underlying causative variables. Its use of pooled data could lead to false conclusions. The studies are based largely on planning and estimated data and one-sided subjective assumptions. Their assertions as to the rates of plant obsolescence, technological innovation, and new service requirements are incapable of test or verification. They overlook or ignore the potentially positive impacts of competition upon incumbents. The model is based on observed patterns when simple technological substitution has occurred, and is not shown to be suited to the complex nature of technological change that is occurring in the telecommunications industry." (Docket UT-961632, In the Matter of the Petition of GTE Northwest Incorporated for Depreciation Accounting Changes, Fourth Supplemental Order, Finding of Fact 9.)

The TFI studies presented in this proceeding use the same technology substitution forecasting method as used in the prior studies and therefore suffer from the same flaws that the Commission found in Docket UT-961632.

Q. Why is the interstate (FCC) depreciation reserve level for Washington different than the intrastate reserve level?

A. The primary reason for the reserve difference is due to the FCC's adoption of the Equal Life Group (ELG) method for calculating depreciation rates in 1982. The WUTC did not allow adoption of ELG for Verizon until 1995.

Q. Please explain why Staff does not believe that the depreciation lives used by Verizon for financial accounting and reporting purposes should be used for regulatory purposes.

A. The depreciation lives used by Verizon for financial accounting are inconsistent with the evidence as to how long assets are actually being used by the company and the economic value of those assets. Depreciation expense should reflect the change in economic value of the company's physical assets, and in theory financial statements should show both the actual value of the assets as a balance sheet item and the actual decline in asset value as a depreciation expense item. However, the reality is that Verizon's GAAP lives have overstated depreciation expense relative to the actual decline in economic value. Over time, this leads to accumulated depreciation reserve levels that are excessive. Verizon NW's GAAP

depreciation reserve ratio was 62 percent as of December 31, 2003.[1] The GAAP theoretical reserve for Verizon in Washington is only 48.2 percent. As the depreciation reserve grows, GAAP depreciation expenses actually decline, because the remaining, undepreciated investment shrinks relative to the remaining life of the plant.

Q. Please explain this point using the actual depreciation expenses and investment of Verizon NW.

A. As shown in Table 2 below, Verizon NW's Washington total investment in plant, property, and equipment is approximately $2.6 billion on both its regulatory books and its financial books.[2] However, the depreciation reserve is much larger on the company's financial books: $1.6 billion versus $1.1 billion on its regulatory books. The remaining undepreciated plant is $1.0 billion on the financial books and $1.5 billion on the regulatory books. Because Verizon's financial depreciation reserve is so large, its depreciation expense is actually lower on its financial books than on its regulatory books, despite the fact that it is using shorter lives for financial purposes.

[1] Verizon NW Consolidated Balance Sheet, December 31, 2003.

Table 2. Comparison of Regulatory and Financial Depreciation Status

Verizon NW - Washington (Millions of dollars)	Regulatory	Financial
Property, plant, and equipment	2,584.3	2,571.1
Depreciation reserve	1,076.8	1,594.7
Net plant	1,507.5	976.4
Depreciation expense	160.9	144.8
Indicated remaining life (years)	9.4	6.7

Q. Is Verizon being consistent in advocating the use of GAAP depreciation lives but not advocating the use of GAAP values for the depreciation reserve and depreciation expense?

A. No. Verizon is taking parts of two depreciation approaches and mixing them in a selective fashion to the unfair benefit of the company. If Verizon truly believes that its financial statements reflect the most accurate valuation of its assets and expenses, then it should be advocating the use of these GAAP results for regulatory purposes. According to Verizon NW, these GAAP results fairly present the financial position and results of the company. These results say that the remaining value of the company's plant is $1.0 billion, and the annual loss of value or depreciation expense is $145 million.

[2] Verizon NW does not produce state-specific financial reports. The values reported here are 61% of the reported total company amounts; 61% reflects the share of Verizon NW plant allocated to Washington state operations.

Despite its representations to its investors that these are a fair presentation of the Company's financial position and results, the Company would ask the Commission to set rates based on a remaining plant value of $1.5 billion – 50 percent more than the value reported to investors. The Company also would ask the Commission to include depreciation expense of $225 million – 55 percent more than the value reported to investors. (See Ex.__(AJF-3) It is inconsistent for Verizon to advocate the use of shorter depreciation lives based on their use in financial accounting but not to use the asset values and depreciation expenses associated with those shorter lives.

Q. What would be the effect on rate base and operating expenses if the Commission were to consistently and completely use the GAAP financial results for ratemaking purposes?

A. One result, the one that Verizon is hoping to effect through its selective GAAP proposal, is that its plant and equipment would be depreciated over a shorter period. The average remaining life of the depreciable assets would decline by almost three years, from 9.4 years to 6.7 years. This would address the stated concern that its plant is losing economic value more quickly as technology changes and competition increases. However, a complete and consistent implementation of GAAP results would also

recognize the loss of value that has, according to the Company, already occurred. According to Verizon NW's reports to its investors, the net plant in service is now worth $1.0 billion – not the $1.5 billion that it seeks to recover through depreciation expense and customer rates.

Q. Is the Staff recommending that GAAP values for net plant and depreciation expense be used for regulatory purposes?

A. No. As I discussed earlier, we believe that Verizon's financial books are not as accurate a presentation of plant value and depreciation expense as the Company's regulatory books. Having closely examined the evidence using traditional depreciation analysis tools, we believe that the plant has greater economic value than the GAAP results indicate and that the remaining economic life of the plant is greater than is assumed for GAAP purposes. We believe it is appropriate and reasonable to set rates based on a net book value of approximately $1.5 billion and to establish capital recovery of that amount over an average remaining life of approximately 8-9 years. However, if the Commission were to decide that the faster recovery implied by GAAP parameters is appropriate, it should implement the GAAP approach in its entirely and recognize the lower net book value that also reported on the Company's GAAP financial results. This complete and consistent

implementation of GAAP would actually reduce Verizon NW's depreciation expense by approximately $25 million, and it would reduce Verizon NW's rate base by over $500 million.

Developing the Staff Depreciation Parameters

Q. How are the plant and equipment parameters developed for the Staff depreciation recommendations?

A. The process of developing projection life and salvage recommendations is an incremental one because knowledge of the telecommunications industry is cumulative. Historically, every three years the company has submitted an updated depreciation study that provides the latest information on plant additions and retirements, adding the recent experience to all past experience. This results in updated estimates of realized life and salvage experience. Reviewing depreciation activity every three years helps avoid sudden large changes in parameters that can result in rate shock to customers or the need to amortize unrecovered investment in plant beyond the final retirement date of the plant.

The life estimation process begins with identification of current estimates of plant service life calculated from the mortality data. The depreciation study submitted by Verizon did not include this information, but it was provided

in response to an informal Staff data request. Next, consideration is given to the effect that the causes of retirement, such as wear and tear, obsolescence, and inadequacy, may have on future service life of the plant. Since these factors were considered in prior depreciation represcriptions, what is considered in the current study is the extent to which new developments may affect the future life of the plant under study. The changes in circumstances which are considered include: (1) retirement activity since the last study, (2) requirements of public authorities, such as undergrounding ordinances, one party-universal service (OPUS), and the Telecommunications Act of 1996 (Act), (3) short term plans of the company, (4) recent legal and technological developments and (5) long term plans of the company. The currently approved lives are then reviewed to determine whether, or the extent to which, any change is justified by the changes in the above-cited factors. Each of the above factors is evaluated in the testimony that follows.

Q. Does retirement activity that occurred since the last depreciation study support Verizon's proposed service lives?

A. Retirement activity in the switching and circuit equipment accounts supports some downward adjustment in the current service lives but does not support

the amount of adjustment proposed by Verizon. Retirement activity in the metallic cable accounts does not support any change in the current service lives.

Q. Do the "requirements of public authorities" criteria support Verizon's proposed service lives?

A. No. There have been no changes to regulatory requirements since the last represcription that would support Verizon's proposed changes.

Q. Do Verizon's short-term plans for network modernization or other projects support the proposed service lives?

A. No. Verizon has indicated in response to a Staff data request that it has no short-term plans for network modernization or other projects in Washington.

Q. Do recent legal developments support Verizon's proposed service lives?

A. There are several recent legal/competitive developments with ramifications for asset lives. These include the changes to FCC rules regarding unbundling obligations and UNE pricing, the introduction of Voice Over Internet Protocol (VOIP) telephony, and increased activity from CATV providers to provide telecommunications services.

The FCC's recent revisions to unbundling rules and pricing reduce the impact of competition on ILEC assets and suggest that to the extent current lives were reduced based on a presumed continuation of CLEC competition, that current lives may now be perceived as being lower than necessary. While Verizon may be experiencing intense competition in certain states and markets, this is not the case in Washington. As I testified in the generic cost proceeding in June 2004 (Docket UT-023003), Verizon in Washington has lost less than 3 percent of its access lines to competition in Washington. Historically, Staff has agreed to lower service lives for the switching, circuit and cable accounts for both Qwest and Verizon based in part on the premise of meaningful competition developing in Washington. As of 2004, such competition has failed to develop for Verizon in Washington. Despite the lack of competition to date, the promise of increased competition via CATV provides some basis for adjustment to the metallic cable account, Buried Cable that will be addressed later.

With regard to Voice over Internet Protocol (VOIP), if Internet Protocol (IP) telephony becomes the dominant mode of calling, some circuit type switches such as the current digital switches, will be replaced with a new generation of packet type switches, but at this point in time many questions remain as to how and when the new technology will be adopted.

Most recently, the FCC preempted states from regulating VOIP. Several state commissions are currently appealing the FCC preemption so the ultimate outcome of the FCC decision is not yet known. VOIP will likely impact network developments in the future, but presumably only after dealing with the inter-carrier compensation, 911 and other related issues. Staff believes it would be premature at this point to react to the introduction of VOIP by adopting the digital switch and circuit equipment service lives proposed by Verizon. The VOIP situation can be monitored and discussed in the next depreciation represcription.

Q. Do recent technological developments support Verizon's proposed service lives?

A. No**.** Verizon's proposed service lives are supported in part by a recent TFI study that predicts a major transformation of the network by 2014. The TFI study predicts that a new generation of switching and circuit equipment using dense wavelength division multiplexing (DWDM), optical circuit equipment and IP switches will dominate the network in 10 years. The problems with TFI studies notwithstanding, the notion that the Verizon – Washington network will experience such rapid and dramatic changes when at the same time the company states that it has no specific short or long-term

plans for modernization in Washington leaves Staff with no basis for agreeing with the Company's proposed changes.

Q. Do Verizon's long-term plans support its proposed service lives?

A. The only long-term plan Verizon has announced is a fiber to the premise (FTTP) initiative that proposes to replace copper with fiber to the home. Staff has several concerns with this initiative. First, unlike short-term plans, long-term plans should not be given much weight in considering service life changes because such plans can and do change with subsequent technological and regulatory developments. One such recent technical development not addressed or discussed by Verizon in its depreciation study which could effect its FTTP plans, is the development of new compression algorithms for DSL that allow for speeds sufficient to support video programming. Staff understands that this next generation of DSL capability is already in use in Japan and is expected to be deployed in the U.S. beginning this year. Second, in the 1990's Qwest began a similar project to provide FTTP in Omaha, Nebraska. When the project ended U S WEST discontinued its pursuit of FTTP due to unforeseen costs and other issues. Verizon has not made any showing of the economic viability of its FTTP initiative. Finally, the FTTP initiative announced by Verizon does not apply

to Verizon – Washington. Verizon's long-term plans do not support the proposed service lives.

Q. What is the Staff recommendation for the digital switching account?

A. After considering the criteria discussed above and the support provided by Verizon for its proposal, Staff recommends a reduction in the digital switch service life from 16.5 years to 13.5 years and an increase in future net salvage from 0 to 3.5 percent. The primary basis for the reduction in service life is the increased retirement activity in this account over the last five years. The current life indication using a 3-year band is 13.5 years. The bottom of the FCC range of lives for digital switches is 12 years. The future net salvage is increased slightly based on actual salvage experience.

Q. What is the Staff recommendation for the circuit equipment account?

A. Staff recommends a reduction in the service life for this account from 11.4 years to 11 years, the bottom of the FCC range. The basis for this change is primarily increased retirement activity over the last five years. The support for the Verizon proposed life was based in part on the previously discussed TFI studies.

Q. What is the Staff recommendation for the metallic cable accounts?

A. Staff recommends a reduction in the service life for the Buried Cable account from 23 to 20 years. While the current cable lives are all within the FCC ranges and recent retirement data do not support any change, the projected increase in the presence of CATV-type competition supports a change to the bottom of the FCC range.

Q. Is Staff recommending any other changes in this represcription?

A. Yes. Staff also recommends a decrease in service life for vehicles from 12 to 8 years. This recommendation is supported by the study data.

Q. How do Staff's recommended depreciation parameters change current depreciation rates and expense?

A. The effect of Staff's recommendations is to increase the composite depreciation rate in Washington from 6.5 percent to 6.8 percent. Depreciation accruals will increase from $160.9 million to $168.6 million based on plant in service as of January 1, 2004. The Staff recommended parameters, rates and accruals are included as Exhibit__TLS-3.

Q. Does this complete your testimony?

A. Yes.