

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

CASE NO. TO-82-3

In the matter of the investigation
of Straight-Line Equal Life Group
and Remaining Life depreciation
methods for Class A and B Missouri
jurisdictional telephone utilities.

APPEARANCES: William C. Harrelson, Assistant General Counsel,
P. O. Box 360, Jefferson City, Missouri 65102,
for the Staff of the Missouri Public Service
Commission.

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65101, for the Office of the Public Counsel and
the Public.

Jack C. Lorenz, Solicitor General - Missouri
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Al Richter, Attorney at Law, 100 N. Tucker, St. Louis,
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Hermann Ivester, Attorney at Law, P. O. Box 2177,
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General Telephone Company of the Midwest and Missouri
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Erwin L. Milne, Attorney at Law, P. O. Box 1280,
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Mutual Telephone Corporation and Kingdom Telephone
Company.

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for United Telephone Company of Missouri.

REPORT AND ORDER

On July 6, 1981, the Staff of the Missouri Public Service Commission filed
a Motion entitled, 'Motion To Establish A Docket For The Investigation Of Utilizing

Remaining Life And Equal Life Group Depreciation Methods For Missouri Jurisdictional Class A and B Telephone Utilities". In an Order dated July 16, 1981, the Commission granted the Staff's Motion and assigned Case No. TO-82-3 to the proceedings.

Notice of the proceeding was given to all Missouri jurisdictional Class A and B telephone companies. The utilities which participated and filed testimony in the case were: Allied Telephone of Missouri, Inc. (Allied), Doniphan Telephone Company (Doniphan), General Telephone Company of the Midwest (GTE), Kingdom Telephone Company (Kingdom), Grand River Mutual Telephone Company (Grand River), Central Telephone Company of Missouri (Central), Missouri Telephone Company (Missouri), Fidelity Telephone Company (Fidelity), Southwestern Bell Telephone Company (SWB) and United Telephone Company of Missouri (UTM). Staff also filed testimony and participated in the proceeding. Public Counsel participated but did not present any direct or rebuttal testimony.

An early prehearing conference was held on October 2, 1981, at which the parties agreed that this was an investigatory and not a rulemaking proceeding. A prehearing conference was held on February 18 and 19, 1982. Parties attending the conference entered into a Hearing Memorandum, and submitted it for the Commission's consideration.

Hearings were held on March 2, 3, 4, and 5, 1982, at the Commission's offices in Jefferson City, Missouri. Subsequent thereto, various parties have filed briefs and reply briefs.

On August 20, 1982, the Staff filed its Motion For Order Authorizing Staff to Supplement Brief. Also, on August 20, 1982, UTM filed United's Motion to Reopen Record For Limited Purpose.

On August 27, 1982, Bell filed responses in which it objected to both motions. On August 31, 1982, Public Counsel filed a Response, also objecting to the motion of UTM.

In the Commission's opinion the motions of UTM and the Staff should be denied and this Report and Order is based on the record completed by the filing of

reply briefs on May 20, 1982.

Findings of Fact

The Missouri Public Service Commission, having considered all of the competent and substantial evidence upon the whole record, makes the following findings of fact:

SWB is the only utility which has any revenue requirements involved in this case. Prior to the initiation of this proceeding, SWB sought to recover the depreciation expense associated with the use of Straight Line Equal Life Group (SLELG) and Straight Line Remaining Life (SLRL), depreciation methods in its 1981 rate case (Case No. TR-81-208). In addition, SWB sought to implement and to recover the revenue requirements associated with revised whole-life depreciation rates for its terminal equipment and digital data system equipment (DDS). Pursuant to a stipulation dated September 3, 1981, the SLELG and SLRL issues in the rate proceeding were transferred to this case. By Commission Order dated January 11, 1982, SWB's whole life depreciation represcription was also included herein.

In Case No. TR-81-208, the Staff agreed with SWB that some modification of the terminal equipment depreciation rates was warranted. Staff objected, however, to SWB's proposal to recover the resulting depreciation expense until such time as the depreciation rates were prescribed by the Federal Communications Commission (FCC).

The FCC has now prescribed certain whole life depreciation rates for those accounts based upon an agreement between SWB, the Commission Staff, and the Staff of the FCC. The additional SWB revenue requirement associated with the whole-life represcription is, by agreement of the parties, \$618,000 for Missouri. No party has raised any objection to the SWB whole-life rates as represcribed, or to their recovery in this case. Accordingly, the Commission is of the opinion that the whole life depreciation rates prescribed by the FCC for SWB's terminal equipment and DDS accounts should be approved.

All parties have agreed that SWB unlike any other Missouri telephone company, has depreciation rates prescribed by the FCC. The FCC, in Docket No. 20188

adopted amendments to its Uniform System of Accounts to permit the use of SLRL and SLELG depreciation. SWB desires to maintain one set of uniform depreciation records for consideration by both the FCC and this Commission. Although their depreciation rates are not determined by the FCC, the other Missouri telephone companies also desire to use SLRL and SLELG depreciation methods. All parties agree that if SWB is authorized the use of SLRL there will be an immediate net operating income requirement of \$5,569,561 and an immediate revenue requirement of \$10,649,000. The parties agreed that approval of SLELG would create an immediate net operating income requirement of \$536,611 and a revenue requirement of \$1,026,000.

On August 9, 1982, SWB notified the Commission that the FCC had prescribed straight line equal life group rates for additions to outside plant, from which the exchange and toll aerial wire was excluded. The applicable exclusion reduced the revenue requirement, relevant to this case, to \$987,000. Bell's notification was provided for in paragraph 4 of the Hearing Memorandum executed in this matter by the parties.

All parties agree that the primary issue to be resolved in this proceeding is whether or not the Commission should authorize the use of either one or both SLELG and SLRL depreciation systems by those Class A and B Missouri telephone companies who desire to use either or both such systems in determining their depreciation rates. The systems are not dependent upon each other and either may be adopted independently of the other. No party to the proceeding is seeking a mandatory directive that SLRL and SLELG must be used by all telephone companies, but only that they be available as an option to those companies who desire to utilize them.

SWB contends that its depreciation rates and the methods, procedures and techniques utilized to derive those rates, are prescribed by the FCC therefore, the essential issue in this proceeding as to SWB is whether this Commission will recognize and utilize SLELG and SLRL depreciation rates in determining SWB's revenue requirements in this and future proceedings.

The Commission Staff and the Public Counsel oppose the blanket approval of

SLELG and SLRL depreciation rate procedures.

Some of the independent telephone companies in this proceeding do not desire the use of SLELG and SLRL depreciation methods on all accounts on an across-the-board basis, but would prefer the flexibility to utilize these methods on some accounts but not others. Some of the companies would oppose any blanket requirement of the use of SLELG and SLRL because of the present inability to maintain increased records that would be required. Some of the independent telephone companies take the position that they have adequate accounting capabilities and property records to enable them to utilize the SLRL and SLELG depreciation methods.

Some of the independent telephone companies do not have the historical property records and other records to support the proposed depreciation rates and take the position that such records and studies could not be developed and maintained by these companies without excessive costs and that capital recovery schedules based on such records and studies available from SWB, GTE and other companies should be adopted for use by them.

Depreciation accounting is generally conceded to be a system of accounting which aims to distribute costs or other basic value of tangible capital assets, less salvage (if any), over the estimated useful life of the unit, or group of assets, in a systematic and rational manner. It is a process of allocation, not of valuation.

A secondary goal of depreciation is to match capital recovery with capital consumption. For years it has been recognized that this goal is difficult to attain, therefore, the emphasis is upon a systematic and rational allocation of the expense of capital consumption. The accounting does not purport to follow the actual rate of consumption of property during individual accounting periods. Therefore, it is equitable and sound as a matter of practical accounting to spread the depreciation expense in equal annual charges over the useful life of the property, but the actual rate of consumption may be different.

Public utilities in this state have been using the straight-line vintage group (SLVG) and straight-line whole life (SLWL) depreciation since approximately

1945 and on a national level SLVG has been used in the regulated utility industry since 1913 with little change.

SLVG employs an estimate of the service lives of each year's (vintage) additions of property. By weighting each of these vintage lives with surviving investment for that vintage, a composite average life is obtained. A fixed rate is obtained by subtracting the percentage of net salvage from 100 percent and dividing by the average service life. If, at some time during the life of the property, the original estimates appear to be in error, correction is made by the application of SLWL.

The process may be illustrated by the use of a hypothetical investment with an original cost of \$2,200 and having an estimated life of 20 years and \$200 of net salvage value. Under SLVG depreciation would be accrued at the rate of five percent a year with a total accrual of \$5,000 after five years. If, at that time, it was realized that the initial estimate of life was in error and that the property will now only last ten years, correction is applied for the whole life of the property. Since it is now known that the proper depreciation rate should have been ten percent per year, depreciation will then be accrued at that rate.

All parties to the proceedings essentially agree that under any of the alternative straight-line methods proposed, the service life estimation is performed in essentially the same manner. All parties agree that this process of estimation is based in part upon judgment.

SWB and the other companies have identified what they characterize as a serious capital recovery problem by calculating a theoretical reserve. The theoretical reserve calculation attempts to estimate what should be in the depreciation reserve at any particular time. SWB's evidence shows that there is a deficiency of approximately \$400,000,000 in its Missouri depreciation reserve and that, while 31 percent of its Missouri investment has been consumed, only 14 percent has been currently recovered. This deficiency in the rate of capital recovery indicates a need to develop and examine other procedures and techniques to accomplish

the purpose and goals of the depreciation process.

The SLVG method and whole-life method corrects an error in depreciation rates to that rate that should have been charged at the outset. The telephone companies contend that its use frequently leaves an unrecovered portion of the cost of the asset at the end of the asset's useful life.

SLELG is a further refinement of SLVG. SLELG disaggregates the vintage groups into the groups of property, by dollar amounts, that will retire each year. The depreciation rate is then applied to each equal life group. The telephone companies argue that SLELG method more closely matches capital recovery with capital consumption.

In the Commission's opinion SLELG does permit closer monitoring and the development of more accurate depreciation rates. Because the groups are disaggregated into equal life as opposed to vintage groups, it is possible to allocate capital costs uniformly over the life of each group. This is consistent with both the straight line method of depreciation and with the goal of depreciation as it has been previously defined.

The Staff does not dispute that SLELG results in capital recovery more in line with its actual consumption. Rather, Staff challenges SLELG because of its complexity; the additional constraints it places or will place on Staff's resources; and because of the revenue requirements involved.

The Commission is of the opinion that SLELG is reasonable and should be approved. The telephone utilities which lack the capacity to implement SLELG should be permitted to continue to utilize the vintage group procedure and the whole life technique on all accounts.

SLRL is the proposed method of correcting the depreciation rate for an initial error in estimation. SLRL determines an annual rate by subtracting the percentage of the depreciation reserve and the percentage of future net salvage from 100 percent and dividing by the average remaining service life. This rate is then applied to the surviving plant investment. SLRL results in the same rates as SLVG

until the life estimate changes. Under SLRL, when the life estimate changes, the rate is additionally adjusted to compensate for presumed over-or-under accruals due to the improper rate having been applied in the past. This additional rate adjustment does not occur under SLVG.

SWB and a number of other Missouri telephone utilities propose the use of remaining life. Public Counsel opposes SLRL on the ground that it constitutes retroactive rate-making. Staff proposes that the whole-life technique be maintained and that any estimating errors be remedied by either underestimating service lives or amortization-type adjustments. Staff further opposes SLRL on the ground that it is part of the Bell System "migration" strategy.

The most significant advantage of SLRL is that it adjusts the depreciation rate to effect fuller recovery during the period when the investment is still used in providing telephone service. Any adjustment during such period is not retroactive rate-making, because the rates are prospectively recovered on investment which is still in use. Underestimating service lives or making post-mortem adjustments after the investment as retired do not fulfill the objective of return of capital in a rational and systematic manner over the investment's service life. Such methods also create a situation wherein the telephone utilities would be required to wait until the investment retires before a corrective adjustment is made. SLRL appears to be a reasonable solution to any capital recovery deficiency in Missouri.

SWB has included a request to recover \$10,649,000 in revenue requirements associated with implementation of SLRL. The revenue requirements are the result of applying SLRL technique to SWB's terminal equipment and DDS accounts in accordance with the SLRL rates prescribed therefor by the FCC. No party has raised any objection to the amount of these revenue requirements and that amount was stipulated to in the Hearing Memorandum filed in this case. Having found that SWB should be allowed to implement SLRL for said accounts, the Commission is of the opinion that the SLRL rates associated therewith should be approved, and SWB should be authorized to file tariffs to recover the resulting revenue requirements.

The parties stipulated in the Hearing Memorandum as to the amount of SWB's additional total revenue requirement and proper rate design to recover that revenue requirement. Agreed-on rate design is as follows:

Local Exchange	\$ 1,250,000
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The services listed below
would be increased by
2.55% to achieve the
following revenue:

General Exchange/Mobile	6,650,000
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Toll/WATS	3,487,000
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Private Line	906,000
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<u>\$12,293,000</u>

As a result of the FCC's recent represcription of straight line SLELG depreciation rates, total additional revenue requirements have been reduced to \$12,254,000. The Commission, after review of the terms of the Stipulation, finds that it is reasonable and should be approved and slightly modified by the recent represcription.

The cost of maintaining the plant records and producing the service life, salvage and cost of removal studies required the support of individual company SLELG and SLRL rates would be excessive in relation to the benefit derived for many of the smaller telephone companies. Such costs are not necessary because surrogate rates that fairly represent service lives of the plant of the smaller companies can be derived from the records and studies pertaining to the comparable exchanges of SWB, GTE and others.

If those smaller companies are not authorized the use of the same SLELG and SLRL rates as are authorized for SWB, there will not only be an underrecovery of capital investment but also inequities in toll settlements. If only SWB was authorized the use of SLELG and SLRL rates, independent companies would be denied the opportunity to recover depreciation expenses at a higher rate comparable to SWB with which they share toll revenues.

In the Commission's opinion the independent telephone companies which cannot maintain plant records and produce the service life, salvage and cost removal studies required to support their own SLELG and SLRL rates and which desire to use such methods, should cooperate with the Commission's Staff in developing appropriate surrogate rates from the records and studies of the companies which have such records and studies.

Although SLELG and SLRL rates should be approved for use by Missouri telephone companies the request of the Staff is reasonable in seeking a requirement that either or both methods be used on an all accounts or nothing basis. The use of dual depreciation systems by the same company, on a selected account basis would unnecessarily complicate the record keeping and monitoring of the company's depreciation accounts.

Conclusions

The Missouri Public Service Commission has arrived at the following conclusions:

The utilities involved in this proceeding are telephone corporations and public utilities which are subject to the jurisdiction of this Commission under chapters 386 and 392, RSMo 1978.

The Commission may, of its own motion, investigate or make inquiry, in a manner to be determined by it, as to any act or thing done or admitted to be done by any telephone corporation, subject to its supervision and the Commission shall make such inquiry in regard to any act or things done or omitted to be done by any such public utility in violation of any provision of law or in violation of any order or decision of the Commission. Section 386.330(1), RSMo 1978.

The Commission has the power to require any or all telephone corporations to carry a proper and adequate depreciation account in accordance with such rules and regulations and forms of account as the Commission shall prescribe. Section 392.280, RSMo 1978.

The Commission has by rule adopted the Uniform System of Accounts for Class

A and B Telephone Companies and all amendments thereto. 4 CSR 240-30.040(1).

This Commission's rules permit the use of SLRL and SLELG, and the same are consistent with the statutory directive that this Commission follow the Uniform System of Accounts for a telephone corporation as nearly as may be. Section 392.210(2), RSMo 1978.

When the competent and substantial evidence demonstrates that SLELG and SLRL are consistent with the goal and purpose of depreciation accounting and policy they should be adopted for use by Missouri telephone companies.

The parties have stipulated as to how any revenue requirement should be recovered herein. For rate-making and rate design purposes, the Commission may accept a reasonable stipulation on any contested matter submitted by the parties. Section 536.060, RSMo 1978.

The objections of SWB and others to certain portions of Exhibit 29 are hereby sustained.

The hearsay objection to Exhibit 36 is hereby sustained and Exhibit 36 is received for the limited purpose of portraying what was stated and not for the purpose of establishing the truth of the contents of the statement.

The Public Counsel has raised the issue of the authority sought being prohibited retroactive ratemaking. The use of SLELG and SLRL depreciation techniques will not result in retroactive ratemaking since those rates are applied prospectively to that portion of the investment in plant currently providing service which has not yet been recovered.

It is, therefore,

ORDERED: 1. That the straight-line equal life group procedure is approved in this jurisdiction for Class A and B Missouri telephone utilities.

ORDERED: 2. That should the Class A and B Missouri jurisdictional telephone companies desire to use straight-line equal life group depreciation procedures they shall be applied to all accounts.

ORDERED: 3. That the use of straight-line remaining life depreciation

technique is hereby approved for Missouri Class A and B jurisdictional telephone utilities.

ORDERED: 4. Those Missouri Class A and B jurisdictional telephone companies desiring to use straight-line remaining life depreciation techniques shall use those procedures on all accounts.

ORDERED: 5. That those Class A and B Missouri jurisdictional telephone utilities who do not wish, or lack the capacity to implement the straight-line equal life group procedures or straight line remaining life techniques, will be permitted to continue to utilize the straight-line vintage group procedure and the whole-life technique.

ORDERED: 6. That independent telephone companies which cannot maintain the plant records and produce the service life, salvage and cost of removal studies required to support their own straight-line equal life group and straight line remaining life rates in an economical manner and which desire to use such methods shall cooperate with the Commission Staff in developing appropriate surrogate rates from the records and studies of Southwestern Bell Telephone Company, General Telephone Company and other companies which have such records and studies.

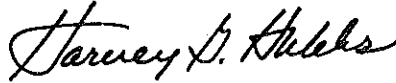
ORDERED: 7. Prior to implementing or using surrogate rates based on studies and records of other companies, the independent companies shall submit those proposed rates for approval by the Commission.

ORDERED: 8. That Southwestern Bell Telephone Company is authorized to file, for Commission approval, revised tariffs to increase its Missouri jurisdictional gross annual telephone revenues by approximately \$12,254,000.

ORDERED: 9. That the tariffs filed by Southwestern Bell Telephone Company shall embody the rate design approved herein.

ORDERED: 10. That this Report and Order shall become effective on the 7th day of October, 1982.

BY THE COMMISSION



Harvey G. Hubbs
Secretary

(S E A L)

Fraas, Chm., Shapleigh and
Musgrave, CC., Concur and certify
compliance with the provisions of
Section 536.080, RSMo 1978.
McCartney, C., Not Participating.
Dority, C., Absent.

Dated at Jefferson City, Missouri,
this 17th day of September, 1982.