Decision 07-05-054 May 24, 2007

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Investigation on the Commission's Own Motion into the Operations and Practices of Sebastian Enterprises, Inc.; Fortel, Inc.; and Foresthill Telephone Company.	Investigation 06-09-007 (Filed September 7, 2006)

DECISION APPROVING SETTLEMENT IN INVESTIGATION 06-09-007

Summary

This decision approves an agreement settling a Commission-initiated investigation. The Commission initiated this investigation to determine whether Sebastian Enterprises, Inc. (SEI),[1] its subsidiary Fortel, Inc. (Fortel) or Foresthill Telephone Company (FTC) violated any law in obtaining a loan and entering into a merger without the Commission's prior approval.

The Settlement Agreement the parties[2] offer for approval provides for SEI and FTC (together, Respondents) to pay the General Fund of the State of California $15,000, to be borne exclusively by shareholders of Respondents. Respondents acknowledge that a merger of FTC and Fortel that occurred on or about August 25, 2005, and the encumbrance of FTC's assets by a $10.5 million

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[1] SEI is the corporate parent of Kerman Telephone Company (Kerman) and Kertel Communications, Inc. (Kertel).

[2] The parties to the Settlement Agreement are SEI, FTC and the Commission's Consumer Protection and Safety Division (CPSD).

loan from Bank of America (BofA), violated Public Utilities Code Sections 851 and 854 and that an extension of the BofA loan violated Section 818.

We find that the Settlement Agreement meets the requirements of Commission Rule 12.1(d), in that it is 1) reasonable in light of the whole record, 2) consistent with law, and 3) in the public interest. Accordingly, we find the Settlement Agreement should be approved and this proceeding dismissed.

Background

The Commission allowed SEI to acquire Kerman and Kertel in Decision (D.) 05-05-045. SEI and its subsidiary Fortel obtained the $10.5 million loan (in the form of a line of credit) from BofA, secured by SEI/Fortel's assets. Using the loan, together with $4 million contributed by SEI, SEI/Fortel acquired FTC, and Fortel and FTC merged on August 25, 2005. Upon merging, FTC assumed all of Fortel's liabilities, including the $10.5 million BofA loan. The parties did not seek or obtain Commission permission for the loan or merger.

FTC later sought to issue two notes totaling $24,901,250, one to the Rural Telephone Bank (RTC) and the other to the Rural Utilities Service (RUS), to upgrade and expand FTC's system and replace the BofA loan. We approved this arrangement in D.06-06-068, on the ground the RTC/RUS financing was at below-market rates and therefore more advantageous than other forms of debt. At the time, however, we advised investigating the merger and BofA loan to determine if SEI, Fortel or FTC violated the Public Utilities Code and whether penalties should be imposed. This investigation ensued.

The Commission's Division of Ratepayer Advocates (DRA) joined the proceeding at the prehearing conference stage to ensure that any penalty imposed would be paid for by Respondents' shareholders, and not by telephone ratepayers. While DRA is not a signatory to the Settlement Agreement, it does not oppose the agreement.[3]

The Administrative Law Judge (ALJ) held a hearing on the Settlement Agreement on February 28, 2007 and sought additional documentation supporting the agreement at that time. SEI and FTC furnished the requested information in submissions filed on March 13 and April 9, 2007.

Discussion

The Settlement Agreement is Reasonable in Light of the Whole Record.

The first Rule 12 criterion for approving settlement agreements is that an agreement be reasonable in light of the whole record. The parties note that between October 27 and December 11, 2006, CPSD propounded a series of data requests to SEI and FTC, that Respondents gave written responses and produced almost 1,000 pages of responsive documents, and that CPSD did not identify any evidence suggesting SEI or FTC intended to violate the Public Utilities Code. The parties state the $15,000 penalty takes into account the unintentional nature of the violations, the size of the companies involved, and the companies' cooperation in the investigation.

Further, the companies' attempt to comply with the Public Utilities Code is evident in their filing of two applications closely related to the transactions at issue, as cited in the Background section above. Had Respondents effected the merger and obtained the BofA loan with the intent to evade Commission approval, we might not have received SEI's application to acquire Kerman/Kertel or FTC's application to issue the RTC/RUS notes. Respondents

[3] See transcript of February 28, 2007 Hearing, p. 4 (DRA attorney states DRA has no objection to Settlement Agreement).

recite in the Settlement Agreement that language in D.05-05-045 (the SEI acquisition of Kerman/Kertel) stating that SEI "may take control of FTC through an intermediate subsidiary if deemed necessary or convenient to secure financing or for related reasons" gave it the right to merge/secure the loan without further action. CPSD disputes this interpretation and contends no approval was obtained, but the existence of this dispute is further evidence of a lack of intent to evade Commission review.[4]

For the foregoing reasons, we find the Settlement Agreement is reasonable in light of the whole record.

The Settlement Agreement is Consistent With Law

The parties' motion for adoption of the Settlement Agreement states the Settlement Agreement is consistent with law because the Commission favors settlement. This is not a basis to approve any settlement. The Settlement Agreement itself must be examined case by case to determine its compliance with law.

The parties also state the penalty is within the range identified by Section 2107. That provision simply provides for penalties in the \$500-\$20,000 range for each offense, so it is difficult, without more information, to verify the parties' claim.

The Settlement Agreement is consistent with law because it allows Respondents to operate in a lawful manner and does not bless an unlawful arrangement. We have no fundamental objection to the FTC-Fortel merger or the BofA loan and no party identifies problems with the underlying conduct. The

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[4] Nothing in this decision constitutes agreement with Respondents' view of what the law required.

problem was in Respondents' failure to receive authorization required by the Public Utilities Code to effect the transaction.

Further, evidence in the record persuades us that ratepayers were not harmed by the transactions at issue. Decision 06-06-068 mandated that ratepayers not pay for either principal or interest on the debt (initially obtained from BofA and later refinanced through the RTC/RUS notes) SEI/Fortel incurred to acquire FTC. The Commission reasoned that the FTC acquisition would "benefit only the owners of the company." (D.06-06-068, mimeo. at 22.)

The evidence the parties offered at the February 28, 2007 hearings on the Settlement Agreement and in their subsequent filings bears out that Respondents met their requirement. FTC there states that it has booked the acquisition debt below the line, so that it was not borne by ratepayers but instead by company shareholders.[5] DRA's representative also expressed satisfaction with how the Respondents accounted for the debt at the February 28, 2007 evidentiary hearing and with the company's current debt structure.[6] Thus, we find the Respondents have complied with D.06-06-068's requirements and that the Settlement Agreement otherwise complies with the law.

The Settlement Agreement is in the Public Interest

The parties claim the Settlement Agreement meets the third criterion for approving a settlement because it includes a penalty even though the violation of statute was unintentional; provides that shareholders and not ratepayers shall

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[5] Response of [SEI] and [FTC] to [ALJ's] Request for Information, filed March 13, 2007, at 2; Second Response of [SEI] and [FTC] to [ALJ's] Request for Information, filed April 9, 2007, at 1.

[6] Transcript of February 28, 2007 Hearing, pp. 21-22.

bear the penalty; and requires FTC to include a statement in future Commission filings that interest associated with the debt SEI/Fortel used to acquire FTC may not be included in rates.

We agree with each of these grounds, and therefore find that the Settlement Agreement is in the public interest.

Thus, the Settlement Agreement meets each of the three criteria for approval, and should be approved. Concurrent with the Settlement Agreement's approval, I.06-09-007 should be dismissed.

Comments on Proposed Decision

This is an uncontested matter in which the decision grants the relief requested. Accordingly, pursuant to Section 311(g)(2) of the Public Utilities Code and Rule 14.6(c)(2) of the Commission's Rules of Practice and Procedure, the otherwise applicable 30-day period for public review and comment is waived.

Assignment of Proceeding

Rachelle B. Chong is the assigned Commissioner and Sarah R. Thomas is the assigned Administrative Law Judge in this proceeding.

Findings of Fact

1. Shareholders, not ratepayers, funded SEI/Fortel's acquisition of FTC.
2. Shareholders will bear the $15,000 penalty.
3. The Commission issued two decisions in proceedings closely related to the transactions at issue in this investigation.
4. DRA expressed satisfaction with Respondents' accounting for the debt used to acquire FTC, and with FTC's debt structure as of December 31, 2006.

Conclusions of Law

1. The Settlement Agreement is reasonable in light of the whole record.
2. The Settlement Agreement is consistent with law.

3. The Settlement Agreement is in the public interest.

4. The Settlement Agreement should be approved and this investigation closed.

O R D E R

IT IS ORDERED that:

1. The Settlement Agreement attached hereto as Exhibit A shall be approved.

2. Nothing in this decision shall be construed as agreement with the interpretation of the Public Utilities Code Respondents recite in the Settlement Agreement.

3. Investigation 06-09-007 shall be dismissed and this proceeding closed.

4. Pursuant to the Settlement Agreement, Respondents Foresthill Telephone Company (FTC) and Sebastian Enterprises, Inc. (SEI) shall pay $15,000, which is a joint and several obligation.

5. Respondents shall forward a check in the amount of $15,000 to the Commission's Fiscal Office, made payable to the General Fund of the State of California, within 10 business days of the issuance of this decision. The check shall contain the following reference: "Settlement of California Public Utilities Commission Investigation 06-09-007 into Operations of Sebastian Enterprises, Fortel, Inc., Foresthill Telephone Co."

6. Respondents shall include a statement in any future filing with the Commission that interest associated with the debt SEI/Fortel used to acquire FTC may not be included in rates.

7. Investigation 06-09-007 is closed.

This order is effective today.

Dated May 24, 2007, at San Francisco, California.

MICHAEL R. PEEVEY
President
DIAN M. GRUENEICH
JOHN A. BOHN
RACHELLE B. CHONG
TIMOTHY ALAN SIMON
Commissioners