COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

APPLICATION OF ALLIED TELEPHONE COMPANY OF KENTUCKY, INC. FOR AN ORDER IMPLEMENTING A DIRECT SALES PROGRAM RELATING TO ITS TELEPHONE INSTRUMENTS	)	CASE NO. 8456

INTERIM ORDER

On January 26, 1982, Allied Telephone Company of Kentucky, Inc., ("Allied," formerly Echo Telephone Company) filed with the Commission its tariff proposing to implement a direct sales program of telephone instruments. Allied proposed a direct sales program in which it would limit its residential and business telephone tariff offerings to those instruments currently in inventory. Allied would continue to offer these instruments on a tariffed, lease basis and provide repair service as long as existing inventory is available. Additionally, Allied would offer on a continuing basis, pursuant to tariff, no customer premises equipment other than basic 500 type, rotary dial or pushbutton desk telephone instruments. Allied would offer for sale to business and residential customers customer premises equipment from existing inventory at negotiated prices not to be below 125 percent of weighted net book value. Maintenance and warranties provided for equipment sold would be on an unregulated basis.

Additionally, Allied proposed to market, through direct sales, customer premises equipment which it would purchase for such use. This equipment would be sold outright to purchasers. Allied would offer maintenance on these instruments on an unregulated, competitive basis.

DISCUSSION

Allied's proposal raises several issues which must be addressed. The first is that this proposal represents a departure from traditional telephone utility regulation. To the extent that Allied would no longer maintain customer premises equipment on a tariffed basis, subscribers would no longer be assured of an orderly, regulated end-user to end-user telecommunication system. However, the Commission is well aware that this orderly system does not necessarily exist now, since subscribers already have the option of supplying their own terminal equipment. Additionally, the Federal Communications Commission ("FCC"), in its Computer II Inquiry, has proposed that terminal equipment not in place as of January 1, 1983, be deregulated.

The Commission recognizes the following advantages to Allied's proposal, that being to limit or reduce its inventory of customer premises equipment and to offer for sale the existing inventory:

(1) Allied would be able to satisfy the desire of customers to purchase their own phones, a desire which is obvious given the availability of other suppliers;

(2) Under proposed changes to the separations manual, used by Allied and other telephone utilities to divide toll revenues, terminal equipment will become a greater burden to the intrastate jurisdiction. The limitation on new purchases and sale of inventory equipment will help to alleviate this burden; and

(3) Following the appropriate accounting treatment as set out in the Uniform System of Accounts, Allied's rate base will be reduced by any net gain derived from the sale of current inventory equipment. To the extent this occurs, basic service ratepayers will benefit in the future from a lower rate base.

Allied proposes to continue offering basic, desk telephone instruments on a tariffed, lease basis. This should insure availability of end-to-end basic telephone service to subscribers.

The sale of new equipment on an unregulated basis raises a more serious question. Allied believes that this program will provide it a head start in meeting competition and will be beneficial in view of the probability of the FCC's order in its Computer II Inquiry becoming effective on January 1, 1983. The problem area is Allied's segregation of expenses and revenues attributable to direct sales.

It is clearly understood that Allied's ratepayers do not stand to benefit from any profits if the unregulated business is successful. Therefore, it must be equally understood that those ratepayers should not subsidize the unregulated business in any way, nor should they be responsible for any losses which may occur. Additionally, ratepayers should benefit in the future to the extent that the regulated business will be less risky; competitive terminal equipment, with its attendant risk, will eventually be phased out of the regulated business. The Commission is especially concerned that, although certain expenses and facilities may be shared between the regulated and unregulated enterprises, the potential exists for Allied to incur expenses at a greater absolute level and thus destroy any benefits of sharing expenses and facilities for the regulated enterprise and ultimately its ratepayers. The issue of allocation of costs cannot be settled completely until specific procedures have been developed, approved and implemented.

The Commission accepts Allied's proposal to sell terminal equipment. Further Allied will be given a period of 4 months in which to develop specific procedures for proper cost allocations between the regulated and unregulated portions of its operations. At the end of that period, the Commission will conduct a thorough and careful review of Allied's procedures to determine their reasonableness. Following that review, and public hearing if necessary, a final order in this matter will be issued, at which point Allied may be required to make retroactive adjustments to its books if any allocation procedures are found unreasonable. The Commission has determined certain guidelines, specified in the findings of this order, which should be adhered to by Allied in developing its allocation procedures.

FINDINGS AND ORDER

The Commission, having considered this matter and being advised, is of the opinion and finds that:

(1) Allied's proposal to limit its present inventory of terminal equipment and continue to lease telephones from that inventory on a tariffed basis only while such inventory remains above the minimum level necessary for replacement of leased, in-place equipment is reasonable and should be approved.

(2) Allied's proposal to continue offering on a tariffed, lease basis basic 500 type, rotary dial or pushbutton desk telephones is reasonable and should be approved.

(3) Allied's proposal to sell instruments from current inventory or on an in-place basis, at negotiated prices which shall not be below 125 percent of weighted net book value is reasonable and should be approved;

(4) Allied should follow the Uniform System of Accounts in recording receipts and expenditures in connection with the sale of current inventory equipment;

(5) Allied's proposal to market, on a detariffed basis, future inventory purchases of customer premises equipment is

reasonable and should be approved, subject to the condition that Allied develop specific procedures for cost allocation subject to the following guidelines:

(a) The allocation of employee time should be based either on an accounting of <u>all</u> time, or in the alternative, that the proposed process be reversed. Time studies would be used to allocate time spent in the regulated business, with all other time, including idle time, being charged to the unregulated portion of the business;

(b) Any costs of training or hiring of new personnel prior to this order in anticipation of this program should be fully allocated to the unregulated business;

(c) A minimum monthly rental of warehouse, business office, and retail outlet space should be charged to the unregulated business, with additional rental insurance, security, and costs of site selection and negotiation charged based on sales revenues, according to current leasing prices and practices;

(d) Phonecenter advertising costs should be allocated to the unregulated business;

(e) Financing costs of potential deferred instrument payment plans should be allocated to the unregulated business;

(f) Where doubt of proper cost allocation exists, the allocation should be made to the unregulated portion of the business.

(6) Allied should be given a period of 4 months to develop specific cost allocation procedures using these guidelines, after which those procedures should be filed with the Commission for review.

IT IS THEREFORE ORDERED that, effective with the date of this order, Allied be and it hereby is authorized to limit its inventory of terminal equipment in accordance with findings no. (1) and (2) of this order.

IT IS FURTHER ORDERED that, effective with the date of this order, Allied be and it hereby is authorized to offer for sale customer premises equipment from its current inventory in accordance with findings no. (3) and (4) of this order.

IT IS FURTHER ORDERED that, effective with the date of this order Allied be and it hereby is authorized to market, on a detariffed basis, future inventory purchases of customer premises equipment in accordance with findings no. (5) and (6) of this order.

IT IS FURTHER ORDERED that Allied shall maintain its accounts for new customer premises equipment according to the amendment to part 31 of the Uniform System of Accounts for Class A and B Telephone Companies, as set out in the FCC's order in Docket No. 79-105, released March 31, 1981.

IT IS FURTHER ORDERED that subaccounts under Miscellaneous Income-Account 31.316 shall be kept in sufficient detail to show the following categories of expense with respect to the sale of non-tariffed, non-rate base equipment;

1. Canvassing and demonstrating non-tariffed telephone equipment for the purpose of selling or leasing.

2. Demonstrating and selling activities in sales room.

3. Installing non-tariffed leased or customer-owned equipment.

4. Preparing advertising materials for non-tariffed equipment lease or sales purposes.

5. Receiving and handling orders for the sale, lease, installation and maintenance of customer-owned or leased non-tariffed telephone equipment.

6. Cleaning and tidying sales rooms.

7. Maintaining display counters and other equipment used in non-tariffed telephone equipment merchandising.

8. Arranging merchandise in sales room and decorating display windows.

9. Reconditioning repossessed and returned non-tariffed equipment.

10. Bookkeeping and other clerical work in connection with non-tariffed telephone equipment sales and leasing activities.

11. Supervising non-tariffed telephone equipment sales and leasing activities.

12. Repair and maintenance of customer-owned or leased non-tariffed equipment.

13. Advertising in newspapers, periodicals, radio, television, etc.

14. Cost of merchandise sold and of materials used.

15. Storage expenses on non-tariffed telephone equipment stocks held for sale or lease.

16. Fees and expenses of advertising and commercial artists' agencies.

17. Printing booklets, dodgers, and other advertising data.

18. Premiums given as inducement to buy or lease non-tariffed telephone equipment.

19. Light, heat and power.

20. Depreciation on equipment used for installation, repair or maintenance of customer-owned or leased non-tariffed telephone equipment.

21. Rent of sales rooms or of equipment.

22. Transportation expense in delivery and pick-up of customer-owned or leased non-tariffed equipment.

23. Stationery and office supplies and expenses.

24. Losses from uncollectible accounts associated with the sale and lease of non-tariffed telephone equipment.

25. Any other pertinent categories of expense.

IT IS FURTHER ORDERED that within 20 days of the date of this order, Allied shall file its tariff concerning the sale of current inventory terminal equipment in accordance with the regulations of the Commission.

Done at Frankfort, Kentucky, this 27th day of May, 1982.

PUBLIC SERVICE COMMISSION

Marlin M. Volz
Chairman

Katherine Randall
Vice Chairman

Commissioner

ATTEST:

Secretary