

combinations are of major interest when considering systems of book depreciation currently being used.

Concepts of Depreciation

Three options are available when defining the concept of depreciation. These include (a) physical condition, (b) decrease in value, or (c) cost of operation. Though all have been used by utilities to determine book value, the cost of operation is, with few exceptions, the concept in current use.

Physical condition is, perhaps, the first option a lay person would think of if asked to define depreciation. An early reference to the relationship between depreciation and physical condition is from the 1588 textbook by John Mellis who referred to a debit to the profit and loss account because "implements of household I doe find at this day to be consumed and worn." A later reference is in the 1833 annual report of the Baltimore and Ohio Railroad, which reported that an annuity was established "to provide for the replacement of oak sills and sleepers and yellow pine string-pieces."

Two problems arise when using the concept of physical condition as a measure of depreciation. First, wear and tear do not account for all retirements; in fact, they are often a minor reason for the retirement of property. Second, physical condition can be difficult to measure. Though it is possible to measure directly the wear of railroad track and the corrosion of cast iron pipe, easily measurable wear is not characteristic of most industrial property.

The concept of loss of value is also a common depreciation concept, and the lay person often uses it to explain the difference between the purchase price and the current market value of an automobile or major household appliance. The definition from the Supreme Court case *Lindheimer v. Illinois Bell Telephone* (1934) is often quoted: "Broadly speaking, depreciation is the loss, not restored by current maintenance, which is due to all the factors causing the ultimate retirement of the property. These factors embrace wear and tear, decay, inadequacy, and obsolescence."

In contrast to the concept of physical depreciation, the Lindheimer definition recognizes that factors other than wear and tear cause or contribute to the retirement of property. The definition refers to the "loss" but does not clearly state what is "lost" or how the "loss" should be measured. A 1935 definition by the Federal Communications Commission was similar to the Lindheimer definition but referred to "loss in service value," where service value is equated to the original cost less salvage.

Use of the concept of loss of value to determine annual depreciation charges might imply the need for an annual valuation of the property owned by the organization, particularly if the rate of loss in value was not

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