

Decision 82 12 067 DEC 15 1982

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of THE PACIFIC TELEPHONE )  
AND TELEGRAPH COMPANY for )  
authorization to transfer specified )  
property to American Bell Inc., a )  
subsidiary of the American Telephone )  
and Telegraph Company. )

Application 82-08-13  
(Filed August 4, 1982)

(Appearances are listed in Appendix A.)

OPINION - TRANSFER PHASE

This application is the first of a series which this Commission must process because of changes to the U.S. telecommunications industry flowing either from United States v American Tel. & Tel. Co. et al.<sup>1</sup> or from various orders of the Federal Communications Commission (FCC).

In a proceeding generally referred to as the Second Computer Inquiry,<sup>2</sup> the Bell System and its operating telephone companies, including The Pacific Telephone and Telegraph Co. (Pacific) may not provide new customer premise equipment (CPE) on and after January 1, 1983. From that date, new CPE must be offered on a nontariffed basis through a fully separated subsidiary.<sup>3</sup>

<sup>1</sup> Civil Nos. 74-1698 et al., U.S. District Court for the District of Columbia: see Court's opinion filed August 11, 1982.

<sup>2</sup> Docket 20828, 77 FCC 2d 384 (1980), modified 84 FCC 2d 50 (1980) and 88 FCC 2d 512 (1981).

<sup>3</sup> To be more specific, Pacific may continue purchasing new CPE for sale or lease until the end of the year. Equipment thus purchased, as well as used and refurbished CPE, is considered "embedded" and may be offered by Pacific after December 31, 1982. After that date Pacific may not purchase new CPE to offer it to the public under its tariffs. Under the District Court's opinion, Bell System operating companies may reenter the CPE market at a later date. No party claims that this reentry proviso is relevant to this present proceeding.

American Telephone and Telegraph Company (AT&T), the parent Bell System Company, has formed American Bell Inc. (AmBell) for this purpose. AmBell is incorporated in Delaware and is qualified to do business in California.

This application's purpose is to obtain Commission authorization to transfer a portion of Pacific's PhoneCenter properties (consisting of leases and property improvements) from Pacific to AmBell as of the end of the year. The application does not include the transfer of any CPE. The application states that Pacific will be compensated for the transferred property by receiving AmBell stock with a value equaling the adjusted net book value of the property. The stock will then be transferred to AT&T.

A prehearing conference was held before Administrative Law Judge (ALJ) Meaney on September 30, 1982, at which time the parties agreed that the application could be bifurcated: the first phase, consisting of transfer of the assets, and the second phase, with hearings in 1983, dealing with all problems relating to valuation of the assets for ratemaking purposes.

A hearing was held on November 8 and 9, 1982, after which the transfer phase of the application was submitted.

Gerald R. Mutz, a division staff manager in charge of PhoneCenter store operations, testified in support of the application. He explained that since Pacific cannot provide new CPE after the end of 1982, there will be a surplus of PhoneCenter locations. Since Pacific may still provide customers with embedded CPE and because PhoneCenter properties have certain other uses, Pacific selected some of its 150 PhoneCenters for retention.

After discussions between AmBell and Pacific, 64 stores were selected for transfer. The witness said that since Pacific will continue to provide basic exchange service and serve the embedded base customer, certain PhoneCenter locations were retained to augment Pacific's residence service centers.

Those selected for transfer are principally the prime retail locations such as centers located in shopping malls. Witness Mutz explained that this was not for the purpose of transferring the good locations and keeping the poor ones.

"American Bell will use PhoneCenters as detariffed retail outlets for terminal products. These stores will be part of the Consumer Products Division (CPD) of American Bell Inc. The Consumer Products Division will have to rely on conventional techniques to attract customers to their stores. [Stricken matter omitted.] On the other hand, Pacific Telephone will be primarily using PhoneCenters as a cost effective method by which customers can establish or make changes in their telephone service, so prime retail locations attracting 'walk-in' traffic will not be as important in the future. Furthermore, prime retail locations demand premium rents. The monthly leasing charges in primary shopping malls are significantly higher than the rent in other PhoneCenter locations. Relinquishing stores in malls will allow Pacific to maintain a less costly set distribution system in 1983. The premium customer access provided by shopping mall locations is only cost justified because of the profit margins associated with new equipment sales. After 1/1/83 and, without these sales, the marginally better retail locations with their prime volume access do not justify the much higher cost." (Exh. 1, p. 5.)

On cross-examination the witness stated that the retained locations are principally spaces in Pacific's own buildings which can be used for multiple purposes.

Staff counsel questioned whether Pacific made an adequate attempt to obtain maximum value for the leases which are being transferred, and whether Pacific should have made an effort to see if other businesses would be willing to pay more for them. Mutz testified that such stratagem would not work with short-term leases

of three to five years duration, and, in any event, in the usual commercial lease, the landlord has the right to approve any sublease or assignment.<sup>4</sup>

Mutz stated that either the nontransferred PhoneCenter properties or existing Bell Customer Service Centers will adequately serve the needs of customers other than selling new CPE (including such functions as service negotiation, credit applications, defective equipment replacement, and providing embedded CPE). Of the retained locations, some are high volume and in the witness' opinion these will be less expensive to operate than the stores being transferred.

Mutz further testified that since Pacific cannot acquire new CPE after the end of the year, inventory will dwindle and company forecasts indicate that by the end of 1983 Pacific will be "restricted to selling or leasing returned/refurbished equipment in these product categories as they become available." (Exh. 1, p.7.) This projected shortage supports release of the PhoneCenter sites to AmBell, according to the witness.

Regarding marketing practices after 1982, Mutz testified that Pacific's name and logo will clearly identify Pacific's own stores and that after 1982 customers would not be referred to non-Pacific stores.

On cross-examination the witness said that geographic coverage was considered and locations were selected for transfer when another center was within several miles.

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<sup>4</sup> This cross-examination produced a dispute on whether Pacific had drafted a standard lease, or whether the leases were drafted by the landlords. The ALJ ordered the leases to be produced in the hearing room. A spot-check of them showed the latter to be the case, with, in some instances, appendixes modifying the terms or adding terms. The appendixes appear to have been the product of negotiation.

Mutz also testified that as a result of the transfer, personnel changes would occur. Approximately 500 service representatives would move from PhoneCenters to service centers, others will be assigned to Pacific's own stores, and customer clerks, who are trained only in sale or lease of equipment, would transfer from Pacific to AmBell.

In connection with these personnel shifts, the staff wishes to place in issue whether any capitalized training costs should be considered in determining the valuation of the property transferred. This subject will be included in the second phase of this application.

Nancy T. Ishibashi of Pacific's accounting department testified concerning the specific plant in service to be transferred (64 PhoneCenters; see Appendix to Exh. 4), and its adjusted net book value. The witness' prepared testimony was accepted at this time for the purpose of specifically identifying the property to be transferred, and cross-examination on the valuation of the property was deferred until the second phase of this proceeding.<sup>5</sup>

Michael J. Galvin, a financial examiner for the Commission staff, testified that certain accounting controls should be required if the Commission authorizes the transfer. Pacific suggested some minor modifications for clarity, to which the staff had no objection. These appear in the order.

#### Discussion

No party to the proceeding opposes the transfer. The application offers two alternatives: (1) a decision authorizing the transfer; or (2) a decision ruling that since the property is no longer necessary and useful to Pacific, no order is necessary under Public Utilities (PU) Code § 851 for the transfer to occur.

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<sup>5</sup> Staff and other parties contend that a fair market value or going-concern value, rather than book value, should be assigned. This is the principal issue for the second phase.

Alternative 1 is the proper course. We disagree with interested party Webb that this situation is the same as when a utility disposes of old surplus property.<sup>6</sup> The property transferred here is no longer useful to Pacific not because it is surplus in the usual sense or because its useful life is at an end, but because Pacific has been ordered to divest itself of a facet of its business. As City of San Francisco and the staff point out, an actual part of Pacific's operations is proposed for transfer from Pacific to AmBell, a nonregulated entity. While PU Code § 851 permits the sale of utility property which is not necessary or useful in the performance of its duties to the public, when a utility proposes, in effect, to transfer a "piece of action," the Commission should first determine whether the property is, in fact, no longer necessary or useful and should, when necessary, attach appropriate conditions to the transfer.

We agree with staff counsel that the record is thin on geographic locations of PhoneCenters to be transferred, and maps of locations should have been provided. At the same time, we believe little if anything would be gained by delaying the transfer to assess independently the value to the public of each location. We agree with Pacific that it is appropriate to transfer the shopping mall-type locations and other high-rental properties, the chief value of which is retailing new CPE.

We also agree with Pacific that, under the particular circumstances, it is most unlikely that either Pacific or its ratepayers would benefit by an attempt on Pacific's part to transfer the leases to the highest bidder. It is sensible for Pacific to negotiate assignment of these leases by the end of the year. There

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<sup>6</sup> We have reviewed Gaynor v Pacific Tel. & Tel. Co. (unreported; Case 10284, Decision (D.) 92233, September 16, 1980; modified by D.92485, December 2, 1980) cited by the parties, and believe our opinion here to be consistent with it. ✓

would be considerable administrative effort involved in trying to market over 60 leases on widely scattered properties on any kind of "bid" basis by the conclusion of the year, especially insofar as such negotiations would have to involve the landlord for each lease, who, under most commercial leases, must approve a sublease or assignment.

The discussion in the preceding paragraph does not stand for a general rule that Pacific need not under appropriate circumstances call for competitive bids (or otherwise establish the maximum market value) of property transferred. We also caution Pacific that our acquiescence in the terms of compensation by AmBell to Pacific by no means reflects any conclusion as to the ratemaking adjustments which should properly flow from this transaction.

Staff counsel suggests that AmBell be ordered to file "voluntary" tariffs concerning prices for new CPE. We reject this suggestion because such an order would be contrary to the FCC's Second Computer Inquiry decisions which require AT&T to offer CPE on an untariffed basis beginning in 1983.

So that the transfer of the subject property may proceed on schedule, the order in this decision will be effective immediately.

By our action today, we do not ignore the recent decision of the U.S. Court of Appeals for the District of Columbia (Computer Communications Industry Association v Federal Communications Commission, slip opinion of November 12, 1982) upholding the FCC's Second Computer Inquiry decisions. Nor do we ignore the FCC's decision of November 10, 1982, approving AT&T's Supplemental Capitalization plan for AmBell (FCC 82-496). We intend, and shall direct the Commission's General Counsel, to seek review of both decisions.

We note the quite narrow scope of the preemption which the FCC has asserted in its Supplemental Capitalization decision:

27. Given that the BOCs will remove from regulated operations assets that AT&T has identified for transfer as of January 1, 1983, a standard valuation methodology must be used to record the transfer from the BOCs to AmBell. We find it essential to the implementation of Computer II that the assets subject to the proposed January 1, 1983 transfer be valued by a method approved by this Commission. Computer II implementation could be delayed if asset transfers required prior approval of a valuation methodology by each of the regulatory jurisdictions. AT&T seeks to transfer the assets at adjusted net book value. We will approve AT&T's proposed adjusted net book valuation of these assets on an interim basis to assure prompt initiation of AmBell's new CPE offerings. In our Computer II Implementation Proceeding, we are currently examining the appropriate valuation methodology to be applied to assets transferred from a carrier's regulated operations. If the valuation methodology chosen in the Implementation Proceeding is different from adjusted net book value, AT&T will be required to make retroactive adjustments. While we are prescribing the valuation methodology to be used to establish the price at which assets are transferred from the BOCs to AmBell, we are not foreclosing states from using alternative valuation methodologies for state ratemaking purposes. However, state commissions may not condition approval of the January 1, 1983 asset transfers to AmBell on AT&T's use of a different valuation methodology.

Since our action today does not condition transfer of Pacific PhoneCenter assets upon use of a particular valuation method, we are not foreclosed from issuing this decision. Nor are we foreclosed from reserving for a second phase of this case inquiries into the proper valuation method for ratemaking purposes. Short of an explicit preemption in the FCC Implementation Proceeding, we intend

to make the necessary ratemaking adjustments to protect ratepayers' interest in PhoneCenter assets<sup>7</sup> and, if preempted, we shall challenge that preemption through appropriate legal channels.

#### Conclusion

In approving the transfer of the PhoneCenter properties without further reviewing U.S. v AT&T or various orders of the FCC, we should not be taken as agreeing with all aspects of the restructuring of the telephone industry. We have supported terminal equipment competition, but we have expressed considerable reservations regarding unrestricted exchange network competition and certain other developments which we fear will make it economically difficult, if not impossible, to perpetuate universal telephone service. The scope of this proceeding is too narrow for a far-ranging discussion of such questions, which are covered at length in our filings on behalf of the people of this State in U.S. v AT&T.

#### Findings of Fact

1. Pacific presently operates approximately 150 PhoneCenter stores in California, some of which are in prime retail locations.
2. Some of these PhoneCenter stores, principally those in prime retailing locations, will not be necessary or useful to Pacific's telephone utility functions on and after January 1, 1983, because the FCC has ordered AT&T to cease furnishing to the public new CPE, either directly or through its local operating telephone companies. Only "embedded" CPE may be provided after 1982 (see footnote 3); otherwise, new CPE must be sold or otherwise offered to the public on an untariffed basis through a fully separated subsidiary.
3. For the purpose of complying with the FCC's orders, AT&T has formed AmBell, a Delaware corporation qualified to do business in California. AmBell is not a public utility.

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<sup>7</sup> See Democratic Central Committee v Washington Metropolitan Transit Commission, 485 F 2d (D.C. Cir. 1973).

4. The process of selecting which stores to transfer was reasonable; and considering the terms of the leases and time constraints, Pacific was not required to offer the leases to the highest bidder.

5. Pacific's request to transfer 64 PhoneCenter properties to AmBell at the end of this year is reasonable.

Conclusions of Law

1. The application should be granted, subject to the conditions in the order.

2. All issues relating to valuation should be reserved for a later decision, after hearings on such issues.

ORDER - TRANSFER PHASE

- IT IS ORDERED that:

1. Pacific is authorized, on or after January 1, 1983, to transfer to AmBell the leases and property associated with the 64 PhoneCenter stores enumerated in the appendix to Exhibit 4, subject to the conditions which follow.

2. Within 60 days after the consummation of any authorized transfer, Pacific shall file a copy of each journal entry used to record the transfer of assets and liabilities on its books, and a list of assets and liabilities actually transferred to AmBell.

3. Pacific shall retain copies of the PhoneCenter leases assigned to AmBell, until the Commission, by resolution, authorizes their destruction.

4. Pacific shall retain all accounting records pertaining to the assets and liabilities transferred to AmBell, and historical employee data on employees transferred to AmBell, until the Commission, by resolution, authorizes the destruction of such records, provided that Pacific may furnish copies of the records to AmBell, and may allow AmBell access to them.

5. Pacific shall track all relocation expenses and inventory reallocation expenses caused by or related to the transfer of PhoneCenter stores and personnel.

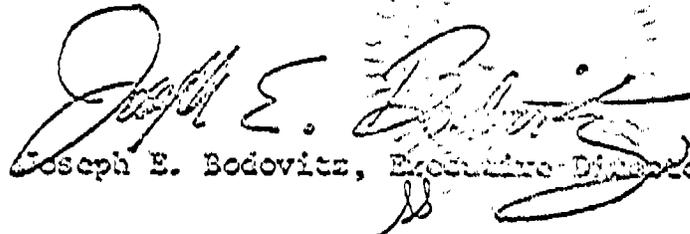
6. Determination of the valuation of assets transferred is reserved for a later decision after hearings on that issue, and this proceeding remains open for that purpose.

This order is effective today.

Dated December 15, 1982, at San Francisco, California.

JOHN E. BRYSON  
President  
RICHARD D. GRAVELLE  
LEONARD M. GRIMES, JR.  
VICTOR CALVO  
PRISCILLA C. CREW  
Commissioners

I CERTIFY THAT THIS DECISION  
WAS APPROVED BY THE ABOVE  
COMMISSIONERS TODAY.

  
Joseph E. Bodovitz, Executive Director

APPENDIX A

List of Appearances

Applicant: William F. Anderson and Duane Henry, Attorneys at Law, for The Pacific Telephone and Telegraph Company.

Interested Parties: Brobeck, Phleger & Harrison, by William H. Booth and Richard C. Harper, Attorneys at Law, for Tele-Communications Association; Antone S. Bulich, Jr. and Allen R. Crown, Attorneys at Law, for California Farm Bureau Federation; A. M. Hart, H. R. Snyder, Jr., Kenneth K. Okel, by Kenneth K. Okel, Attorney at Law, for General Telephone Company of California; William L. Knecht, Attorney at Law, for himself; Pelavin, Norberg, Harlick & Beck, by Alvin H. Pelavin and William R. Haerle, Attorneys at Law, for Calaveras Telephone Company, Capay Valley Telephone System, Inc., Dorris Telephone Company, Ducor Telephone Company, Evans Telephone Company, Foresthill Telephone Company, Happy Valley Telephone Company, Hornitos Telephone Company, Kerman Telephone Company, Livingston Telephone Company, Mariposa County Telephone Company, Pinnacles Telephone Company, Ponderosa Telephone Company, Sierra Telephone Company, Siskiyou Telephone Company, and Volcano Telephone Company; Thelen, Marrin, Johnson & Bridges, by Robert B. Pringle, Attorney at Law, for American Bell Inc.; Leonard R. Snalder, Attorney at Law, and Robert R. Laughead, P.E., for the City and County of San Francisco; Sidney Webb, for himself; and Graham & James, by Boris H. Lakusta, David J. Marchant, Thomas J. MacBride, and Ann C. Pongracz, Attorneys at Law, for California Hotel and Motel Association.

Commission Staff: Rufus G. Thayer, Attorney at Law, Michael J. Galvin, and Dean J. Evans.

(END OF APPENDIX A)

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4. The process of selecting which stores to transfer was reasonable; and considering the terms of the leases and time constraints, Pacific was not required to offer the leases to the highest bidder.

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1. The application should be granted, subject to the conditions in the order.

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4. Pacific shall retain all accounting records pertaining to the assets and liabilities transferred to AmBell, and historical employee data on employees transferred to AmBell, until the Commission, by resolution, authorizes the destruction of such records, provided that Pacific may furnish copies of the records to AmBell, and may allow AmBell access to them.

5. Determination of the valuation of assets transferred is reserved for a later decision after hearings on that issue, and this proceeding remains open for that purpose.

This order is effective today.

Dated DEC 15 1982, at San Francisco, California.

JOHN E. BRYSON  
President  
RICHARD D. GRAVELLE  
LEONARD M. GRIMES, JR.  
VICTOR CALVO  
PRISCILLA C. GREW  
Commissioners