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Division of Public Utilities

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To: Public Service Commission of Utah

From: Utah Division of Public Utilities
Chris Parker, Director
William Duncan, Manager, Telecommunications

Re: Docket 17-R008-01
Depreciation Workgroup – Division of Public Utilities statement of initial position

The Division of Public Utilities (DPU) generally supports any depreciation method that reasonably matches depreciation expense to an asset's useful life, as embodied in the Commission approved depreciation life. The DPU does not support depreciation methods or practices that unreasonably accelerate depreciation rates or inflate depreciate expense beyond that of the PSC approved rate.

In calculating Universal Service Fund (USF) distributions, U.C. 54-8b-15(5) (b) states that qualifying companies "may use any depreciation method allowed by the Federal Communications Commission." However, the legislature grants authority to the PSC to determine if a regulated carrier is correctly applying a depreciation method described in 54-8b-15(5) (b). Any depreciation method that unreasonably inflates depreciation expense by accelerating depreciation or otherwise calculating in such a manner that results in a depreciation life of an asset or group of assets shorter than what is approved by the PSC or an accumulated depreciation to book value ratio that is significantly mismatched with the remaining PSC approved life would constitute an incorrect application of that method. The matching principle is fundamental to any depreciation method, including proper application of any FCC approved method.

In reviewing depreciation expense and methods of several Utah telephone companies over the past years, the DPU has identified a depreciation method, used by several providers, commonly known as "group depreciation". This method, when applied incorrectly, may unreasonably accelerate deprecation life, and inflate depreciation expense. Group depreciation is accepted by the FCC, but no guidance or rules have been supplied by the FCC to ensure that this method is

applied correctly. It is mentioned only in a Part 32 reference on computation of depreciation rates:

§ 32.2000 Instructions for telecommunications plant accounts.

(g) *Depreciation accounting*.

(1) *Computation of depreciation rates*.

(i) Unless otherwise provided by the Commission, either through prior approval or upon prescription by the Commission, depreciation percentage rates shall be computed in conformity with a ***group plan of accounting*** for depreciation and shall be such that the loss in service value of the property, except for losses excluded under the definition of depreciation, may be distributed under the straight-line method during the service life of the property.

(ii) In the event any composite percentage rate becomes no longer applicable, revised composite percentage rates shall be computed in accordance with subparagraph (g)(1)(i) of this section.

(iii) The company shall keep such records of property and property retirements as will allow the determination of the service life of property which has been retired, or facilitate the determination of service life indications by mortality, turnover, or other appropriate methods. Such records will also allow the determination of the percentage of salvage value and cost of removal for property retired from each class of depreciable plant.

Since this method is accepted by the FCC, the DPU proposes that the PSC consider clarifying how the group method is applied correctly in rule so that misapplication of the FCC method will not subvert the basic principles of depreciation. Any depreciation method may be misapplied. Lack of enforcement by the FCC against a misapplication of the group method should not be considered an allowed depreciation method. The Commission should clarify that, regardless of method chosen, applying the method correctly results in recovery of the cost of an asset spread reasonably evenly over the PSC approved depreciable life. Some methods the PSC may consider are these:

1. Calculation of depreciation rate utilizing the following formula developed by the FCC – Depreciation rate = $\frac{100\% \text{ - accumulated depreciation\% - future net salvage \%}}{\text{Average remaining life}}$
2. The use of vintage depreciation
3. Requiring carriers to remove from the group depreciation expense calculation any assets that are beyond the PSC approved depreciable life.
4. Require regulated carriers to provide regular depreciation studies or conduct a depreciation study for all rural carriers that would provide safe harbor depreciation rates.

5. Require regulated carriers to follow the FCC Part 32.2000 (g)(1)(i) requirement that the application of the method chosen "shall be such that the loss in service value of the property, except for losses excluded under the definition of depreciation, may be distributed under the straight-line method during the service life of the property."
6. Require regulated carriers to comply with FCC Part 32.2000 (g)(1)(ii) by annually revising the composite percentage rate computation for each group such that the results of the depreciation method and application remain consistent with the requirement in (g)(1)(i). This may require the use of a revised percentage rate that is not numerically matched to the book value divided by the PSC approved remaining depreciable life where use of a typical straight-line depreciation calculated rate is inconsistent with (g)(1)(i) in result. The critical requirement is that the effect of any method shall meet the FCC requirement that the loss in service value match the distribution of depreciation expense over that assets useful life.

While these methods may mitigate the issues in using group depreciation, there may also be other methods that distort depreciation expense. The DPU supports methods that evenly distribute depreciation expense over the Commission approved life of an asset.