ALJ/jt

ORIGINAL

Decision 83 09 024 SEP 7 1983

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY, a corporation, for authority to increase certain intrastate rates and charges applicable to telephone services furnished within the State of California.	Application 59849 (Filed August 1, 1980; amended August 28, 1980 and October 14, 1980)
In the Matter of the Application of THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY, a corporation, for authority to increase certain intrastate rates and charges applicable to telephone services furnished within the State of California.	Application 59269 (Filed November 13, 1979; amended November 15, 1979)
Re Advice Letter (PT&T) No. 13640 to reprice certain telephone terminal equipment and Resolution No. T-10292 granting approval of said changes.	Application 59858 (Filed August 1, 1980)
In the Matter of Advice Letter Filing No. 13641 of THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY for authority to increase certain rates for key telephone service by $30.1 million.	Application 59888 (Filed August 19, 1980)
Investigation on the Commission's own motion into the rates, tolls, rules, charges, operations, costs, separations, inter-company settlements, contracts, service, and facilities of THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY, a California corporation; and of all the telephone corporations listed in Appendix A, attached hereto.	OII 63 (Filed December 18, 1979)

Investigation on the Commission's own motion into the rates, tolls, rules, charges, operations, costs, separations, inter-company settlements, contracts, service, and facilities of THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY, a California corporation; and of all the telephone corporations listed in Appendix A, attached hereto.	)	OII 81 (Filed August 19, 1980)
Investigation on the Commission's own motion into the Matter of Revision of the Accounting for Station Connections and related Ratemaking Effects and the Economic Consequences of Customer-owned Premise Wiring.	)	OII 84 (Filed December 2, 1980)
Application of THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY for authority to increase and reduce certain intrastate rates and charges and establish certain new rates applicable to telephone services furnished within the State of California.	)	Application 82-10-23 (Filed October 12, 1982)

(See Decisions 93367, 93728, and 82-08-077 for appearances.)

Additional Appearances

Arthur G. Closson, for Perimeter Security & Sound, Inc.; Bart Kinne, for Xerox Palo Alto Research Center, Xerox Corporation; and Michael Sauvante, for Interconnect Options, interested parties.

INDEX

Subject	Page
INTERIM OPINION ON SALE OF STAND-ALONE 1A KEY TELEPHONE EQUIPMENT	3
I. BACKGROUND	4
II. THE COMMISSION'S AUTHORITY TO REQUIRE SALE OF TELEPHONE EQUIPMENT	5
A. Positions of Parties	6
B. Discussion	9
III. STAFF PROPOSAL FOR SALE OF 1A KEY SYSTEMS	14
A. Staff Justification for Requiring a KTS Sales Program	15
B. Implementation Procedures and Customer Options	16
C. Cost Analysis and Pricing	18
D. Deferred Matters	20
IV. CRITICISM OF THE STAFF PROPOSAL	20
A. Pacific's Position	20
1. Implementation Procedures and Customer Options	21
2. Cost Analysis and Pricing	22
B. CIA's Position	23
C. General's Position	25
D. Staff Acceptance of Pacific Plan with Exceptions	26
V. DISCUSSION	27
A. Should the Commission Require Pacific To Offer 1A Key Equipment for Sale to Customers on a Tariffed Basis in 1983?	27
B. Should the Staff Exceptions to Pacific's Plan be Adopted?	32
1. Pricing Factor	32
2. Installment Payment Plans	34
3. Warranty Terms and Options	34
4. Disposition of Inside Wiring	35
5. Projected Take Rate	37
6. Deferred Matters	40
C. How Should Sales Prices for Key Telephone Systems be Determined?	41
1. Formula for Cost Estimation	41
2. Estimated Unit Costs	42
3. Transaction Costs	44
4. Prices for Sale of In-Place Systems	46
5. Pricing for Sales from Inventory	48
6. Pricing of Other Activities	48

I N D E X

Subject	Page
D. Would a Sales Program Based on the Terms Stated Above Have Unacceptable Effects on Competition?	49
E. What Should be Required of Other Telephone Companies?	53
F. How Will Implementation of a KTS Sales Program Be Affected By the Transfer of Pacific's KTS Assets to AT&T?	54
VI. SALE OF ADDITIONAL MULTI-LINE EQUIPMENT	54
Findings of Fact	58
Conclusions of Law	63
INTERIM ORDER	64
APPENDIXES	

INTERIM OPINION ON SALE OF STAND-ALONE
1A KEY TELEPHONE EQUIPMENT

This decision requires The Pacific Telephone and Telegraph Company (Pacific) to institute a program offering its existing stock of stand-alone 1A key telephone equipment for sale to its customers and to file tariffs with this Commission setting forth prices and conditions of sale for that equipment consistent with the terms set forth in this opinion and the accompanying order. This decision determines that the Commission has the authority to require Pacific to institute such a sales program as a regulatory response to current and impending changes in the telecommunications marketplace, and that this action neither conflicts with federal regulatory jurisdiction nor disrupts the plans of the Federal Communications Commission (FCC) for deregulation of customer premises equipment (CPE).

The adopted program for the sale of 1A key telephone system (KTS) equipment is based on a plan presented by Pacific in response to an initial proposal offered by the Commission staff. The prices at which equipment will be offered are based on net book values plus the cost of sale. Pacific's proposal to set prices at higher levels to reflect prices of competing equipment and generate greater revenue is rejected as to in-place equipment, as inconsistent with the sales program's purpose of protecting ratepayer interests in the face of impending deregulation. Higher prices are allowed for sales from inventory. Impacts of the adopted program on competition are evaluated and found to be acceptable.

The costs of the program are analyzed in detail as is the prospective take rate - the proportion of key equipment customers expected to purchase their equipment. A take rate of 20% is adopted and factored into the calculation of program costs. It is determined that inside wiring associated with a KTS installation should be sold as part of the key system, with its net book value reflected in the sales price. The staff's proposal as to warranties to accompany sold equipment is adopted, except that a proposed extended warranty option

will not be offered. Nor will Pacific be required to offer an installment payment option. Accounting and tax implications and any revenue surplus or deficiency associated with the key equipment sales program will be addressed in Pacific's pending general rate proceeding, A.83-01-22.

I. BACKGROUND

In Decision (D.) 93367 issued August 4, 1981, in these proceedings the Commission discussed the desirability of Pacific offering CPE for sale because of the impending deregulation of that equipment. We found that sale is a desirable concept and ordered Pacific, and any other parties wishing to do so, to file proposals for the sale of equipment. Pacific filed such a proposal in September 1981, and shortly thereafter various parties filed briefs on the limited question of the Commission's legal authority to order utilities to sell in-place terminal equipment.

Subsequently, the Commission adopted a staff proposal to bifurcate the proceeding into separate phases, addressing first the sale of single-line CPE, with multi-line equipment reserved for later consideration. The initial phase concluded on August 4, 1982, with issuance of D.82-08-017, by which the Commission approved tariffs filed by Pacific under Advice Letter 14270 for sale of single-line equipment, both in place and from inventory, on the basis of net book value plus the costs of sale.

Meanwhile, both Pacific in March 1982 and the staff in May made initial filings for the sale of multi-line terminal equipment to Pacific's customers. Pacific made further filings thereafter until October, when its multi-line filing was substantially complete.

On October 20, 1982, Pacific moved that all further proceedings regarding the sale of multi-line equipment be terminated. On October 25 Administrative Law Judge (ALJ) Porter granted Pacific interim relief from further filing requirements

previously ordered by the Commission. In December the staff filed its opposition to Pacific's motion for termination of the multi-line sale phase of this proceeding and recommended that the Commission go forward with the multi-line hearings on a phased basis, with the first phase limited to a plan for the sale of stand-alone 1A key telephone equipment.

In January 1983 the staff filed a revised plan for the sale of KTS equipment by Pacific to its 1A key system customers, a plan later designated Exhibit 512. Later that month a prehearing conference was held, at which ALJ Porter granted a staff recommendation to go forward with hearings regarding sale of 1A key equipment.

These hearings were held in San Francisco in February and March before ALJ Porter and ALJ Martin Mattes. Active participants, besides Pacific and the staff, were the California Interconnect Association (CIA), which is an association of independent CPE manufacturers, and General Telephone Company of California (General). Concurrent briefs were filed in April and the matter was submitted upon the conclusion of oral replies to the briefs on May 6, 1983.

II. THE COMMISSION'S AUTHORITY TO REQUIRE SALE OF TELEPHONE EQUIPMENT

The first issue which must be addressed in this decision is whether it is within the legal authority of this Commission to require Pacific to offer for sale to its customers on a tariffed basis portions of the CPE which it owns and which it presently leases to customers or holds in inventory. This issue was the subject of briefs and oral replies in the Single-Line Telephone Equipment Sale Phase of this proceeding, but resolution of the issue was not necessary in that phase due to Pacific's willingness to undertake a program for sale of single-line equipment on a voluntary basis. (See D.82-08-017, mimeo. pp. 4-6.) Briefs were filed on this issue by Pacific, General, CIA, the California Retailers Association,

and the Tele-Communications Association (CRA/TCA), Telephone Answering Services of California (TASC), and the staff. Oral replies were heard by the Commission October 9, 1981.

A. Positions of the Parties

Pacific contends that the Commission lacks authority to require Pacific to sell to customers any portion of the CPE which it owns. Pacific argues that a Commission order requiring sale of terminal equipment would conflict with the regulatory structure mandated by the FCC in its Second Computer Inquiry, FCC Docket No. 20828. Pacific further argues that, regardless of federal preemption, the Commission lacks authority under the federal Constitution and state law to mandate such a sales program.

According to Pacific, for the Commission to require sale of CPE would represent an attempt to override the FCC's judgment that detariffed provision of CPE in a competitive marketplace is in the public interest. Such a requirement would affect Pacific's ability to recover its CPE investments from the corporate affiliate which the FCC has required to take over Pacific's provision of CPE, and would affect the future financial viability of that affiliate. Pacific asserts that the FCC has preempted such action by this Commission. In addition, Pacific asserts that, because the FCC has decided that "an indivisible portion" of CPE is used in providing interstate service, a sale order by this Commission would force Pacific to dispose of interstate property and to discontinue a part of its interstate operations, thus directly conflicting with the regulatory jurisdiction of the FCC.

Pacific further argues that a sale order would amount to a requirement that Pacific dedicate its property to providing a new form of public service but that the Commission has long recognized limits on its authority to impose such a requirement, citing Holocard, v Pacific Tel. & Tel. Co., D.92791 dated March 17, 1981 in C.10240, and Cal. Community Television Ass'n v General Tel. Co.

(CCTA) (1972) 73 CPUC 507. Pacific contends that the Commission's role in the taking of public utility property for public use is limited by statute to valuing the property, with the decision whether a taking is justified being left to the courts. According to Pacific the Commission's authority under Public Utilities (PU) Code § 851 is limited to approving the sale of public utility property, and does not extend to requiring such a sale. The Commission's broad regulatory powers under PU Code §§ 701 and 729 are limited to actions "cognate and germane" to the regulation of public utilities and so, according to Pacific, are limited by the extent of public utility use to which Pacific has dedicated its property. Finally, Pacific argues that a sale order would have the effect of a taking of property for a private use, which exceeds the bounds of the right of eminent domain recognized by the federal and state Constitutions.

The positions of General and CIA are similar to that of Pacific. Both contend that the Commission lacks legal authority to require Pacific to offer for sale terminal equipment which Pacific does not wish to sell. General especially relies upon statements of the California Supreme Court defining the limits of Commission authority in Pacific Tel. & Tel. Co. v Eshleman (1913) 166 C 640, and Pacific Tel. & Tel. Co. v Public Utilities Comm'n (1950) 34 C 2d 822. Like Pacific, General emphasizes that the Commission's regulatory authority does not extend to requiring a public utility to devote its property to a use other than that to which it has been dedicated, citing Cal. Water & Tel. Co. v Public Utilities Comm'n (1959) 51 C 2d 478, as well as CCTA and Holocard, supra. CIA likewise sees the focal point of discussion to be the question of dedication, arguing that Pacific "has not dedicated itself to sell in-place terminal equipment," so the Commission lacks authority to require such sales.

CRA/TCA, TASC, and the staff take a considerably broader view of the Commission's authority. On the issue of federal preemption the staff contends that the federal Communications Act of

1934 reserves to the states authority over the tariffing of CPE; TASC argues that, in any event, Commission issuance of a sale order would not conflict with or frustrate the objectives of the FCC's Second Computer Inquiry. All three of these parties assert that the Commission's regulatory authority extends to ordering a sales program of the sort here proposed.

CRA/TCA emphasizes the broad nature of the Commission's regulatory authority over public utilities within its jurisdiction, including the power to affect property rights. CRA/TCA bases its analysis on the function which a sales program would play in responding to the stranded investment problem and other effects of the Bell System migration strategy, which seeks to persuade customers to abandon still useful CPE in favor of newer Bell System equipment. Noting that the Commission has authority to exclude stranded utility assets from rate base, thus denying any reimbursement through rates, CRA/TCA argues that the Commission clearly can order a sales program that will provide full reimbursement, while disposing of assets which might otherwise be stranded. Thus, CRA/TCA sees a sale order as one of several regulatory options available to the Commission within the scope of its oversight of Pacific's provision of public utility service. Pacific has dedicated its CPE property to public use; that dedication having been made, all the Commission's powers come into play. CRA/TCA denies that a valid distinction can be made between dedication for lease and for sale.

The staff agrees, contending that to require that CPE be provided on a sale basis as well as a leased basis "is nothing more than a change in service consistent with the deregulatory policy for CPE." The staff argues, in fact, that the Commission can require a utility to provide service "on a different basis" than the particular use for which it has dedicated its property, citing Greyhound Lines v Public Utilities Comm'n (1968) 68 C 2d 406. Like CRA/TCA, the staff sees a sale order as an appropriate regulatory response to the risk of stranded investment inherent in the Bell System migration

strategy. The only limit the staff sees to the Commission's authority is the utility's right to adequate compensation for its property.

TASC agrees with CRA/TCA and the staff that the opponents of a sales program draw the limits of public utility dedication too narrowly. According to TASC the dedication of Pacific's CPE to public use under lease brings into play the entire range of the Commission's regulatory powers. A sale order "would only alter the form" in which these dedicated utility facilities are offered to customers, a change falling squarely within the Commission's regulatory powers.

B. Discussion

At the time for oral replies to the briefs on the jurisdictional issue, the FCC had just adopted a Memorandum Opinion and Order on Further Reconsideration in the Second Computer Inquiry proceeding. That FCC opinion, released October 30, 1981, affirmed a bifurcated approach to the "detariffing" of CPE, extending until January 1, 1983, the date from which provision by public utilities of new CPE would be detariffed, but maintaining tariffed rate regulation with respect to "embedded" CPE until an as yet undetermined future date.[1] The FCC rejected a proposal by American Telephone & Telegraph Company (AT&T) for "flash cut"" deregulation of all CPE, new and embedded, simultaneously, which would have entailed transfer of all Pacific's CPE assets to a fully separated affiliate now designated as AT&T Information Systems (ATTIS).

The FCC expressly recognized this Commission's concern about the prospect of all Bell System CPE being transferred to a deregulated affiliate, and quoted portions of our D.93367 in this proceeding indicating our intention to move quickly to offer

---

[1] The FCC opinion (mimeo. p. 16) defines embedded CPE as that equipment or inventory which is tariffed or otherwise subject to the jurisdictional separations process as of January 1, 1983, including terminal equipment on customer premises or in utility inventory on that date.

Pacific's customers the opportunity to purchase CPE at a reasonable price. The FCC stated that such state regulation does not necessarily conflict with federal policy and that the federal agency "did not intend to foreclose the sale of existing CPE as a mechanism for deregulation." The FCC concluded that:

> "...to foreclose State Commissions, which have traditionally regulated rates for the vast majority of CPE owned by the Bell System, from proceeding with deregulation through the sale of embedded CPE is unwarranted." (FCC, Amendment of Section 64.702 of the Commission's Rules and Regulations (Second Computer Inquiry, 88 FCC 2d 512 (1981) (mimeo. pp. 12-13.))

More recently, the FCC has confirmed its view "that the sale of embedded CPE under the auspices of the state commissions is a useful means of easing the transition to an unregulated CPE marketplace." (FCC, Procedures for Implementing the Detariffing of Customer Premises Equipment and Enhanced Services (Second Computer Inquiry), CC Docket No. 81-893, Notice of Proposed Rulemaking, issued June 21, 1983, mimeo. p. 12.)

The FCC opinions clearly demonstrate that for this Commission to mandate a sales program for all or a portion of Pacific's embedded CPE would neither conflict with federal regulatory jurisdiction nor disrupt the FCC's plan for deregulation of the CPE marketplace. Rather, the FCC has designed its plan for deregulation in contemplation that state commissions may choose to require such sales programs and, in fact, that state-mandated sale of embedded CPE may be an appropriate "mechanism for deregulation."[2]

---

[2] The FCC also has stated that "...the promulgation of a plan requiring carriers to provide subscribers with an option to purchase embedded equipment is well within our authority under [Communications] Act and does not _per se_ raise any constitutional concerns." (FCC Notice of Proposed Rulemaking in CC Docket No. 81-893, supra, mimeo. p. 12 n. 17.)

In approaching the question of this Commission's authority to order Pacific to offer CPE for sale to customers, it is important to bear in mind that such a sales program is, indeed, a mechanism for coping with deregulation. In D.93367 we recognized that, as deregulation approaches, offering CPE for sale to customers at net book value appears to be fairer and more reasonable for utility and user than continued rental of such equipment. We noted that sale of CPE offered a variety of benefits to customers and utility alike: limitation of theft of increasingly mobile equipment; limitation of billing and tracking expense: greater customer understanding and choice of products; enhanced utility cash flow; mitigation of AT&T's dominance in the future CPE marketplace; and protection from the higher rental rates and stranded investment likely to result from the Bell System migration strategy. (D.93367 mimeo. pp. 166-68.) Thus, the Commission's consideration of a CPE sales program comes as a regulatory response to current and impending changes in the telecommunications marketplace.

We agree with those parties to this proceeding who see an order requiring Pacific to offer embedded CPE for sale to customers on a tariffed basis as a permissible option within the regulatory authority of this Commission. Our authority to order such a sales program does not flow from PU Code § 1401, et seq., which empowers the Commission to determine just compensation in certain eminent domain cases, nor from PU Code § 851, by which we may authorize the sale or other disposition of public utility property. Rather, we find that authority to require a telephone utility under our jurisdiction to offer for sale to customers at a reasonable tariffed price terminal equipment which otherwise would soon be transferred to an unregulated affiliated corporation derives from our authority under PU Code §§ 728, 761, and 762 to determine or to change the just and reasonable rates, classifications, rules, practices, contracts, equipment, facilities, service, and methods to be enforced and employed by public utilities in this state, as well as from our

general authority under PU Code § 701 to do all things which are necessary and convenient in the exercise of our supervisory and regulatory jurisdiction.

All parties appear to agree that to determine the Commission's authority to mandate a sales program requires analysis of the dedication issue. Pacific, General, and CIA rely upon the Commission's decision in Holocard v Pacific Telephone & Telegraph Co., D.92791 dated March 17, 1981 in C.10240, as recognizing limits to the Commission's authority to require a public utility to dedicate its property to providing a new form of public service. In that decision the Commission surveyed the concept of dedication in California public utility law, concluding that this Commission's authority over a public utility has been limited to the extent of the property and services that have been dedicated to the public service. (D.92791, mimeo. p. 20.)

There is no disputing that Pacific has dedicated its CPE, including stand-alone 1A key telephone systems, to the public service. The issue is whether that dedication is limited to the offering of such equipment for the use of customers on a leased basis, or whether dedication extends to whatever arrangement the Commission requires for the provision of such equipment to customers. In Holocard the Commission found itself without authority to require Pacific or General to provide a billing and collecting service for a nonutility business customer, because the utilities had not dedicated their facilities to providing such a service. On the other hand, in Greyhound Lines, supra, the California Supreme Court sustained the Commission's finding that Greyhound's dedication of its facilities extended beyond transportation along a specific route, to the broader enterprise of "providing commutation service in the area and to the population affected." (68 C 2d at 417.)

In Greyhound Lines, the Court recounted the history of the dedication concept as a restraint on regulatory authority, observing that changes in constitutional law principles have made it

inappropriate to extend the concept's restraining power further than logic and precedent require. The Court recounted various "indicia of dedication" which have been applied differently in different factual contexts, concluding that

> "the scope of dedication is not determined by mechanical formulas but ultimately by the fact that the utility has dedicated its resources to a particular enterprise, venture, or undertaking."

(Id. at 413-15. Cf. Rising Sun Mine Property Owners Ass'n v Pacific Gas and Electric Co. (1979) 2 CPUC 2d 522, 526.)

Following the principle of Greyhound Lines, we decline to characterize the extent of Pacific's dedication of its CPE facilities as solely to an equipment leasing service. Rather, we find that Pacific has dedicated these facilities for use by customers in receiving and transmitting telecommunications. Consequently, it is within this Commission's regulatory authority to determine the appropriate means by which Pacific shall offer those facilities for their dedicated use.

CRA/TCA and the staff argue that the Commission may mandate a sales program as an appropriate regulatory response to a ratemaking problem: Pacific's pursuit of the Bell System migration strategy in the context of impending CPE deregulation. As previously noted, we recognized in D.93367 that a sales program offers a variety of benefits to customers and the utility at this stage of reorientation of the telecommunications industry. In view of these considerations, we conclude that a mandated program for the sale of CPE is a matter "cognate and germane to the regulation of public utilities" and within the broad regulatory authority of this Commission pursuant to its police power. (See Pacific Tel. & Tel. Co. v Eshleman, supra; City of San Mateo v Railroad Comm'n (1937) 9 C 2d 1, 6.)

Both Pacific and General assert that Pacific Tel. & Tel. Co. v Public Utilities Comm'n, supra, prevents the Commission from

ordering a sales program, because it would amount to the Commission undertaking the management of the utility's property. In that case the California Supreme Court held that the Commission lacks jurisdiction to prescribe the terms on which a utility may contract with its parent corporation. However, the Court clearly distinguished contracts and practices affecting the utility's relationship to consumers from those affecting its relationship to suppliers of materials and services. Indeed, the Court noted with approval decisions in other jurisdictions which recognized regulatory control over contracts "that directly affect the service the ratepayer will receive at a particular rate." (34 C 2d at 828-30.) In prescribing a CPE sales program, we are setting the terms of contracts that directly affect service to ratepayers.

III. STAFF PROPOSAL FOR SALE OF 1A KEY SYSTEMS

The staff presented its proposal of a program for Pacific's sale of 1A key telephone systems through Exhibit 512 and the testimony of staff financial examiners Nagel, Nemecek, and Louie. The staff proposal was based upon initial filings of proposed plans for the sale of all multi-line terminal equipment made by both the staff and Pacific on March 1, 1982, and upon several supplements to Pacific's plan filed later in 1982. Exhibit 512 does not in itself present a full description of the staff proposal, but is devoted mainly to discussions of specific elements of the proposal which differ from features of Pacific's previously filed multi-line sales plan. The components of 1A key equipment are described in the Appendix to Exhibit 512, as revised February 28, 1983.

Pacific subsequently filed a revised version of its multi-line terminal equipment sales plan confined solely to key telephone systems. This Stand-Alone 1A Key Systems Sales Proposal was introduced into evidence as Exhibit 517 and portions thereof were sponsored by Pacific's witnesses Lewis, Parrick, Myers, Gueldner, and Dahl. Exhibit 517 thereafter was treated as the basic sales plan proposal, with the numerous alterations proposed by the staff and

other parties being discussed in the context of that plan. However, the sole proponent of a KTS sales program remains the staff.

A. Staff Justification for Requiring a KTS Sales Program

The staff contends that the Commission should require Pacific to offer stand-alone key telephone systems for sale to customers on a tariffed basis as a response to the uncertain future which faces users of such equipment. Staff sees this uncertainty as due to FCC preemption of state ratemaking authority with respect to new CPE, the impending divestiture of Pacific from AT&T, and AT&T's request for early federal preemption and deregulation of embedded CPE. Staff quotes the Commission's assertion in a November 1982 filing in FCC Docket No. 81-893, that:

> "...the most appropriate means for treating embedded CPE is to provide for a sales program with tariffed, regulated prices under the direction of state regulatory agencies."

According to the staff, the commission took this position because:

> "If embedded CPE were deregulated, there is simply no assurance that sufficient competition would exist to protect consumers against the deregulated company demanding excessive prices for embedded CPE." (Comments of the People of the State of California and the Public Utilities Commission of the State of California on the Supplementary Comments of American Telephone and Telegraph Company, filed November 23, 1982, FCC Docket No. 81-893.)

Staff suggests that the Commission's concerns expressed to the FCC are particularly applicable to stand-alone 1A key customers, due to Bell System domination of the 1A key market and because certain flexible contracting arrangements for other multi-line customers are not available to key system users. The staff contends that a sales program with regulated prices, terms, and conditions would give stand-alone 1A key customers the option of purchasing

their equipment under tariff, and thus provide assurance that a stable pricing environment will be available into the future.

Staff favors extension of a tariffed CPE sales program to key system customers for the further reasons that 1A key equipment represents a limited, manageable variety of equipment types; that much of the program can be handled by mail or telephone, thus minimizing transaction costs; that Pacific's market research indicates price elasticity and customer willingness to purchase 1A key equipment: and that a KTS sales program would provide an immediate cash flow to Pacific which staff estimates at over $60 million. The staff also sees KTS customers as especially threatened by the Bell System migration strategy, which was the subject of Findings 60 through 67 of D.93367 in this proceeding.

The staff notes that Pacific has approximately 256,000 stand-alone 1A key customers, representing about 80% of all its multi-line customers. According to the staff, 99% of these 1A key customers have systems of fewer than ten lines, and approximately 218,000 customer locations (some customers having multiple locations) are served by systems of three or fewer lines. Staff figures show a mid-1981 gross investment in 1A key equipment of $486.5 million for Pacific, 46% of its total gross investment in multi-line CPE. Staff therefore concludes that it is:

> "...logical, easiest and most beneficial to the greatest number of customers to proceed with the sale of multi-line equipment to the stand-alone 1A key customers of Pacific." (Exhibit 512, at 1-8.)

B. Implementation Procedures and Customer Options

The staff accepts as reasonable most of the implementation procedures set forth in Pacific's multi-line sales plan, with a few exceptions. The major exception is the staff recommendation that Pacific's estimated 120-day preparation time can be shortened to 30 days, because of experience with the single-line sales program and

the limitation of the proposed sales program to 1A key customers. The staff sees a shortened preparation time as important because of the brief time which may be available before the FCC detariffs embedded CPE.

The staff also addresses the problem of implementing sale for Pacific's estimated 165,000 1A key customers who share certain common items of equipment, including frames, power units, line interrupters, and cross-connection fields. The staff proposes several options, but recommends an approach whereby shared common equipment be offered for sale, if, but only if, all sharing customers elect to purchase their equipment. In the event one or more sharing customers choose not to purchase, others would be permitted to purchase their nonshared equipment at a reduced price reflecting only the equipment purchased. In this event purchasing customers would have to replace the shared equipment they would no longer use.

The staff proposes that certain customer options be included in the sales program beyond what Pacific's plan envisions. These concern payment plans and equipment warranties.

In accord with D.82-08-017, which set the terms of Pacific's single-line CPE sales program to include optional 6- and 12-month installment payment plans, the staff proposes that purchasing customers be offered installment sale payment plans with terms of 12, 18, and 24 months. Staff believes the availability of such options will stimulate sales, and notes that a 24-month plan would offer monthly payments less than the customer's current monthly lease rate.

The staff also recommends that, consistent with D.82-08-017, Pacific's proposed warranty periods of 30 days for in-place sales and 90 days for sales from inventory be extended to 90 and 180 days, respectively. Staff further proposes that an optional extended warranty up to one year from date of purchase be made available.

C. Cost Analysis and Pricing

The staff proposal for sale of 1A key system contemplates sale of roughly 200 specific types of equipment, which are categorized by Universal Service Order Code (USOC). The calculation of the "cost of goods sold" is intended to be based on net book investment, but is complicated by the fact that current accounting procedures do not allow tracking of investment by USOC. In Exhibit 512, Staff therefore calculates the cost of goods sold as the product of the annualized monthly rate, times an investment to revenue ratio, times the net plant factor. The investment to revenue ratio is based on Pacific's Vertical Embedded Analysis (VEA) data, which show booked investment and revenues for product groups, adding to the disposition investment a .30615 loading factor for nondisposition material. This is the same loading factor adopted in D.82-08-017 for Pacific's single-line CPE sales plan. The net plant factor arrives at net book value by reflecting the appropriate depreciation reserve ratio.

The staff differs with Pacific's plan as to several important aspects of cost analysis and pricing. These are the projected take, inside wiring costs, transaction costs, and the appropriate pricing factor. Also, staff's estimate of administrative cost, a factor of .0682, differs from Pacific's estimate of .079.

The projected "take" is the number of customers estimated to purchase their systems. The take rate is very important because it determines the number of sales over which transaction costs associated with the program will be allocated. The staff projects a 25% take rate while Pacific's plan estimated a 15% take. The staff's more optimistic estimate results from its belief that Pacific's market survey provided sampled customers inadequate information for them to reach an informed decision and failed to test a program including the more attractive prices as well as payment and warranty options proposed by staff. Apparently the staff did not consider the

shared equipment problem in estimating the projected take. Staff witness Nagel termed the 25% take projection "an informed estimate," but not a mathematical calculation.

The staff proposes that inside wiring associated with 1A key equipment should be sold with the equipment as a unit, with an appropriate amount included in the sales price to reflect the net book value of the inside wire. In Exhibit 512, page 11-6, the staff has proposed a pricing matrix for such inside wiring. The staff favors sale of inside wire along with the 1A key equipment because, conceptually, it is part of the customer's communication system; purchase of the wiring will leave the customers free to make subsequent rearrangements; Pacific will recover its capital investment in inside wiring more rapidly; the general body of ratepayers will bear less burden due to abandoned wiring; and the clear demarcation point between Pacific and customer facilities will reduce confusion as to maintenance responsibilities.

Transaction costs include expenses related to information mailings, handling of customer responses, development of price quotes, and premise visits to mark equipment upon sale. The staff's calculations of transaction costs differed in certain details from those of Pacific. In the course of cross-examination, staff witness Nemecek conceded that his calculations did not account for certain transaction costs implicit in the proposed sales program, such as the cost of a second mailing to 1A key customers, the cost of mailing firm price quotes to purchasing customers, the cost of incomplete installment sales, and the cost of certain premise visits. The staff believes at least a portion of these costs are covered by a "cushion" built into its estimate, but agrees that equipment should be priced to recover all transaction costs. Staff later accepted Pacific's calculations of transaction costs.

A major staff difference with Pacific's plan is the staff's rejection of Pacific's 1.5 pricing factor. As stated in Exhibit 512:

"The Team's prices for in-place equipment are based on net book value and do not include an arbitrarily selected factor to increase the sales price beyond net book value such as the 1.5 factor Pacific recommends in its proposal."

The staff justifies pricing based directly on net book value by citing statements in D.93367 as to the fairness of such a pricing arrangement and by referring to AT&T's advocacy of adjusted net book valuation of CPE and related assets to be transferred from the Bell operating companies to American Bell Inc. (ABI).

D. Deferred Matters

The staff proposes that consideration of certain effects of an equipment sales program be deferred. Specifically, the staff would defer consideration of the tax consequences and accounting treatment of direct sales of key system equipment, with these issues to be considered in Pacific's pending general rate increase application, A.83-01-022. The staff also recommends that the Commission establish a balancing account mechanism to determine the effects of the sales program on Pacific's revenue requirements. In D.82-08-017 the Commission contemplated such a balancing account to track costs and revenues of the single-line sales program, but establishment of such an account has not yet been ordered.

IV. CRITICISM OF THE STAFF PROPOSAL

Pacific, CIA, and General all opposed and criticized aspects of the staff proposal. All contended that the Commission should not order a sales program for 1A key systems at this time.

A. Pacific's Position

Pacific argues that it would be inappropriate to initiate a sales program for 1A key equipment prior to implementation of the Bell System divestiture. Pacific contends that its staff resources are completely occupied with preparations for divestiture and that it would be burdensome to add another complex program to the utility's management tasks. Pacific argues that to initiate a KTS sales

program at this time will compound confusion among customers already uncertain about the future of their telephone service. Pacific also contends that a KTS sales program would not meet a substantial need, in that no significant customer interest in purchasing such equipment has been shown.

1. Implementation Procedures and Customer Options

Pacific challenges the staff estimate that a 30-day preparation period for a KTS sales program would be feasible. Pacific witness Parrick testified that the minimum preparation time required to develop procedures and training material and to hire and train personnel would be 90 days. The most time-consuming element appears to be the development of procedures and reference material, which according to Pacific's witness must be substantially completed before training can begin.

Pacific criticizes all the staff's options for dealing with the problem of shared common equipment. The staff's recommended approach, which permits purchase of common equipment where all sharing customers choose to participate but also provides for purchase of nonshared equipment in other cases, is opposed as overly complex and also inadequate. Pacific points out the difficulty of identifying all sharing customers and of establishing arrangements for continued sharing of jointly owned common equipment. Whether a customer continues such sharing or purchases only the nonshared equipment, Pacific considers staff's proposal inadequate, because the customer will not be left owning a system capable of operating on its own. In Pacific's view, this postpones facing a future problem (e.g., when a customer moves), which Pacific would be obligated to bring to the customer's attention.

Pacific proposes what it sees as a more workable, less confusing approach to the shared equipment problem. Under this approach, a customer found to be sharing common equipment would be permitted to purchase nonshared equipment only in coordination with

obtaining common equipment through an outside vendor. Either the vendor or Pacific could install the new common equipment. In any event Pacific would charge on a time and materials basis for rearranging the customer's lines, but would credit the purchase price to adjust for the nonpurchased shared equipment. This approach, according to Pacific, eliminates customer confusion and "solves the shared equipment problem once and for all."

Pacific opposes provisions for installment payment plan options. Pacific does not wish to operate as a lending institution, and asserts that payment plans would deprive it of the cash flow advantage offered by a sales program, and would require additional preparation time and training and add to program costs. Among other complications, residential customers would have to be provided complex disclosure statements in compliance with the Federal Truth in Lending Act.

Pacific does not expressly oppose the staff proposal of longer basic warranty periods consistent with D.82-08-017, but does object to warranties or installment payments lagging over beyond the divestiture date. Pacific's witness criticized the proposal to offer extended warranties as abnormal in the sale of used equipment. Pacific asserts that after divestiture it will lack the personnel needed to honor such a warranty. Pacific's witness argued that the total warranty period should not exceed one year and that any extended warrants should be available only at the time of purchase and only for complete, stand-alone key systems.

2. Cost Analysis and Pricing

Pacific challenges the staff's projected take rate of 25%, asserting that the staff has a "history...of being overly optimistic in the single-line phase of this proceeding," in which a staff witness forecast a 50% take. The Commission's decision was based on a 25% take, and as of April 1983 the experienced take rate was only 14%. Pacific's market research indicates a 17% take rate for key telephone systems, but Pacific's own witness discounted that projection because:

> "...[t]raditionally, in this type of study, the results tend to overstate the percentage of customers who actually purchase their systems."

Pacific does not believe that sale of inside wiring as part of the sale of key equipment is a means of recovering Account 232 investment preferable to the current amortization approach in effect pursuant to D.93728, issued November 13, 1981 in OII 84. However, Pacific's primary concern in this respect is simply to assure the recovery of the capital investment represented by embedded inside wire. Pacific's witness asserted that the staff's calculation of inside wire costs fails to recognize a portion of Account 232-02 associated with stand-alone key system installations.

Pacific calculates significantly higher transaction costs than did the staff. Staff has stipulated to Pacific's calculations in most respects. Resolution of the issues as to take rate, installment payment plans, and warranty options will affect the determination of transaction costs.

Believing that the market will sustain a price greater than cost, Pacific advocates use of a 1.5 pricing factor, setting prices at 150% of net book value, plus transaction costs. Pacific bases this position on an unusual mix of concerns about pricing at book value: The loss of potential capital recovery, the possible adverse impacts on competitors, and the risk of hasty purchase decisions by customers.

Pacific advocates that the tax consequences and accounting treatment of key equipment sales should be determined in this proceeding, through further hearings, rather than in the general rate case. Pacific also calls for a surcharge mechanism to be implemented concurrently with any sales program, to assure full recovery of revenue requirements.

B. CIA's Position

CIA seconds Pacific's view that a sales program for 1A key equipment should not be ordered at this time. CIA criticizes the staff proposal as suffering "some of the inevitable flaws of haste"

and argues that "a more deliberate approach to some very difficult questions would yield better answers." At the same time, CIA argues that the January 1, 1984 divestiture target will necessarily serve as the "end-date" for Pacific's sale of embedded CPE, and that sales tariffs based on the present record might not properly be imposed upon AT&T, the post-divestiture transferee of the embedded equipment. CIA contends that the Commission should defer action on sale of Pacific's 1A key equipment and initiate a sales program after transfer of the equipment to AT&T.

CIA's major criticisms of the staff proposal relate to staff's calculations of the costs associated with a sales program. CIA argues that the evidence does not provide an adequate basis to conclude that the prices proposed by the staff will defray all costs of sale.

CIA challenges staff's method of calculating the "cost of goods sold." CIA asserts that the staff's approach will yield a book value for 1A key equipment consistent with Pacific's regulated accounts only if all such equipment is sold. CIA also questions the reliability of the VEA data employed by staff to calculate an investment to revenue ratio and of the .30615 loading factor for nondisposition investment.

CIA favors Pacific's higher estimate of administrative costs (a .079 factor versus the staff's .0682) and argues that the calculation of warranty costs should be based on Pacific's revised estimate, yielding an $11.40 cost for a 90-day warranty as compared to the staff's $7 estimate. CIA also favors Pacific's estimate of certain transaction costs.

CIA challenges both Pacific's and staff's projected take rates, based on criticism of Pacific's market survey by CIA witness Fishman, a marketing research specialist. Fishman testified to methodological flaws in Pacific's survey concluding that it "almost surely overstates future purchases." In view of the uncertainty as to customer response, CIA argues for use of a take rate of 5 to 10% to assure recovery of all transaction costs from purchasing customers.

CIA contends that income tax expenses and installation costs, apparently including those related to inside wiring, should be reflected in the pricing of equipment. CIA also would require that purchasers be informed of costs they will incur after sale, including an estimated $74 per transaction "retermination" charge.

Finally, CIA expresses concern over the impact of a sales program on competition if prices are significantly below those of competitive offerings, and suggests that such pricing may violate the antitrust laws. CIA points to evidence, including that offered by its witnesses Healy and Horvath, that the proposed pricing will substantially undercut competitors, and calls for a "substantial increase" in the pricing factor beyond the 1.5 level proposed by Pacific.

C. General's Position

General shares the view of Pacific and CIA that the Commission should not seek to implement a 1A key equipment sales program at this time. General argues that there is insufficient time to implement such a plan prior to Pacific's divestiture from AT&T without generating excessive confusion among customers. General challenges the staff's assertion that a 30-day preparation time is feasible, and asserts that the staff's projected take rate is unrealistically high, citing the program's short duration, Pacific's overly optimistic market survey estimate, the lower take projection of a comparable survey conducted by General, and the problem of shared common equipment as factors indicating a lower take rate. General argues, like Pacific, that shared common equipment should not be offered for sale and that Pacific should not be required to offer an installment payment option. General suggests inclusion of a no-warranty option if a sales program is ordered.

General's opposition to the staff's proposal is based on concern over its implications for General's own key systems offerings. General opposes the extension to it of any sales program modeled on the staff proposal. Specifically, General considers it inappropriate for the Commission to require sales of key equipment on

a tariffed basis, because the sale of embedded CPE is not a utility service and so "should not be considered a regulated offering." If the Commission insists on the filing of tariffs in connection with CPE sales, such tariffs should simply authorize sale and should not specify price levels. General also opposes requiring tariffs to govern provision of post-warranty maintenance services.

D. Staff Acceptance of Pacific's Plan with Exceptions

In its brief the staff restates its belief that its recommendations set forth in Exhibit 512 are fair and reasonable, but declares that Pacific's counterproposal presented in Exhibit 517 "sufficiently meets essential features of the staff proposal so that for the purpose of expediency, the staff will accept the PT&T proposal subject to the following exceptions:

"1. Pricing Factor - 1.0 vs. 1.5.

"2. Percent Take - 25% vs. 17%.

"3. Inclusion of an Installment Payment Plan - 12, 18, 24 months.

"4. Warranty Period - In place 90 days vs. 30 days; inventory 180 days vs. 90 days.

"5. Inclusion of an extended warranty option - Maximum 1 year.

"6. Accounting and Tax Treatment - To be decided in additional hearings on the matter.

"7. Revenue Requirements Effect - Balancing account mechanism....

"8. Sale of Wire - Should be included in sale of equipment."

The staff's acceptance of Pacific's plan as to all other elements represents concessions on substantial previously contested issues. Staff agrees to Pacific's approach to the problem of shared common equipment and accepts Pacific's calculation of transaction costs. By implication, staff also accepts Pacific's somewhat higher calculations of administrative and warranty costs, as well as Pacific's proposed handling of sales from inventory, post-warranty maintenance, and other associated activities.

V. DISCUSSION

A. Should the Commission Require Pacific to Offer 1A Key Equipment for Sale to Customers on a Tariffed Basis in 1983?

The primary justification for the staff's proposal of a key equipment sales program is the foreseeable deregulation of embedded CPE. The recent FCC preemption of state authority over new CPE, the impending transfer by Pacific of its embedded CPE to AT&T in the course of Pacific's divestiture from its parent, and the current AT&T proposal for "detariffing" all embedded CPE by January 1, 1984, make clear that the present system of tariffed leasing of CPE will soon come to an end. In referring to this course of events in our earlier decision approving a single-line CPE sales plan, we noted as follows:

> "While we believe terminal equipment deregulation ultimately will be beneficial for consumers, a major transition problem exists. AT&T, through its ownership of the embedded base of terminal equipment, could, upon deregulation, exert substantial market power and conceivably raise terminal equipment prices substantially. AT&T's migration strategy found in D.93367 is evidence of AT&T's ability and intention in this regard. The sale of much of the embedded base to customers should reduce AT&T's potential market power, and ease the transition to full deregulation." (D.82-08-017 mimeo. pp. 17-18.)

As the staff has noted, our concern to protect ratepayer interests during the transition to CPE deregulation is particularly relevant to stand-alone 1A key system customers due to the Bell System's continuing domination of the 1A key market and because of the limited contracting arrangements available to key system users. Moreover, we note that key equipment is the most substantial category of CPE which AT&T has chosen <u>not</u> to offer for sale under its price predictability program for detariffed embedded CPE, as proposed to the FCC in CC Docket No. 81-893.

Since submission of this matter, the FCC has issued a Notice of Proposed Rulemaking in CC Docket No. 81-893, indicating its tentative view that:

> "...the most effective detariffing plan would combine the sale of embedded CPE in place with the transfer of embedded CPE to the carrier's unregulated service.... The continuation of state sales programs, together with the establishment of a sale option in this proceeding as part of a transfer plan, offers several advantages. First, the option to purchase embedded CPE increases the choices available to consumers. Second, it is our tentative view that making embedded CPE available for purchase is a sufficient mechanism for meeting our obligation to balance equitably the interests of ratepayers and carriers' investors in accordance with the tests established in Democratic Central Committee v. Washington Metropolitan Area Transit Commission, 485 F 2d 786 (D.C. Cir. 1973), cert. denied sub nom. D. C. Transit System v. Democratic Central Committee, 415 U.S. 935 (1974).... Third, the sale of embedded CPE, combined with the detariffing of that portion of the embedded base which remains unsold, advances our efforts to achieve the deregulatory goals established in Second Computer Inquiry. (FCC Notice of Proposed Rulemaking in CC Docket No. 81-893, supra, mimeo. pp. 12-13.)

While indicating support for state-authorized or mandated CPE sales programs, the FCC notice also discusses favorably AT&T's proposal to detariff and transfer to its unregulated CPE affiliate all embedded CPE by January 1, 1984. (See id. at 41.) It appears likely that the FCC will approve early detariffing of most or all embedded CPE, subject to requirements that at least some important categories of such CPE be offered for sale to customers at prices reflecting net book value. It is uncertain, however, for how long such sales programs will be subject to regulatory oversight.

The FCC recognizes that:

> "...failure to offer a significant portion of embedded CPE for sale while it is under tariff, or shortly after it is detariffed, at a price

> which gives ratepayers an opportunity to realize any gain in the value of the CPE would pose significant problems under Democratic Central Committee." (Id., p. 21.)

The reason for the FCC's concern is that Democratic Central Committee requires that gains or losses on transfer or sale of assets must go to that class, carriers' investors or ratepayers, which bore the risk of loss of capital value over the regulated life of the asset. (485 F 2d at 806-08.) The FCC has tentatively found that its regulatory scheme, which allows carriers to file tariffs designed to earn an allowed rate of return and to recover reasonable depreciation expenses, "has placed the risk of loss on the ratepayers." (FCC Notice of Proposed Rulemaking in CC Docket No. 81-893, supra, mimeo. pp. 18-19.)

This Commission has applied the principle of Democratic Central Committee in a variety of contexts. We have determined that a gas company's gain resulting from the prospective removal of pipeline assets from utility service should be flowed through directly to ratepayers. (Southern California Gas Co. (1978) 84 CPUC 405.) We have required that a water company's gain from the sale of watershed timber be amortized as an offset to future utility revenue requirements. (Citizens Utilities Co. of California - Felton Water Dist., D.82-05-038, issued May 4, 1982.) Most recently, we have required an electric utility to pay to its ratepayers its gain on the sale of coal properties acquired in contemplation of a generating plant which has not been built, to the extent those properties had been included in rate base. (Pacific Gas & Electric Co., D.82-12-121, issued December 30, 1982.)

We agree with the FCC that the rule of Democratic Central Committee must be applied in the process of detariffing CPE and transferring embedded CPE assets to an unregulated entity such as ATTIS. The price predictability program which AT&T has proposed to FCC to accompany detariffing would not apply to 1A key equipment. Thus, users of 1A key equipment would be denied even the questionable

protection offered by AT&T's price predictability program for their legally recognized interest in any excess in the market value of 1A key equipment beyond its net valuation on the books of the Bell companies.

We also agree with the FCC that the option to purchase embedded CPE at net book value protects the ratepayer's legal interest under the rule of Democratic Central Committee. However, AT&T's price predictability proposal does not protect the interests of 1A key equipment customers. We can protect those interests by requiring Pacific to offer 1A key systems for sale on a tariffed basis.

Several of the parties have criticized the staff sales plan in view of the brief period of time available for implementation prior to the transfer of Pacific's embedded CPE to AT&T as part of the Bell System divestiture, scheduled to occur by January 1984. In our view, however, the impending transfer does not justify inaction but rather warrants prompt implementation of a sales program, if a reasonable program can be fashioned.

We note that the transfer of embedded CPE from Pacific to AT&T will not, based on present facts, immediately terminate our regulatory authority over these assets. We can, if appropriate, require that any sales program ordered for Pacific to conduct be continued in effect by AT&T or whatever AT&T affiliate receives Pacific's embedded CPE. It is for this reason that, in comments filed in the FCC's CC Docket No. 81-893, we have requested that the FCC defer detariffing the Bell System's embedded CPE to permit adequate time for states to implement CPE sales programs.

Pacific offers three principal reasons why the Commission should not require a key equipment sales program in 1983. The chief problem Pacific sees is that the burden of administering such a program will divert talent and resources away from preparation for the impending divestiture from AT&T. Pacific asserts that announcement of a key equipment sales plan will compound existing

uncertainty and confusion in the minds of its customers. Finally, Pacific points out the expense of informing its 250,000 key equipment customers of the sales program, and expresses concern that other ratepayers may end up sharing that expense, in the absence of significant customer interest in buying key equipment. As noted above, General and CIA second Pacific's concern about the diversion of resources and customer confusion which might result from ordering a sales program this year.

We are persuaded that these parties exaggerate the difficulty of implementing a key equipment sales program at this time. As the staff notes, Pacific's prior experience with the single-line equipment sales plan provides the company with invaluable experience which should shorten its tasks in implementing a key equipment program. We also agree with the staff that availability of a key equipment sales program in the later months of 1983 will tend to remedy, rather than compound, confusion among customers, particularly in view of AT&T's plans to conduct an intensive nationwide sales campaign relating to single-line equipment during this period. It should prove beneficial to ratepayers if Pacific is in a position to "piggyback" on AT&T's advertising campaign by having a key equipment sales plan in place to respond to resultant customer inquiries.

As for the cost of Pacific's informational efforts, if the Commission properly estimates the take rate for a key equipment program and sets prices to reflect the resultant transaction cost, all such costs will be recovered through the prices of key systems sold. The general body of ratepayers will stand at minimal risk, and will benefit to the extent that the sales program enhances Pacific's cash flow.

We find that prompt implementation of a key equipment sales program along the lines proposed by the staff would be consistent with, indeed would complement, ongoing actions by the FCC, would protect the legal interests of key system customers, and would not

impose serious burdens on Pacific or its other customers. We conclude that Pacific should be required to offer its embedded stand-alone 1A key equipment for sale to customers on a tariffed basis beginning as soon as is feasible.

B. Should the Staff Exceptions to Pacific's Plan be Adopted?

Having determined that we can and should require Pacific to institute a tariffed sales program for embedded 1A key equipment, we next must decide certain issues critical to formulating an appropriate program. Most of these issues are related to the exceptions which the staff has taken to the sales plan formulated by Pacific as Exhibit 517. The staff exceptions to Pacific's plan, as summarized in the staff brief, are set forth in Section III.D. of this opinion, supra. The other major issues are the determination of sales prices and assessment of competitive impact, matters of particular concern to CIA, and the implications of our decision for other telephone companies, which is General's main concern.

1. Pricing Factor

We agree with the staff that the prices for embedded equipment sold should be based on net book value, without application of any pricing factor other than 1.0. Pacific's reasons for advocating a higher pricing factors are unpersuasive. Accelerating Pacific's recovery of capital invested in CPE is a welcome effect of a sales program, but it is not the Commission's principal goal. Moreover, the record suggests that a lower pricing factor might generate sufficient additional sales to result in only a very slight diminution in cash recovery. As noted above, we believe 1A key system customers should be offered an opportunity to purchase their equipment on a tariffed basis prior to its deregulation as a means of protecting the ratepayers' legal interest in the appreciation in value of these public utility assets. According to this rationale, the customers are entitled to purchase that equipment at a price reflecting its net book value plus the costs of sale. Market value

is not a relevant consideration, so long as there is not an unreasonably adverse effect upon competition.

As we will discuss more thoroughly later, we are unpersuaded by arguments that sales of 1A key equipment based on net book value will be anticompetitive. To begin with, pricing at net book value, with the addition of appropriate factors to reflect all costs of the sales program, avoids any legitimate claim of predatory conduct. If Pacific's costs are lower than those of its competitors, there is nothing improper in giving its customers the benefit of that cost advantage.

Moreover, a regulated sales program at this time will tend to frustrate possible efforts by the Bell System to orchestrate the movement of key system customers from present equipment into the next generation of Western Electric products, a practice known as the installed base migration strategy. In D.93367 in this proceeding, we expressed our conviction "that Pacific did indeed embrace and pursue the goals of the Bell System migration strategy." (D.93367 mimeo. p. 161.) We found that:

> "Pacific should not be allowed to adopt marketing or pricing practices, the purpose of which is to accomplish post-deregulation market positioning, if such practices result in unwarranted rates for customers of installed base equipment or create a residue of stranded investment to be recouped from the regulated operation's ratepayers." (D.93367, Finding 65, mimeo. p. 217.)

Requiring that 1A key equipment be offered for sale at prices based on net book value, without adjustment by an arbitrary pricing factor, will help carry out the purpose of that finding.

Finally, Pacific's suggestion that sales prices based on net book value unadjusted by a pricing factor might lead key system customers into hasty purchase decisions is not a matter for concern. Key system customers are predominantly business enterprises, fully capable of calculating the pros and cons of a particular purchase option and planning for their future communication needs. The market

for business telephone equipment is a vigorous and highly competitive one, fully sufficient to inform such customers of the alternatives available. Moreover, Pacific's expressed concern about hasty purchases is inconsistent with its pessimistic expectations as to the "take rate," suggesting that this is but a make-weight argument at best.

2. Installment Payment Plans

The staff proposes to provide for optional 12-, 18-, and 24-month installment payment plans, in accord with the terms of Pacific's single-line CPE sales plan authorized by D.82-08-017. Pacific objects to this proposal, among other reasons, because it does not wish to operate as a lending institution and sees these options as sacrificing the cash flow benefits of a sales program and as requiring added preparation time and increasing program costs.

Pacific's concerns impress us as outweighing the uncertain value of an installment payment option. There is no compelling need to offer a financing service to the predominantly business customers who use 1A key equipment; businesses interested in purchasing such equipment can be expected to have sufficient sources of financing available to them. This difference in customer target group, as well as the much greater purchase price per transaction in this case, may justify departing from the terms of the single-line program.

We also wish to avoid unnecessarily creating contractual relationships between Pacific and embedded CPE customers which will carry over beyond the date of transfer of Pacific's embedded CPE operations to AT&T. Moreover, it is essential to minimize features of the program which will add to Pacific's preparation time. In view of these several factors, we will not require provision for installment payment options as part of Pacific's 1A key equipment sales program.

3. Warranty Terms and Options

No party objected seriously to the staff proposal that the proposed equipment warranties of 30 days for in-place sales and 90

days for sales from inventory be extended to 90 and 180 days, respectively. The staff proposal is more consistent with industry practice, provides assurance to customers that their equipment is in working order, is consistent with D.82-08-017, and will be adopted.

The staff also proposes an optional extended warranty up to one year from date of purchase. This proposal presents the same disadvantages as the installment purchase options - adding complexity to the program, and thus extending Pacific's needed preparation time, and increasing Pacific's contractual commitments after divestiture. The extended warranty option is not of such importance as to justify these added burdens to the sales program; the longer basic warranty periods should sufficiently protect purchasers. An extended warranty option will not be required.

General proposes a further option of purchasing equipment with no warranty but at a slight discount. Pacific opposes this proposal, but calculates that the elimination of warranty costs could reduce the price of a typical three-line seven-station system by about $40. It is uncertain, however, to what extent Pacific might remain potentially liable for equipment failure even in the absence of an express warranty, suggesting that Pacific's actual cost savings under a no warranty sale might be significantly less than indicated. In view of this uncertainty, a no warranty option will not be required.

4. Disposition of Inside Wiring

The staff proposes that inside wiring associated with 1A key equipment be sold with the equipment as a unit, with the sales price based on a pricing matrix derived from a similar matrix developed by Pacific for sale of in-place wiring under its tariff Schedule 161-T. This pricing matrix is set forth at page 11-6 of Exhibit 512. Pacific would prefer to continue the present course toward amortization of Account 232 inside wiring investment, but is primarily concerned to assure recovery of all such investment.

The staff presents several arguments, which have been noted earlier, in favor of the sale of inside wiring along with the 1A key equipment. We find these arguments persuasive. The inside wiring associated with a stand-alone 1A key system is distinguishable from the wiring linked to a single-line instrument. In the case of a key system the wiring is an integral part of the equipment installed on the customer's premises; purchase of the wire will leave the customer free to make subsequent rearrangements and will provide a clear demarcation of Pacific's utility service obligations, both now and subsequent to divestiture. Sale of the inside wire will provide Pacific with more rapid recovery of its Account 232 investment and of the resulting revenue requirement recognized in D.93728. Sale of wiring also will increase the prices of key systems sold, thus responding to concerns about undercutting competitors while remaining faithful to the principle of sale at net book value.

We will require that ownership of inside wiring associated with a 1A key system be conveyed to the purchaser of that system, but we must determine whether the pricing matrix set forth in Exhibit 512 should be used in calculating the sales price of the key system. Pacific witness Gueldner asserts that the prices in this matrix "relate only to a portion of the total Account 232-02 investment associated with stand-alone 1-A kev," failing to recognize the portion of that investment associated with the capitalized installation of the 1A key apparatus itself. (Exhibit 516, at 35.)

The pricing matrix in the staff exhibit is not a precise statement of net book values drawn from Account 232. Such values apparently are not determinable on a system-by-system basis. The matrix does not "relate" directly either to the capitalized costs of installing inside wiring or to those of installing key equipment. Rather, it is the pricing table which Pacific developed for the sale of installed inside wiring associated with key systems of 20 or fewer stations.

According to staff witness Louie, these prices are not based directly on book values but rather on "the fair market value or replacement value for installing the wire...inclusive of station handling, travel time, installing, unpacking, testing." (Exhibit 514, at 7.) Louie testified that an entry in the pricing matrix applicable to a typical 1A key system "should be higher than the net book cost of the wires" but he agreed that it is "a pretty good approximation of the total cost incurred by the company when it made the installation associated with this equipment." (Tr., at 15327-28.)

Further examination of witness Louie clarified that, due to the amortization of Account 232 investment beginning as of October 1, 1981, pursuant to D.93728, the net book values reflected in that account will by now have been diminished significantly below original installation costs. The result would be that pricing inside wire, according to the staff's matrix, would result in a gain to Pacific. (Tr., at 15333.) The staff witness suggested that special provision might be made to reimburse purchasers for such overpayment. It would be preferable, however, to address this problem directly.

The pricing matrix set forth in Exhibit 512 is an appropriate basis for pricing inside wiring and other Account 232 investment associated with key systems to be sold. However, the matrix should be adjusted to reflect the reduction in the net book value of such investment during the past two years pursuant to the ten-year amortization schedule ordered by D.93728. A revised version of the pricing matrix set forth in Exhibit 512, adjusted by reducing each entry by 20%, is attached to this opinion as Appendix A. Inside wiring sold together with 1A key equipment pursuant to this opinion should be priced in accordance with Appendix A.

5. Projected Take Rate

The staff has accepted Pacific's estimates of transaction costs in all respects except the projected take rate. The take rate, *i.e.* the percentage of 1A key system customers completing the

purchase of their systems, is a critical factor in pricing the goods to be sold. Transaction costs will include expenses of customer contact work, the magnitude of which will vary independently or partially independently with the number of completed sales. A substantial portion of transaction costs per completed sale will vary inversely with the take rate. Thus, a higher take rate will mean lower transaction costs per sale, hence lower prices.

The staff projects a 25% take. Pacific's market survey indicated a 17% take, but Pacific's witness discounted that estimate, favoring a number closer to 15%. General points to its own survey results indicating that only 14% of its key system customers would be "very interested" in purchasing their equipment, and CIA's counsel argues for a take rate as low as 5%.

CIA witness Fishman was far less definite than its counsel in assessing Pacific's market survey. It was his opinion that the study clearly overestimated potential sales, but allowed only a rough idea of what potential sales might be. (Tr., at 15485-86.) The testimony of other CIA witnesses, however, suggests a much higher take rate. In fact, CIA's showing presents an internal contradiction. CIA contends that pricing key equipment on net book value basis will be anticompetitive because the offering prices will be substantially below current market levels. CIA witness Horvath testified that,

> "...a sales program such as that recommended by the [staff] would seriously curtail interconnect company sales of competitive equipment... I am certain that sales of 1A key equipment at the prices proposed by the [staff] will entrench a significant portion of this market..." (Exhibit 521, at 3.)

Similarly, CIA witness Healy predicted that,

> "Sales at the prices recommended by the staff will inevitably have the effect of diverting most, if not all, of our sales in the 1A key market." (Exhibit 520, at 2-3; see also Tr., at 15611.)

If pricing at the staff-proposed level of net book value will have effects at all like those predicted by CIA's witnesses, then the percent take will have to be much higher than CIA claims.

The staff offers several reasons why the percent take should prove higher than indicated by Pacific's market survey. Most importantly, the survey employed Pacific's proposed 1.5 pricing factor. Because the survey did indicate that customers' purchase intent is price elastic, pricing at net book value should yield a significantly higher take rate. Staff witness Nagel used Pacific's price elasticity table to determine the estimated take based on the staff's 1.0 pricing factor. Applying the derived price of a typical system to Pacific's table yields an estimated take of 20%.

The staff also asserts that Pacific's market survey did not provide enough information to the customer for the customer to make an informed decision in that the survey did not give the customer a purchase price comparison with his monthly rate, and did not explain to the customer about the impending deregulation. The staff also notes that Pacific's survey did not inform prospective purchasers of the staff-proposed warranty and/or optional warranty nor of any installment payment option. Moreover, the staff feels that the public is now more aware of the changes occurring in the telephone industry than they were when the survey was performed in March of 1982, and so will be more inclined to purchase their equipment under a regulated plan. The staff emphasizes that AT&T's intensive advertising campaign to encourage purchase of CPE other than 1A key systems should induce greater awareness and interest among key system customers as well, which surely will enhance the take rate.

We agree with the staff that increased public awareness of opportunities to purchase telephone equipment, as well as mounting public concern about future rate increases and unregulated pricing, will lead more key system customers to take advantage of a regulated sales program. Changes we will order in the staff proposal tend to cancel out their respective impacts on the take rate (e.g.

elimination of extended warranties and installment sales versus reduced pricing of inside wire). However, we note that the staff apparently did not consider the shared equipment problem in developing its take rate, and we recognize that the staff overestimated the take rate in the single-line equipment sale phase of this case. Consequently, in consideration of all the evidence, we will find that a 20% take rate is a fair and reasonable projection of key equipment sales under the plan we will authorize.

6. Deferred Matters

The staff proposes that we defer consideration of the income tax consequences and appropriate accounting treatment of direct sales of KTS equipment, with these issues to be considered in Pacific's pending rate increase application, A.83-01-022. Pacific would prefer to have these issues examined in this proceeding. CIA stresses the need to defray income tax expenses associated with KTS sales through the prices charged for the equipment. The staff favors establishment of a balancing account to reflect the revenue reequirements effects of a sales program and to adjust rates accordingly. Pacific prefers that an appropriate surcharge be implemented concurrently with a sales program.

D.82-08-017 authorizing a sales program for single-line CPE contemplated establishment of a balancing account to facilitate Pacific's recovery of program costs. In October 1982 both Pacific and the staff submitted proposals for balancing account procedures. Thereafter, however, Pacific included estimated revenue requirements associated with the single-line sales program in its 1983 results of operations studies in A.83-01-022. Both Pacific and the staff proceeded to offer extensive evidence and testimony as to these revenue requirements in the initial phase of that rate proceeding. The company and staff showings in A.83-01-022 have clearly defined issues as to accounting treatment and income tax consequences of the single-line sales program which have substantial impact on revenue requirements. We will determine those issue in A.83-01-022.

Accordingly, we will defer to A.83-01-022 our consideration of the accounting and tax implications of the proposed KTS sales program. We expect that the issues will be the same as those already heard and briefed in that rate proceeding. We note that the record in A.83-01-022 evidences disagreement as to whether tax consequences of the single-line program will add to Pacific's revenue requirements. In any event, we expect that any such tax expense will not be of such magnitude as to necessitate higher pricing of key systems offered for sale. We will provide that the revenue deficiency or surplus associated with the KTS sales program will be determined in the second phase of hearings in A.83-01-022, based on the resolution of the accounting and tax issues in the current phase of that proceeding. Any such revenue deficiency or surplus will be taken into account in determining Pacific's revenue requirements for 1984 in the final decision in A.83-01-022.

C. How Should Sales Prices for Key Telephone Systems be Determined?

All parties agree that sales prices for 1A key telephone systems should be set at levels which can be expected to cover all the utility's costs, including its net investment in the key equipment and a sufficient allocation of all costs of the sales program. This is important not only to assure fair treatment to Pacific, but also to give Pacific adequate incentive to pursue the sales program vigorously and, in addition, to assure that competing sellers of equipment are not unfairly disadvantaged.

1. Formula for Cost Estimation

Our decision to employ a 1.0 pricing factor implies that the sales price for an in-place 1A key system should be set at a level expected to cover all the costs of sale, but no higher. Thus, sales price should equal the estimated cost of sale. Pacific presented a formula for estimating the cost of sale in Exhibit 517, a formula which was not challenged by any party. The formula is as follows:

Estimated Cost of Sale = (Estimated Unit Cost x Quantity) + Transaction Cost

where

Estimated Unit Cost = Cost of Goods Sold + Administrative Cost + Warranty Cost.

The formula is slightly misleading in that, strictly applied, it fails to provide for differences in the quantity of equipment sold by individual rate element, or USOC. A more useful variant of the formula would be as follows:

Estimated Cost of Sale = (Estimated Unit Cost_1 x Quantity_1) + (Estimated Unit Cost_2 x Quantity_2) +...+ (Estimated Unit Cost_n x Quantity_n) + Transaction Cost

where

Estimated Unit Cost_n = Unit Cost of Goods in USOC_n Sold + Administrative Cost + Warranty Cost.

In either version of the formula, the basic factors to be considered are unit cost and quantity of goods sold, administrative cost, warranty cost, and transaction cost.

2. Estimated Unit Costs

Both Pacific and the staff apply the same procedure to calculate the unit cost of goods sold for a particular USOC as the product of the annualized monthly rate for that USOC, times the investment to revenue ratio, times the net plant factor. Calculations of the unit cost of goods sold, per USOC, are set forth in Exhibit 512, pages 6-4 to 6-15, and in Exhibit 517, pages 5-F-2 to 5-F-6, for the staff and Pacific, respectively. As compared to the staff, Pacific's calculations show slightly higher annualized monthly rates per USOC, an identical investment to revenue ratio, and a slightly lower net plant factor, resulting in cost of goods sold per USOC generally 2 to 5% lower than the staff figures. The major difference, in the net plant factor, is due to Pacific's use of

slightly later data than the staff. Because Pacific's KTS assets have not been augmented by new additions since detariffing of new CPE took effect in January 1983 per Second Computer Inquiry, Pacific's later data reflects higher depreciation accruals. The staff accepted Pacific's calculations as reasonable.

As noted previously, CIA challenged the staff's calculations of the cost of goods sold on several grounds, mostly relating to the investment to revenue ratio, as to which both the staff and Pacific proposed the same ratio of 1.12. We believe the staff witness adequately substantiated his procedure for calculating the cost of goods sold, and that his procedure is reasonable in light of the limited accounting records available. We note that the staff procedure reconciles with total KTS investment, after depreciation, as shown on Pacific's books and is consistent with the procedure adopted in D.82-08-017. We will find that Pacific's calculations of the cost of goods sold, using the same procedure as the staff but with more recent data, provide a reasonably close approximation of net book value per USOC.

Both Pacific and the staff propose to recover administrative costs through a percentage factor multiplied by the cost of goods sold. Staff proposed a factor of .0682 but accepts the company's proposed factor of .079. CIA favors Pacific's higher estimate. We will adopt Pacific's estimate.

Pacific estimates warranty cost at $3.80 for each USOC which represents a major rate element for 1A key systems. The staff applies a similar procedure, arriving at a $7 per USOC cost for its 90-day proposed warranty. CIA argues that the appropriate warranty cost estimate would be $11.40 per USOC, three times Pacific's estimate for its 30-day proposed warranty. This figure is consistent with Pacific's estimating procedure and was later accepted by the staff. We will adopt it.

The adopted values for cost of goods sold, administrative cost, and warranty cost add up to the appropriate estimated unit costs per USOC.

The calculations of estimated unit costs per USOC at pages 5-F-7 to 5-F-11 of Exhibit 517 set forth the adopted cost of goods sold per USOC as well as calculations of administrative cost per USOC based on the adopted factor with appropriate roundings. The proper warranty cost per USOC may be derived from these pages as well, by tripling the warranty costs shown in column E. Thus, the estimated unit costs to be used in pricing key equipment for sale should be derived by adding, with respect to each USOC, the figures shown in columns B and D together with three times the figure shown in column E of pages 5-F-7 to 5-F-11 of Exhibit 517.

The sales price of a key system will be derived by multiplying these estimated unit costs per USOC by the quantity of each USOC item in the system and adding to that total the appropriate transaction cost. Thus, the final pricing element to be determined is the transaction cost per KTS sale.

3. Transaction Costs

The staff initially estimated transaction costs as varying between $210 and $250 per system sold; Pacific's estimate in Exhibit 517 was $340 per system sold. Both estimates required adjustment to reflect changed assumptions as to the procedures incident to a sales program, including customer mailings and procedures addressing the shared equipment problem. The staff eventually accepted Pacific's estimates of the costs of various procedures to be covered by the transaction cost, but continues to differ as to the total transaction cost due to disagreement over projected take rate. A higher take rate will increase some transaction cost elements and decrease others, while increasing the number of sales by which the transaction costs are to be divided to determine the transaction costs per completed sale.

We will accept as reasonable Pacific's estimates of the costs of the various procedures required to implement a key equipment sales program, but will apply to them estimates of customer response consistent with the adopted 20% take rate. Cost estimates also will

be adjusted to reflect a 60-day preparation time and the use of only a single mailing of an informational letter to prospective purchasers. We consider that a 60-day preparation time is feasible as a compromise between the staff's 30-day estimate and Pacific's claim to need 90 days, particularly in view of our simplifying the staff proposal by eliminating the extended warranty and installment payment options. A preparation time no longer than 60 days from the effective date of this decision is essential to provide KTS customers a realistic opportunity to purchase their equipment from Pacific. We assume a single mailing to customers because that is all Pacific has time to respond to in 1983.

Based on all these considerations, we will accept as reasonable Pacific's procedures for estimating transaction costs, set forth in Attachment 5-B of Exhibit 517. Pacific's estimates will be adjusted to reflect estimates of customer response consistent with the adopted take rate projection of 20%, a more precise estimate of 256,000 customer locations, a 60-day preparation time, and only a single informational mailing to prospective purchasers. These adjustments call for increases in certain transaction cost elements, specifically the use of more computer time, of more personnel to handle customer responses and requests for price quotes, and of more computer terminals to develop price quotes. The resultant estimate of transaction costs, in the format provided at page 5-B-2 of Exhibit 517, is summarized in Table I, infra. We will find that $320 per completed sale is a reasonable estimate of transaction costs associated with sales of in-place 1A key systems.

TABLE I

SUMMARY OF IN-PLACE TRANSACTION COSTS
(Per Purchase)

1.	Customer Contact	
	1a. Informational letter	$ 4.73
	1b. Customer Response Center	1.33
	1c. Firm price quote	6.57
	1d. Contact sales work	97.86
	Subtotal	$110.49
2.	Validation and Update	
	2a. Pre-sale visit	$ 46.83
	2b. Post-sale inventory	135.00
	2c. Post-sale marking	26.00
	Subtotal	$207.83
3.	Total Transaction Costs	$318.32
	Use:	$320.00

4. Prices for Sale of In-Place Systems

A revised version of pages 5-F-7 to 5-F-11 of Exhibit 517, reflecting the above determinations as to the various elements of the estimated cost of sale, is attached to this opinion as Appendix B. In-place 1A key telephone systems sold pursuant to this opinion should be priced in accordance with Appendix B. Table II, infra, applies the adopted price elements from Appendix B to the example of a typical 1A key system consisting of three lines, seven stations, and associated equipment including wiring. The sales price of such a system would be $1,380.

TABLE II

1A KEY TYPICAL SYSTEM

3 LINES 7 STATIONS

USOC *	COST OF GOODS GOLD	ADMINISTRATIVE COST	WARRANTY COST	TOTAL	QUANTITY	SALE PRICE
a	b	c	d	e=b+c+d	f	g=exf
KSE	$ -	$ -	$ -	$ -	1	$ 0
KLD	36	2.80	-	39	3	117
KVX+6	55	4.30	11.40	71	7	497
DA9	74	5.75	-	80	1	80
TEF	105	8.25	-	115	1	115
SUBTOTAL						$ 809
INSIDE WIRE						201
TRANSACTION COST						320
TOTAL						$1,330

*USOC	Identification
KSE	Common Equipment - First 4 lines per customer account
KLD	Line Card - Hold illumination and common bell line unit - per line
KVX+6	Set - 6 Button Set - Touch-Tone Desk
DA9	Intercom - Dial Select intercom single talk path - maximum 40 codes - first 9 codes
TEF	Each Intercommunicating line equipped for Touch-Tone

5. Pricing for Sales from Inventory

Pacific's plan provides for sales from its inventory of all the items of key telephone equipment offered on an in-place basis, but only to the extent that stocks of such equipment are available. A price list for sales from inventory is proposed at pages 6-21 to 6-25 of Exhibit 517. These prices are either identical to or slightly higher than those proposed by Pacific for in-place sale of the same equipment types, because they are calculated by use of a 1.5 pricing factor. They also contemplate a transaction charge of $340 per KTS sale.

Despite its advocacy of a 1.0 pricing factor and adjustments to the transaction cost to reflect a higher take rate in the context of in-place sales, the staff accepts Pacific's pricing of individual pieces of equipment for sales from inventory. Apparently the staff believes that the key equipment customers' interests are adequately protected by offering them only their in-place equipment on a net book value basis, and that it is appropriate for sales from inventory to be priced at levels closer to the market prices of competing suppliers. We agree. Proceeds from inventory sales in excess of net book value and associated costs of sale should redound to the benefit of the general body of ratepayers.

Pacific's proposed price list for sales of key equipment from inventory is attached to this opinion as Appendix C. 1A key equipment sold from inventory pursuant to this opinion should be priced in accordance with Appendix C.

6. Pricing of Other Activities

Pacific's plan provides that all post-sale maintenance services will be performed on a time and materials basis. The same is true of services provided for installation, growth, rearrangement, or removal of 1A key and ancillary equipment, except for a transaction cost of $56 per transaction for such activities and a 9.2% loading factor to cover Pacific's administrative and processing

costs where labor is performed for Pacific by an outside vendor. The same administrative loading factor is included in Pacific's fully assigned labor rates for all such services.

The staff accepts Pacific's method of calculating the charges applicable to these ancillary activities as reasonable and recommends that they be filed in tariff form together with prices for sales from inventory as discussed above. The staff believes that customers should have this option of meeting growth and replacement needs through purchase on a tariffed basis. The staff would allow Pacific to change any of the initial tariffs for the sale of equipment or service with new tariffs after the statutory period (per General Order 96-A) by advice letter filing and with the filed tariffs to remain in effect for a minimum of 30 days.

We agree that all prices and charges related to Pacific's key equipment sales program should be prescribed by filed tariffs, and that all charges to customers should be in accordance with those tariffs. Contrary to the view expressed by General, we are persuaded that the offering for sale to customers by a telephone utility of CPE acquired and previously employed by that utility in the provision of public utility service and included in that utility's rate base does constitute a public utility service. Such a sale offer should be considered a regulated offering and so should be conducted on a tariffed basis with specification of all prices and charges or clear formulas for determining such prices and charges.

D. Would a Sales Program Based on The Terms Stated Above Have Unacceptable Effects on Competition?

Many of the dramatic changes now occurring in telecommunications are intended to enhance competition in that industry. In particular, decisions of federal courts and agencies leading toward deregulation of the CPE business and the institutional separation of Bell System CPE operations from Bell System local exchange telecommunications services are intended to enhance

competition in the manufacture and marketing of CPE. By contrast, the primary goal of CPE sales programs of the sort here proposed by the staff is not to promote competition, but rather to ensure that the interests of Pacific's ratepayers are adequately protected during the transition to a more competitive CPE marketplace. The Commission's concern in considering adoption of a CPE sales plan is not whether such a plan will maximize competition, but rather whether the plan can adequately protect ratepayer interests without thwarting the trend toward a more competitive CPE industry.

The Commission is obliged to take into account the antitrust aspects of applications before it, and "must place the important public policy in favor of free competition in the scale along with the other rights and interests of the general public." (Northern California Power Agency v PUC (1971) 5 C 3d 370, 379.) Moreover, the Commission must be concerned to avoid subjecting public utilities under its jurisdiction to significant risks of liability for anticompetitive conduct. A CPE sales program laden with such risks would not protect the interests of California's ratepayers.

Witnesses for both Pacific and CIA expressed concern about the impact upon competition of Commission initiation of a 1A key sales program with prices significantly below the prices of competitive offerings. CIA argues that setting prices can violate the antitrust laws even where those prices recover costs, citing Transamerica Computer Co., Inc. v International Business Machines Corp. (9th Cir. 1983) 698 F 2d 1377. CIA contends that all competent record evidence on the issue indicates that the prices recommended by both the staff and Pacific for the sale of 1A key equipment fall well below the levels at which competing concerns are able to offer comparable CPE.

Out of its concern to prevent pricing of embedded CPE at prices "so dramatically far below competitive equipment offerings," CIA supports Pacific's approach of factoring in an increase in prices at some level above costs in order to fit its equipment into the

structure of competitive market activities. However, CIA contends that Pacific underestimates competitive equipment prices and, consequently, the level of the factor to be applied to achieve a proper price structure for 1A key equipment. According to CIA, a substantial increase in Pacific's proposed pricing factor is needed to bring the prices realized by it for 1A key equipment more closely in line with competitive offerings and to ensure that the return from the company's sales program adequately offsets the costs incurred by it in pursuing 1A key equipment sales.

Transamerica Computer, the only case cited by CIA, concerned a claim that a dominant computer manufacturer engaged in predatory pricing by repackaging existing products and offering them at lower prices. In that case the district court had held that the dominant supplier had not violated the antitrust laws, holding that prices above average total cost should be conclusively presumed legal. The appeals court disagreed, pointing out discrete circumstances under which pricing above average cost could be predatory, mostly as part of strategies designed to discourage new market entrants. (Transamerica Computer, supra, at 1386-87.) The appeals court nonetheless held that:

> "If the challenged prices exceed average total cost, the plantiff must prove by clear and convincing evidence - i.e., that it is highly probably true - that the defendant's pricing policy was predatory." (Id. at 1388.)

Applying this test, the appeals court affirmed the district court's decision that the defendant had not violated the antitrust laws.

The court in Transamerica Computer defined predatory pricing as occurring:

> "When a company that controls a substantial market share lowers its price to drive out competition so that it can charge monopoly prices, and reap monopoly profits, at a later time." (Id. at 1384.)

We have adopted generous estimates of the various cost elements involved in the proposed 1A KTS sales plan, including several estimates suggested by CIA, in order to ensure that sales prices fully cover all Pacific's costs of equipment and of sale. As noted previously, addition of a pricing factor exceeding 1.0 must be rejected in order to protect ratepayers' legal interest in the appreciation in value of 1A key equipment during the years of regulation.

We have no predatory intent in pricing key systems on the basis of net book costs. It is not our intent "to drive out competition," nor is there any prospect that Pacific, when it reenters the CPE market, from scratch, in 1984, will be able to charge monopoly prices or reap monopoly profits. Nor will our action enable AT&T to do so. Indeed, as noted in our prior discussion of the pricing factor issue, implementation of a regulated KTS sales program at this time, employing prices appropriate from a public utility perspective, will tend to frustrate possible efforts by the Bell System to effect an anticompetitive installed base migration strategy. Our conclusion in this regard is consistent with that expressed by the FCC in its Notice of Proposed Rulemaking in CC Docket No. 81-893, supra, at 17.

The evidence in this proceeding indicates that even the sales plan proposed by the staff, with prices significantly lower than those we will authorize, would have no more than a marginal impact on competing equipment suppliers. This is because an embedded key equipment sales program is directed toward serving a market segment different from those served by the equipment suppliers represented by CIA and its witnesses.

The vast majority of KTS subscribers, roughly 97%, have systems of fewer than ten lines; about 80% have three lines or fewer. The typical key system, used as an example by all parties to this proceeding, features three lines and seven telephone

instruments. The embedded systems to be offered for sale are entirely non-state-of-the-art electromechanical equipment.

The competitors represented by CIA, in contrast, sell primarily modern electronic equipment. CIA witness Healy testified that this is the developing area, where the most business opportunities present themselves. Healy stated that generally speaking the breakpoint for customers to "graduate" to an electronic system is a minimum of ten instruments and five access lines. CIA witnesses Healy and Horvath both conceded that reaching customers with fewer than ten instruments was not a "major thrust" of their businesses. Both acknowledged that they looked particularly to customers planning to relocate or outgrowing their present systems as the "classic" prospect for sale of competing equipment.

Pacific's customers who will take advantage of a KTS sales program will be predominantly small-scale customers for whom a sophisticated electronic system is uneconomic and customers who are not planning to relocate or expand their facilities in the near future. Others will be unlikely to find it to their interest to purchase the embedded equipment. Thus, the major choice which a KTS sales program will offer to customers will not be whether to buy an embedded Pacific system versus a competing manufacturer's system but rather whether to buy the embedded system or continue to lease it from Pacific, and soon from AT&T. Thus, the only "competitor" which appears likely to suffer a significant disadvantage from prompt implementation of a KTS sales program is AT&T. This implies no injury to the public policy in favor of free competition. In fact, diminishing the share of the embedded key equipment which AT&T will acquire in 1984 should enhance the competitiveness of the CPE marketplace.

E. What Should Be Required of Other Telephone Companies?

General opposes the extension to it of any sales program modeled on the staff proposal. The staff does not see General as

subject to the staff proposals in this proceeding and is not prepared at this point to advise whether the proposed sales program should be enlarged to cover General.

In view of the impending divestiture of Pacific from AT&T, involving the transfer of Pacific's embedded base of key equipment to AT&T, it is necessary to implement the proposed sales program as rapidly as possible. Consideration of comparable programs for other telephone utilities is less urgent. In any event, the present record is inadequate to determine whether other telephone companies should be authorized or required to implement KTS sales program.

F. How Will Implementation of a KTS Sales Program Be Affected by the Transfer of Pacific's KTS Assets to AT&T?

We will require Pacific to file tariffs providing for sale of embedded 1A key equipment at the prices and under the terms specified in this opinion and in Appendices A, B, and C. If the FCC does not deprive us of regulatory jurisdiction over AT&T's management of the embedded base of CPE, we will require that AT&T adopt Pacific's tariffs relating to the KTS sales program concurrently with the transfer of that embedded base from Pacific to AT&T.

VI. SALE OF ADDITIONAL MULTILINE EQUIPMENT

Among the reasons for deferring consideration of a sales program for multi-line CPE other than stand-alone 1A key systems was the inadequacy of Pacific's GE-100 costing methodology for determining appropriate net book values for such equipment. D.83-04-012, issued April 6, 1983, in this proceeding, established more appropriate costing procedures for CPE and private line service, with the intention that the approved "costing manuals" be applied in Pacific's future rate proceedings. Issuance of D.83-04-012 set the stage for consideration of the sale of further portions of Pacific's multi-line CPE assets, especially private branch exchange (PBX) equipment.

On April 20, 1983, the California Hotel and Motel Association (CHMA) filed a petition for immediate hearings to enable the Commission to fix terms under which Pacific would be required to offer to customers its in-place multi-line CPE other than key systems. CHMA indicated that it would offer a qualified witness to show that "an impressively high percentage of hotels having in-place terminal equipment of the older variety would have a serious interest in purchasing such equipment at a reasonable cost."

Pacific opposed the CHMA petition, contending that it was impractical to seek to hold hearings, render a decision, and have Pacific implement a sales program within the eight months preceding Pacific's divestiture from AT&T. Pacific has asserted that Commission consideration of a sales program for additional multi-line CPE was unnecessary because AT&T had proposed a post-transfer 18-month price predictability plan for all in-place business CPE, a plan already approved in principle by the FCC in late April. Pacific further contended that CHMA ignored a lack of interest in sale by hotels and motels, as demonstrated by Pacific's customer survey results appended to its filing.

CHMA replied on May 16 to Pacific's filing by proposing a very compact schedule for hearing, decision, and implementation of a further CPE sales program. CHMA disputed Pacific's claim that the pending FCC consideration of AT&T's price predictability plan would adequately protect California customers, and asserted that its own inquiry into its members' interest in purchasing multi-line CPE refuted Pacific's customer survey findings.

On May 23 TASC filed a petition analogous to that of CHMA, seeking an "expedited order" directing Pacific to implement a plan for the sale of telephone answering service equipment prior to January 1, 1984, and at net book values consistent with the D.83-04-012 costing manual. TASC expressed particular interest in the offering for sale of "vintage" 551 and 557 switchboard equipment. TASC proposed that Pacific be ordered to make a revised

offering by July 1 of this equipment reflecting the new costing manual, with hearings to be held in late July and TASC given an opportunity to submit a counterproposal, followed by further hearings in August and briefs filed in early September. On June 20 Pacific filed its opposition to TASC's petition, on grounds virtually identical to those upon which it had opposed that of CHMA.

On July 11 the staff filed a reply supporting both the CHMA and TASC petitions. The staff considers it important to allow these customers to purchase their present equipment so that they will be able "to make considered judgments as to the next generation of terminal equipment," free of the pressures of the installed base migration strategy. According to the staff the principal deterrent to effecting sales of the in-place PBX equipment of concern to CHMA and TASC is the price which Pacific would ask. The staff suggests, in line with TASC's petition, that the Commission direct Pacific to file tariffs providing for sale of this equipment at prices based on the costing procedures specified in D.83-04-012 plus reasonable charges for processing the sale. The staff notes that all such equipment must, in any event, be valued in Pacific's current rate proceeding (A.83-01-22) according to the D.83-04-012 costing procedures, so that Pacific should be in a position to file sales tariffs expeditiously, subject to prompt acceptance or protest of such tariffs by interested parties. Apparently the staff sees no necessity for hearings to be scheduled to review such tariffs, except possibly in the event protests are filed.

On August 1, 1983, Pacific filed a response to the staff reply, denying that cost studies based on D.83-04-012 had been submitted in A.83-01-22 and, therefore, that Pacific could promptly file tariffs to sell it PBX equipment based on the approved costing methodology. Pacific criticizes the staff proposal for not dealing with the points Pacific had made in response to the CHMA and TASC petitions, and argues that the time required to implement a PBX equipment sales program, including the review of protests likely to

be generated, would leave "essentially no time in which customers could react to a sales offer" prior to the transfer of such equipment to AT&T in January 1984. Pacific reiterates its concern about it and the Commission expending resources at this time to formulate a program for which there is minimal customer interest and which duplicates efforts already well underway before the FCC. Pacific also questions the staff's argument that purchase of in-place equipment will leave subscribers freer to choose among the next generation of terminal equipment; rather, a hasty purchase might "lock in" a purchaser and hinder later opportunities.

We agree with the staff, CEMA, and TASC that it is appropriate to make available to PBX equipment customers a purchase option comparable to that which has been offered to single-line CPE customers and which we are today authorizing for stand-alone 1A key equipment, at least insofar as administrative and transaction costs associated with such sales can be kept to reasonable levels. The procedure suggested by the staff, by which Pacific would develop tariffs based on the Commission's approved costing manual subject to possible protest by interested customers, appears to offer a minimally burdensome, yet workable, approach to the task, suitable to the relatively sophisticated and well-represented character of the PBX equipment customer class.

We are, however, reluctant to impose on Pacific the burden of implementing yet another CPE sales program at this date so near to the impending divestiture. Pacific has asserted, plausibly, that the cost studies required to implement a PBX sales program have not been done. Our own resources to formulate and monitor such a program are severely limited by responsibilities of broader import. We are also hesitant to divert Pacific's attention from the promptest possible implementation of the KTS sales plan we will approve today. Moreover, there appears to be insufficient time to implement PBX equipment sales before the January 1984 divestiture date. We will,

therefore, not require Pacific to offer its in-place PBX equipment for sale to customers at this time.

We do not, however, determine that the petitions of CHMA and TASC are without merit. To the contrary, it is only the pressure of time and the complexity of divestiture implementation which prevent us from acting favorably on those petitions. To the extent that we retain regulatory authority over the in-place PBX equipment which Pacific will transfer to AT&T at the time of divestiture, we intend during 1984 to require that AT&T implement an appropriate sales program for such equipment based upon this Commission's approved costing manual. We have filed comments with the FCC in its Second Computer Inquiry implementation proceeding, Docket No. CC 81-893, requesting that the FCC not "detariff" embedded CPE until state authorities have had a reasonable opportunity to implement equipment sales programs. If the FCC heeds that request, we will be able to respond positively to the CHMA and TASC petitions after divestiture has been implemented. For that reason this decision will be interim in nature.

Findings of Fact

1. Embedded CPE is that equipment or inventory owned by a telephone company which was tariffed or otherwise subject to the jurisdictional separations process as of January 1, 1983, including terminal equipment on customer premises or in utility inventory on that date.

2. For this Commission to mandate a sales program for Pacific's embedded CPE would not disrupt the FCC's plan for deregulation of the CPE marketplace.

3. This Commission's consideration of a CPE sales program is a regulatory response to current and impending changes in the telecommunications marketplace.

4. Pacific has dedicated its CPE, including stand-alone 1A key telephone systems, to the public service, for use by customers in receiving and transmitting telecommunications.

5. A mandated program for the sale of embedded CPE is a matter cognate and germane to the regulation of telephone companies.

6. In prescribing a CPE sales program, the Commission is setting the terms of contracts that directly affect service to ratepayers.

7. The present system of tariffed leasing of CPE will soon come to an end, creating concern for the protection of ratepayer interests during the transition to CPE deregulation.

8. The Bell System dominates the market for stand-alone 1A key telephone equipment.

9. Stand-alone 1A key telephone equipment is the most substantial category of CPE which AT&T has chosen not to offer for sale under its price predictability program for detariffed embedded CPE proposed to the FCC in CC Docket No. 81-893.

10. It is likely that the FCC will approve early detariffing of most or all embedded CPE.

11. The regulatory scheme which has governed the provision of CPE has placed the risk of loss of capital value on the ratepayers.

12. A requirement that Pacific offer its embedded 1A key telephone equipment for sale on a tariffed basis can protect the legal interest of KTS customers in that equipment.

13. Pacific's prior experience with a single-line CPE sales plan should shorten its tasks in implementing a KTS sales program.

14. Availability of a KTS sales program in the later months of 1983 will tend to remedy confusion among customers.

15. A KTS sales program with prices set at appropriate levels stands to benefit the general body of ratepayers and will subject them to minimal risk.

16. A regulated KTS sales program with prices based on net book values will tend to frustrate possible Bell System efforts to implement the so-called installed base migration strategy.

17. Pricing in-place KTS equipment for sale to present customers on the basis of net book value plus appropriate factors to reflect all costs of the sales program will not be anticompetitive.

18. Prices for embedded KTS equipment sold in-place should be based on net book value, without application of any pricing factor other than 1.0.

19. A 60-day preparation time should be adequate prior to Pacific's implementation of the KTS sales plan we will authorize.

20. The installment payment options proposed by the staff should not be required.

21. The longer warranty periods proposed by the staff are reasonable, but the staff-proposed extended warranty option and the no-warranty option proposed by General should not be required.

22. Inside wiring associated with KTS equipment is an integral part of the equipment installed on the customer's premises.

23. Purchase of the inside wiring associated with KTS equipment will leave the customer free to make subsequent rearrangements and will clearly demark Pacific's utility service obligations.

24. Sale of inside wiring will accelerate recovery of Account 232 investment.

25. Sale of inside wiring will increase the prices of key systems sold while remaining faithful to the principle of sale at net book value.

26. Inside wiring associated wih KTS equipment should be sold with the equipment at prices based on the matrix set forth in Appendix A.

27. A 20% take rate is a fair and reasonable projection of key equipment sales under the plan we will authorize.

28. Evidence presented by Pacific and the staff in A.83-01-22 has clearly defined issues as to accounting treatment and income tax consequences of the single-line CPE sales program which substantially affect Pacific's revenue requirements.

29. Tax consequences of KTS sales will not be of such magnitude as to require higher pricing of key equipment than under the plan we will authorize.

30. The latter formula set forth at page 42, supra, is the appropriate means of estimating the cost of sale under a KTS sales plan.

31. Pacific's calculations of the costs of goods sold provide a reasonably close approximation of net book value per USOC.

32. Pacific's estimate of an administrative cost factor is reasonable.

33. An appropriate warranty cost factor is three times Pacific's estimate.

34. $340 per completed sale is a reasonable estimate of transaction costs associated with sales of in-place 1A key systems under the plan we will authorize.

35. In-place 1A KTS sold pursuant to this opinion should be priced in accordance with Appendix B.

36. Sales of stand-alone 1A key telephone equipment from inventory should be based on a pricing factor more reflective of the market prices of competing suppliers, but proceeds from such sales in excess of costs should redound to the benefit of the general body of ratepayers.

37. 1A key telephone equipment sold from inventory pursuant to this opinion should be priced in accordance with Appendix C.

38. All prices and charges related to Pacific's KTS sales program should be prescribed by filed tariffs.

39. Sales prices for key telephone equipment under the KTS sales plan we will authorize are based on generous estimates of

various cost elements, in order to ensure that sales prices fully cover Pacific's equipment and sales costs.

40. This Commission has no predatory intent in pricing key systems on the basis of net book costs.

41. There is no prospect that Pacific, when it reenters the CPE market in 1984, will be able to charge monopoly prices or reap monopoly profits; nor will this decision enable AT&T to do so.

42. An embedded KTS sales program serves a market segment different than those served by independent CPE suppliers.

43. The vast majority of KTS subscribers have systems of fewer than ten lines; about 80% have three lines or fewer.

44. All embedded key equipment to be offered for sale under the plan we will authorize is non-state-of-the-art electromechanical equipment.

45. Independent CPE suppliers sell primarily modern electronic KTS equipment; their business is mainly oriented toward customers with ten or more lines and planning to relocate or outgrowing their present key telephone systems.

46. Customers who will take advantage of Pacific's KTS sales program will be predominantly small-scale customers for whom an electronic system is uneconomic and who are not planning to relocate or expand their facilities in the near future.

47. The only competitor likely to be significantly disadvantaged by the KTS sales plan we will authorize is AT&T.

48. Diminishing the share of embedded key equipment which AT&T will acquire in 1984 should enhance the competitiveness of the CPE marketplace.

49. It is more urgent to implement a KTS sales program for Pacific than for other telephone utilities in California.

50. It can be seen with certainty that there is no possibility that the sales plan we will authorize may have a significant effect on the environment.

51. An immediate effective date for the accompanying order is necessary to enable Pacific's KTS customers to take advantage of the sales plan we will authorize.

52. The accompanying order should be interim in nature in order to permit further consideration of the CEMA and TASC petitions after divestiture has been implemented.

Conclusions of Law

1. Pursuant to the Commission's authority under PU Code §§ 701, 728, 761, and 762, it may require a telephone company under its jurisdiction to offer for sale to customers at a reasonable tariffed price used and useful CPE which otherwise would soon be transferred to an unregulated affiliated corporation.

2. It is within the regulatory authority of this Commission to require Pacific to offer embedded CPE for sale to customers on a tariffed basis; such a program would not conflict with federal regulatory jurisdiction.

3. The Commission has authority to prescribe the terms of contracts which directly affect the service a ratepayer will receive.

4. Gains or losses on transfer of Pacific's embedded CPE to an unregulated affiliate should be allocated between investors and ratepayers in proportion to the extent to which one or the other class bore the risk of loss of capital value over the regulated life of such embedded CPE.

5. The Commission can, if appropriate, require that any embedded CPE sales program ordered for Pacific be continued in effect by AT&T or whatever AT&T affiliate receives Pacific's embedded CPE.

6. Pacific should be required to offer its embedded stand-alone 1A key telephone equipment for sale to customers on a tariffed basis beginning as soon as is feasible.

7. Pacific's stand-alone 1A KTS customers should be entitled to purchase their in-place equipment at a price reflecting its net book value plus the costs of sale.

8. It is reasonable to determine any revenue deficiency or surplus associated with the KTS sales program in the second phase of

hearings in A.83-01-22, based on the resolution of relevant accounting and tax issues in the current phase of that proceeding, with any such revenue deficiency or surplus to be taken into account in determining Pacific's 1984 revenue requirements in the final decision in A.83-01-22.

9. The offering for sale to customers by a telephone utility of CPE acquired and previously employed by that utility in providing public utility service and included in that utility's rate base constitutes a public utility function, which should be conducted on a tariffed basis.

10. The KTS sales plan we will authorize will not cause either the Commission, Pacific, or AT&T to engage in predatory pricing or to violate the antitrust laws.

11. Pacific should be required to implement a KTS sales plan with the characteristics determined appropriate in this opinion.

INTERIM ORDER

IT IS ORDERED that:

1. The Pacific Telephone and Telegraph Company (Pacific) shall, on not less than five days' notice to the Commission and the public and not later than 30 days from the effective date of this decision, file tariffs to implement a sales program for stand-alone 1A key telephone system equipment in conformity with the determinations reached in the foregoing interim opinion and with sales prices for such equipment set in accordance with the attached Appendixes A, B, and C.

2. Sales of equipment under the tariff authorized in Ordering Paragraph 1 and notification to customers eligible for the sales program shall commence not later than 60 days from the effective date of this decision.

3. Pacific shall submit its proposed notice to customers eligible for the sales program to the Commission staff and the Administrative Law Judge assigned to these matters for their review not later than 30 days from the effective date of this decision.

4. Pacific shall, within six months of the effective date of this decision, file with the Commission staff a report detailing the results of the sales program authorized by this decision, including analysis of the quantity and types of equipment sold, the percent take, and the net gain or loss to Pacific.

5. Any revenue deficiency or surplus for ratemaking purposes associated with the sales program authorized by this decision shall be determined in the second phase of hearings in A.83-01-22, based on the resolution of relevant accounting and tax issues in the current phase of that proceeding, with any such revenue deficiency or surplus to be taken into account in determining Pacific's 1984 revenue requirements in the final decision in A.83-01-22.

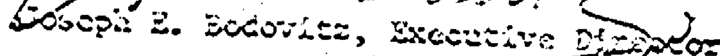
This order is effective today.

Dated SEP 7 1983, at San Francisco, California.

LEONARD M. GRIMES, JR.
President
VICTOR CALVO
PRISCILLA C. GREW
DONALD VIAL
Commissioners

Commissioner William T. Bagley being necessarily absent, did not participate.

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



Joseph E. Bodovitz, Executive Director

APPENDIX A

THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY
Pricing Matrix for Sale of Non-Inventoried In-Place Inside Wiring
1A Key Telephone System

No. of In-Place Wiring Facilities	No Common Answrg Point Station Cable Size				One Common Answrg Point Station Cable Size				Two Common Answrg Point Station Cable Size			
	6 Pr	12 Pr	16 Pr	25+Pr	6 Pr	12 Pr	16 Pr	25+Pr	6 Pr	12 Pr	16 Pr	25+ Pr
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)	(k)	(l)	(m)
2	20	30	42	54	50	60	72	85	89	103	122	141
3	32	47	66	86	50	60	72	85	89	103	122	141
4	40	59	84	110	58	73	90	110	89	103	122	141
5	52	77	107	141	70	90	114	140	89	103	122	141
6	60	89	126	164	78	102	133	164	97	116	140	164
7	76	111	154	201	94	124	162	201	114	138	169	201
8	88	129	178	231	106	142	185	231	126	155	193	232
9	105	150	207	268	122	164	214	268	142	178	222	269
10	121	173	236	304	139	186	242	304	158	199	250	305
11	144	202	273	355	182	235	298	373	221	268	325	392
12	160	225	302	392	198	258	327	410	237	290	354	429
13	172	242	325	422	210	274	351	440	249	307	378	458
14	188	264	354	458	226	297	380	477	265	330	406	494
15	211	294	390	509	250	326	416	527	288	359	443	545
16	227	316	419	546	266	349	445	564	304	381	472	582
17	250	346	456	597	289	378	482	614	327	410	508	633
18	262	363	479	628	301	395	506	645	339	428	532	664
19	278	385	508	664	317	418	534	682	356	450	561	701
20	302	414	545	714	340	447	571	733	378	480	598	751
21 and above, price for each additional unit	18	24	31	41	20	26	33	43	22	28	34	45

(END OF APPENDIX A)

1A-KEY-AS-MAIN
SUMMARY OF ESTIMATED UNIT COSTS
IN-PLACE SALES

USOC	Cost of Goods Sold ($)	Transaction Cost* ($)	Admin. Cost ($)	Warranty Cost ($)	Total ($)
A	B	C	D	E	F=B+C+D+E
44R	150	0	12.00	0.00	160
44U	89	0	7.00	0.00	96
49S	25	0	2.00	0.00	27
57K	51	0	4.00	0.00	55
6LU	24	0	1.90	0.00	26
8AF+6	185	0	15.00	11.40	210
8AF+K	180	0	14.00	11.40	205
8AR+6	160	0	13.00	11.40	185
8AR+K	150	0	12.00	11.40	175
8BG+6	620	0	49.00	11.40	680
8BG+K	615	0	49.00	11.40	675
8BX+6	125	0	10.00	11.40	145
8BX-K	120	0	9.50	11.40	140
8CJ+6	745	0	59.00	11.40	815
8CJ+K	745	0	59.00	11.40	815
8DM+6	895	0	71.00	11.40	975
8DM+K	895	0	71.00	11.40	975
8ST+6	105	0	8.25	11.40	125
8ST+K	100	0	8.00	11.40	120
CDE+R	110	0	8.75	0.00	120
CDE+T	115	0	9.00	0.00	125
CDM+R	150	0	12.00	0.00	160
CDM+T	155	0	12.00	0.00	165
D2F	1,500	0	120.00	11.40	1,600
D5H	17	0	1.30	0.00	18
D7K	42	0	3.30	0.00	45
DA9	74	0	5.75	0.00	80
DAA	39	0	3.10	0.00	42
DAD	23	0	1.80	0.00	25
DAH	3	0	0.00	0.00	3
DAM	42	0	3.30	0.00	45
DAR	39	0	3.10	0.00	42
DBJ	1,500	0	120.00	11.40	1,600
DC9	455	0	36.00	0.00	490
DCJ	1,500	0	120.00	11.40	1,600
DCP	57	0	4.50	0.00	62
DE1	52	0	4.10	0.00	56
DEY	13	0	1.00	0.00	14
DEYAA	13	0	1.00	0.00	14
DEYAB	13	0	1.00	0.00	14

*Transaction Cost for 1A Key-as-Main = $320 per system.

1A-KEY-AS-MAIN
SUMMARY OF ESTIMATED UNIT COSTS
IN-PLACE SALES

USOC	Cost of Goods Sold ($)	Transaction Cost* ($)	Admin. Cost ($)	Warranty Cost ($)	Total ($)
A	B	C	D	E	F=B+C+D+E
DEYAC	13	0	1.00	0.00	14
DGJ	1,700	0	135.00	11.40	1,800
DJJ	100	0	8.00	0.00	110
DKL+R	125	0	10.00	11.40	145
DKL+T	135	0	11.00	11.40	155
DKV+R	140	0	11.00	0.00	150
DKV+T	150	0	12.00	0.00	160
DL4	34	0	2.70	0.00	37
DLY	42	0	3.30	0.00	45
DS7	30	0	2.40	0.00	32
GQS	160	0	13.00	0.00	175
GQY	150	0	12.00	0.00	160
HMF	22	0	1.70	11.40	35
HTG	6	0	0.00	0.00	6
JEJ	19	0	1.50	0.00	21
JML	1,700	0	135.00	11.40	1,800
JNL	1,700	0	135.00	11.40	1,800
K1Y+1	26	0	2.10	11.40	40
K1Y+3	26	0	2.10	11.40	40
K1Y+G	21	0	1.70	11.40	34
K1Y+M	21	0	1.70	11.40	34
K42+R	97	0	7.75	0.00	105
K42+T	105	0	8.25	0.00	115
K46+R	140	0	11.00	0.00	150
K46+T	140	0	11.00	0.00	150
K4R	13	0	1.00	0.00	14
K8M	15	0	1.20	0.00	16
KB3	71	0	5.50	11.40	88
KB4	125	0	10.00	11.40	145
KB6	105	0	8.25	11.40	125
KB6AA	105	0	8.25	11.40	125
KB7	180	0	14.00	11.40	205
KBB	21	0	1.70	0.00	23
KBC	145	0	11.00	11.40	170
KBD	210	0	17.00	11.40	240
KBU	17	0	1.30	0.00	18
KC8	21	0	1.70	0.00	23
KCA	115	0	9.00	0.00	125
KCB	21	0	1.70	0.00	23
KCC	140	0	11.00	0.00	150

*Transaction Cost for 1A Key-as-Main = $320 per system.

1A-KEY-AS-MAIN
SUMMARY OF ESTIMATED UNIT COSTS
IN-PLACE SALES

USOC	Cost of Goods Sold ($)	Transaction Cost* ($)	Admin. Cost ($)	Warranty Cost ($)	Total ($)
A	B	C	D	E	F=B+C+D+E
KCF	115	0	9.00	0.00	125
KCJ	115	0	9.00	0.00	125
KCM	105	0	8.25	0.00	115
KD2+R	97	0	7.75	11.40	120
KD2+T	105	0	8.25	11.40	125
KD3+R	125	0	10.00	11.40	145
KD3+T	130	0	10.00	11.40	150
KD4+R	140	0	11.00	11.40	160
KD4+T	140	0	11.00	11.40	160
KD6	23	0	1.80	0.00	25
KD8	57	0	4.50	11.40	73
KD8AA	24	0	1.90	11.40	37
KD8AB	24	0	1.90	11.40	37
KD9	62	0	4.90	11.40	78
KD9AA	28	0	2.20	11.40	42
KD9AB	28	0	2.20	11.40	42
KDL+R	150	0	12.00	11.40	175
KDL+T	155	0	12.00	11.40	180
KDN+R	125	0	10.00	0.00	135
KDN+T	130	0	10.00	0.00	140
KDS+R	110	0	8.75	11.40	130
KDS+T	115	0	9.00	11.40	135
KDU+R	125	0	10.00	0.00	135
KDU+T	135	0	11.00	0.00	145
KDV+R	165	0	13.00	11.40	190
KDV+T	175	0	14.00	11.40	200
KEJ+4	62	0	4.90	11.40	78
KEJ+6	62	0	4.90	11.40	78
KEJ+B	57	0	4.50	11.40	73
KEJ+K	57	0	4.50	11.40	73
KEP+R	125	0	10.00	0.00	135
KEP+T	135	0	11.00	0.00	145
KER+R	115	0	9.00	0.00	125
KER+T	120	0	9.50	0.00	130
KES+R	145	0	11.00	0.00	155
KES+T	150	0	12.00	0.00	160
KG1+6	72	0	5.75	11.40	89
KG1+K	67	0	5.25	11.40	84
KGM	22	0	1.70	0.00	24
KKT	140	0	11.00	0.00	150

*Transaction Cost for 1A Key-as-Main = $320 per system.

1A-KEY-AS-MAIN
SUMMARY OF ESTIMATED UNIT COSTS
IN-PLACE SALES

USOC	Cost of Goods Sold ($)	Transaction Cost* ($)	Admin. Cost ($)	Warranty Cost ($)	Total ($)
A	B	C	D	E	F=B+C+D+E
KL4	19	0	1.50	0.00	21
KL8+6	55	0	4.30	0.00	59
KL8+K	49	0	3.90	0.00	53
KLD	36	0	2.80	0.00	39
KLL	10	0	0.00	0.00	10
KMB	17	0	1.30	0.00	18
KPE	13	0	1.00	0.00	14
KQU	150	0	12.00	0.00	160
KS9	22	0	1.70	0.00	24
KSC+6	89	0	7.00	11.40	105
KSC+K	86	0	6.75	11.40	105
KSK+6	140	0	11.00	11.40	160
KSK+K	135	0	11.00	11.40	155
KSR	78	0	6.25	11.40	96
KU2+4	89	0	7.00	11.40	105
KU2+6	89	0	7.00	11.40	105
KU2+B	82	0	6.50	11.40	100
KU2+K	82	0	6.50	11.40	100
KUW+R	150	0	12.00	0.00	160
KUW+T	160	0	13.00	0.00	175
KV1+4	78	0	6.25	11.40	96
KV1+6	78	0	6.25	11.40	96
KV1+B	74	0	5.75	11.40	91
KV1+K	74	0	5.75	11.40	91
KV2+6	105	0	8.25	11.40	125
KV2+K	97	0	7.75	11.40	115
KVX+4	55	0	4.30	11.40	71
KVX+6	55	0	4.30	11.40	71
KVX+B	49	0	3.90	11.40	64
KVX+K	49	0	3.90	11.40	64
KXM	78	0	6.25	11.40	96
KXT	24	0	1.90	0.00	26
KZZ	10	0	0.00	0.00	10
L27	255	0	20.00	0.00	275
L29	210	0	17.00	0.00	225
L37	270	0	21.00	0.00	290
L39	230	0	18.00	0.00	250
LBS	150	0	12.00	0.00	160
LE2	65	0	5.25	0.00	70
LE4	105	0	8.25	0.00	115

*Transaction Cost for 1A Key-as-Main = $320 per system.

1A-KEY-AS-MAIN
SUMMARY OF ESTIMATED UNIT COSTS
IN-PLACE SALES

USOC	Cost of Goods Sold ($)	Transaction Cost* ($)	Admin. Cost ($)	Warranty Cost ($)	Total ($)
A	B	C	D	E	F=B+C+D+E
LFA	105	0	8.25	11.40	125
LFB	125	0	10.00	11.40	145
LFE	125	0	10.00	0.00	135
LFG	145	0	11.00	0.00	155
LFM	33	0	2.60	11.40	47
LFP	51	0	4.00	0.00	55
LFQ	34	0	2.70	0.00	37
LOC	9	0	0.00	0.00	9
LOT	78	0	6.25	0.00	84
NCM	14	0	1.10	0.00	15
NTS	15	0	1.20	0.00	16
NTT	15	0	1.20	0.00	16
NVA	1,200	0	95.00	11.40	1,300
NVCAL	195	0	15.00	0.00	210
NVCAS	93	0	7.25	0.00	100
NVD	93	0	7.25	11.40	110
NVE	62	0	4.90	11.40	78
NVG	78	0	6.25	11.40	96
NVH	105	0	8.25	11.40	125
NVJ-C	28	0	2.20	11.40	42
NVJ-T	35	0	2.80	11.40	49
NVK	62	0	4.90	0.00	67
NVM	47	0	3.70	11.40	62
PMT1R	97	0	7.75	0.00	105
PMT1T	100	0	8.00	0.00	110
PMT2R	110	0	8.75	0.00	120
PMT2T	125	0	10.00	0.00	135
PPK12	330	0	26.00	0.00	355
PPK50	270	0	21.00	0.00	290
TDS	300	0	24.00	0.00	325
TEF	105	0	8.25	0.00	115
XLX	16	0	1.30	0.00	17

*Transaction Cost for 1A Key-as-Main = $320 per system.

(END OF APPENDIX B)

PRICE LIST*
KEY
FROM INVENTORY

USOC	UNIT PRICE ($)
44R	$240
44U	145
49S	40
57K	85
6LJ	40
8AF-6	325
8AF-K	315
8AR-6	280
8AR-K	265
8BG-6	1,030
8BG-K	1,020
8BX-6	225
8BX-K	220
8CJ-6	1,230
8CJ-K	1,230
8DM-6	1,470
8DM-K	1,470
8ST-6	190
8ST-K	180
CDE-R	180
CDE-T	190
CDM-R	240
CDM-T	250
D2F	2,415
D5E	30
D7K	70
DA9	120
DAA	65
DAD	40
DAE	5
DAM	70
DAR	65
DBJ	2,415
DC9	735
DCJ	2,415
DCP	95
DEL	85
DEY	25
DEYAA	25
DEYAB	25

*TRANSACTION COSTS FOR KEY = $340 PER SYSTEM

APPENDIX C
Page 2

PRICE LIST*
KEY
FROM INVENTORY

USOC	UNIT PRICE ($)
DEYAC	$25
DGJ	2,715
DJJ	165
DKL-R	225
DKL-T	240
DKV-R	225
DKV-T	240
DL4	55
DLY	70
DS7	50
GQS	265
GQY	240
EME	60
EHG	10
JEJ	35
JML	2,715
JNL	2,715
KLY-1	65
KLY-3	65
KLY-G	55
KLY-M	55
K42-R	160
K42-T	175
K46-R	225
K46-T	225
K4R	25
K8M	25
KB3	135
KB4	225
KB6	190
KB6AA	190
KB7	315
KBB	35
KBC	255
KBD	360
KBU	30
KC8	35
KCA	190
KCB	35
KCC	225

*TRANSACTION COSTS FOR KEY = $340 PER SYSTEM

PRICE LIST*
KEY
FROM INVENTORY

USOC	UNIT PRICE ($)
KCF	$190
KCJ	190
KCM	175
KD2-R	180
KD2-T	190
KD3-R	225
KD3-T	235
KD4-R	250
KD4-T	250
KD6	40
KD8	115
KD8AA	60
KD8AB	60
KD9	125
KD9AA	70
KD9AB	70
KDL-R	265
KDL-T	270
KDN-R	205
KDN-T	210
KDS-R	205
KDS-T	210
KDU-R	205
KDU-T	220
KDV-R	285
KDV-T	310
KEJ-4	125
KEJ-6	125
KEJ-B	115
KEJ-K	115
KEP-R	205
KEP-T	220
KER-R	190
KER-T	195
KES-R	235
KES-T	240
KG1-6	140
KG1-K	130
KGM	40

*TRANSACTION COSTS FOR KEY = $340 PER SYSTEM

PRICE LIST
KEY
FROM INVENTORY

USOC	UNIT PRICE ($)
KL4	$35
KL8-6	90
KL8-K	80
KLD	60
KLL	15
KMB	30
KPE	25
KQU	240
KS9	40
KSC-6	165
KSC-K	160
KSK-6	250
KSK-K	240
KSR	150
KU2-4	165
KU2-6	165
KU2-8	155
KU2-K	155
KUW-R	240
KUW-T	265
KV1-4	150
KV1-6	150
KV1-8	145
KV1-K	145
KV2-6	190
KV2-K	180
KVX-4	110
KVX-6	110
KVX-8	100
KVX-K	100
KXM	150
KXC	40
KZZ	15
L27	415
L29	340
L37	435
L39	375
L35	240
LE2	105
LE4	175

*TRANSACTION COSTS FOR KEY = $340 PER SYSTEM

PRICE LIST*
KEY
FROM INVENTORY

USOC	UNIT PRICE ($)
LFA	$190
LFB	225
LFE	205
LFG	235
LFM	75
LFP	85
LFQ	55
LOC	15
LOT	130
NCM	25
NTS	25
NTT	25
NVA	1,965
NVCAL	315
NVCAS	150
NVD	175
NVE	125
NVG	150
NVH	190
NVJ-C	70
NVJ-T	80
NVK	100
NVM	100
PMT1R	160
PMT1T	165
PMT2R	180
PMT2T	205
PPK12	535
PPK50	435
TDS	490
TEF	175
XLX	25

*TRANSACTION COSTS FOR KEY = $340 PER SYSTEM

(END OF APPENDIX C)

(CCTA) (1972) 73 CPUC 507. Pacific contends that the Commission's role in the taking of public utility property for public use is limited by statute to valuing the property, with the decision whether a taking is justified being left to the courts. According to Pacific the Commission's authority under Public Utilities (PU) Code § 851 is limited to approving the sale of public utility property, and does not extend to requiring such a sale. The Commission's broad regulatory powers under PU Code §§ 701 and 729 are limited to actions "cognate and germane" to the regulation of public utilities and so, according to Pacific, are limited by the extent of public utility use to which Pacific has dedicated its property. Finally, Pacific argues that a sale order would have the effect of a taking of property for a private use, which exceeds the bounds of the right of eminent domain recognized by the federal and state Constitutions.

The positions of General and CIA are similar to that of Pacific. Both contend that the Commission lacks legal authority to require Pacific to offer for sale terminal equipment which Pacific does not wish to sell. General especially relies upon statements of the California Supreme Court defining the limits of Commission authority in Pacific Tel. & Tel. Co. v Eshleman (1913) 166 C 640, and Pacific Tel. & Tel. Co. v Public Utilities Comm'n (1950) 34 C 2d 822. Like Pacific, General emphasizes that the Commission's regulatory authority does not extend to requiring a public utility to devote its property to a use other than that to which it has been dedicated, citing Cal. Water & Tel. Co. v Public Utilities Comm'n (1959) 51 C 2d 478, as well as CCTA and Holocard, supra. CIA likewise sees the focal point of discussion to be the question of dedication, arguing that Pacific "has not dedicated itself to sell in-place terminal equipment," so the Commission lacks authority to require such sales.

CRA/TCA, TASC, and the staff take a considerably broader view of the Commission's authority. On the issue of federal preemption the staff contends that the federal Communications Act of

ordering a sales program, because it would amount to the Commission undertaking the management of the utility's property. In that case the California Supreme Court held that the Commission lacks jurisdiction to prescribe the terms on which a utility may contract with its parent corporation. However, the Court clearly distinguished contracts and practices affecting the utility's relationship to consumers from those affecting its relationship to suppliers of materials and services. Indeed, the Court noted with approval decisions in other jurisdictions which recognized regulatory control over contracts "that directly affect the service the rate-payer will receive at a particular rate." (34 C 2d at 828-30.) In prescribing a CPE sales program, we are setting the terms of contracts that directly affect service to ratepayers.

III. STAFF PROPOSAL FOR SALE OF 1A KEY SYSTEMS

The staff presented its proposal of a program for Pacific's sale of 1A key telephone systems through Exhibit 512 and the testimony of staff financial examiners Nagel, Nemecek, and Louie. The staff proposal was based upon initial filings of proposed plans for the sale of all multi-line terminal equipment made by both the staff and Pacific on March 1, 1982, and upon several supplements to Pacific's plan filed later in 1982. Exhibit 512 does not in itself present a full description of the staff proposal, but is devoted mainly to discussions of specific elements of the proposal which differ from features of Pacific's previously filed multi-line sales plan. See Mary

Pacific subsequently filed a revised version of its multi-line terminal equipment sales plan confined solely to key telephone systems. This Stand-Alone 1A Key Systems Sales Proposal was introduced into evidence as Exhibit 517 and portions thereof were sponsored by Pacific's witnesses Lewis, Parrick, Myers, Gueldner, and Dahl. Exhibit 517 thereafter was treated as the basic sales plan proposal, with the numerous alterations proposed by the staff and

therefore, not require Pacific to offer its in-place PBX equipment for sale to customers at this time.

We do not, however, determine that the petitions of CHMA and TASC are without merit. To the contrary, it is only the pressure of time and the complexity of divestiture implementation which prevent us from acting favorably on those petitions. To the extent that we retain regulatory authority over the in-place PBX equipment which Pacific will transfer to AT&T at the time of divestiture, we intend during 1984 to require that AT&T implement an appropriate sales program for such equipment based upon this Commission's approved costing manual. We have filed comments with the FCC in its Second Computer Inquiry implementation proceeding, Docket No. CC 81-893, requesting that the FCC not "detariff" embedded CPE until state authorities have had a reasonable opportunity to implement equipment sales programs. If the FCC heeds that request, we will be able to respond positively to the CHMA and TASC petitions after divestiture has been implemented. For that reason this decision will be interim in nature.

Findings of Fact

1. Embedded CPE is that equipment or inventory owned by a telephone company which was tariffed or otherwise subject to the jurisdictional separations process as of January 1, 1983, including terminal equipment on customer premises or in utility inventory on that date.

2. For this Commission to mandate a sales program for Pacific's embedded CPE would ~~neither conflict with federal regulatory jurisdiction nor~~ disrupt the FCC's plan for deregulation of the CPE marketplace.

3. This Commission's consideration of a CPE sales program is a regulatory response to current and impending changes in the telecommunications marketplace.

51. An immediate effective date for the accompanying order is necessary to enable Pacific's KTS customers to take advantage of the sales plan we will authorize.

52. The accompanying order should be interim in nature in order to permit further consideration of the CHMA and TASC petitions after divestiture has been implemented.

Conclusions of Law

1. Pursuant to the Commission's authority under PU Code §§ 701, 728, 761, and 762, it may require a telephone company under its jurisdiction to offer for sale to customers at a reasonable tariffed price used and useful CPE which otherwise would soon be transferred to an unregulated affiliated corporation.

2. It is within the regulatory authority of this Commission to require Pacific to offer embedded CPE for sale to customers on a tariffed basis; such a program would not conflict with federal regulatory jurisdiction.

3. The Commission has authority to prescribe the terms of contracts which directly affect the service a ratepayer will receive.

4. Gains or losses on transfer of Pacific's embedded CPE to an unregulated affiliate should be allocated between investors and ratepayers in proportion to the extent to which one or the other class bore the risk of loss of capital value over the regulated life of such embedded CPE.

5. The Commission can, if appropriate, require that any embedded CPE sales program ordered for Pacific be continued in effect by AT&T or whatever AT&T affiliate receives Pacific's embedded CPE.

6. Pacific should be required to offer its embedded stand-alone 1A key telephone equipment for sale to customers on a tariffed basis beginning as soon as is feasible.

7. Pacific's stand-alone 1A KTS customers should be entitled to purchase their in-place equipment at a price reflecting its net book value plus the costs of sale.

8. It is reasonable to determine any revenue deficiency or surplus associated with the KTS sales program in the second phase of

hearings in A.83-01-22, based on the resolution of relevant accounting and tax issues in the current phase of that proceeding, with any such revenue deficiency or surplus to be taken into account in determining Pacific's 1984 revenue requirements in the final decision in A.83-01-22.

9. The offering for sale to customers by a telephone utility of CPE acquired and previously employed by that utility in providing public utility service and included in that utility's rate base constitutes a public utility ~~service~~ function, which should be conducted on a tariffed basis.

10. The KTS sales plan we will authorize will not cause either the Commission, Pacific, or AT&T to engage in predatory pricing or to violate the antitrust laws.

11. Pacific should be required to implement a KTS sales plan with the characteristics determined appropriate in this opinion.

INTERIM ORDER

IT IS ORDERED that:

1. The Pacific Telephone and Telegraph Company (Pacific) shall, on not less than five days' notice to the Commission and the public and not later than 30 days from the effective date of this decision, file tariffs to implement a sales program for stand-alone 1A key telephone system equipment in conformity with the determinations reached in the foregoing interim opinion and with sales prices for such equipment set in accordance with the attached Appendixes A, B, and C.

2. Sales of equipment under the tariff authorized in Ordering Paragraph 1 and notification to customers eligible for the sales program shall commence not later than 60 days from the effective date of this decision.

3. Pacific shall submit its proposed notice to customers eligible for the sales program to the Commission staff and the Administrative Law Judge assigned to these matters for their review not later than 30 days from the effective date of this decision.