Public Service Commission of Wisconsin

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

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FCC - MAIL ROOM

March 8, 1993

Donna R. Searcy, Secretary
Federal Communications Commission
1919 M Street, NW
Washington, DC 20554

Re: FCC 92-537; CC Docket No. 92-296 - Simplification of the Depreciation Prescription Process (Notice).

Dear Secretary Searcy:

The Public Service Commission of Wisconsin (PSCW) appreciates the opportunity to comment on the above-referenced notice of proposed rulemaking. The PSCW has participated in the Federal Communication Commission's (FCC) represcription of depreciation rates in the past and has found the information received from the FCC both informative and helpful in our state depreciation proceedings.

The PSCW supports efforts to reduce unnecessary regulatory burdens and their associated costs. Your review aimed at simplifying the depreciation setting process is to be encouraged.

The PSCW experience shows that the booking of annual depreciation expense, one of the largest components of the telephone carriers' expenses, has major effects on utility financial statements, the recovery of capital invested in utility plant over its useful life and consumer price-setting functions.

The recording of annual depreciation expenses does not create a cash outflow from the telephone carrier. This does not make depreciation any less of an expense than any other expense requiring a cash outflow. From a regulatory standpoint, however, it requires an analysis of the method of allocation of this expense. Attempts to record depreciation in the cheapest and simplest method, if done on a judgmental basis only, could cause inter-generational cost allocation problems, erroneous pricing signals to customers and a lack of confidence in the financial statements. The regulatory process requires a higher standard of review for the reasonable allocation of the cost of utility plant in accordance to their useful lives. Even in price cap regulation, the regulator must be concerned that a reasonable level of depreciation is charged so that future ratepayers will not be asked to bear the burden of underdepreciated investments.

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The foregoing concerns do not preclude the consideration of simpler methods of prescribing depreciation rates but if and only if carriers continue to maintain their continuing property records in accordance with the provisions of the uniform system of accounts.

The *Notice* proposes four options for simplification. From our reading of the *Notice*, it appears the FCC will choose one of the four methods to simplify the depreciation process for all accounts. When this choice is made the other three methods will be discarded.

If the FCC finds that the federal depreciation process can only be simplified by choosing one of the options, the PSCW strongly urges that the Basic Factors Range Option be selected. Only with the Basic Factors Range Option will the necessary data and depreciation process framework be maintained over time to allow depreciation analyses and reasonable judgments to be made regarding price setting and the adequacy and pace of recovery for the carriers' capital. This is particularly important under the current regulatory framework at the federal and state levels. The Basic Factors Range Option allows for state commission and ratepayer input to the FCC regulatory processes. The other options, over time, would produce "guesstimates" rather than informed estimates.

The prescription of depreciation rates under any of the proposed options require a starting point. Since the present depreciation procedures contain a wealth of quality historical and statistical data, the obtaining of a consensus of depreciation parameters, ranges or schedules for the various accounts is not a particularly difficult task. However, with the passage of time the downside risk to any simplified procedure is that quality data will no longer be required and therefore will not be prepared in the future. If an option is chosen that no longer requires any detailed analysis of depreciation parameters (curve shape, service life or net salvage), then as time passes the depreciation rates will become more judgmental as the information needed to make a quality judgment on the reasonableness of the depreciation allocation process is no longer prepared or available. An additional factor is that the present depreciation procedures include a useful review of the adequacy of the accumulated depreciation for every account, based on the depreciation parameters in the current study. Any method which does not study the basic depreciation parameters also makes the accumulated depreciation analysis more judgmental as time passes.

Our further comments on the individual options are as follows:

A. The Basic Factors Range Option (Option A)

This option would best suit the current regulatory framework of the

PSCW. Use of this option would allow the telephone carriers to mix and match the depreciation parameters of projection life, curve shape and future net salvage, to best suit the telephone carrier's experience or future plans. With a range of basic factors to choose from it would appear there would be less need to request waivers for basic factors that fall outside the parameter ranges. Allowing a choice of parameters to be used in the depreciation rate calculation also allows these factors to be used in developing theoretical-to-actual accumulated depreciation comparisons. A carrier's choice of individual depreciation parameters will allow the individual states to participate in the depreciation prescription process more fully and gain a better understanding for factors used in the depreciation rate calculation. This option could be used successfully for any or all of the plant accounts.

Use of depreciation data and statistics from represcription proceedings from the past several years could form a foundation and starting point for the discussion of the proper curve shapes, projection lives, salvage and cost of removal for this option. Analysis of this data for the past several years would also help determine the latest trends for these depreciation parameters.

Once the ranges are established these basic range factors should be mandatory for all telephone carriers. However, application for a waiver dependent on the special circumstances of an individual telephone carrier should be allowed. The width of the ranges established should be sufficient to accommodate at least 80% of the past two represcriptions. The telephone carriers should have the flexibility to choose any parameters within the ranges. The option to choose individual depreciation parameters should be an annual choice with the election available during the year the accruals are being booked. The election should not be retroactive such that an election is made and then applied to the prior year's balances.

The Basic Factors Range Option would produce the smallest administrative savings in the short term when compared to the other options. However, this option would still be an excellent use of the FCC and telephone carrier's resources. This option overwhelmingly provides the best historical data for future modification of the depreciation parameters.

Because of technological and the evolutionary trends in the telephone industry, the basic factors should be reviewed at least every three years. This option could be phased in for all telephone carriers over a three-year period.

B. The Depreciation Rate Range Option (Option B)

If Option A is not chosen the PSCW recommends the use of the

Depreciation Rate Range Option only for selected accounts that have depreciation parameters which have been historically less subject to change due to technology or other factors. The list of the selected accounts is as follows:

Account	Description
2112	Motor Vehicles
2115	Garage Work Equipment
2116	Other Work Equipment
2121	Buildings
2122	Furniture
2123	Office Support Equipment
2123	Company Communications Equipment
2124	General Purpose Computers
2351	Public Telephone Terminal Equipment
2362	Other Terminal Equipment
2411	Poles
2421.1	Aerial Cable-Metallic
2441	Conduit Systems

The PSCW believes the choice of the Depreciation Rate Range Option for these selected accounts, if Option A is not chosen, is an acceptable method for simplification for all parties involved in the depreciation proceedings. We also would recommend that if this option is chosen that implementation would be phased in for all telephone carriers over a three-year time period.

The telephone carriers should have the flexibility to immediately choose any depreciation rate within the ranges. The option to choose should be an annual choice with the election available during the year the accruals are being booked. The election should not be retroactive such that an election is made and then applied to the prior year's balances.

The establishment of the initial depreciation rate ranges would be similar to our comment on the Basic Factors Range Option in that analysis of the past several years of industry data concerning curve shapes, projection lives, salvage and cost of removal would serve as a starting point for determining the depreciation rate ranges, which take into effect the latest trends. The use of statistics and standard deviations to set the range width is a mathematical way of setting the ranges and removing most of the judgment in the setting of the ranges. Some judgment should be exercised to ensure that the depreciation rate ranges established have sufficient breadth to include most of the depreciation rates now used by the telephone carriers.

Our comment regarding the period of time between reviews of the depreciation rates are the same as in the Basic Factors Range

Option. Because of technological change and the evolutionary trends in the telephone industry, the basic factors should be reviewed at least every three years.

The downside risk in this option is that it is difficult to compare the telephone carrier's actual accumulated depreciation balances to theoretical accumulated depreciation balances. The telephone carriers would have to monitor their accumulated depreciation balances to plant balances in concert with their future plans for the equipment in each account. The annual election of a depreciation rate by the telephone carriers would shift most of the burden of adequate capital recovery to the telephone carriers.

The ability of the telephone carriers to choose a depreciation rate from a range of depreciation rates, derived from industry statistics accumulated by the FCC, would provide a great deal of simplification for the telephone carriers and a large savings in resources. It would also provide a state commission with depreciation rate ranges which it could use or compare with the rates prescribed by the state commission. Use of depreciation rate ranges is a fully understandable method presently used by several state commissions.

C. The Depreciation Schedule Option (Option C)

This option should <u>not</u> be selected because of the judgment involved in making long term projections or should be reserved for accounts where future retirements are: a) relatively predictable, b) part of the telephone carrier's immediate plans and budgets, and c) not merely part of a long-term forecast. The accounts which could be considered for the Depreciation Schedule Option are as follows:

Account	Description
2211	Analog Electronic Switching
2215	Electromechanical Switching
2220	Operator Systems
2231	Radio Systems
2232.2	Circuit Equipment-Analog
2431	Aerial Wire

If this option were chosen the immediate concern would be determination of the year of final retirement for each account selected for this option. A starting point could be an industry-wide survey on the plans of each telephone carrier for accounts which would be allowed to use this option. A survey of other telecommunications research and engineering experts to confirm or modify judgments of the final year of retirement should follow. A FCC comparison of the actual historical trends to the survey predictions would then be used to form a fair judgment of the final year of retirement for each account. The setting of the same final year of retirement for all telephone carriers may seem inflexible when each telephone carrier has its own individual plans. However, setting dates for the modernization of telephone infrastructure in the depreciation process may aid in the actual replacement of the older technologies by all telephone carriers at the same pace and time frame, which would be an engineering and technological benefit to the entire telephone network.

Once the final year of retirement is selected the individual carriers would calculate an amortization schedule, based upon their own plant balances, which would fully depreciate the plant account by the final year of retirement. Alternatively they could calculate their own average year of final retirement and develop the required depreciation rate which would fully depreciate the plant account by the final year of retirement.

If this option is adopted for selected accounts, it should be mandatory for all telephone carriers. Both new and embedded investment should be subject to the Depreciation Scheduling Option by the use of a composite depreciation percentage or amortization as calculated by the telephone carriers, based upon individual account investments.

This particular option should be reviewed every three years to determine the progress of the retirement process. A three-year periodic review of the depreciation schedules and progress of replacements would help in the review of accumulated depreciation and the avoidance of imbalances.

The administration of this option could be more costly than a depreciation rate range option. The PSCW thinks this is warranted for those selected accounts because when plant is nearing end of service life it is very important that the allocation of depreciation expense be as accurate as possible to fully depreciate the plant investment over its remaining useful life. If the cost of plant investment is not recovered by the time of its retirement, the spreading of these remaining costs to future generations is not equitable and it creates pricing mismatches in the cost of telephone service studies.

D. The Price Cap Carrier Option (Option D)

In our initial comments we stated that the booking of annual depreciation expense has a major effect on financial statements, the recovery of capital invested in utility plant over its useful life and consumer price setting functions.

We also stated that if an option is chosen that no longer requires any detailed analysis of depreciation parameters (curve shape, service life or net salvage) then, as time passes, the depreciation rates become more judgmental as the information needed to make a judgment on the reasonableness of the depreciation allocation process is no longer prepared or available.

The regulatory depreciation process has a responsibility to the telephone carriers that their capital investments be returned to them in a systematic and rational manner over the useful life of the plant investment. The PSCW and the FCC have the same responsibility to the customers of the telephone carriers that their cost of telephone service contains the costs determined in a systematic and rational manner, without inter-generational inequities.

To allow telephone carriers to choose any depreciation rate without providing supporting data would, over time, remove the ability of commissions and customers to question the validity of the depreciation allocation process. Almost all residential customers have no alternative basic telephone service to choose from. Under a different regulatory approach, for example, price caps, it is appropriate for the commission to establish a depreciation floor and to limit the risk for ratepayers to recover future reserve deficiencies.

If the FCC decides to use this option the PSCW would strongly recommend that it be used only for the following accounts under our current regulatory structure:

Account	Description
2112	Motor Vehicles
2115	Garage Work Equipment
2116	Other Work Equipment
2122	Furniture
2123	Office Support Equipment
2123	Company Communications Equipment

These accounts require substantial amounts of time and effort to analyze with normally little material change to depreciation expense or to the depreciation parameters.

In addition, adoption of this Price Cap Carrier Option for these selected accounts would not hamper the overall ability of state commissions or customers to participate or make recommendations in the depreciation rate prescription process.

Finally the PSCW would question whether the required statutory prescription of depreciation rates is being met when the FCC is merely accepting the rates as filed by the carriers.

Additional Comments Related to Options A, B, C and D.

An overall comment to this simplification notice is that the PSCW would encourage the FCC not to simplify the depreciation procedures by limiting themselves to the choice of only one of the options to the exclusion of the rest. When your simplification procedures contain more than one option it allows the modification of the simplification procedures to change an account from one option to another when the circumstances warrant. Over time it also allows one to evaluate the success of one method against the another. Restricting your choices to only one option may actually complicate the depreciation process in the long run.

E. Additional Simplification: Salvage

The simplification of the depreciation processes by eliminating the salvage and cost of removal parameters from the depreciation calculation has been studied several times over the last ten years. The most recent revival of this topic is an article in the 1991 Journal of the Society of Depreciation Professionals, entitled, "Gross Salvage and Cost of Removal, The Case for Current Period Accounting in the Telephone Industry". This article concludes that current period accounting for cost of removal and gross salvage should be adopted. This article also shows the impact on operating revenues for a six-year period and concludes that the revenue requirement reduction would be significant.

Elimination of the salvage and cost of removal parameters would shift the analysis from the depreciation process to the revenue requirement process. The analysis in the revenue requirement process would normally be confined to the test year and would not normally be concerned beyond the test year. If the focus is shifted to a present cost analysis, and continued environmental concerns exist regarding the removal and disposal costs of retired utility plant, how are the probable high future costs of removal of utility plant going to be allocated to the present users of the telephone plant? If these costs are not allocated to the present users, future customers will have to pay for this deferral.

Simplification of our present depreciation procedures by treating salvage and cost of removal as current period charges or credits would simplify the depreciation procedures but would truly complicate other regulatory procedures. A separate docket studying all of the effects of this proposal should be initiated.

If you have any questions please call Clarence Mougin at (608) 267-0637.

Sincerely,

Scot Cullen

Scot Cullen, P.E.
Administrator
Telecommunications Division