

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA



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Order Instituting Investigation on the Commission's own motion into the alleged failure of TracFone Wireless, Inc. (U-4321-C)¹ to collect and remit public purpose program surcharges and user fees on revenue from its sale of intrastate telephone service to California consumers, in violation of the laws, rules and regulations of this State; Order to Show Cause why Respondent should not immediately be ordered to pay all such outstanding sums plus interest, and be subject to penalties for such violations.

I.09-12-016
(Filed December 17, 2009)

**OPENING POST-HEARING BRIEF
OF THE SAFETY AND ENFORCEMENT DIVISION
(FORMERLY KNOWN AS THE CONSUMER PROTECTION
& SAFETY DIVISION)**

****PUBLIC VERSION****

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¹ There was a typographical error in the Order Instituting Investigation (OII), and many subsequent filings in this case, showing this "U" number for TracFone when the correct U number is U-4231.

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I. INTRODUCTION

Pursuant to Rule 13.11 of the California Public Utilities Commission's Rules of Practice and Procedure and the schedule established by Administrative Law Judge McKinney, the Safety and Enforcement Division of the Commission, formerly named Consumer Protection and Safety Division (CPSD/SED), files this Opening Post-Hearing Brief.

In Phase I of this proceeding, the Commission found that TracFone Wireless, Inc. (TracFone) had violated California law by failing to collect and remit public purpose program surcharges, and (a separate offense) by failing to remit required PUC user fees. In Phase II, the issues are simple: how much in back surcharges and user fees does TracFone owe? And what penalties should the Commission assess against TracFone for its violation of the law?

CPSD/SED submits that TracFone's intentional course of conduct in violating California law, and its continuing failure to comply with the law when confronted with its violations, justify a Commission order that TracFone remit the full amount of principal and interest due (between \$20 and \$37 million), and pay substantial penalties for its knowing and continued violation of Commission rules.

TracFone's major premise for arguing that it cannot collect surcharges from consumers – that it cannot compel its retailers to collect a surcharge – was never credible, and becomes even less credible in light of newly-surfaced evidence that TracFone has a direct electronic link to the point of sale (the third party vendor's cash register), as well as ongoing communications (such as text messages) with those consumers. A full discussion of this is found at Section IV(E)(2) below. The revelation of this direct electronic link-obscured by TracFone's insistence in Phase I that it had no contract with Wal-Mart or other third party retailers to provide this communication² – reflects the intentional nature of TracFone's course of conduct over the last fifteen years in California. This intent, coupled with TracFone's refusal to comply with the law when

² See, e.g., Phase I Hearing Transcript (HT) at 424:7-14.

confronted with its violations in 2009, TracFone’s continuing failure to comply with D.12-02-032, its “subsidy arbitrage” (see below), and other aggravating factors warrant a substantial penalty as a deterrent against this sort of conduct in the future.

II. SCOPE OF PHASE II, AND SUMMARY OF EVIDENCE

In Phase I, the Commission found that TracFone was a public utility telephone corporation, that it was not a debit card company within the exclusions of G.O. 153, and that it therefore was required to collect and remit public purpose surcharges and user fees.

The August 2, 2012 Assigned Commissioner and Administrative Law Judge’s Scoping Memo and Ruling, set out the following two issues for Phase II:

1. The *amounts* of user fees and surcharges owed by TracFone. This issue includes determining what reasonable methodologies are available for calculating the user fees and surcharges. Evidence regarding what methodologies have been accepted by the Commission in the past is within the scope of this issue. However, evidence regarding the content of Commission communications with other prepaid wireless carriers is not within the scope of this issue.
2. Whether TracFone is subject to penalties pursuant to the provisions of Public Utilities (P.U.) Code § 2100 et seq. for failure to pay the PUC user fees and Public Purpose Program (PPP) surcharges on its prepaid wireless services provided prior to the effective date of the Phase 1 Decision, and if so, the *amount* of penalties. The issue includes identifying any mitigating factors. However, evidence regarding whether other prepaid wireless carriers paid PUC user fees and PPP surcharges is not within the scope of this issue.³

Despite this clear direction, TracFone submitted no testimony whatsoever on the “amounts of user fees and surcharges owed by TracFone,” and no testimony on what would be “reasonable methodologies . . . for calculating the user fees and surcharges,” preferring instead to attack the Commission for its alleged lack of formally adopted a

³ Emphasis added.

calculation methodology specific to the Commission’s public purpose surcharges and user fees. In surrebuttal testimony, after staff had succeeded in obtaining TracFone’s submissions to the California Board of Equalization (BoE) (demonstrating that TracFone can indeed calculate intrastate revenue and remit state surcharges), TracFone tacitly admitted that it can and does calculate California intrastate revenue for the E911 surcharge. Other than this, however, TracFone’s Phase II testimony generally constituted a recapitulation of its Phase I testimony, a collateral attack on the Commission’s two Phase I decisions, D.12-02-032 and D.12-10-018, and an affront of the Assigned Commissioner and Administrative Law Judge’s August 2, 2012 Scoping Memo and Ruling.

Even when it came to “mitigating factors” that might argue for a lesser penalty amount, TracFone offered no evidence addressing the Commission’s penalty policy and mitigation factors, set out in D.98-12-075, App. A (which requires that a utility wishing to lower or mitigate a statutory penalty show that it had taken efforts to “prevent, detect, disclose and rectify” the violations in question) – in favor of retreading its arguments about notice and impossibility, arguments rejected in D.12-02-032 and D.12-10-018.

In this vacuum, the testimony of Llela Tan-Walsh provides the only competent evidence concerning the *amounts* owed by TracFone – based on different number sets describing TracFone’s California intrastate revenue. The numbers provided by TracFone to the Commission, both those labeled by TracFone as “hypothetical” and those not so labeled, are substantially lower than the intrastate numbers provided by TracFone to the Board of Equalization. These number sets yield a range of amounts for back surcharges and user fees, and allowable interest, between \$15.4 and \$37.4 million, as shown below.⁴

The question of methodology is largely subsumed in the choice between these two existing number sets. Staff witness Christiansen testified that the separation of revenue into interstate and intrastate buckets (really the only contested point of calculation) has traditionally occurred at this agency and throughout the industry under the aegis of Parts

⁴ See CPSD Exhibit 17, Christiansen Opening Testimony, at Table 5; Exhibit 20, [Revised] Table 5C.

32 (Uniform System of Accounts, or USOA) and Part 36 (separation) of the Code of Federal Regulations.⁵ All evidence points to the fact that TracFone uses the “books and records” method, rather than traffic studies or the inverse of the federal safe harbor.⁶

As to mitigation, TracFone offers no evidence of due diligence before deciding in 1997 that it was a debit card provider (rather than the “cellular reseller” it had claimed to be) and was therefore exempt from surcharges, and no evidence of due diligence before its 2003-04 decision to stop paying user fees. The evidence allows only one conclusion: TracFone was betting that it could elude the Commission’s surcharge and fee obligations altogether. This strategy is cut from the same cloth as TracFone’s nationwide campaign challenging any state surcharge, tax, or user fee requirements which it considered vulnerable to attack, as discussed further below. The strategy manifests itself again in TracFone’s current failure to pay roughly \$875,000 in surcharges accrued since D.12-02-032.⁷

III. REASONABLE METHODOLOGY AND AMOUNTS OWED

When a utility fails to pay user fees, “the commission *may estimate* from all available information the appropriate fee ... and the person or *corporation shall be estopped to complain of the amount of the commission’s estimate.*” P.U. Code § 405 (emphasis added). There is no reason this policy should not apply to surcharges as well as user fees. Staff has been at great pains to estimate what TracFone owes in back fees and surcharges, and it is entirely appropriate that TracFone be estopped from contesting the amounts estimated below – particularly given TracFone’s failure to provide any hard intrastate revenue numbers in Phase II, and its repeated obstruction of this Commission’s factfinding processes.⁸

⁵ CPSD Exhibit 17, at 2-5; CPSD Exhibit 18 (Christiansen Rebuttal), at 1-16.

⁶ Exhibit 18/18C, Christiansen Rebuttal, at 11 (A22-23).

⁷ See Appendix C to this Brief, TracFone’s January 28, 2013 letter to CPUC staffperson Eric van Wambeke; see also further discussion of this below.

⁸ Staff’s examination of TracFone’s tax and surcharge accountant, Chesley Dillon provides a painful example of this obstruction, where eight pages of transcript were consumed with the question of whether TracFone’s use of “minutes” and “units was synonymous (HT 1214:9-1222:17), and a further twelve pages with the question of whether there was any difference between methodology and surcharge base

A. Reasonable Methodology

As Commission President Peevey has said, the Commission will accept “*any reasonable method*” used by a carrier to establish the carrier’s California intrastate revenue, upon which number both public purpose surcharges and user fees are calculated (sometimes called the “surcharge base”).² At bottom, intrastate revenue is intrastate revenue.¹⁰ In a perfectly logical and transparent world, each of the three calculation methods identified in Mr. Christiansen’s testimony -- “books and records”; traffic studies; and the inverse of the FCC’s “safe harbor”¹¹ – would yield the same result. In the real

that might distinguish TracFone’s “hypothetical” CPUC numbers from its BoE numbers. *See* HT at 1230:27-1242:6. This mirrors the start of the Phase II process, when TracFone delayed for four months the production of intrastate revenue numbers pursuant to CPSD’s data requests. *See* Exhibit 16/16C, at Attachment E (Summary of Discovery), and Attachments G-J (TracFone’s responses).

² CPSD Exhibit 18, Att. F, March 22, 2012 letter, at p. 2 (Request 4).

¹⁰ The FCC, CPUC, and Board of Equalization all agree on this point. *See, e.g.*, FCC decision 98-278, at p.4 ¶ 6, available at <http://www.fcc.gov/search/results/FCC%2098-278>:

In general, the jurisdictional nature of a call depends solely upon where the call originates and where it terminates, without regard to where or how the call is carried in between the origination and termination points.

The CPUC’s General Order 153, section 2.33, defines intrastate service as :

All telecommunications services that both originate and terminate within the State of California, whether tariffed or detariffed, that are used by, and billed to, the final user of the service.

The Board of Equalization defines intrastate service for the E911 surcharge base as “all local or toll telephone services where the point or points of origin and the point or points of destination of the services are all located in this state.” *See* Title 18 of Cal Code of Regulations, § 2401(b)(1).

¹¹ CPSD Exhibit 17/17C, Christiansen Opening Testimony, at 4-5, A4; 18/18C, Christiansen Rebuttal at 1-17. Although the question of the most reasonable or appropriate methodology becomes largely moot when the Commission has before it specific and historic intrastate revenue numbers from TracFone (the 2000-2004 intrastate revenue numbers associated with surcharges and the 2007-2009 numbers – CPSD Exhibit 1, Attachments J and O respectively, and the BoE numbers going back to 2000 – Exhibit 16/16C, Attachment N; TracFone Exhibit 204, Dillon Testimony, at Attachment F), TracFone’s suggestion that this Commission has no methodology to calculate intrastate revenue borders on the ludicrous. Mr. Christiansen details how the separation of revenue into inter- and intrastate components has been common practice all of his 31-year career at the CPUC, how Parts 32 (Uniform System of Accounts) and 36 (Separations) were adopted for “all carriers” in D.87-12-063, and how these provide the framework and common industry understanding of what separations is and how it is conducted. *See* Exhibit 17/17C, at 2 (A3); Exhibit 18/18C, at 1-16. The fact that these regulations sometimes refer to “incumbent” carriers is not surprising given their genesis in a time of monopoly incumbents, and does not detract from the reality that Parts 32 and 36 provide the *framework* for all carriers’ separation of revenues. And they are far from a dead letter. In 2011, for instance, the Commission directed a competing carrier (CLEC-IXC) to comply with Part 32. *See* D.11-02-007, Attachment B, O.P. 8 (Applicant must comply with 47 CFR Part 32 USOA).

world, the FCC’s “safe harbor” number is an aggregate of all wireless traffic in the country, and may be different from the interstate/intrastate split of any given carrier. Each of the three methods are ultimately based on call records showing where calls begin and end, and each are reasonable methods to determine jurisdictional separation of revenues.¹²

In this case, the question of methodology is largely subsumed by the choice of two (or three) existing number sets, both of which have been derived by some variation of the “books and records” method. As described below, staff has presented two ranges of TracFone’s intrastate revenue numbers: (1) the “hypothetical” and pre-“hypothetical” intrastate numbers provided by TracFone to the Commission during *and before* this Phase II proceeding; and (2) the higher intrastate numbers TracFone submitted to the BoE. Both sets appear to be based on the “books and records” of TracFone (including its call detail records or CDRs), rather than traffic studies or a “safe harbor.”¹³

¹² See generally CPSD Exhibit 18/18C, at page 5 (traffic studies can be seen as an aggregation of call records). CDRs are “subsidiary records,” thus part of the “books and records” method. Exhibit 17/17C, Christiansen Testimony, at 3-4, A3-4; regarding “subsidiary records” generally, see 47 CFR §§ 32.12, 32.13(e)(3), 32.4999(f). Traffic studies are also based on analysis of some subset of CDRs which is supposed to stand in for the entirety of a carriers’ traffic. *In the Matter of Universal Service Contribution Methodology*, 21 FCC Rcd 7518 (2006), at ¶ 25, and fn. 96 (a TracFone study “analyzed call records from the third quarter of 2004 and based on information contained on customer bills, allocated minutes of use to the interstate and intrastate jurisdiction based on the originating numbering plan area (NPA) state and the terminating NPA state”). And the FCC’s safe harbor was based on a set of traffic studies provided by the industry. *Id.* at ¶ 10 and fn. 34 (safe harbor based on traffic studies submitted by CTIA).

¹³ As much as TracFone tried to muddy its actual practices in hearing, TracFone could not deny that it uses some version of the “books and records” method (rather than a traffic study or “safe harbor” method). Call Detail Records are a form of “books and records.” See Exhibit 18/18C, at 2, A5 (CDRs are “subsidiary records”); HT at 794:20-23 (Christiansen cross-examination); 1183:22-28 (Dillon – CDRs “part of calculation”); HT at 1183:22-28 (use of CDRs for BoE revenue separation); 1195:18-22 (“call detail records are used in analysis of the intra and interstate percentages that are developed, yes”); 1203:22-26 (same); 1208:5-11 (TracFone used the Form 499 revenue as starting point for CPUC “hypothetical numbers”); 1208:26-1209:1 (CDRs used to remove non-telecom charges from Form 499 revenue); Dillon Testimony at 4:1-5 (FCC percentages used for separation with BoE); HT 1208:26-1209:1, 1211:23-28 (non-telecommunications numbers eliminated from CPUC “hypothetical” numbers); TracFone Exhibit 204,. It is clear that call detail records are used at many turns of TracFone’s separation of intrastate from interstate revenue. The exact mechanics of this are unclear, although it appears that TracFone’s “hypothetical” numbers are in some way simply the inverse of what it reports to the FCC/USAC.

B. Principal Amounts Owed.

In determining how much past surcharges and fees are owed by TracFone, the factfinder must first determine what TracFone's intrastate revenue was for each of the years in question, as intrastate revenue is the base on which surcharges and user fee percentages are calculated. In determining or estimating an intrastate revenue number for TracFone, the finder of fact has two data sets from which to draw. As shown below, however, the BoE numbers were *substantially* more than what TracFone reported to the Commission, raising further questions about the details of its methodology, questions which are in any event subsumed in the choice of data sets presented by staff's testimony.

1. Choice of Years – Appropriate to Recover Unremitted Surcharges and Fees Going Back to 2000.

A threshold issue for the Commission is the range of years, if any, for which TracFone will be deemed liable for surcharges and user fees which it failed to collect and/or remit. The Order Instituting Investigation (OII) refers to a “fail[ure] to collect and remit public purpose surcharges and user fees since *at least* 2004.” OII at 5 (emphasis added). CPSD/SED believes it is appropriate to go back to the year 2000 for surcharges (TracFone paid user fees through 2004Q1) because that was the first full year of operation in after América Móvil obtained control of the company.¹⁴ To do otherwise would reward TracFone for its decision to play hard-ball with the State of California (as it has done with States all across the country – see below). In any event, staff has presented a year by year analysis to enable the Commission to choose the date range it deems appropriate for recovery of unremitted surcharges and fees.¹⁵

2. TracFone Has Refused to Provide Reliable Intrastate Revenue Numbers.

When it appeared that Phase II of this proceeding was likely to go forward, staff propounded (on April 10, 2012) a data request to TracFone, asking for its California

¹⁴ CPSD Exhibit 15/15C, Tan-Walsh Opening Testimony, at 4 (Q/A 6).

¹⁵ *Id.* at Confidential Attachment A; CPSD Exhibit 20C, at Confidential Attachment A.2.

intrastate revenue for the years 2003 to date (staff already had the years 2000 to 2003).¹⁶ CPSD/SED did not receive an answer to this request until exactly four months later, on August 10, 2012, and even then TracFone insisted that any revenue numbers it gave to staff were “hypothetical.”¹⁷ TracFone refused during the pendency of Phase II to provide anything other than “hypothetical” numbers, including a refusal to provide its intrastate revenue and surcharge submissions to the BoE.¹⁸

3. The Range of TracFone Intrastate Revenue Estimates.

Ms. Tan-Walsh was nevertheless able to submit multiple sets of possible TracFone intrastate revenue numbers with her testimony. Some of these were submitted to the Commission *before* Phase II, i.e., before TracFone claimed it could only submit “hypothetical” numbers, some were the “hypothetical” numbers, and some were and are the substantially higher numbers submitted to the Board of Equalization (and obtained by CPSD/SED without TracFone’s assistance). For reasons stated below, staff believes that the numbers submitted to the BoE are the most accurate.

a) Early, Pre-“Hypothetical” Numbers.

Although TracFone has complained within Phase II that it could not provide intrastate revenue numbers to the Commission, it did exactly that before methodology was put at issue in this proceeding. In 2000-2003 inclusive, when it was still paying user fees to the Commission, TracFone reported California intrastate annual revenue that rose

¹⁶ CPSD Exhibit 16, Attachment F.

¹⁷ Although it had previously provided non-“hypothetical” numbers to the CPUC, and although it had for the entire relevant time reported California intrastate numbers to the BoE, TracFone claimed that it was unable to provide anything more than “hypothetical” numbers to CPSD/SED in this Phase II because the Commission had not adopted a specific and detailed methodology for such calculations. *See* CPSD Exhibit 16C, Confidential Attachments H, TracFone’s August 8, 2012 Response to DR 1, propounded on April 10, 2012, at page 1 – TracFone claimed that because it was “unaware of any published CPUC guidance on this matter” or “any statutory provision directing the use of the FCC method ... the figures provided in this Response are made on a hypothetical basis only.” This, of course, ignores the fact that there was an understanding in the industry that the “separation” of interstate from intrastate revenue occurs within the framework of the USOA, Part 32, and Part 36 of CFR (Exhibit 18/18C, at 1-16); and (b) TracFone used a methodology for its BoE submissions that was not specifically called out by BoE regulations. HT at 1195:10-17.

¹⁸ CPSD Exhibit 16, Attachment M.

from \$14.9 to \$27 million (non-confidential numbers). In 2009, in response to a staff data request, TracFone reported intrastate revenue for 2006-2008 rising from \$57 to \$62 million. Neither of these number sets were qualified as “hypothetical” (or as “confidential”). *See* CPSD Phase 1 Exhibit 1, Attachments J (2006-2008) and O (2000-2004 Q1). Staff has compared these early, pre-“hypothetical” numbers with the “hypothetical” numbers provided in Phase II; this comparison demonstrates that the later-provided “hypothetical” numbers – which TracFone may claim are without foundation – are in fact consistent with TracFone’s prior reporting to the Commission.¹⁹

b) “Hypothetical” Numbers.

On August 10, and again on September 4, 2012 TracFone provided “hypothetical” numbers, which it also claimed were confidential. Although not matching exactly, these “hypothetical” numbers are generally within the range of the “pre-hypothetical” numbers discussed above.²⁰ Based on the numbers within the “hypothetical” and pre-hypothetical range, TracFone owes \$15.4 million in surcharges and user fee principal, without interest or penalties added. Exhibit 18, Christiansen Opening Direct Testimony, at Table 5.

c) BoE Numbers.

After being told that TracFone no longer had access to the calculations it had performed to derive the California intrastate revenue numbers it submitted with its user fee remittances from 2000-2004,²¹ staff asked TracFone for the calculations of California

¹⁹ *See* Confidential Attachment B, found initially with Exhibit 15C, Tan-Walsh Opening Testimony, and in amended form in Exhibit 16C, Tan-Walsh Rebuttal Testimony (amended to include BoE numbers). In both cases, Confidential Attachment B shows that the “hypothetical” intrastate revenue numbers are generally consistent with the pre-“hypothetical” intrastate revenue numbers.

²⁰ *Id.* The August 10 and September 4, 2012 TracFone Responses are found at CPSD Exhibit 16C, Attachments J and H.

²¹ The intrastate revenue numbers submitted in years 2000-2004(Q1) are found at CPSD Exhibit 1, Attachment O. When CPSD asked for the methodology used to provide those numbers, TracFone first said that these filings “were submitted on TracFone’s behalf by a third party that is no longer in business.” Exhibit 16/16C, Attachment K. In response to a follow-up request, TracFone provided “the name and former business address” of the “third party” that had prepared its 2000-2004 user fee remittances, a Tax Partners, LLC, at 3101 Tower Creek Pkwy, in Atlanta. *Id.* at Attachment L. What TracFone knew but failed to tell staff was that Tax Partners, LLC had been bought by a company that continued to submit TracFone’s E911 surcharges under Tax Partners name through February 28, 2010, at

intrastate revenue that TracFone had done for the BoE. TracFone objected to the production of same,²² and staff was unable to secure a timely order compelling production of these documents *from* TracFone. In desperation, CPSD/SED turned to the BoE. After checking with their legal and disclosure officers, BoE staff produced as public documents the E911 surcharge submissions made by TracFone for the years 2009-2011.²³ These verified California intrastate revenue numbers were *substantially higher* than the “hypothetical” and pre-“hypothetical” numbers TracFone had reported to the CPUC.

CPSD/SED received these numbers for the years 2009-2011 shortly before its Rebuttal Testimony was due; the numbers showed a substantial gap between what TracFone was reporting to CPUC (even if “hypothetical”) and what it was reporting to BoE; CPSD presented these findings in its Rebuttal testimony. Staff subsequently obtained from BoE (and immediately produced to TracFone) TracFone’s BoE submissions for the years prior to 2009, which narrowed the gap, but the BoE numbers were still in the aggregate significantly higher. Based on these significantly higher numbers, CPSD/SED submitted a revised form of Table 5B (as found in the Christiansen Rebuttal Testimony), denominated Table 5C, which is found at CPSD Exhibit 20C. This Table 5C reports almost identically the same BoE numbers as TracFone’s accountant Dillon.²⁴ Based on these revised numbers, TracFone owes \$18.3 million in back surcharge and user fee principal, without interest or penalties added. Exhibit 20C, at Table 5C.

TracFone now explains that the higher BoE numbers inadvertently included “non-telecommunications service revenues.” Exhibit 204, at 14:4-6. That a sophisticated

a *different* address in Atlanta, and then simply changed its name (at that different address) to Thomson Reuters. *Id.* at Attachment N (BoE returns). Thus, TracFone effectively prevented staff from obtaining further documents directly from Tax Partners/Thomson Reuters.

²² *Id.* at Attachment M.

²³ *Id.* at Confidential Attachment N (TracFone claims these publicly produced documents are “confidential”).

²⁴ *Compare* TracFone Exhibit 204, Attachment F; *see also* HT at

operator like TracFone would inadvertently overstate its surcharge-able revenue or pay fees and surcharges it was not required to pay seems unlikely. TracFone’s theory is also problematic for other reasons: (1) as far as the record shows, TracFone bills all of its services – telecommunications and allegedly non-telecommunications -- by minute units, i.e., as if they were telephone services, suggesting at a minimum that the “non-voice” or non-telecommunications services are inextricably bundled with the voice services;²⁵ (2) the BoE surcharge base is legally no different than the CPUC or FCC surcharge base inasmuch as all three are based on “telecommunications” revenue;²⁶ (3) it is unclear as a regulatory matter, both at the federal and state level, what the regulatory classification of various allegedly “non-voice” services is;²⁷ (4) TracFone failed to provide *any* proof – call detail records,²⁸ engineers’ declarations – i.e., anything beyond Mr. Dillon’s brute say-so, that the vastly increased revenues were due to non-surcharge-able, non-telecommunications services; and (5) even if some of the substantially larger revenue numbers reported to the BoE were fairly attributed to non-voice, non-telecommunications services that were outside the surcharge base, TracFone’s Dillon testified that this would only account for 70% of the increase.²⁹ Thus, even by TracFone’s own admission, 30% of the increased revenue is attributable to voice.

Bracketing out the “non-telecommunications” issue (as it should be), CPSD/SED believes that the BoE intrastate revenue numbers are the most reliable numbers, because they were “certified” by TracFone’s accountants to be “true, correct, and complete.”³⁰ Indeed, if anything, TracFone’s intrastate numbers should be less under the BoE-defined

²⁵ CPSD Exhibit 28 (website re Data Services).

²⁶ See Cal. Rev. & Tax’n Code § 41020 (“surcharge is hereby imposed on amounts paid [for] intrastate telephone communication service ... [and] VoIP service”).

²⁷ See, e.g., *In the Matter of Universal Service Contribution Methodology A National Broadband Plan For Our Future*, 27 FCC Rcd 5357 (2012) at ¶ 49 (“The Commission has not addressed whether text messaging revenues are subject to federal universal service contribution requirements”).

²⁸ See HT at 1208:26-1209:1 (CDRs used to separate telecom from non-telecom).

²⁹ HT at 1227:22-23.

³⁰ CPSD Exhibit 18C, Attachment N (claimed to be confidential although produced to CPSD/SED as a public document).

surcharge base, as BoE does not include “breakage” (unused, expired minutes) in revenue, while the CPUC assesses on all revenue received for the service, whether used or unused.³¹ In addition, TracFone is also – legally or illegally – not paying the BoE the retail price charged for their cards.³² Again, in this regard, TracFone’s calculated surcharge base for BoE should be less than it should be for CPUC.³³

Despite TracFone’s attempts to muddy the record, it is clear as a *matter of law* that the BoE surcharge base is otherwise equivalent to that of the Commission in all material ways:

- the BoE statutory framework also puts the initial or nominal responsibility to pay the surcharge on the end user – *see* Cal. Rev. & Tax’n Code § 41021(a) (“A service provider shall collect the surcharge from each service user ...”);
- the BoE statutory framework also requires all carriers, including prepaid carriers like TracFone, to collect from “billed” revenue – *Id.* (“... at the time it collects its billings from the service user”); and
- the BoE statutory framework also nominally requires a line item on a bill – *see* Rev. & Tax’n Code § 41022 (“the surcharge required to be collected by the service supplier shall be added to and stated separately in its billings to the service user”).

While TracFone asserted that it used a different *method* to calculate the BoE numbers,³⁴ and claimed that it had inadvertently included revenue from “non-telecommunications services” in its BoE submissions, it was unable to identify anything in the surcharge base that would make the BoE numbers substantially different. Indeed,

³¹ 19 Cal. Code of Reg’s § 2403 (“Dollar Amounts or minutes of Telephone service which are forfeited because they have not been used prior to the expiration of the prepared paid calling card are not subject to the surcharge”).

³² *Compare* HT at 1189:4-1190:7; CPSD Exhibit 27C, last page.

³³ D.96-10-066, 1996 Cal. PUC LEXIS 1046, at *269 (with all end users surcharge, surcharge “imposed on all customers’ expenditures for telecommunications services”).

³⁴ HT at 1129-30.

Mr. Dillon stated that he was “not testifying one way or another on what the proper revenue base for the E911 surcharges is.”³⁵

The greater importance of the BoE numbers is that they unmask TracFone’s charade of impossibility. Despite the presence in the legal definition of the BoE surcharge base of the *exact same factors that TracFone claims make it impossible for TracFone to collect the CPUC surcharges* – a “billed” revenue base, an ultimate obligation in the end-user, and a line-item requirement -- TracFone somehow managed to remit E911 surcharges to the BoE for each of the past twelve years.

4. CPSD-SED’s Best Estimate of TracFone’s Intrastate Revenue.

In all but two of those years, the intrastate revenue numbers that TracFone certified to the Board of Equalization were substantially more than the previous year, defining a sweeping upward curve from 2000-2011.³⁶ This is consistent with América Móvil’s portrayal of the growth in TracFone subscriber numbers and overall revenues, as reported in its SEC filings.³⁷ By contrast, TracFone’s reports to the CPUC show a sharp drop-off after 2007, and have never returned to the 2007 level.³⁸

Because the CPUC has neither audited nor certified revenue numbers from TracFone,³⁹ the best it can do is provide the Commission with what it believes is the most reasonable estimate of TracFone’s intrastate revenue surcharge base during the years in

³⁵ TracFone Exhibit 204, Dillon Testimony, at 11:29-30.

³⁶ Nearly identical sets of these BoE numbers are found in Dillon Attachment F (Exhibit 204), and in CPSD Exhibit 20C, Attachment D.1.

³⁷ TracFone’s rapidly increasing subscriber numbers are captured in América Móvil’s 2009-2010 Annual Report. CPSD Exhibit 1, Attachment K1. At page 26 of its Operating Review, América Móvil states that “TracFone added 3.2 million subscribers in 2009 (93% more than a year before) on the successful nationwide launch in over 3,000 WalMart stores of its new product StraightTalk,” bringing its total subscriber base to over 14 million. *Id.* at 26. In first half of 2010, it “added 1.5 million new clients to finish June with 15.9 million subscribers, 27.4% more than the prior year.” *Id.* Ironically, 2009 is a year that saw the intrastate revenue TracFone admitted to the CPUC (both hypothetically and otherwise) drop precipitously. *See* Dillon Attachment F (Exhibit 204), and in CPSD Exhibit 20C, Attachment D.1.

³⁸ Dillon Attachment F (Exhibit 204); CPSD Exhibit 20C, Attachment D.1.

³⁹ Staff does not have TracFone’s user fee remittance forms for the years 2000-2004 (as reflected in the user fee payment history at Exhibit 1, Attachment 0); staff acknowledges the possibility that some of those forms may have provided a certification of intrastate revenue.

question. The numbers given to the BoE are certified to be correct. CPSD-SED believes that the Commission should at least bend the “hypothetical” revenue curve in the more realistic direction of the certified BoE revenue curve.

Thus, staff’s best (and most conservative) estimate of TracFone revenue during the time at issue would be to take as its surcharge base the hypothetical numbers for years 2000-2008, and then add 30% of the difference between the hypothetical numbers and the BoE numbers for 2009-2011. In the absence of firmer numbers from TracFone, this estimate is necessarily inexact, but it is consistent with Mr. Dillon’s estimate that the ratio of non-telecommunications to telecommunications (or “voice”) services in the increased amount was in the 70/30 range.⁴⁰ Staff has prepared a calculation with the “hypothetical” numbers for years 2009-2012 increased by 30% of the difference between it and the BoE numbers for those years. See Confidential Appendix E. Based on this methodology, TracFone owes \$16.1 million in back surcharge and user fee principal, without interest or penalties added, more than the \$15.4 million in surcharges and user fee principal calculated on the straight hypothetical numbers, but substantially less than the \$18.3 million in back surcharge and user fee principal TracFone would owe were the Commission to use the more BoE-oriented intrastate revenue numbers found in CPSD Exhibit 20C, at Table 5C.

C. Interest

The controversy here is whether the Commission should assess simple or compound interest on amounts owed for roughly 12 years of non-compliance with surcharge remittance requirements, and roughly 8 years of non-compliance with user fee requirements. Staff believes that compound interest should be applied, because

⁴⁰ In his Prepared Testimony, Chesley Dillon states that the differences between the BoE and CPUC numbers were primarily in 2009-2011, years “in which the two sets of figures differed the greatest.” TracFone Confidential Exhibit 204, at 14:1-2. Mr. Dillon testified (or strongly implied) that the primary explanation for the big jump in revenue reported in 2009-2011 was “non-telecommunications service revenues.” *Id.* at 12:3-6, 14:14-20. At hearing, staff asked Mr. Dillon what percentage of the increase (and therefore the difference between CPSD and BoE numbers) was attributable to non-telecommunications services, and Mr. Dillon testified as follows: “You are asking the percentage of the non-voice? ... Okay, of that amount that has been increased it is in the 70 percent range.” HT at 1227:19-23

compound interest is what any consumer would pay for a delinquent debt. Again, however, CPSD/SED has provided both interest alternatives to the Commission. Simple interest would boost the amount owing based on the “hypothetical”/pre-“hypothetical” intrastate revenue from \$15.4 million to \$17.1 million; compound interest would take that number to \$31.4 million. Using the BoE revenue base, simple interest would boost the lesser but still significantly higher principal-only number from \$18.3 million to \$20.2 million; compound interest would take that number to \$37.4 million. CPSD Exhibit 20C.

Under the middle “best estimate” scenario described above, simple interest would increase principal amounts owed to \$17,812,770, and compound interest could take those numbers to \$32.4 million. The Commission clearly has discretion to apply any interest rate it considers reasonable under the circumstances. For further example, the Commission could use the IRS interest calculation of “the federal short-term rate plus 3 percent... compounded daily.”⁴¹

IV. THE COMMISSION SHOULD ASSESS PENALTIES ON TRACFONE PURSUANT TO STATUTE AND COMMISSION RULES.

A. Statutory Basis and Rules Related to Penalties.

Section 2107 of the Public Utilities Code provides that:

Any public utility that violates or fails to comply with any provision of the Constitution of this state or of this part , or fails or neglects to comply with any part or provision of any order, decision, decree, rule, direction, demand, or requirement of the commission, in a case in which a penalty has not otherwise been provided, is subject to a penalty of not less than five hundred dollars (\$500), nor more than fifty thousand dollars [\$20,000 through 2011 and \$50,000 beginning in 2012] for each offense.

Section 2108 provides that:

⁴¹ See <http://www.irs.gov/taxtopics/tc653.html>. Staff is prepared to submit a recalculation of interest, as requested, based on this or other commercially typical interest rates.

Every violation of the provisions of this part or of any order, decision, decree, rule, direction, demand, or requirement of the commission, by any corporation or person is a separate and distinct offense, and in case of continuing violation each day's continuance thereof shall be a separate and distinct offense. [Emphasis added]

The Commission has explained that the purpose of a fine is deterrence: “The purpose of a fine is to go beyond restitution to the victim and to effectively deter further violations by this perpetrator or others.” D.98-12-075, App. A, at Section D(2)(b) (LEXIS *79).

B. Violations Established in Phase I.

In Phase I, the Commission found that “TracFone violated statutory law and Commission decisions in failing to ensure the payment of these [public purpose] surcharges.” D.12-02-032, Slip Op. at 2. More particularly, the Commission found that:

- TracFone’s failure to pay the universal lifeline surcharge is a violation of state law and Commission decisions, including, §§ 871 et seq. (*Id.* at 33 and CoL 51.)
- TracFone is in violation of state law for failure to pay the user fees set forth in §§ 401-410, 431-435. *Id.* at 48 and Concl. of Law (CoL) 12.

The Decision on Rehearing was more explicit about the past and continuing nature of these violations:

- The record supports the findings in D.12-02-032 that TracFone has failed to remit the requisite user fees and has violated state law by failing to pay the user fees set forth in sections 401-410, 431-435. (D.12-10-018, Slip Op. at 19.)
- The record supports the findings that TracFone has failed to collect and remit the requisite public purpose surcharges and has violated state laws by failing to comply with sections 275, 276, 280, 281, 739.3, 871 et seq., and 2881.1 et seq., and Commission decisions concerning collection and remittance by telephone

corporations of those public purpose surcharges and fees. (Id. at 19-20.)

CPSD is not seeking Section 2107 penalties for user fees, as the statute (P.U. Code § 405) characterizes the 25% interest rate as a penalty.

C. CPSD/SED’s Calculation of a Penalty Range.

CPSD/SED has made penalty recommendations to the Commission, consistent with D.98-12-075, the standard Commission reference for calculating fines under § 2107. See CPSD Exhibit 17, Christiansen Opening Testimony, at 9.⁴² In determining whether to impose a fine and, if so, at what level, the Commission will consider the severity of the offense, the utility’s conduct, the financial resources of the utility, the totality of circumstances in furtherance of the public interest, and the role of precedent.

Taking the first and last factors together, one measure of the severity of TracFone’s offense is that staff has been unable to find *any* precedent for TracFone’s behavior – a sustained refusal to abide by California law and the Commission’s regulations, lasting over twelve years, including the three years this proceeding has been pending, *and* the nine months since the Commission’s Phase I decision which ordered TracFone to begin compliance “immediately.”

The utility’s conduct here was and remains reprehensible. There was no mitigation of the violations by TracFone. And in fact aggravating circumstances are plainly evident: TracFone’s failure to comply with D.12-02-032; the calculated nature of TracFone’s non-compliance, as manifest by its nationwide litigation campaign against state surcharges and fees; and what is now revealed to be a fiction at the heart of TracFone’s claim that it could not collect surcharges at point of sale.

At the same time, the financial resources of this utility are enormous. TracFone is owned by the powerful Mexican telephone company, América Móvil, which in turn is

⁴² Citing Rulemaking to Establish Rules for Enforcement of the Standards of Conduct Governing Relationships between Energy Utilities and Their Affiliates Adopted by the Commission in Decision (D.) 97-12-088 and D.98-12-075, App. B

owned by Carlos Slim, reputedly the richest man in the world.⁴³ In the fourth quarter of 2011, alone, TracFone’s revenue was over a billion dollars, a 30% jump over the previous year’s fourth quarter.⁴⁴ On annual revenue of over \$3.8 billion for 2011, TracFone’s operating income (EBITDA) was \$334 million.⁴⁵ During the period 2000-2011 (the largest part of the time period at issue), TracFone’s revenue was approximately \$15.3 billion, and América Móvil’s total revenue was over \$252 billion dollars.⁴⁶

As to the totality of the circumstances, seen from the perspective of the public interest, TracFone has violated the cardinal assumption on which the public communications network now runs: that all carriers and their customers (including VoIP and wireless carriers) will contribute equally and equitably to a universal service and rule of a telephone network provider: equal support from all carriers and consumers for universal service. *See* discussion of “goal of universal service” below.

In light of all these factors, CPSD/SED recommends a fine set at least at \$1000/day/violation.⁴⁷ This yields a low fine of approximately \$26,584,000.⁴⁸ Even at the \$1000 level, the fine would amount to less than two-tenths of one percent of TracFone’s revenue during the period at issue.⁴⁹ The Commission can, of course, decide to go higher, or lower.

D. No Mitigation of Penalties is Warranted.

“Mitigation,” by definition, means factors that may be considered – *once a violation has been established* – to possibly diminish the amount of penalty that may be imposed for that violation. “The Commission will review facts which tend to mitigate

⁴³ CPSD Phase I Exhibit 3 (Staff Report Excerpt), at 2, fn. 5.

⁴⁴ http://www.americamovil.com/amx/cm/reports/Q/4Q11_VF.pdf

⁴⁵ *Id.* Staff concedes that TracFone has elsewhere reported a slightly lower number for 2011 revenue. *See infra.*

⁴⁶ Exhibit 17, Christiansen Opening Testimony, at pp. 11-12, and Table 3.

⁴⁷ The Legislature changed the range of allowable penalties in [2011], from \$500-20,000 per violation/day, to \$500-\$50,000 per violation/day. P.U. Code § 2107, as amended by SB 879 (2011).

⁴⁸ Exhibit 18/18C, Christiansen Rebuttal Testimony, at Attachment G, Table 2A.

⁴⁹ Exhibit 18, Christiansen Rebuttal, Attachment G, Table 3A.

the degree of wrongdoing as well as any facts which exacerbate the wrongdoing. In all cases, the harm will be evaluated from the perspective of the public interest.”⁵⁰

D.98-12-075, Appendix A, states that “facts which tend to mitigate the degree of wrongdoing” involved in a violation of utility law include: (1) the “utility’s actions to prevent a violation”; (2) the “utility’s actions to detect a violation”; and (3) the “utility’s actions to disclose and rectify a violation.”⁵¹

Once the Commission has established that there were violations, it becomes TracFone’s burden to establish these mitigation factors, a burden TracFone has failed to carry.⁵² TracFone offers no evidence of what it did to prevent, detect, disclose or rectify its violations, but instead challenges the existence of the violations in the first instance.

1. TracFone Did Not Take Reasonable Measures to Prevent or Detect the Violations Found in Phase I.

As the Commission stated in D.98-12-075:

Prior to a violation occurring, prudent practice requires that all public utilities take reasonable steps to ensure compliance with Commission directives. This includes becoming familiar with applicable laws and regulations, and most critically, the utility regularly reviewing its own operations to ensure full compliance. In evaluating the utility's advance efforts to ensure compliance, the Commission will consider the utility's past record of compliance with Commission directives.⁵³

As shown below, TracFone *did nothing* to apprise itself the meaning of the registration letter it received in 1997, which required it to comply with all laws and pay surcharges. TracFone submits no testimony on the penalty factors set out in D.98-12-075, App. A – which require that a utility show what it had done to “prevent,

⁵⁰ D.98-12-075, App. A, factor iv (“Totality of the Circumstances”).

⁵¹ *Id.*, factor ii (“Conduct of the Utility”).

⁵² *See* Cal. Evidence Code § 500 (“...a party has the burden of proof as to each fact the existence or nonexistence of which is essential to the claim for relief or defense that he is asserting”).

⁵³ D.98-12-075, App. A, at Section D(2)(b)(ii).

detect, disclose and rectify” a violation in seeking to lower or mitigate the statutory penalty.

TracFone could have, for example, communicated its belief in its debit card status in some meaningful way, so as to allow the Commission to issue a formal (or at least written) opinion about whether TracFone was exempt from a surcharge as a debit card company in the sense of D.96-10-066. TracFone never did this, and today *relies solely on alleged oral statements by a staff member* to demonstrate due diligence. When TracFone finally did present the debit card issues to this Commission, in this proceeding, the Commission rejected it in its Phase I decision. As shown (again) below, TracFone could never have reasonably believed this.

a) Public Purpose Surcharge Violations.

TracFone offers no evidence of due diligence at or before the decision it made in 1997 to ignore the surcharge and user fee obligations in its wireless registration letter, with what is by all appearances the *ex post facto* explanation that it believed itself to be a debit card provider (rather than the “cellular reseller” it had claimed to be) and therefore had no duty to pay surcharges. TracFone offers no document or other evidence of due diligence from 1997 until the alleged 2003 letter to Mr. Mirza. On cross-examination, TracFone’s General Counsel denied any knowledge of the 1997 corporate decision.⁵⁴ Staff does not believe that the Mirza letter constitutes any sort of credible attempt to prevent a violation of the law.

b) User Fee Violations.

Although CPSD-SED is not seeking additional section 2107 penalties for the user fee violations (the 25% interest/penalty provisions of section 405 should be sufficient deterrent if calculated on a compound basis), TracFone’s conduct with regard to user fees is telling, and reveals much about TracFone’s corporate state of mind. TracFone’s corporate strategy is revealed even more starkly by TracFone’s treatment of its user fee obligation. TracFone simply stopped paying user fees in 2004, and *never* communicated

⁵⁴ HT 1103-1107.

to the Commission its newfound belief that it was no longer a public utility, or take any other action to prevent a potential violation.

The user fee statutes do not require the user fee to be based on “billed revenue,” or “end user” contributions, and contain no debit card exemption or “line item” requirement. *See* P.U. Code 401(a) (“...a reasonable fee imposed upon each common carrier and business related thereto, each public utility that the commission regulates, and each applicant for, or holder of, a state franchise ...”). Thus, the only path for TracFone to evade the user fee obligation was to claim it was not a public utility, which it eventually did. But not in the Mirza letter, in which TracFone did not raise the public utility issue.

TracFone tacitly acknowledged in the Pollak Testimony that user fees are a different issue than surcharges, and only the denial of public utility status (and common carriage) would free it from its user fee obligations.⁵⁵ TracFone now claims that it decided that it was not a public utility, sometime during a “general review of tax policy” in 2003, and on that basis stopped paying the user fees.⁵⁶ On cross-examination, TracFone’s General Counsel was unable to explain whether it thought that it was a public utility *before* 2003, and on that basis paid user fees, and then what changed that led it to conclude that it was not (or was no longer) a public utility. HT at 1117:5-1120-:20. Indeed, TracFone General Counsel Salzman, while half-admitting that the question of whether TracFone was a “public utility” was a legal question (“I guess that is a legal question whether it is a tax question”), denied any part in making that legal decision, and claimed he could not remember seeing anything related to that decision. *Id.* at 1120:1-20.

In all of this, as with the 1997 decision not to pay surcharges, TracFone has no opinion of an outside counsel, no record of internal deliberation, and *no documentation* whatsoever to show that it made any effort to prevent and detect a violation of the law.

⁵⁵ TracFone Exhibit 111, Pollak Prepared Testimony, at 16:11-19; *compare* P.U. Code § 401(a). TracFone also acknowledge this by paying user fees back to the February decision, D.12-02-032 (CPSD Exhibit 18/18C, Attachment E), but failing so far to do this for surcharges. *See* Appendix C hereto.

⁵⁶ Exhibit 111, Pollak Prepared Testimony, at 16:11-19.

2. TracFone did Not Take Reasonable Measures to Disclose or Rectify the Violations Found in Phase I.

From March 2003 (and possibly from 1997 registration letter) to May 1, 2009, TracFone made no attempt to inform the Commission that it believed that it was not a public utility, that it believed that it fit into the “debit card” exception of its 1997 registration letter (entirely unmentioned in the Mirza letter), or that it was not remitting surcharges or fees as required of all telecommunications carriers.

Even when Communications Division staff informed TracFone on May 1, 2009 that its conduct was in violation of the law, TracFone did nothing to disclose the extent of the violations or to rectify them. Instead, it embarked on a course of scorched-earth litigation, as it has done in so many states across the country, to protect its subsidy arbitrage (as described below).

The fact that TracFone continues to ignore the Commission’s Phase I order to move “immediately” into compliance with its surcharge obligations (as discussed at length below, under “exacerbating” factors) only underscores its *continuing* failure to rectify the violations.

3. TracFone’s Conduct Subverts the Goal of Universal Service, and Violates the Public Interest.

Since its inception in the early 20th century, the public telephone system has been based on two principles: common carriage and universal service. The principle of universal service is anchored in 47 U.S.C. § 254(d):

Every telecommunications carrier that provides interstate telecommunications services shall contribute, on an equitable and nondiscriminatory basis, to the specific, predictable, and sufficient mechanisms established by the Commission to preserve and advance universal service.

Federal statute specifically authorizes states to set up universal service surcharge mechanisms parallel and complementary to the federal system:

A State may adopt regulations not inconsistent with the Commission’s rules to preserve and advance universal service. Every telecommunications carrier that provides

intrastate telecommunications services shall contribute, on an equitable and nondiscriminatory basis, in a manner determined by the State to the preservation and advancement of universal service in that State. A State may adopt regulations to provide for additional definitions and standards to preserve and advance universal service within that State only to the extent that such regulations adopt additional specific, predictable, and sufficient mechanisms to support such definitions or standards that do not rely on or burden Federal universal service support mechanisms.⁵⁷

California's statutes relating to universal service and public purpose program surcharges reflect a legislative intent to include all carriers and their customers within the surcharge revenue base. Section 739.3(c) of the Public Utilities Code requires that the rural (high-cost) support programs be "competitively neutral and broadbased." Sections 275(b), 276(b), 277(b), and 280(c) relating to the CHCF-A, CHCF-B, ULTS, and CTF funds respectively, are predicated on "all revenues collected by telephone corporations in rates." Section 871.5(d) requires that public purpose programs "should be supported fairly and equitably by every telephone corporation." The Legislature has several times voiced its support for a "broad-based" and "competitively neutral" surcharge revenue base.⁵⁸

It is clear that the statutory architecture authorizing the Commission's universal service programs, read as a whole, is based on the notion that all telecommunications carriers will participate. There is, on the other hand, no hint of any authorization for an exemption of prepaid wireless carriers from these surcharge obligations.

General Order 153 reflects this as well. From 2000 through December 1, 2011, G.O. 153 required that "All carriers shall assess, collect, and remit the ULTS surcharge";⁵⁹ thereafter the "all carriers" requirement was found in the requirement that

⁵⁷ 47 U.S.C. § 254(f).

⁵⁸ See, e.g., P.U. Code § 739.3, and history set forth above.

⁵⁹ This language was originally found in section 9.1 of GO 153, as amended in 2000. See D.00-10-028, with G.O. 153 attached Appendix B, available online at http://docs.cpuc.ca.gov/PublishedDocs/WORD_PDF/FINAL_DECISION/2942.PDF. In April 2009, Resolution T-17202 amended GO 153 and renumbered the sections so that this language was then found

all carriers must “annually submit to CD an estimate of the carrier’s projected gross revenues subject to the California LifeLine surcharge for the following year,” and that “all end-user intrastate telecommunications services, whether tariffed or not, are subject to the California Lifeline surcharge.”⁶⁰

TracFone’s subsidy arbitrage (as further described below), the cloth from which its defiance of Commission orders and California statutes is cut, threatens this carefully constructed system of complementary state and federal universal service subsidies.

E. Factors that Aggravate or Exacerbate TracFone’s Violation.

1. TracFone Has Failed to Comply With D.12-02-032.

Even after being *ordered* to comply “immediately” with Commission public purpose surcharge and fee requirements -- Ordering Paragraph 2 of D.12-02-032, the Phase I decision issued on February 24, 2012, ordered TracFone to begin remitting surcharges and user fees “immediately” -- TracFone did not do so. Under the guise of negotiating with the Communications Division, TracFone dragged out compliance with its surcharge requirements until the second half of October, 2012. HT at 1139:6-21. It has still not remitted surcharges for the period February 24, 2012 through October 15, 2012, and now appears to be refusing to pay those surcharges altogether.

Prior to the hearing, staff counsel wrote to TracFone’s counsel (on January 3, 2013) and posed the question, “Does TracFone intend to remit surcharge payment for months February through September?”⁶¹ TracFone’s counsel stated he was too busy to respond, and that staff should “raise [the] question ... with Rick Salzman during cross.”⁶² On cross-examination, TracFone’s Mr. Salzman stated that he was still “working with the

in section 10.1. *See*

http://docs.cpuc.ca.gov/PublishedDocs/WORD_PDF/FINAL_RESOLUTION/99996.DOC.

⁶⁰ GO 153, at sections 10.4.1 and 10.5.1 (continuing the previous exception for “Coin sent paid telephone calls (coin in box) and debit card calls”). This version is found at http://docs.cpuc.ca.gov/WORD_PDF/GENERAL_ORDER/154648.pdf, and as TracFone Exhibit 213.

⁶¹ January 3-4, 2013 email exchange with opposing counsel, attached hereto as Appendix B. This email was brought to the hearing room by the undersigned, and provided to the Assigned ALJ.

⁶² *Id.*

Communications Division on paying back amounts for the gap period between February and October.”⁶³ It is now clear, however, why TracFone’s counsel dodged the question: TracFone *has no plans to pay back amounts for the “gap period,”* and is in fact now arguing to CD that its half-payment for October surcharges should be deemed total compliance for the whole “gap” period (itself a TracFone construction). See TracFone’s January 28, 2013 letter, attached hereto as Appendix C. TracFone’s argument seems to be that it had no duty to make any surcharge payments until it reached agreement with CD as to methodology, and that when the Commission ordered TracFone to begin paying “immediately,” it really meant “only when TracFone agrees with staff on an acceptable payment method.” *Id.* Staff estimates that TracFone owes \$875,000 in back surcharges for the period February 24 through October 15, 2012.⁶⁴ Staff submits that this delay and obfuscation is typical of TracFone’s conduct across the country, as described more fully below.

2. A Central Tenet of TracFone’s Impossibility Argument – that it has no Direct or Billing Relationship with its Customers – Proves to Be a Fiction.

As it did in Phase I, TracFone again submits evidence (much of it the *same* evidence as submitted in Phase I) to prove its point that it cannot coerce its retail distributors to collect fees and surcharges for it. See *generally* Montenegro Testimony (Exhibit 201). This in turn is based on TracFone argument, now apparently taken up by the prepaid industry, that TracFone has no contact with end-user customers, and no presence at the point of sale.

This is fiction. As explained below, there is a direct electronic link between TracFone’s “back-end” computers and the point-of-sale (i.e., the cash register). Moreover, there is continuing contact between TracFone and its end-users each time the

⁶³ This is the ALJ’s summary (at HT 1147:14-23) of what Mr. Salzman stated at greater length at 1139:6-21.

⁶⁴ An explanation for this assertion is found in Confidential Appendix D.

user redeems his/her airtime card, and TracFone loads wireless minutes onto the user's telephone. HT 1040:13-16.

This fiction is found throughout TracFone's testimony. Exhibit 201, Montenegro at 2:18-3:12; HT at 982:2-16; *see also* Salzman Testimony (Exhibit 203, at 4:27-5:3, 6:38-7:4, 24:9-26:6. It is also central to TracFone's argument, across multiple states, that only legislation can solve a problem that now appears as if it does not exist. TracFone has sold this fiction to the National Conference of State Legislatures, which is promoting the same sort of model "point-of-sale" legislation that TracFone claims is necessary in California. The NCSL puts the case this way on its website (and as quoted in a document that TracFone tendered as evidence, and then withdrew):

... fees have historically been collected from telecommunications users on their monthly bills and remitted to governments by telecommunications providers. *However, the lack of a billing relationship between the prepaid wireless user and the sellers and providers of prepaid wireless service means that the existing collection methodologies are not well suited to prepaid wireless, causing administrative and legal disputes that inhibit collection of [such] fees on prepaid wireless service.*⁶⁵

As legal argument, this has been rejected by this Commission in Phase I, and by other public utility commissions across the country. As factual assertion, it begs the question of how TracFone facially complies with the federal universal service requirements, which it does even though those requirements are also based on "billed revenue",⁶⁶ and *why* TracFone chooses to comply with federal law but not state law (see section below on "subsidy arbitrage").

⁶⁵ See <http://www.ncsl.org/issues-research/telecom/prepaid-point-of-sale-status.aspx>; this quotation is also found in a purported Board of Equalization "Collection Method Research Report" that TracFone had marked as its Exhibit 214, and then withdrew (see page 3). The NCSL reports that 18 states have adopted the model legislation. We believe a similar number have rejected it.

⁶⁶ See CPSD Phase I Exhibit 2, Confidential Attachment V, TracFone's Form 499 submissions to the Universal Service Admin. Corp. (USAC) – see instructions between lines 402 and 403 ("Report billed revenues"); see line 410 (where TracFone reports all of its revenue on a line labeled "Message charges including roaming"); *see also* TracFone Exhibit 209, Form 499 Instructions for 2012, at page 12, where the instructions for "Lines 403-418" are "Report gross billed revenues as directed."

a) The Collection Impossibility Argument Was Rejected in Phase I.

The Commission’s decision on rehearing in Phase I noted that the *duty to collect and remit was TracFone’s*, not that of its third-party retailers:

[TracFone’s] arguments that it is not a telephone corporation, not a public utility, is operating under some other authorization than the one it holds (e.g., that it is merely a debit card call service), *and that it does not know how to and/or cannot collect and remit such fees are contradicted by the record, constitute subterfuge, and are entirely without merit.*⁶⁷

“It is TracFone the public utility,” the Commission continued, “and not any third-party retail establishment, which is responsible for compliance with the relevant laws at issue here”⁶⁸:

TracFone’s argument regarding methods for collection of surcharges from its customers amount to nothing more than a red herring. We are not persuaded by its argument. There is no question that TracFone is legally responsible for collecting and remitting the surcharges and fees in question. Nor is there any question that the evidence amply establishes that TracFone has failed for quite some time to comply with its carrier duties and responsibilities.⁶⁹

As shown in the “subsidy arbitrage” section below, other states have rejected the collection impossibility argument.

b) The Collection Impossibility Argument Was Always a Fiction -- TracFone Has the Means to Enforce Collection at Point of Sale.

TracFone’s impossibility argument is based on the fiction that TracFone has no contact with its end users, i.e., “a lack of a billing relationship.” This is misleading, if not false, in two material respects: (i) TracFone has a direct electronic link to the customer at

⁶⁷ D.12-10-018, Slip Op. at 16 (emphasis added).

⁶⁸ *Id.* at 20.

⁶⁹ *Id.*

the point of sale; and (ii) TracFone has a direct electronic link to the customer after the point of sale (through the handset). And it is wholly inapplicable to customers who buy their airtime online.

It is now clear that TracFone has a direct electronic link to the point of sale, and it is TracFone (or TracFone's agent) – not the third-party retailer – that scans and activates the “airtime” card at the point of sale. TracFone has a “Transaction Processing Agreement” with a third party, Airtime Technologies to do this.⁷⁰ Airtime provides a direct near real-time link between TracFone and the retailer's point of sale; this gives TracFone the means to monitor the sale, and provides TracFone with a means to enforce collection of surcharges and fees at the point of sale.⁷¹ TracFone testified that the scan triggers a simultaneous sale from TracFone to the retailer, and from retailer to consumer – effectively from TracFone to the consumer. As TracFone CEO Pollak testified in Phase I, three things happen simultaneously when the airtime card is scanned at the point of sale:

[B]ecause the [Airtime] card itself is largely worthless until activated, the retail vendor's purchase of the card occurs simultaneously with the sale of the card to the retail end user customer. For example, if a prepaid airtime debit card is purchased at Walmart, it is not active until the cashier at Walmart scans the card at the point of purchase. Upon scanning the card, several things happen at once.

- * First, Walmart effectively buys the card (and associated minutes) from TracFone and becomes obligated to pay for that card.
- * Second, Walmart sells the card to the consumer and receives payment from the consumer.

⁷⁰ The TracFone-Airtime Transaction Processing Agreement is found at Confidential Exhibit 22C. Staff has requested that TracFone allow some portion of this agreement be made available as a publicly accessible Exhibit, but TracFone has so far declined to do so. Confidential excerpts from this Exhibit are found in Confidential Appendix A hereto.

⁷¹ See excerpts of the Transaction Processing Agreement (*ibid*) found in Confidential Appendix A; see also cross-examination testimony recited below.

- * Third, the scanning process makes the card active such that the consumer can subsequently load the minutes from that airtime debit card to his or her TracFone.⁷²

The factfinder can reasonably infer that TracFone “effectively” sells the airtime card to the consumer at the point of sale, with the retailer in the middle; the retailer gets the “earned revenue percentage” or “retail margin percentage,” and TracFone gets the rest.⁷³ Airtime Technologies, Inc. provides TracFone with “host to host connectivity” that links TracFone’s backend computers with the point of sale (i.e., the cash register).⁷⁴ See Confidential Appendix A (with excerpts from the TracFone-Airtime contract which TracFone claims is confidential).

The operation of this contract, and the role that Airtime plays as a middleman between TracFone and the third party retailer, was explained in public testimony. As TracFone General Counsel Richard Salzman testified in Phase I:

A. [T]here's a third party in the middle [between TracFone and Walmart], and they probably have contracts that, you know, explain what they do. But I haven't seen them."

Q. Okay. Who’s the third party?

A. I don't know the name of the company that does that. These companies have merged and changed names. I mean, years ago, it was called Air Time. Air Time Technologies I believe."⁷⁵

Mr. Salzman elaborated how this process works in Phase II:

I brought a demonstrative aid if that helps. I have a TracFone card. Not this one but a card like this -- this is not scratched off. My understanding of Air Time Technologies is when you sell this card -- this TracFone card at a retail store, it has

⁷² TracFone Phase I Exhibit 111, at 6 (original uses “Target” as an example, TracFone errata changed that to “Walmart”).

⁷³ Compare HT at 1189:4-1190:7; CPSD Exhibit 27C, last page.

⁷⁴ HT 1160:1-10 (Salzman), 1256:11-13 (Dillon); Confidential Exhibit 22C, Amended Transaction Processing Agreement, at 1-2 (excerpted in Appendix A hereto)

⁷⁵ Hearing Transcript (HT) 528-29. This admission came after staff counsel repeatedly asked how TracFone and Walmart could communicate information about the airtime card inventory; no documents were produced, however.

a scratch-off here. If this was a live card, in other words you could take it to the store and walk out like this or scratch off the number and take a picture of it and put it back on the shelf and it would be live, you would have stolen that from us or from Walmart.

I think Air Time Technologies' business was to allow prepaid debit card carriers to put these out on the shelf in what you call a non-live, inactive status. So you could steal this piece of paper and take it home, but it's just a very nice piece of paper. Or you could scratch the code and it wouldn't work.

They provide a service [that] sit[s] between us and them so when this card goes through the register -- I think this was covered yesterday -- somehow -- now, the technology is way beyond me -- it tells our back end system -- now, because they have a contract with Walmart too I believe. Somehow that knowledge gets to our back end and says whoever has bought this card has paid for it and it's a live card.

Q. The consumer can walk out the door of the store, scratch it out at that time, put it into his phone, and those minutes would get uploaded to his phone?

A. It should work that way, yes, sir.⁷⁶

Mr. Salzman confirmed that the communication of the scanned information between the third-party retailer was “rather immediate”:

Q. ... that transmission of information is rather immediate, is it not, so that the customer can walk out the door and put that pin code into his phone and get minutes uploaded?

A. I think when you're talking with computers and things like that, it would be rather immediate. I don't think the system should have any sort of delay – material delay anyway.⁷⁷

TracFone’s Senior Vice-President Montenegro, who reports to Mr. Salzman, was more circumspect than Mr. Salzman (or Mr. Dillon), but also could not deny the system architecture as described by her colleagues:

⁷⁶ Salzman, Phase II, HT 1158 *ff*

⁷⁷ HT 1160

Q. Okay. So -- and you have no understanding of any link between the retailer on the one hand and TracFone on the other, any electronic link?

A. What do you mean by understanding?

Q. Do you have --

A. I know there's some communication.

....

Q. Have you ever heard of an electronic data interface between the two?

A. I've heard that term.

Q. Have you ever heard of Air Time Technologies?

A. Yes.

Q. Okay. What is it -- what is your understanding of what Air Time Technologies does?

A. My understanding is that Air Time Technologies is a third-party vendor that provides a service between TracFone and certain retailers.⁷⁸

Mr. Dillon confirmed that “there is a process of point of sale activation, you know, that takes place at the scan, at a register.”⁷⁹

This evidence compels the factfinder to conclude that there is a *direct real-time (or near-real time) electronic link between TracFone’s “back end [computer] system” and the retailer’s cash register*. TracFone’s argument that it could not compel its retail distributors to collect surcharges on its behalf, never particularly credible, becomes even less so in light of this communication link which allows (or could allow) TracFone to immediately know the retail price at and location of the point of sale. To the extent that a surcharge amount was not programmed into the retailer’s cash register system, TracFone could communicate that surcharge amount to the cash register

The immediate electronic link between TracFone and its consumers continues when the consumer walks out the door of the retail establishment. The consumer uploads

⁷⁸ HT 1001-02

⁷⁹ HT at 1256:11-13.

the minutes on her airtime card to the TracFone handset, at which point TracFone sends a “short text message” to the consumer, “an acknowledgement that the card was redeemed, essentially.”⁸⁰ Without these minutes, TracFone will not allow the handset to operate.⁸¹ TracFone’s text message could also be used to provide “line item” information to consumer about the amount of the surcharges deducted. For instance, a TracFone text message that stated “You have 200 new minutes, 5 minutes were deducted for CA surcharges and fees” consists of 64 characters, 77 if one counts the spaces, well within the character limit for TracFone’s text messages.⁸²

TracFone’s internal Customer Communication Policy makes clear that TracFone can and does send text messages to its customers in many different situations.⁸³ TracFone also communicates with some of its customers via email (HT 1033:11-15), via “voice blasts” (HT 1033:25 – 1034:4) (“I’m referring to a marketing type message that’s communicated to a large number of customers at one time”), and via direct mail (HT 1034:14-18).

In addition, TracFone makes “direct sales” of its minutes to a substantial (if still unknown) percentage of its customers online, which generate a computer screen and email “billing summary” that spells out the E911 surcharge, and the Federal Universal Service Charge (as well as a “Regulatory Cost Recovery Fee” to “help cover our costs related to complying with government regulations and programs.”⁸⁴

⁸⁰ HT at 1033:1-5 (Montenegro cross-examination).

⁸¹ “Customer usage,” TracFone’s parent asserts, “is controlled using patented, proprietary software installed in each phone TracFone sells, and TracFone provides customer service and manages customers as though it were a network-based carrier.” América Móvil SEC filing, Form 20-F at 57 (CPSD Exhibit 1, Attachment L.1).

⁸² CPSD Confidential Exhibit 23C, TracFone’s Customer Communication Policy, at sections 3 (TF II – 00716) and 6.6 (TF II- 00717).

⁸³ *Id.*, at TF II – 000711, *passim*.

⁸⁴ CPSD Exhibit 17/17C, Christiansen Opening Testimony, at Attachment A, page 11. Apparently TracFone also designs the “911 Surcharge” on direct sales to remunerate TracFone for “its cost of complying with E911 laws and regulations” in a number of states, including California. *Id.*

Finally, TracFone regularly deducts minutes and minute fractions (the coin of the realm) from the consumer’s account for traditional voice and other services.⁸⁵ TracFone could deduct fractions of a minute to reflect the surcharges and fees. TracFone testified that it does collect a zip code from every customer at the time the handset is purchased, which it uses to determine the state to which the revenue is allocated. HT at 1182:2-10. It is clear that TracFone can obtain what information it needs from the consumer to effect revenue and surcharge and user fee collection from the consumer.

3. TracFone’s Violations of California Law Appear to Be Part of a Nationwide Strategy That Can Only Be Described as Subsidy Arbitrage -- Maximizing the Collection of Federal Universal Service Subsidies, While Minimizing Any Remittance of Surcharges or Fees to State Public Purpose Programs.

TracFone has drawn down over \$1.4 billion dollars in federal universal service subsidies from the Universal Service Administrative Corporation (USAC) since October, 2008.⁸⁶ Year by year, federal subsidies account for an increasing percentage – approximately 12.4% in 2011 -- of TracFone’s annual revenue.⁸⁷

⁸⁵ CPSD Exhibit 28, TracFone website regarding Data Services, which recounts how customers can pay for mobile web access, content (ringtones and graphics), picture and multi-media messaging, and information services by using “units” or minutes. *See also* HT 1218:2-12 and 1221:27-1222:17 (units synonymous with minutes).

⁸⁶ *See* CPSD Exhibit 17/17C, Christiansen Opening Testimony, at p. 14, Table 4. Served before year end, Mr. Christiansen’s Prepared Testimony was necessarily incomplete as to year 2012. Here is the table updated to include subsidy draw through January 2013:

Year	Amount of USAC Disbursement	Amount of Total TracFone Operating Revenue	% of Total Operating Rev. Provided by USAC Disbursement
2008 (oct - dec)	\$984,284.00		
2009 (jan – dec)	\$166,371,415.00	\$1.750 billion	9.5%
2010 (jan – dec)	\$338,006,189.00	\$2.872 billion	11.7%
2011 (jan – dec)	\$419,455,407.00	\$3.389 billion	12.4%
2012 (jan – dec)	\$448,051,519.00		
2013 (jan)	\$35,038,690.00		
Grand Total	\$1,407,907,504.00		

The source data for these figures is available at <http://www.usac.org/li/tools/disbursements/default.aspx> (SPIN: 143030103).

At the same time, TracFone has unleashed a nationwide litigation campaign against a wide array of state-imposed surcharges and user fees, including but not limited to the payment of user fees, 911 emergency fees, and public purpose surcharges. In California, for instance, TracFone “determined that it should not have paid these [user] fees because it was not a California public utility,” and did so “[i]n 2003, as part of an overall review of our tax programs.”⁸⁸ Either as a result of this or other “overall review,” TracFone launched challenges to fee and surcharge obligations in a number of states, which in turn precipitated state administrative and/or judicial proceedings in Arizona,⁸⁹ Colorado,⁹⁰ Idaho,⁹¹ Indiana,⁹² Iowa,⁹³ Kansas,⁹⁴ Kentucky,⁹⁵ Maine,⁹⁶ Minnesota,⁹⁷

⁸⁷ The TracFone Operating Revenue in the preceding footnote were reported in CPSD Exhibit 17/17C, at Attachment B, and were derived from the SEC Forms 20-F, as filed by TracFone’s parent company, América Móvil. A number very close to the underlying 2009 operating revenue figure shown here is also in the record at Exhibit CPSD 1, Attachment K.1.

To review the individual SEC forms, go (for year 2011) to <http://www.sec.gov/Archives/edgar/data/1129137/000119312512196609/d341769d20f.htm>, at Item 4. Information on Company, page 41.

2010 see <http://www.sec.gov/Archives/edgar/data/1129137/000119312511138519/d20f.htm>, at page F-96 (12.38 pesos/dollar exchange ratio is noted at page 1); for 2009, see: <http://www.sec.gov/Archives/edgar/data/1129137/000119312510128293/d20f.htm> at page F-60.

⁸⁸ TracFone Phase I Exhibit 111, Prepared Testimony of TracFone CEO F.J. Pollak, at 16:13-15.

⁸⁹ Arizona Corporation Commission, Docket no. T-20664A-09-0 148, available at <https://edocket.azcc.gov>.

⁹⁰ Colorado Public Utilities Commission, Docket No. 09A-393T, available at https://www.dora.state.co.us/pls/efi/EFI_Search_UI.search.

⁹¹ Idaho Public Utilities Commission, Case No. TFW-T-09-01, available at <http://www.puc.idaho.gov/internet/cases/summary/TFWT0901.html>.

⁹² Indiana Utility Regulatory Commission, Cause No. 43732 and Cause No. 43524, available at <https://myweb.in.gov/IURC/eds/Guest.aspx?tabid=7>.

⁹³ Iowa Utilities Board, Case No. IAC-2009-3902, available at <http://www.state.ia.us/government/com/util/>.

⁹⁴ Kansas Corporation Commission, Docket no. 09-TFWZ-945-ETC, available at <http://www.kcc.state.ks.us/docket/docket.htm>.

⁹⁵ *Commonwealth of Kentucky CMRS Emergency Telecom. Bd. v. TracFone*, 735 F.Supp.2d 713, 2010 U.S. Dist. LEXIS 87379 (W.D. Ky, 2010).

⁹⁶ Maine Public Utilities Commission, Docket No. 2011-69, available at <http://www.maine.gov/mpuc/>.

⁹⁷ Minnesota Department of Commerce, Docket No. P-6823/ CI-10-519, available at <https://www.edockets.state.mn.us/EFiling/edockets/searchDocuments.do?method=showeDocketsSearch&searchType=new>.

Nevada,⁹⁸ New Mexico,⁹⁹ North Carolina,¹⁰⁰ Ohio,¹⁰¹ Oregon,¹⁰² Utah,¹⁰³ and Washington.¹⁰⁴

The choice of the States (rather than USAC) as targets for TracFone's litigation appears to be no accident, for two reasons: (1) TracFone needs USAC as the source of the \$1.4 billion in federal surcharges it has received to date; and (2) TracFone *must* file universal service returns with, and make contributions to, USAC, as a precondition to obtaining service from its underlying carriers (which would otherwise be responsible for the universal service contribution):

[The reseller] must certify under penalty of perjury that either the company contributes directly to the federal universal support mechanisms, or that each entity to which the company provides resold telecommunications is itself an FCC Form 499 worksheet filer and a direct contributor to the federal universal service support mechanisms.¹⁰⁵

States with sufficient resources and political will to fight back have prevailed in the TracFone litigation wars. In Indiana, where Mr. Pollak suggested that the state

⁹⁸ Public Utilities Commission of Nevada, Docket No. 09-10037, available at <http://pucweb1.state.nv.us/PUCN/SearchDocNum.aspx>.

⁹⁹ New Mexico Public Regulatory Commission, Case No. 09-00300-UT, available at <http://www.nmprc.state.nm.us/general-counsel/case-lookup.html>.

¹⁰⁰ North Carolina Administrative Docket No. 06-DST-0643, available at https://www.nc911.nc.gov/Board/agenda/Book/20060519_tab09%20TracFone%20Prehearing%20Statement%20final%205-10-06.pdf.

¹⁰¹ Public Utilities Commission of Ohio, Case No. 97-632-TP-COI and Case no. 10-2377-TP-COI, available at <http://www.puco.ohio.gov/puco/>.

¹⁰² Oregon Public Utilities Commission, Docket No. UM1437, available at <http://apps.puc.state.or.us/edockets/search.asp>.

¹⁰³ Public Service Commission of Utah, Docket No. 09-20-10, available at <http://www.psc.utah.gov/utilities/telecom/telecomindx/2006-2009/09251101indx.html>.

¹⁰⁴ The Washington Supreme Court ordered TracFone to pay fees. *TracFone v. [Washington State] Dept. of Revenue*, 170 Wn.2d 273, 242 P.3d 810, 2010 Wash. LEXIS 922 (2010).

¹⁰⁵ CPSD Phase I Exhibit 10 (FCC Form 499 instructions for 2009), at page 19; *see also* TracFone Exhibit 209, 2012 Form 499 instructions, at 21-22 (“Attributing Revenues from Contributing Resellers and from End Users”).

agency had accepted TracFone's claims,¹⁰⁶ the Indiana Utility Regulatory Commission, in fact (1) rejected TracFone's claim that it was not a utility, and (2) affirmed TracFone's liability to pay universal service fees.¹⁰⁷ "TracFone's obligation to pay such fees is not left to TracFone's discretion."¹⁰⁸

In Minnesota, the state PUC granted ETC designation only on condition that TracFone pay E911 and disabled-access surcharges:

Obviously, a telecommunications service provider cannot be excused from the surcharge requirements of [Minnesota statutes] on grounds that its chosen business model (in this case, offering prepaid service through third-party retail outlets) makes collecting surcharges from customers difficult. Further, it appears that other carriers offering prepaid service through third-party retail outlets – including Verizon, AT&T, and T-Mobile, all cited in TracFone's comments – have found ways to accomplish this.¹⁰⁹

In a similar vein, the United States District Court in Kentucky rejected TracFone's "impossibility" defense, as well as TracFone's defense that it should not now be forced to pay what it had earlier failed to remit:

TracFone argues that because its customers owe the service fee and no one collected any fees under the 1998 Act after 2003, the Board cannot now force TracFone to remit fees out-of-pocket. Such an interpretation, of course, would completely alleviate the CMRS provider of its obligation to collect and remit the fees. Clearly, the statute did not intend this result.¹¹⁰

¹⁰⁶ Phase I Hearing Transcript at 504-05.

¹⁰⁷ November 4, 2010 Order on Rehearing of Indiana Regulatory Commission, pp. 2-3, available at https://myweb.in.gov/IURC/eds/Modules/Ecms/Cases/Docketed_Cases/ViewDocument.aspx?DocID=0900b6318014ecef.

¹⁰⁸ *Id.* at 2.

¹⁰⁹ June 9, 2010 Order Granting One-Year Conditional ETC Designation and Opening Investigation, at 11, available at <https://www.edockets.state.mn.us/EFiling/edockets/searchDocuments.do?method=showPoup&documentId={63A94800-882F-4A6F-AB15-299DA05B0827}&documentTitle=20106-51399-02>.

¹¹⁰ *Commonwealth of Kentucky CMRS Emergency Telecom. Bd. v TracFone*, 735 F.Supp. 2d 713, 724, 2010 U.S. Dist. LEXIS 87379 (W.D.KY 2010) (LEXIS version attached as Appendix 2 to CPSD's

In Washington, the state Supreme Court granted summary judgment affirming a Washington Department of Revenue order that TracFone pay state E911 excise taxes on its prepaid wireless telephone service. The court rejected TracFone’s assertions that it did not have the appropriate customer information to calculate accurately the tax to be imposed on customers. The Court also agreed with the Department of Revenue that “it is not required to explain to TracFone how to conduct its business in order to comply with the tax collection obligation.”¹¹¹

The Nebraska Supreme Court and the Lancaster County District Court affirmed the Nebraska Public Service Commission’s decision rejecting TracFone’s proposed methods of collecting an E911 surcharge because they failed to adequately fulfill the statutory requirements of the 911 surcharge.¹¹² In oral argument before the Nebraska Supreme Court, TracFone asserted that it could not collect the E911 surcharge from a customer who buys a TracFone product from a retail store because TracFone has no direct financial relationship with the customer.¹¹³ The Nebraska Supreme Court rejected that argument: “TracFone’s choice of business model does not give it license to throw up its hand and pay nothing.”¹¹⁴

Although the theories TracFone has used in its avoidance strategy are many, the basic animus is the same – to avoid, if at all possible, any and all state tax, fee, and surcharge obligations. At the same time, TracFone nominally complies with federal filing requirements, because this is an obvious pre-condition to the well over a billion dollars which TracFone has obtained in federal universal service surcharges, and also a pre-condition to obtaining network capacity, as described above. TracFone’s differing

December 9, 2010 Reply in Support of Summary Adjudication).

¹¹¹ *TracFone v. Washington, supra*, at ¶ 37, 2010 Wash. LEXIS 922, ***25 (decision available at <http://caselaw.findlaw.com/wa-supreme-court/1543171.html>).

¹¹² See <http://www.commlawgroup.com/news/2010/02/16/nebraska-high-court-ruling-subjects-tracfone-wireless-to-e911-fee-collection-requirement/>.

¹¹³ Nebraska Judicial Branch, Supreme Court Oral Arguments, S-08-1109, available at <http://www.leagle.com/xmlResult.aspx?xmlDoc=In%20NECO%2020100212328.xml>.

¹¹⁴ *TracFone Wireless v. Nebraska Public Service Comm’n*, 279 Neb. 426, 435, 778 N.W. 2d 452, 2010 Neb LEXIS 24 (2010).

approaches to federal and state surcharge obligations reveal its strategy for what it is: a federal-state arbitrage to exploit the universal service subsidy system.

F. TracFone’s Other Arguments Have No Weight.

1. TracFone’s Argument that it had No Notice of its Duties to Collect and Remit Strains Credulity (and Re-Plays TracFone’s Debit Card Gambit).

Mr. Salzman’s Phase II testimony contains an entire section entitled “Lack of Notice.” *See* pages 9-13. In particular, TracFone argues that the wireless registration letter it received in 1997 did not provide notice that TracFone was not a prepaid debit card provider (and was instead a full-service telephone utility required to pay surcharges), that TracFone thought the prepaid debit card exclusion applied to it, and that it never received a “warning notice as required by G.O. 153.” *Id.*

This, again, is a recapitulation of TracFone’s Phase I themes. TracFone’s Application for Rehearing, for instance, argues that its “due process rights to notice and an opportunity to comment on a prospective change in law” were violated. The rehearing decision squarely rejects that claim: “TracFone was fully notified upon receiving its [1997 wireless registration letter] that it must comply with the relevant laws, regulations and rules.”¹¹⁵

Consistent with CPSD/SED’s evidence,¹¹⁶ the Commission also flatly rejected TracFone’s assertion that was a debit card provider: “TracFone’s assertion that the debit card exemption is within TracFone’s rationale – no bills – for the coin-sent paid calling exemption fails.”¹¹⁷ The Commission’s decision on rehearing is more explicit: “the evidence establishes that the telephony services provided by TracFone cannot be reduced

¹¹⁵ D.12-10-018, at 18.

¹¹⁶ The Commission’s Phase I decisions do not specifically address staff’s evidence, but it is overwhelming, including TracFone’s description of itself in its letter applying for registration as a “reseller of commercial mobile services” (and not a debit card company – see CPSD Exhibit 1, Attachment A), its failure to register under the debit card statutes (P.U. Code §§ 885-86, HT at 1111-12), and its election to report its income on its federal 499 form not as debit card income but as wireless usage (Exhibit 2, Confidential Attachment V, at lines 410 and 411).

¹¹⁷ D.12-02-032, Slip Op. at 29; *see generally id.* at 29-30.

to a description of a mere debit calling card provider. The debit card exclusion does not pertain to TracFone's airtime sales."¹¹⁸

2. The Fact that the Commission Did Not Detect TracFone's Violations for over Ten Years Does Not Validate TracFone's Conduct or Mitigate TracFone's Culpability.

TracFone has argued that the fact that the Commission did not detect TracFone's violations for over ten years somehow ratifies TracFone's conduct.¹¹⁹ While this may not reflect positively on the Commission (or may be a reflection of the Commission's lack of resources), it does *nothing* to exculpate TracFone's conduct. Rather, TracFone aggressively tried to take advantage of the Commission's limitations, as it has done at state agencies across the country. It succeeded in flying under the radar for approximately 10 years. Shortcomings in state oversight do not vitiate the obligations of the regulated utility.

By the time a PD issues in this matter, it will be almost 4 years since staff informed TracFone that its conduct was illegal.¹²⁰ TracFone's conduct during that period – full-throated defiance and expensive litigation -- is telling. In finally calling TracFone to account, California should not hesitate to follow other states which have rejected TracFone's attempts to end-run around state surcharge and fee requirements, as described above.

V. OTHER REMEDIES

Staff requests that TracFone be ordered to preserve all documents now in existence relating to California intrastate revenue calculations 2000-2013 for at least three years from the date of any decision in this matter, and at least six years from their

¹¹⁸ D.12-10-018, Slip Op. at 27.

¹¹⁹ Exhibit 203, Salzman Testimony, at 10:15-17, 12:10-12 (passage of time “indicates to me that prior to that Decision, the Commission had never intended to treat revenues from prepaid wireless debit card services differently from revenues derived from wireline debit card services”), 12:13-15, 17:13-15, *passim*.

¹²⁰ CPSD Exhibit 1, Attachment F (Christiansen May 1, 2009 email, which almost four years ago laid out the fallacies of TracFone's approach similar to the findings of D.12-02-032).

date of creation (and longer if other laws so require), should this Commission elect to undertake or participate in an audit of this public utility.

VI. CONCLUSION

TracFone (and its owner América Móvil) have apparently made the decision to compete not in the marketplace, but in litigation tribunals, regulatory agencies,¹²¹ legislative chambers across the country (where TracFone pushes its “model point-of-sale legislation”¹²²), and regulatory proceedings. As shown above, however, TracFone’s arguments of impossibility (which it claims require such legislation) are a sham. TracFone has it within its power to collect and remit surcharges and user fees if it so chooses.

If the Commission continues to support the concept of universal communications service, and intends to carry out the statutory mandate for universal service programs, then it must pay attention to how those programs are funded, and it must uphold the law which requires that “every carrier” contribute to the universal service funds on a fair and equitable basis.

If past conduct is any guide, TracFone will continue to challenge the Commission at every turn. As stated above, the purpose of Section 2107 penalties is “deterrence.” In TracFone’s case, it is imperative that the Commission make a strong statement about TracFone’s obligations, and the Commission’s resolve to enforce those obligations. Such a statement must include a substantial penalty – staff recommends not less than \$1000 day/violation – so that the Commission’s “statement” has deterrent effect. In addition,

¹²¹ By recent count, TracFone has applied to the FCC for forbearance or other exceptions from the rules at least 10-12 times in the last several years.

¹²² In California, the proposed model legislation would split jurisdiction for collection of CPUC public purpose surcharges and user fees between the Commission (which would still be responsible for post-paid, and possibly also for prepaid direct sales, e.g. TracFone’s direct Internet sales) and BoE (which would collect prepaid from point-of-sale establishments). Staff believes that this split jurisdiction would make it substantially more difficult for the Commission to obtain a complete picture of a utility’s operations and revenue, especially for those companies that sell both prepaid and postpaid wireless service (e.g., Verizon Wireless). It would also require the BoE to establish a new computer tracking system to track sales at tens (if not hundreds) of thousands of retail establishments across the state, rather than collect the E911 surcharge (as it now does) and other surcharges directly from the carrier. For these reasons *inter alia*, the Commission is on record opposing last year’s “TracFone” bill (AB 1050).

interest must be assessed at a rate sufficient to compensate the Commission and the public funds for the lost time value of the unpaid surcharges and fees.

Respectfully submitted

/s/ CHRISTOPHER WITTEMAN

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February 6, 2013

APPENDIX A- CONFIDENTIAL

**Excerpts of TracFone's Contract with Airtime Technologies, Inc
CPSD Exhibit 22C**

APPENDIX B

January 3-4, 2013 Email Exchange Between Counsel

From: McTarnaghan, James W. [mailto:JWMcTarnaghan@duanemorris.com]
Sent: Friday, January 04, 2013 6:05 PM
To: Witteman, Chris; 'brecherm (brecherm@gtlaw.com)'; Ansley, Jolie-Anne S.
Cc: Christiansen, Charles H.; Tan-Walsh, Llela
Subject: RE: Last Minute Pre-Hearing Details -- Errata; Surcharge and Fee Remittances

Counsel,

We crossed in the mail here. I just sent in our exhibit list, errata and an estimate of cross examination time by email to ALJ McKinney and you. We'd like to get your cross examination estimates as well.

I didn't respond to your email from 10:41 PM last night because I'm really needing to focus on hearing preparation and about a dozen other things. I suggest that the best approach would be to raise question 1 with Rick Salzman during cross and to raise question 2 with Chesley Dillon so that the information will be on the record.

Jim McTarnaghan
415-957-3088

From: Witteman, Chris [mailto:chris.witteman@cpuc.ca.gov]
Sent: Friday, January 04, 2013 5:35 PM
To: McTarnaghan, James W.; 'brecherm (brecherm@gtlaw.com)'; Ansley, Jolie-Anne S.
Cc: Christiansen, Charles H.; Tan-Walsh, Llela
Subject: RE: Last Minute Pre-Hearing Details -- Errata; Surcharge and Fee Remittances

Counsel:

Attached is our Errata sheet. The Rebuttal Testimony corrections were made in MS Word before service yesterday. The Opening Testimony corrections were made by hand interlineation. Please share any errata you have with us at your earliest convenience.

Didn't hear back from you on my inquiry (below) re current status of TracFone surcharge and user fee payments. We would like to be as accurate as possible in any representations at hearing. Below is what we have in our system, but please let us know if that is not accurate, not complete, or if TracFone plans further remittances in the immediate future (particularly re surcharges February-September 2012).

Christopher Witteman
Staff Counsel

Legal Division/Telecommunications
California Public Utilities Commission
505 Van Ness Ave., Room 5028
San Francisco, CA 94102
Tel: 415.355.5524
Fax:415.703.2262
Cell: 415.806.4694

From: Witteman, Chris
Sent: Thursday, January 03, 2013 10:41 PM
To: 'McTarnaghan, James W.'; brecherm (brecherm@gtlaw.com); Ansley, Jolie-Anne S.
Cc: Christiansen, Charles H.; Tan-Walsh, Llela
Subject: TracFone Surcharge and Fee Remittances

Counsel:

I want to make sure staff doesn't misrepresent the state of TracFone's compliance with OP2 of D.12-02-032. We have evidence of TracFone user fee remittance dated November 14, 2012 in amount of \$70,865 (Attachment E to Christiansen Rebuttal Testimony), based on reported monthly intrastate revenue in the \$5-6 million range. We have evidence of a TracFone surcharge payment made November 20, 2012 for month of October, 2012, based on intrastate revenue for that month of a little over \$3 million.

Two questions:

1. Does TracFone intend to remit surcharge payment for months February through September?
2. Can you explain the apparent inconsistency between the monthly intrastate revenue base numbers for surcharges on the one hand, and user fees on the other?

Thank you for your attention to this matter.

Christopher Witteman
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APPENDIX C

TracFone January 28, 2013 Letter To Communications Division Staff

APPENDIX D - CONFIDENTIAL

**Estimated Calculation of Back Surcharges for the Period
February 24 through October 15, 2012,
Based on Allegedly Confidential Information**

APPENDIX E – CONFIDENTIAL

**Calculation of Surcharges and User Fees
Based on Chesley Dillon Testimony that 30 Percent of Difference Between
TracFone Intrastate Revenue Reported to BoE and
TracFone Intrastate Revenue Reported to CPUC (“Hypothetical” and Pre-
“Hypothetical”) for 2009-2011 was Telecommunications Revenue
Based in Part on Allegedly Confidential “Hypothetical” Numbers**