COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

* * * * *

In the Matter of:

APPLICATION OF GENERAL TELEPHONE COMPANY OF KENTUCKY FOR AN ORDER IMPLEMENTING A DIRECT SALES PROGRAM RELATING TO ITS SINGLE LINE TELEPHONE INSTRUMENTS	)))))	CASE NO. 8258

INTERIM ORDER

On June 12, 1981, General Telephone Company of Kentucky ("General") filed with the Commission its application for authority to implement a direct sales program of its single line telephone instruments. General proposed to implement a direct sales program in which it would limit its current single line telephone tariff offerings to those instruments currently in inventory. General would continue to offer these instruments on a tariffed, lease basis and provide repair service thereon as long as existing inventory is available. The inventory of such offerings would not be supplemented by purchases of new instruments but only by refurbishing of existing instruments recovered through outward movement. Current customers would be permitted to purchase these instruments on an in-place or outward movement basis. Customers could also purchase refurbished instruments when available. Any telephone instruments purchased under this procedure would be guaranteed by General for a 30-day period.

In addition to the program outlined above, General proposed to market, through direct sales, single line instruments which it would purchase for such use. These instruments would be sold outright to purchasers, and would be warranted for a period of up to 12 months. General would offer maintenance on these instruments after expiration of the warranty on an unregulated, competitive basis.

A hearing was held on September 17, 1981, in the offices of the Public Service Commission at Frankfort, Kentucky. At that time, General filed tariffs proposing to make its program effective October 1, 1981. These tariffs were suspended until March 1, 1982. At the hearing, all parties of interest were allowed to be heard. The Consumer Protection Division of the Attorney General's Office intervened on behalf of consumers.

DISCUSSION

General'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 General would no longer maintain single line instruments 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 the first portion of General's proposal, that being to cap its inventory of single line instruments and to offer for sale the existing inventory:

(1) General 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 General and other telephone utilities to divide toll revenues, terminal equipment will become a greater burden to the intrastate jurisdiction. The capping 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, General'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.

For these reasons, the Commission will accept the first portion of General's proposal. However, unless and until the FCC's order in its Computer II inquiry becomes effective, this Commission has a definite responsibility to insure the availability of end-to-end basic telephone service to subscribers. Therefore, General should be required to offer one basic telephone (Model 80E Desk Rotary) on a tariffed, lease basis until the FCC order is effective.

The second part of General's proposal, which is to sell single line telephone equipment on an unregulated basis, raises a more serious question. General 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 General's plan to segregate expenses and revenues attributable to direct sales.

It is clearly understood by all parties involved that General's ratepayers do not stand to benefit from any profits if the unregulated business is successful. Therefore, it must be equally understood by all parties that those ratepayers should not subsidize the unregulated business in any way, nor should those ratepayers 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 since competitive single line terminal equipment, with its attendant risk, will eventually be phased out from 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 General 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.

General did not provide a satisfactory explanation of its plans to allocate the expenses of its unregulated sales program, perhaps because General does not have sufficient experience at this time in unregulated selling. However, no matter what the reason, the issue of allocation of costs can not be settled completely until specific procedures have been developed, approved, and implemented.

The Commission accepts General's proposal to sell single line terminal equipment. Further, General 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 General's procedures to determine their reasonableness. Following that review, and further public hearing if necessary, a final order in this matter will be issued, at which point General 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 General 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) General's proposal to cap its present inventory of single line 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,

with the exception that General should continue to carry and lease one type of basic telephone (Model 80E Desk Rotary) on a tariffed basis until such time as this Commission no longer has jurisdiction over such terminal equipment offerings;

(2) General's proposal to attempt to sell instruments from current inventory or on an in-place basis, at price levels ranging from 25 percent to 100 percent above weighted net book value per unit, in accordance with General's filing of September 17, 1981, is reasonable and should be approved. The minimum price at which General is authorized to sell in-place single line equipment is 25 percent above weighted net book value per unit;

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

(4) General's proposal to market, on a detariffed basis, future inventory purchases of single line terminal equipment is reasonable and should be approved, subject to the condition that General 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 all 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 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, with the exception of the portions of such advertising related to multi-line systems;

(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.

(5) General 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, General be and it hereby is authorized to cap its inventory of single line terminal equipment in accordance with finding no. (1) of this order.

IT IS FURTHER ORDERED that, effective with the date of this order, General be and it hereby is authorized to offer for sale single line instruments from its current inventory in accordance with findings no. (2) and (3) of this order.

IT IS FURTHER ORDERED that, effective with the date of this order, General be and it hereby is authorized to market, on a detariffed basis, future inventory purchases of single line terminal equipment in accordance with findings no. (4) and (5) of this order.

IT IS FURTHER ORDERED that General shall maintain its accounts for new terminal 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 Federal Communication Commission'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 nontariffed 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 rooms 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. Stores 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, General shall file its tariffs concerning the sale of current inventory single line terminal equipment in accordance with the regulations of the Commission.

Done at Frankfort, Kentucky, this 1st day of March, 1982.

By the Commission

ATTEST

Secretary

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, General shall file its tariffs concerning the sale of current inventory single line terminal equipment in accordance with the regulations of the Commission.

Done at Frankfort, Kentucky, this 1st day of March, 1982.

PUBLIC SERVICE COMMISSION

Marlin M. Volz
Chairman

Katherine Randall
Vice Chairman

Commissioner

ATTEST:

Secretary