

**PUBLIC UTILITIES COMMISSION**505 VAN NESS AVENUE  
SAN FRANCISCO, CA 94102-3298**FILED**01-25-11  
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Adjudicatory

## TO PARTIES OF RECORD IN APPLICATION 07-12-026

This is the proposed decision of Administrative Law Judge (ALJ) Bushey. It will not appear on the Commission's agenda sooner than 30 days from the date it is mailed. The Commission may act then, or it may postpone action until later.

When the Commission acts on the proposed decision, it may adopt all or part of it as written, amend or modify it, or set it aside and prepare its own decision. Only when the Commission acts does the decision become binding on the parties.

Parties to the proceeding may file comments on the proposed decision as provided in Article 14 of the Commission's Rules of Practice and Procedure (Rules), accessible on the Commission's website at [www.cpuc.ca.gov](http://www.cpuc.ca.gov). Pursuant to Rule 14.3, opening comments shall not exceed 15 pages.

Comments must be filed pursuant to Rule 1.13 either electronically or in hard copy. Comments should be served on parties to this proceeding in accordance with Rules 1.9 and 1.10. Electronic and hard copies of comments should be sent to ALJ Bushey at [mab@cpuc.ca.gov](mailto:mab@cpuc.ca.gov) and the assigned Commissioner. The current service list for this proceeding is available on the Commission's website at [www.cpuc.ca.gov](http://www.cpuc.ca.gov).

/s/ KAREN V. CLOPTONKaren V. Clopton, Chief  
Administrative Law Judge

KVC:tcg

Attachment

Decision **PROPOSED DECISION OF ALJ BUSHEY** (Mailed 1/25/2011)

**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

Application of Calaveras Telephone Company (U1004C), Cal-Ore Telephone Co. (U1006C), Ducor Telephone Company (U1007C), Happy Valley Telephone Company (U1010C), Hornitos Telephone Company (U1011C), Kerman Telephone Co. (U1012C), The Ponderosa Telephone Co. (U1014C), Sierra Telephone Company, Inc. (U1016C), The Siskiyou Telephone Company (U1017C), Volcano Telephone Company (U1019C), and Winterhaven Telephone Company (U1021C) for Ratemaking Determination regarding Dissolution of Rural Telephone Bank.

Application 07-12-026  
(Filed December 20, 2007)

**DECISION ON ORDER TO SHOW CAUSE  
WHY A FINE SHOULD NOT BE LEVIED FOR FAILURE TO DISCLOSE  
PUBLIC UTILITY REVENUE IN CALIFORNIA HIGH COST FUND A  
ADVICE LETTER AND FOR VIOLATION OF RULE 1**

**1. Summary**

This decision finds that applicants Happy Valley Telephone Company, Hornitos Telephone Company, and Winterhaven Telephone Company are subject to penalties for violating Rule 1 of the Commission's Rules of Practice and Procedure, and applicants Calaveras Telephone Company, Cal-Ore Telephone Co., Ducor Telephone Company, Kerman Telephone Co., The Ponderosa Telephone Co., Sierra Telephone Company, Inc., The Siskiyou

Telephone Company, and Volcano Telephone Company are subject to penalties for violating both Rule 1 of the Commission's Rules of Practice and Procedure and the California High Cost Fund A rules. Each applicant's fine is tabulated below.

<b>Telephone Company</b>	<b>California High Cost Fund A Violation Fine</b>	<b>Rule 1 Violation Fine</b>	<b>Total Fine</b>
Calaveras	\$20,000	\$15,000	\$35,000
Cal-Ore	\$20,000	\$15,000	\$35,000
Ducor	\$20,000	\$15,000	\$35,000
Happy Valley	\$0	\$20,000	\$20,000
Hornitos	\$0	\$20,000	\$20,000
Kerman	\$20,000	\$20,000	\$40,000
Ponderosa	\$20,000	\$15,000	\$35,000
Sierra	\$20,000	\$20,000	\$40,000
Siskiyou	\$20,000	\$15,000	\$35,000
Volcano	\$20,000	\$20,000	\$40,000
Winterhaven	\$0	\$20,000	\$20,000

## **2. Background**

Applicants received \$31,299,810.13 from Rural Telephone Bank stock redemption and dividends, and on December 20, 2007, applied for Commission

authorization to credit \$3,037 of those funds to ratepayers.<sup>1</sup> In D.10-06-029, the Commission ordered all the funds returned to ratepayers.

The Commission also found that the applicants should be required to show cause why they should not be fined for the following apparent violations:

(A) failure to disclose the substantial revenue from the dissolution of the Rural Telephone Bank in their respective 2006 California High Cost Fund A advice letter filings as required by Decision 91-09-042, and

(B) failure to comply with Rule 1 of the Commission's Rules of Practice and Procedure for filing an application that did not disclose the actual amount at issue and not being forthcoming with relevant information.

On July 28, 2010, applicants filed a Motion for Rehearing of D.10-06-029, a request for official notice, and a Motion for Stay of Decision D.10-06-029 until the Motion for Rehearing had been ruled upon. On August 18, 2010, the applicants filed a motion for an order directing the Commission's Docket Office to accept the July 28, 2010 request for official notice for filing. The Commission denied all these motions on October 28, 2010, in D.10-10-036.

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<sup>1</sup> The extensive history of the Rural Telephone Bank is set out in Decision (D.) 10-06-029. In summary, Congress created the Bank in 1971 to make low-cost capital available to rural telephone providers. The applicants obtained substantial loans from the Rural Telephone Bank. They also obtained stock in the Rural Telephone Bank through the loans and as refunds of interest paid on the loans. In August 2005, the Board of Directors of the Rural Telephone Bank authorized its dissolution and initiated the stock redemption process. Redemption payments began in April 2006.

### **3. Position of the Applicants**

Applicants oppose the imposition of fines and contend that they have not engaged in wrongdoing in connection with this proceeding. First, they argue that they were under no requirement to include Rural Telephone Bank stock redemption proceeds in their 2006 California High Cost Fund A filings. The rules for those filings, found in D.91-09-042, require filing an advice letter to request California High Cost Fund A funding for the upcoming calendar year with “at least seven months of recorded data annualized for the year in which the advice letter is filed and adjusted for known Commission regulatory decisions regarding the utility’s rate of return.”<sup>2</sup> Applicants maintain that this recorded data does not include interstate revenue, non-operating, or unregulated revenue data. Nor does it include a “regulatory change of industry-wide effect” pursuant to D.91-09-042.

The applicants also argue that the forms submitted with the California High Cost Fund A filings, including the “means test,” do not include any line items that could be construed to call for the identification of Rural Telephone Bank redemption proceeds.

Applicants further argue that since they were specifically directed by the Commission to address the Rural Telephone Bank redemption through a separate application and not through the California High Cost Fund A process, the Commission acknowledged that Rural Telephone Bank stock redemption would not naturally be included in the California High Cost Fund A filings. The

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<sup>2</sup> D.91-09-042, Appendix, Paragraph B.

applicants conclude that this direction exempted them from disclosing the redemption proceeds as required by D.91-09-042.

The applicants contend that their filings in this proceeding reflect their understanding that the Commission's 2006 decision on the Allocation of Gains on Sale of Utility Assets ("Utility Assets Decision") would control the distribution of Rural Telephone Bank proceeds.<sup>3</sup> They maintain that the redeemed patronage shares were never in rate base, and therefore the applicants "naturally assumed that they would be excluded from distribution to ratepayers in this proceeding."<sup>4</sup> The applicants also point to the Federal National Exchange Carrier Association (NECA) determinations regarding the interstate treatment of patronage shares, which held that patronage shares were to be assigned strictly to shareholders because they were held outside of rate base. As such, the applicants maintain that shareholders reasonably retained all revenue from the redemption of patronage shares.

The applicants also maintain that their treatment of the shares was reasonable because the Commission provided no guidance on how to frame the application. Therefore, the applicants filed the application that identified funds that would be subject to ratepayer sharing under the applicants' interpretation of the Utility Assets Decision.

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<sup>3</sup> Order Instituting Rulemaking on the Commission's Own Motion for the Purpose of Considering Policies and Guidelines Regarding the Allocation of Gains from Sales of Energy, Telecommunications, and Water Utility Assets, D.06-05-041, as modified by D.06-12-043.

<sup>4</sup> July 28, 2010 filing, Response to Order to Show Cause in Ordering Paragraph 5 of D.10-06-029 and Additional Evidence and Argument in Response to Ordering Paragraph 6 of D.10-06-029 at 9.

Additionally, the applicants argue that the patronage shares were plainly disclosed in their application in a footnote, and alternately, the Commission had constructive knowledge about the patronage shares and it is therefore unreasonable that the applicants be guilty of wrongdoing for not affirmatively highlighting the patronage shares in their application.

The applicants contend that they were forthcoming in responding to all data requests. They believe in good faith that the patronage shares were never part of the discussion in this proceeding until the October 15, 2009 ruling when they were asked for a “verified accounting of all amounts, excluding loan proceeds, received from the Rural Telephone Bank at any time, including as a result of dissolution and stock redemption.”<sup>5</sup> Up until this request, applicants maintain that they had determined that the “patronage shares were not within the scope of the application or an area of interest from a ratemaking perspective.”<sup>6</sup>

In response to the California High Cost Fund A interest rate the Commission found will apply if the applicants had an obligation to disclose their receipt of the Rural Telephone Bank stock redemption proceeds, the applicants state that the case cited by the Commission as precedent does not govern. They also argue that the Commission improperly computed the fines to be assigned under § 2107 of the Pub. Util. Code because their behavior does not warrant maximum penalties and they believe D.10-06-029 has already defined the terms of the penalties.

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<sup>5</sup> *Id.* at 13.

<sup>6</sup> *Ibid.*

Applicants Happy Valley Telephone Company, Hornitos Telephone Company, and Winterhaven Telephone Company filed a separate Response to Order to Show Cause, but fully joined in the Additional Evidence and Arguments of all other applicants. These three applicants presented an additional defense to the Order to Show Cause and argue that they cannot be penalized for violating D.91-09-042 because they did not seek any support payments from California High Cost Fund A in the 2006 Advice Letters. The “means test” requires utilities requesting California High Cost Fund A support to submit at least seven months of recorded data, annualized for the year in which the Advice Letter is filed.<sup>7</sup> This applies only “for those companies requesting California High Cost Fund A support.”<sup>8</sup> Utilities not requesting California High Cost Fund A support are only required to file an advice letter with the net settlement effects on the company’s revenue requirement of regulatory changes ordered, which these three applicants did.<sup>9</sup> Finally, these applicants argue that the 10% interest rate should not apply to them because they did not receive any support from the California High Cost Fund A in 2007.

#### **4. Need for a Hearing**

The applicants have provided additional materials for the record in response to the Order to Show Cause. No party intervened in this proceeding at the evidentiary stage and no disputed issues of material fact have been identified that would require an evidentiary hearing. Therefore, no hearings are necessary.

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<sup>7</sup> D.91-09-042, Appendix, Paragraph B.

<sup>8</sup> *Ibid.*

<sup>9</sup> *Ibid.*

**5. Discussion**

Pursuant to Pub. Util. Code § 2107, the Commission is vested with the authority to fine a public utility which violates or fails to comply with any Commission decree or directive between \$500 and \$20,000 per offense.

In D.10-06-029, the Commission ordered the applicants to show cause why a fine of \$20,000 should not be levied on each applicant for each of the following alleged violations:

(A) failure to disclose the substantial revenue from the dissolution of the Rural Telephone Bank in their respective 2006 California High Cost Fund A advice letter filings as required by Decision 91-09-042, and

(B) failure to comply with Rule 1 of the Commission's Rules of Practice and Procedure by filing an application that did not disclose the actual amount at issue and not being forthcoming with relevant information.

The Commission provided for applicants to submit additional evidence and argument on the show cause matters, which applicants did on July 28, 2010. No other party presented additional information.

As set forth below, we have considered the applicants' additional evidence and argument. On the California High Cost Fund A issue, we find that three of the applicants neither sought nor obtained support from Fund A based on the 2006 accounting. These applicants, Happy Valley Telephone Company, Hornitos Telephone Company, and Winterhaven Telephone Company, have presented good cause to justify not levying a fine. Each of the other applicants, however, sought and received substantial funding for Fund A with an accounting that

omitted the revenue obtained from the Rural Telephone Bank dissolution.<sup>10</sup>

These applicants, Calaveras Telephone Company, Cal-Ore Telephone Co., Ducor Telephone Company, Kerman Telephone Co., The Ponderosa Telephone Co., Sierra Telephone Company, Inc., The Siskiyou Telephone Company, and Volcano Telephone Company, have failed to show good cause for not levying a fine, and a fine of \$20,000 is imposed on each.

On the Rule 1 Show Cause Order, we find that all applicants failed to disclose the total amount of the stock redemption proceeds in their application and that the amount omitted was material. Each applicant should be fined for this omission.

Five of the applicants, however, disclosed a portion of the stock redemption proceeds, but the other applicants, Happy Valley Telephone Company, Hornitos Telephone Company, Kerman Telephone Co., Sierra Telephone Company, Inc., Volcano Telephone Company, and Winterhaven Telephone Company, joined the application but disclosed no proceeds whatsoever. As noted in D.10-06-029, nearly two years of repeated staff inquiries were necessary to reveal that these applicants, despite having disclosed no proceeds in the application, had actually received over \$15 million Rural Telephone Bank stock redemption proceeds. We find that submitting an application showing no proceeds at all is an aggravating factor and that these applicants should be fined the highest statutory amount, \$20,000 each, and the applicants that disclosed some proceeds should be fined \$15,000 each.

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<sup>10</sup> D.10-06-029, *mimeo.* at 15.

We analyze the record and applicable law for each of the show cause issues below.

### **5.1. California High Cost Fund A**

We begin with the role of Rural Telephone Bank stock redemption proceeds in California High Cost Fund A draws. As explained in D.10-06-029, the California High Cost Fund A pays the eligible applicants the difference between their local exchange revenue requirement and the amount that could be recovered from customers with rates set at 150% of urban area rates.<sup>11</sup> The Commission annually calculates each applicant's support from the Fund based on actual earnings during the previous year, adjusted for regulatory changes as ordered by the Commission or the Federal Communications Commission and Universal Service Fund<sup>12</sup> estimated support amount. That revenue requirement is then subject to a "means test," except for the year following a general rate case, based on seven months actual data annualized, to ensure the rate of return does not exceed 10%. Thus, recorded financial data from 2006 was an important input to calculate support paid to eligible recipients in 2007. As described above, during 2006 the applicants received approximately \$28 million in stock redemption proceeds from the Rural Telephone Bank which were not disclosed to the Commission.

Happy Valley Telephone Company, Hornitos Telephone Company, and Winterhaven Telephone Company did not seek any support payments under California High Cost Fund A in 2007 and therefore did not request any funding

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<sup>11</sup> See generally Re Alternative Regulatory Framework for Local Exchange Carriers, 41 CPUC2d 326, 330 (D.91-09-042 *modifying* D.91-05-016).

<sup>12</sup> A federal program providing support for rural telephone carriers.

based on their 2006 Advice Letters.<sup>13</sup> Commission rules<sup>14</sup> require only applicants seeking California High Cost Fund A support to include at least seven months of recorded data as part of the “means test.” Consequently, these three applicants were not required to disclose recorded financial data from public utility operations in their 2006 Advice Letters and were therefore not in violation of D.91-09-042. Accordingly, we find Happy Valley Telephone Company, Hornitos Telephone Company, and Winterhaven Telephone Company have shown good cause not to impose fines for their 2006 High Cost Fund A advice letters.

In contrast, the remaining eight applicants: Calaveras Telephone Company, Cal-Ore Telephone Co., Ducor Telephone Company, Kerman Telephone Company, The Ponderosa Telephone Company, Sierra Telephone Company, Inc., the Siskiyou Telephone Company, and Volcano Telephone Company, have not presented a valid defense against penalties for failing to disclose their Rural Telephone Bank proceeds in their advice letters filed in 2006 for California High Cost Fund A funds.

These applicants contend that they were not required to disclose any Rural Telephone Bank stock redemption in their 2006 California High Cost Fund A advice letters because the Rural Telephone Bank stock was an “unregulated investment” akin to owning shares of Microsoft.<sup>15</sup>

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<sup>13</sup> July 28, 2010, Response of Happy Valley Telephone Company, Hornitos Telephone Company, and Winterhaven Telephone Company, at 2, and attached testimony of Duane D. Dickson.

<sup>14</sup> D.91-09-042, Appendix, Paragraph B.

<sup>15</sup> Applicants’ Response at 3.

As demonstrated in D.10-06-029, the Rural Telephone Bank stock is directly related to public utility operations because the loans from which the stock originated are secured by mortgages on public utility property and the proceeds from the loans were used for public utility purposes and included in revenue requirement.<sup>16</sup> Public Utilities Code Section 817 specifically precludes mortgaging public utility property for private shareholder purposes. Thus, as a matter of law, Rural Telephone Bank stock cannot be an unregulated investment of the shareholders and must be part of the regulated public utility operations of each applicant. Accordingly, the proceeds from the redemption of this stock were required to have been included in the seven months of recorded financial data shown in each applicant's 2006 advice letter, but were not.

The purpose of the recorded financial data is to conduct a means test and develop a snapshot of the utility's expenses and revenues. Anything that affects the utility's revenue should be included in the means test to give the Commission an accurate financial picture of the utility's past and projected revenue. In this way, the Commission can ensure that the subsidized utilities are not earning above their authorized rate of return.

In their defense, applicants argue that there is not a specific line item in the advice letter form for regulated stock redemption proceeds. The form does contain, however, a "miscellaneous" line item in the revenue report, which provides an obvious place to show the unusual revenue obtained from the Rural Telephone Bank dissolution. Another option would be to add a new line. There is no suggestion, however, that the absence of a labeled line indicates that the

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<sup>16</sup> D.10-06-029 at 42.

Commission authorizes the exclusion of other public utility revenue. The form is intended and seeks to include all utility revenue. Finally, even if the applicants were unsure of exactly where to present the information, they could have asked for Commission staff guidance, either formally or informally. Instead, they opted to omit the millions of dollars of proceeds and failed to present an accurate picture of their finances to the Commission, on which the Commission relied for its decision to distribute public subsidy funds.<sup>17</sup>

Therefore, we conclude that Calaveras Telephone Company, Cal-Ore Telephone Co., Ducor Telephone Company, Kerman Telephone Company, The Ponderosa Telephone Company, Sierra Telephone Company, Inc., the Siskiyou Telephone Company, and Volcano Telephone Company were required by Commission decision to include the Rural Telephone Bank stock redemption proceeds in their 2006 High Cost Fund A advice letters and that these applicants did not comply with this requirement. As provided in Pub. Util. Code § 2107, any public utility which violates or fails to comply with a Commission decision is subject to a penalty of not less than \$500, nor more than \$20,000.

In establishing an appropriate fine under § 2107, the Commission considers two general factors: the severity of the offense and the conduct of the utility. In addition, the Commission considers the financial resources of the

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<sup>17</sup> Applicants also contend that the Commission's directive to file a ratemaking application for Rural Telephone Bank proceeds impliedly exempts them from complying with the High Cost Fund A requirements. The Commission, however, addresses High Cost Fund A issues via the means test advice letter process and not through a ratemaking application.

utility, and the totality of the circumstances related to the violations.<sup>18</sup>

Commission precedent should also be considered when assessing fines.<sup>19</sup>

The amount of a fine imposed pursuant to § 2107 must be proportional to the severity of the offense. Here, these applicants obtained substantial amounts of public subsidy funds based on incomplete advice letters which created a false impression of the applicants' actual financial position, upon which the Commission dispensed public funds. As this fact pattern illustrates, disregarding a statutory or Commission directive is accorded a high level of severity because compliance is absolutely necessary to the proper functioning of the regulatory process.<sup>20</sup> These applicants omitted relevant and material financial information and undermined the entire regulatory process by preventing the Commission from adequately performing its duties.

Accordingly, we find that the severity of this violation is of the highest level and the fine amount should also be set at the highest level.

In considering the conduct of the utility, the Commission reviews the utility's efforts to prevent, detect, disclose, and rectify the violation.<sup>21</sup> Here, there is no evidence that any applicant made any effort to prevent, detect, or disclose and rectify the violation. A reasonable step for a utility when presented with novel, but significant, revenue which is related to public utility operations,

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<sup>18</sup> Rulemaking to Establish Rules for Enforcement of the Standards of Conduct Governing Relationships Between Energy Utilities and Their Affiliates Adopted by the Commission in D.97-12-088, 84 CPUC2d 155, 182-84 (D.98-12-075).

<sup>19</sup> *Id.* at 184.

<sup>20</sup> *Ibid.*

<sup>21</sup> *Id.* 183-184.

would have been to make an informal inquiry of Commission staff. Such inquiries are routine. Applicants chose not to pursue this readily available avenue and instead concealed the stock redemption proceeds while obtaining millions of dollars in public subsidy payments. We find, therefore, that the conduct of the utility is an aggravating factor on this issue.

The size of the fine should reflect the financial resources of the utility. All of the applicants are small local exchange companies with limited finances. Collectively, however, they received over \$31 million. The highest level of fine is required to deter future such conduct, and is consistent with the totality of the circumstances in furtherance of the public interest.<sup>22</sup>

Precedent also supports a fine at the high end of the spectrum. In D.09-07-021, we fined the utility \$10,000 per incident for each violation of a Commission order.<sup>23</sup> The utility failed to file four customer-complaint reports ordered by the Commission. We found that since the utility was not a repeat offender in that it had never been before the Commission for a violation of this type, it would be fined \$10,000 for each violation. However, we noted that the utility's "conduct clearly undermines the proper functioning of the regulatory process because the Commission cannot identify and correct poor utility

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<sup>22</sup> *Ibid.*

<sup>23</sup> Application of California-American Water Company for Authorization to Increase its Revenues for Water Service in its Monterey District by \$24,718,200 or 80.30% in the year 2009; \$6,503,900 or 11.72% in the year 2010; and \$7,598,300 or 12.25% in the year 2011 Under Current Rate Design and to Increase its Revenues for Water Service in the Toro Service Area of its Monterey District by \$354,324 or 114.97% in the year 2009; \$25,000 or 3.77% in the year 2010; and \$46,500 or 6.76% in the year 2011 Under the Current Rate Design and Current Matters (D.09-07-021), 2009 Cal. PUC LEXIS 346, \*120.

customer service without adequate data.”<sup>24</sup> Here, the applicants’ conduct resulted in a multi-million dollar windfall, which requires a higher level of fine to deter future violations.

Upon review, we do not find any mitigating factors which would lessen the violation. As a result, Calaveras Telephone Company, Cal-Ore Telephone Co., Ducor Telephone Company, Kerman Telephone Company, The Ponderosa Telephone Company, Sierra Telephone Company, Inc., the Siskiyou Telephone Company, and Volcano Telephone Company are each fined \$20,000 for violating D.91-09-024. This amount shall be payable to the State of California General Fund. This amount is sufficient to deter future violations by the applicants and others.

## **5.2. Violations of Rule 1**

Rule 1.1 of the Commission’s Rules of Practice and Procedure states that any person who transacts business with the Commission agrees to “never mislead the Commission or its staff by an artifice or false statement of law or fact.” As set forth below, we find that applicants violated this rule, some applicants more egregiously than others.

In the application, six of the named applicants disclosed no Rural Telephone Bank stock redemption proceeds whatsoever despite seeking, as clearly stated in the caption, a “Ratemaking Determination Regarding Dissolution of the Rural Telephone Bank.” After repeated inquiries from Commission staff, these applicants admitted to receiving over \$15 million in Rural Telephone Bank stock redemption proceeds.

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<sup>24</sup> *Id.* at \*118.

The other five applicants disclosed that they received some Rural Telephone Bank stock redemption proceeds, but only a fraction of the total. We find that acknowledging and disclosing at least a portion of their Rural Telephone Bank stock redemption proceeds in the initial application is a mitigating factor and that these five applicants should be granted a small reduction in their fines for displaying some degree of candor with the Commission.

We now turn to the arguments presented by all the applicants against a finding that Rule 1 required them to disclose the full amount of their Rural Telephone Bank stock redemption. Applicants first argue that they “plainly” disclosed the “existence and nature of the patronage shares” in footnote 21 of the application.<sup>25</sup>

That footnote, however, does not indicate that the applicants received over \$24 million for this type of stock which, in the context of an application to credit ratepayers with \$3,000, is a significant amount. Footnote 21 includes no amounts at all, and does not explain that the stock was obtained as a refund of interest paid by ratepayers on the loans.

Applicants go on to argue that the footnote 21 and “ample public information”<sup>26</sup> gave the Commission constructive notice of the patronage stock. We specifically address this argument to disabuse these applicants, and all practitioners before the Commission, of the notion that the doctrine of

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<sup>25</sup> Applicants’ Response at 8.

<sup>26</sup> *Id.* at 11.

constructive notice can be relied on to cure deficiencies in applications presented to the Commission.

Constructive notice can be contrasted with actual notice. The California Civil Code defines actual notice as notice “which consists in express information of a fact” and constructive notice as that “which is imputed by law.” Cal. Civ. Code § 18. Constructive notice is analogous to “implied actual notice” and “inquiry notice”. *F. P. Baugh, Inc. v. Little Lake Lumber Co.*, 297 F.2d 692, 696 (9th Cir. Cal. 1961).

The issue of constructive notice arises in very specific legal disputes, including trademark infringement, tort law, and real property law. When a trademark is registered with the Office of the Federal Register, this is sufficient to give notice to any person subject to or affected by the registration, regardless of whether actual notice is received. 44 U.S.C.S. § 1507. In tort law, constructive notice is used in severe instances where one of the parties knew or should have known about the existence of a dangerous condition. In these cases, constructive notice is inferred when the plaintiff can show that the condition existed for such a period of time and was of such an obvious nature that, with the exercise of due care, the defendant should have discovered the condition and its dangerous nature.<sup>27</sup>

Property law, on the other hand, utilizes the concept of constructive notice in real estate transactions. Recording a deed is equivalent to putting interested

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<sup>27</sup> *Delta Farms Reclamation Dist. v. Superior Court*, 33 Cal. 3d 699, 712 (Cal. 1983); *Ortega v. Kmart Corp.*, 26 Cal. 4th 1200, 1203 (Cal. 2001) (plaintiff customer slipped on a puddle of milk, was injured, and had the burden of proof to show that the dangerous condition existed for a sufficient time to support a finding that the store owner had constructive notice of the condition.)

parties on constructive notice such that they can obtain actual notice through a search or inquiry.<sup>28</sup>

By suggesting constructive notice as a theory to support their omission of relevant material from a document presented to the Commission, the applicants deeply misunderstand Rule 1.1 and their proper role before this Commission. “Any person” who presents a document to the Commission “agrees . . . never to mislead the Commission or its staff.” This standard requires all utilities and practitioners before the Commission to present documents, especially applications, with all relevant and material information shown in a clear and understandable manner. The burden is on the applicant to present the information necessary to meet this standard, and such information cannot be “imputed” to the Commission. In short, Rule 1.1 requires “every person” transacting business with the Commission to give actual notice of all relevant and material facts. Accordingly, we find no merit in applicants’ constructive notice argument.

Similarly, applicants argue that no Commission decision or resolution directed that “a full accounting of all shares must be provided” with any application and they “believed that the Commission’s concern was not with the patronage shares.”<sup>29</sup> The fact that the majority of the Rural Telephone Bank stock redemption proceeds, \$24 million of the total \$31 million, arose from patronage refund stock substantially undermines the applicants’ argument. The

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<sup>28</sup> *Basch v. Tidewater Associated Oil Co.*, 49 Cal. App. 2d Supp. 743, 748 (Cal. App. Dep't Super. Ct. 1942) (by presuming that all recorded deeds are constructive notice of possession of property, a purchaser is expected to know or ascertain all information that is available from a reasonably diligent inquiry.)

applicants offer no facts supporting their “belief” that the Commission’s only ratemaking “concern” was for the far smaller share of the proceeds resulting from loan purchased stock.

As we found in D.10-06-029, applicants are cost-of-service regulated public utilities and Rural Telephone Bank stock obtained with loans secured by public utility property, or interest paid on such loans, and included in regulated revenue requirement is public utility property subject to the ratemaking jurisdiction of this Commission. Applicants have presented no evidence to support their dubious “belief” that this Commission was not concerned with a multi-million dollar revenue windfall related to public utility property.<sup>30</sup>

Rule 1.1 prohibits any person from misleading the Commission through “an artifice,” which Black’s Law Dictionary defines as “trick or fraud” implying “craftiness or deceit.”<sup>31</sup> As analyzed above, the applicants presented an application to this Commission seeking a ratemaking determination regarding the dissolution of the Rural Telephone Bank which omitted any meaningful disclosure of the significant amounts received from the Rural Telephone Bank. This document constituted an artifice within the meaning of Rule 1.1 because it created the false impression that a trivial amount was subject to Commission disposition pursuant to the application. Therefore, we find that all applicants violated Rule 1.1 of the Commission’s Rules of Practice and Procedure.

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<sup>29</sup> Applicants’ Response at 10.

<sup>30</sup> Applicants similarly offer no evidence for their suggestion that the Commission must affirmatively require a full accounting of all public utility revenue from a cost-of-service regulated utility.

<sup>31</sup> Black’s Law Dictionary, 6<sup>th</sup> ed. (1990) at 113.

As discussed above, when setting a fine under § 2107, the Commission considers the severity of the offense, the conduct of the utility, the financial resources of the utility, the totality of the circumstances, and Commission precedent.<sup>32</sup>

As with the High Cost Fund A issue analyzed above, the applicants' offense is severe because misleading representations to the Commission undermine the proper functioning of the regulatory process. The conduct of the utility in preventing, detecting, or disclosing and rectifying the violation is an aggravating factor as, again, there is no evidence that any applicant made any effort to prevent, detect, or disclose and rectify the violation. Due to the amount at issue, \$31 million, the highest level of fine is necessary. In D.01-08-019, we fined a utility \$10,000 per offense for violating Rule 1 in responses to data requests, with a total of \$200,000 assessed against the utility.<sup>33</sup> Here, the total amount is substantially less and in line with the applicants' financial status.

As noted above, upon review, we find that Happy Valley Telephone Company, Hornitos Telephone Company, Kerman Telephone Co., Sierra Telephone Company, Inc., Volcano Telephone Company, and Winterhaven Telephone Company, joined the application but disclosed no proceeds whatsoever, despite having received substantial proceeds, and that this is an aggravating factor. These applicants should be fined the highest statutory amount, \$20,000 each, for failing to comply with Rule 1.1 of the Commission's

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<sup>32</sup> *Id.* at 184.

<sup>33</sup> Order Instituting Rulemaking on the Commission's Own Motion into Competition for Local Exchange Service. (D.01-08-019), 2001 Cal. PUC LEXIS 653, \*17.

Rules of Practice and Procedure by filing an application that failed to disclose all relevant and material information.

The applicants that disclosed a portion of their Rural Telephone Bank stock redemption proceeds - Calaveras Telephone Company, Cal-Ore Telephone Co., Ducor Telephone Company, The Ponderosa Telephone Company, and the Siskiyou Telephone Company - are each fined \$15,000 for violating Rule 1.1 of the Commission's Rules of Practice and Procedure by submitting an application that failed to disclose all relevant and material facts.

Each applicant shall pay the above-stated amount to the State of California General Fund within 20 days of the effective date of this order.

### **5.3. Interest Rate**

In D.10-06-029, the Commission stated that:

The amount credited to the California High Cost Fund A or monthly line charges should immediately include interest calculated at the annualized, financial 90-day commercial paper rate from April 11, 2006, to the refund date(s), and if the Commission determines that disclosure of the stock redemption proceeds was required, then the California High Cost Fund A interest rate of 10% should apply.<sup>34</sup>

Applicants contend that this interest rate is an impermissible additional penalty that would exceed the \$20,000 amount authorized by Pub. Util. Code § 2107.<sup>35</sup> Applicants explain that this punitive interest rate was adopted by the

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<sup>34</sup> D.10-06-029 at Conclusion of Law 24.

<sup>35</sup> Applicants' Response at 15.

Commission in 1998 “for amounts wrongfully withheld by carriers without any possible justification” and not as compensation for the time value of money.<sup>36</sup>

In D.98-01-023, the Commission adopted the 10% interest rate for payments due from carriers for two of the three telecommunications public policy programs - High Cost Fund B and California Teleconnect program. This interest rate was subsequently extended to the High Cost Fund A in D.98-06-065. The first decision adopted interest rates applicable to a number of elements of these programs and specifically addressed rates necessary “to make carriers whole for the time value of money” and required carriers to invest High Cost B and Teleconnect held funds in interest-bearing accounts.<sup>37</sup> The Commission adopted the 10% interest rates for overdue payments with little discussion, and nowhere in the decision does the Commission indicate any punitive intent. Given that the overarching topic for the entire decision was interest rates, and the detail into which the Commission delved on the topic, it is reasonable to expect that the Commission would have revealed any intent to create a penalty. Consequently, we conclude that the Commission did not intend to impose a penalty on carriers with the 10% interest rate.

In considering whether this interest rate nevertheless constitutes a penalty, we begin with the “interest rate” each applicant charges its ratepayers for the time value of shareholders’ invested capital, i.e. the cost of capital. Each applicant includes in its revenue requirement a cost of capital of 10%. The

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<sup>36</sup> *Id.*

<sup>37</sup> Rulemaking on the Commission’s Own Motion into Universal Service, R.95-01-020/I.95-01-021, 78 CPUC 2d 272 (headnote only) (1998 Cal. PUC LEXIS 97, 12-15).

Commission has repeatedly found this to be just and reasonable. Moreover, California telephone companies are authorized to charge up to 18% annual interest on late payments from customers.<sup>38</sup> Neither of these interest rates has been found to be punitive.

In conclusion, we find that the long-standing, Commission-adopted 10% interest rate for payments due to the California High Cost Fund was not intended to be a penalty within the meaning of Section 2107, and is in line with other interest rates charged by the applicants. Consequently, we find no merit to applicants' arguments. Consistent with the 1998 decision, we find that interest should be included on amounts owed to the California High Cost Fund A at the applicable rate of 10% per year.

## **6. Assignment of Proceeding**

Michael R. Peevey is the assigned Commissioner and Maribeth A. Bushey is the assigned ALJ in this proceeding.

## **7. Comments on Proposed Decision**

The proposed decision of the ALJ in this matter was mailed to the parties in accordance with Section 311 of the Public Utilities Code and comments were allowed under Rule 14.3 of the Commission's Rules of Practice and Procedure. Comments were filed on \_\_\_\_\_, and reply comments were filed on \_\_\_\_\_ by \_\_\_\_\_.

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<sup>38</sup> [http://www.calphoneinfo.ca.gov/NR/ronlyres/27DAE2C5-BF27-4F29-AD42-46FE5AB7ED28/3288/late\\_payments\\_eng\\_feb2008.pdf](http://www.calphoneinfo.ca.gov/NR/ronlyres/27DAE2C5-BF27-4F29-AD42-46FE5AB7ED28/3288/late_payments_eng_feb2008.pdf).

**Findings of Fact**

1. Happy Valley Telephone Company, Hornitos Telephone Company, and Winterhaven Telephone Company did not seek and did not receive support payments under California High Cost Fund A in 2007.

2. Calaveras Telephone Company, Cal-Ore Telephone Co., Ducor Telephone Company, Kerman Telephone Company, The Ponderosa Telephone Company, Sierra Telephone Company, Inc., the Siskiyou Telephone Company, and Volcano Telephone Company filed advice letters in 2006 to receive funds from the California High Cost Fund A in 2007.

3. The California High Cost Fund A advice letter must include “at least seven months of recorded financial data” and the form includes a line for miscellaneous operating revenue. All utility revenue must be included in the means test to give the Commission an accurate financial picture of the utility’s past and projected revenue.

4. The applicants’ omission of significant public utility operating revenue from the California High Cost Fund A advice letter means test interfered with the Commission’s regulatory duty to fairly administer the Fund.

5. Stock redemption payments from the Rural Telephone Bank for stock purchased with public utility loans or as refund of interest paid on such loans is public utility operating revenue.

6. Calaveras Telephone Company, Cal-Ore Telephone Co., Ducor Telephone Company, Kerman Telephone Company, The Ponderosa Telephone Company, Sierra Telephone Company, Inc., the Siskiyou Telephone Company, and Volcano Telephone Company all did not report the revenue each received from the Rural Telephone Bank stock redemption in their California High Cost Fund A advice letter filed in 2006.

7. Calaveras Telephone Company, Cal-Ore Telephone Co., Ducor Telephone Company, Kerman Telephone Company, The Ponderosa Telephone Company, Sierra Telephone Company, Inc., the Siskiyou Telephone Company, and Volcano Telephone Company failed to prevent, detect, or correct their omissions of Rural Telephone Bank proceeds in the 2006 California High Cost Fund A advice letters.

8. All of the applicants are small local exchange companies with limited finances.

9. Calaveras Telephone Company, Cal-Ore Telephone Co., Ducor Telephone Company, Kerman Telephone Company, The Ponderosa Telephone Company, Sierra Telephone Company, Inc., the Siskiyou Telephone Company, and Volcano Telephone have undermined the integrity of the regulatory process by omitting pertinent financial information in their 2006 California High Cost Fund A advice letters.

10. In the initial application, only Calaveras Telephone Company, Cal-Ore Telephone Co., Ducor Telephone Company, The Ponderosa Telephone Co., and the Siskiyou Telephone Company disclosed that they received any Rural Telephone Bank stock redemption proceeds.

11. Happy Valley Telephone Company, Hornitos Telephone Company, Kerman Telephone Co., Sierra Telephone Company, Inc., Volcano Telephone Company, and Winterhaven Telephone Company did not disclose that they had received any funds whatsoever from the Rural Telephone Bank stock redemption in their initial applications seeking a ratemaking determination regarding dissolution of the Rural Telephone Bank.

12. A vague reference to an unquantified value of patronage stock in a footnote does not inform the Commission and prospective parties of the amount at issue.

13. No evidence has been presented to support a good-faith belief that the Commission disclaimed ratemaking jurisdiction over or interest in the \$24 million of patronage refund stock.

14. All public utility revenue is subject to the Commission's jurisdiction under cost-of-service ratemaking.

15. The initial application in this proceeding revealed only a small portion of the total revenue received from the Rural Telephone Bank dissolution and created a misleading impression of the amount at issue pursuant to the application.

16. Misleading or incomplete representations to the Commission undermine the regulatory process and impede the Commission in performance of its duties.

17. Applicants failed to prevent, detect, or disclose and rectify their violations of the High Cost Fund A means test requirements or the Rule 1.1 violations.

18. The highest level of fine is necessary to deter future violations where multi-million dollar windfalls are at issue.

19. No evidence was presented that the Commission intended the 10% interest rate adopted for California High Cost Fund A, B, and the California Teleconnect program to be punitive.

20. California telephone corporations may charge customers an interest rate of up to 18% annually.

21. The cost of capital included in each applicant's revenue requirement is 10%.

**Conclusions of Law**

1. No hearing is necessary.
2. Pursuant to Pub. Util. Code § 2107, the Commission is vested with the authority to fine a public utility which violates or fails to comply with any Commission decree or directive between \$500 and \$20,000 per offense.
3. Happy Valley Telephone Company, Hornitos Telephone Company, and Winterhaven Telephone Company have shown good cause to not be fined for failure to disclose Rural Telephone Bank proceeds in their California High Cost Fund A filings.
4. Happy Valley Telephone Company, Hornitos Telephone Company, and Winterhaven Telephone Company should not be fined for a violation of D.91-09-042.
5. Rural Telephone Bank stock cannot be an unregulated investment of the shareholders and must be part of the regulated public utility operations of each applicant.
6. Calaveras Telephone Company, Cal-Ore Telephone Co., Ducor Telephone Company, Kerman Telephone Company, The Ponderosa Telephone Company, Sierra Telephone Company, Inc., the Siskiyou Telephone Company, and Volcano Telephone Company were required to disclose the Rural Telephone Bank stock redemption proceeds in their 2006 Advice Letters seeking California High Cost Fund A funds.
7. The public interest requires that Calaveras Telephone Company, Cal-Ore Telephone Co., Ducor Telephone Company, Kerman Telephone Company, The Ponderosa Telephone Company, Sierra Telephone Company, Inc., the Siskiyou Telephone Company, and Volcano Telephone Company pay the highest fine amount for violating D.91-09-042 because they omitted pertinent financial

information, undermined the regulatory process, failed to correct their omissions, and failed to bring this violation to the Commission's attention.

8. Calaveras Telephone Company, Cal-Ore Telephone Co., Ducor Telephone Company, Kerman Telephone Company, The Ponderosa Telephone Company, Sierra Telephone Company, Inc., the Siskiyou Telephone Company, and Volcano Telephone Company's interest rate for the entire period should be increased to 10% and their refund obligation should be recalculated and conforming changes made to the refund tariffs or California High Cost Fund A draw.

9. Rule 1.1 of the Commission's Rules of Practice and Procedure states that any person who transacts business with the Commission agrees to "never mislead the Commission or its staff by an artifice or false statement of law or fact."

10. The applicants' incomplete application violated Rule 1.1 by creating a misleading impression of the amount at issue.

11. Rule 1.1 and the proper functioning of the Commission's proceedings require actual notice of relevant and material facts, and constructive notice can not be used to remedy deficiencies in a document presented to the Commission.

12. All public utility revenue is subject to the Commission's ratemaking jurisdiction for cost-of-service regulated utilities.

13. The public interest requires that Happy Valley Telephone Company, Hornitos Telephone Company, Kerman Telephone Co., Sierra Telephone Company, Inc., Volcano Telephone Company, and Winterhaven Telephone Company pay a fine \$20,000 each because they omitted pertinent financial information, undermined the regulatory process, failed to correct their omissions, and failed to bring this violation to the Commission's attention.

14. Calaveras Telephone Company, Cal-Ore Telephone Co., Ducor Telephone Company, The Ponderosa Telephone Co., and the Siskiyou Telephone Company acknowledged and disclosed a portion of their Rural Telephone Bank stock redemption proceeds in their initial application and should be granted a small reduction in their Rule 1 violation fines for displaying some degree of candor with the Commission.

15. The public interest requires that Calaveras Telephone Company, Cal-Ore Telephone Co., Ducor Telephone Company, The Ponderosa Telephone Co., and the Siskiyou Telephone Company pay a fine of \$15,000 each for violating Rule 1 in their application.

16. In sum, applicants should be fined the following amounts:

<b>Telephone Company</b>	<b>California High Cost Fund A Violation Fine</b>	<b>Rule 1 Violation Fine</b>	<b>Total Fine</b>
Calaveras	\$20,000	\$15,000	\$35,000
Cal-Ore	\$20,000	\$15,000	\$35,000
Ducor	\$20,000	\$15,000	\$35,000
Happy Valley	\$0	\$20,000	\$20,000
Hornitos	\$0	\$20,000	\$20,000
Kerman	\$20,000	\$20,000	\$40,000
Ponderosa	\$20,000	\$15,000	\$35,000
Sierra	\$20,000	\$20,000	\$40,000
Siskiyou	\$20,000	\$15,000	\$35,000
Volcano	\$20,000	\$20,000	\$40,000
Winterhaven	\$0	\$20,000	\$20,000

## **O R D E R**

Therefore, **IT IS ORDERED** that:

1. Calaveras Telephone Company must pay a fine of \$35,000 to the State of California General Fund and tender to the Commission's Fiscal Office within 20 days from the effective date of this Order.
2. Cal-Ore Telephone Co. must pay a fine of \$35,000 to the State of California General Fund and tender to the Commission's Fiscal Office within 20 days from the effective date of this Order.

3. Ducor Telephone Company must pay a fine of \$35,000 to the State of California General Fund and tender to the Commission's Fiscal Office within 20 days from the effective date of this Order.

4. Happy Valley Telephone Company must pay a fine of \$20,000 to the State of California General Fund and tender to the Commission's Fiscal Office within 20 days from the effective date of this Order.

5. Hornitos Telephone Company must pay a fine of \$20,000 to the State of California General Fund and tender to the Commission's Fiscal Office within 20 days from the effective date of this Order.

6. Kerman Telephone Company must pay a fine of \$40,000 to the State of California General Fund and tender to the Commission's Fiscal Office within 20 days from the effective date of this Order.

7. The Ponderosa Telephone Company must pay a fine of \$35,000 to the State of California General Fund and tender to the Commission's Fiscal Office within 20 days from the effective date of this Order.

8. Sierra Telephone Company, Inc. must pay a fine of \$40,000 to the State of California General Fund and tender to the Commission's Fiscal Office within 20 days from the effective date of this Order.

9. The Siskiyou Telephone Company must pay a fine of \$35,000 to the State of California General Fund and tender to the Commission's Fiscal Office within 20 days from the effective date of this Order.

10. Volcano Telephone Company must pay a fine of \$40,000 to the State of California General Fund and tender to the Commission's Fiscal Office within 20 days from the effective date of this Order.

11. Winterhaven Telephone Company must pay a fine of \$20,000 to the State of California General Fund and tender to the Commission's Fiscal Office within 20 days from the effective date of this Order.

12. The interest rate for the refunds ordered in Decision 10-06-029 from Calaveras Telephone Company, Cal-Ore Telephone Co., Ducor Telephone Company, Kerman Telephone Company, The Ponderosa Telephone Company, Sierra Telephone Company, Inc., the Siskiyou Telephone Company, and Volcano Telephone Company's must be increased to 10% and these applicants must file Tier 2 advice letters recalculating their refund obligation and making conforming changes made to the refund tariffs or California High Cost Fund A draw.

13. This proceeding is closed.

This order is effective today.

Dated \_\_\_\_\_, at San Francisco, California.

**INFORMATION REGARDING SERVICE**

I have provided notification of filing to the electronic mail addresses on the attached service list.

Upon confirmation of this document's acceptance for filing, I will cause a Notice of Availability of the filed document to be served upon the service list to this proceeding by U.S. mail. The service list I will use to serve the Notice of Availability of the filed document is current as of today's date.

Dated January 25, 2011, at San Francisco, California.

/s/ TERESITA C. GALLARDO  
Teresita C. Gallardo

**N O T I C E**

Parties should notify the Process Office, Public Utilities Commission, 505 Van Ness Avenue, Room 2000, San Francisco, CA 94102, of any change of address to ensure that they continue to receive documents. You must indicate the proceeding number on the service list on which your name appears.

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The Commission's policy is to schedule hearings (meetings, workshops, etc.) in locations that are accessible to people with disabilities. To verify that a particular location is accessible, call: Calendar Clerk (415) 703-1203.

If specialized accommodations for the disabled are needed, e.g., sign language interpreters, those making the arrangements must call the Public Advisor at (415) 703-2074 or TDD# (415) 703-2032 five working days in advance of the event.