ALJ/MCK/eap **DRAFT** Agenda ID #4614
Adjudicatory
6/16/2005 Item 47

Decision **DRAFT DECISION OF ALJ MCKENZIE** (Mailed 5/17/2005)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Investigation into NOS COMMUNICATIONS, INC. (U-5251-C), dba International Plus, 011 Communications, Internet Business Association (INETBA), I-Vantage Network Solutions; AFFINITY NETWORK, INC. (U-5229-C), dba QuantumLink Communications and HorizonOne Communications; and the corporate officers of NOS and ANI, to determine whether they have violated the laws, rules, and regulations governing the manner in which California subscribers are solicited, switched from one presubscribed carrier to another, and billed for telephone services.	Investigation 02-05-001 (Filed May 2, 2002)

OPINION APPROVING REVISED SETTLEMENT AGREEMENT

In this decision, we consider a settlement agreement submitted by the parties on January 19, 2005, which is appended hereto as Attachment A.[1] The agreement is a revised version of the December 9, 2003 settlement agreement in

[1] The 10-page settlement agreement consists of a description of the parties, a "summary/joint statement of the case," and then nine numbered sections. In addition, three appendices designated A through C are attached to the settlement agreement. Unless otherwise specified, references to paragraph numbers in this decision are to the numbered paragraphs that appear under each of the nine numbered sections in the settlement agreement.

this proceeding that was approved with modifications in Decision (D.) 04-06-017. However, because NOS Communications, Inc. (NOS) and the other respondents herein objected to some of the modifications required by D.04-06-017, they caused the December 9, 2003 settlement agreement to be rescinded pursuant to its terms and then filed an application for rehearing of D.04-06-017.

The principal modification in D.04-06-017 to which respondents objected was the refusal to approve a term under which the Consumer Protection and Safety Division (CPSD) agreed to withdraw its protest to Application (A.) 01-12-013. In that application, Blue Ridge Telecom Systems, LLC (Blue Ridge), an NOS affiliate, sought a certificate of public convenience and necessity (CPCN) authorizing it to offer limited facilities-based and resold local exchange services. The December 9, 2003 settlement agreement provided that upon the withdrawal of CPSD's protest, "the Commission agrees . . . to resolve A.01-12-013 as an unopposed application." D.04-06-017 concluded that this term unreasonably tied the Commission's hands, and that before any CPCN could be granted, (1) Blue Ridge should be required to supplement its application with information regarding the litigation history of itself and its affiliates before courts and administrative agencies, and (2) the assigned Administrative Law Judge (ALJ) should be free to hold a hearing on Blue Ridge's fitness if the ALJ considered a hearing necessary.

The respondents' objections to these modifications have now been mooted by the conditional issuance of a CPCN to Blue Ridge in D.04-12-021. Accordingly, the respondents herein have now joined with CPSD in executing a new settlement agreement, the terms of which that relate to this investigation are virtually identical to those contained in the agreement of December 9, 2003. Because we concluded in D.04-12-021 that our concerns about the original settlement's disposition of the Blue Ridge application had been satisfied, and

because D.04-06-017 concluded that, with minor exceptions, the parts of the original settlement agreement relating to this investigation met our requirements for settlements, we approve the revised settlement agreement submitted by the parties on January 19, 2005. By virtue of this approval, the condition set forth in Ordering Paragraph (OP) 1 of D.04-12-021 has been satisfied, so the CPCN conditionally granted to Blue Ridge in that decision is also deemed issued.

A. Procedural Background

As noted in D.04-06-017, this investigation was commenced three years ago, when the Commission issued an Order Instituting Investigation (OII) alleging that NOS and its affiliate, Affinity Network, Inc. (ANI), had engaged in deceptive marketing, slamming and cramming. The OII alleged that NOS and ANI had engaged in this unlawful conduct through the following means:

> "They solicit new customers, primarily small and medium size businesses, by telemarketing. Respondents' telemarketers represent that telephone service will be charged on a per minute usage basis. However, customers are subsequently charged according to a 'Total Call Unit' (TCU) pricing methodology that consists of usage and non-usage charges and [is] not based on cents per minute usage. Determining the TCU charges requires a conversion calculation that few, if any, customers can understand." (OII, p. 2.)

The OII also noted that while respondents contended their telemarketers disclosed the general terms of the TCU methodology to prospective customers, many customers who had signed up for respondents' services claimed otherwise:

> "Consumers consistently express surprise when they discover their telephone billings are based on TCUs and exceed the per minute usage rates promised by the Respondents' telemarketing. Consumers complain that they were not informed of the TCUs before they switched to the Respondents and never authorized the TCUs. Those who have reviewed the

> Respondents' explanations of the TCU, find [them] so complicated and indecipherable as to amount to no disclosure or an apparent effort to deceive, hide, or misrepresent the Respondents' excessive rates." (*Id.* at 3.)

The OII concluded that the alleged conduct appeared to violate several provisions of the Public Utilities Code, including §§ 2889.5 and 2890.

At the first prehearing conference (PHC) held on June 21, 2002, counsel for the Consumer Services Division (CSD), predecessor of CPSD, stated that his client would need several more months to complete its investigation, and then might move to amend the OII to add additional allegations. For their part, the respondents filed a series of motions directed at the sufficiency of the OII. (D.04-06-017, *mimeo.* at 5-7.)

As a result of the investigation's slow progress, we eventually issued D.03-04-053, which concluded that the 12-month deadline for the OII set forth in Pub. Util. Code § 1701.2(d) could not be met, and that the appropriate course of action was to extend this deadline and take steps to ensure that the investigation was either brought to hearing or settled within a reasonable time. (*Mimeo.* at 9.) To these ends, the ALJ was instructed to hold another PHC within 90 days.

The required PHC was held on June 20, 2003. Based on the parties' representations that they had made significant progress in negotiating a settlement, the ALJ ruled that the parties should continue their discussions and advise him by July 21, 2003 whether they had been able to reach a settlement. If they had not, the ALJ continued, another PHC would be held shortly thereafter to set a hearing schedule. Because no settlement was reached by the July 21 deadline, a PHC was held on July 28, 2003 to establish the hearing schedule. However, this schedule was rendered moot when the parties informed the ALJ about two weeks later, on August 8, that they had been able to reach a

settlement. (D.04-06-017, *mimeo.* at 8-9.) As noted above, the settlement agreement was filed on December 9, 2003, and received detailed consideration in D.04-06-017.

B. Terms of the Proposed Settlement

Like the original settlement agreement submitted in December 2003, the revised agreement of January 19, 2005 contains three principal provisions relating to this investigation. First, respondents[2] agree to make payments to the Commission totaling $2,950,000 over a 24-month period. Second, from this total amount, respondents agree that $50,000 will be set aside to handle restitution, with about $35,000 being paid to eligible customers, and $7,825 going as a fee to the settlement claims administrator, Rosenthal & Company LLC (Rosenthal). Third, respondents promise that for a two-year period following the Commission's approval of the settlement, they will abide by the "Call Unit Marketing and Sales Compliance Program" that was included in the settlement and consent decree the respondents entered into with the Federal Communications Commission (FCC) in December 2002.[3] The settlement agreement recites that as consideration for these three promises, "the Commission agrees to end its investigation and close the docket in I.02-05-001,"

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[2] The settlement agreement states that the respondents entering into it are NOS, ANI, and NOSVA Limited Partnership (NOSVA). As noted in D.04-06-017, CPSD had filed a motion seeking to add NOSVA as a respondent during the period between the issuance of D.03-04-053 and the PHC held on June 20, 2003. (*Mimeo.* at 8-9.) NOSVA holds a CPCN from this Commission under corporate identification number U-5434-C.

[3] *NOS Communications, Inc. and Affinity Network Incorporated,* Order, File No. EB-00-TC-005, 17 FCC Rcd 26853 (December 26, 2002). Hereinafter, this will be referred to as the "FCC TCU Consent Decree."

and that respondents will not be deemed to have admitted any "fact, law, or violation" by virtue of having entered into the settlement.

As to the details of how the $2,950,000 payment will be structured, the agreement provides that within 45 days after the Commission's decision approving the settlement, respondents will furnish two checks: one for $500,000 payable to the Commission for deposit into the General Fund, and a second check for $50,000 payable to Rosenthal. (¶1.2.) Within each three-month period following these initial payments, the respondents agree to deliver another check payable to the Commission in the amount of $300,000, "until the Respondents' installment payments to the Commission accumulate to $2.95 million." (¶1.3.)[4] The agreement also states that respondents waive any "potential, residual, or current" claim or interest to any of the settlement funds, "except if this Settlement is rescinded or its approval by the Commission [is] vacated." (¶1.4.) Finally, upon payment of the full $2.95 million, the respondents will be released from liability for "all costs, direct or indirect, presently known or unknown, accruing to or incurred by the Commission" in connection with this investigation. (¶5.2.)

Sections 2, 3 and 4 of the settlement agreement concern the settlement claims process and the duties of Rosenthal. First, respondents agree to execute the fee agreement with Rosenthal within the same 45-day period in which they

[4] In addition to their payment obligations, the respondents agree that within 10 days after issuance of a Commission decision approving the settlement, they will "cease or cause to cease . . . all billing, collecting, or demand for payment of any telephone billing, service fee, or outstanding balance that resulted from or was caused by" any of the unlawful conduct alleged in the OII. (¶3.4.)

must deliver their first two checks to the Commission.[5] (¶2.1.) Rosenthal agrees to establish an escrow account into which the $50,000 check will be deposited, to segregate the amount representing its fee, and to inform CPSD that the account is open and that the restitution process can proceed. (¶2.2.) Within 10 days after such notification, CPSD agrees to furnish Rosenthal with the name, address, telephone billing number and other appropriate data for each of the approximately 1400 customers who are considered "Eligible Consumers" entitled to a restitution payment.[6] (¶2.3.) Within 30 days after receipt of this data from CPSD, Rosenthal is obliged to distribute the restitution checks (each in the amount of $25) to the Eligible Consumers, along with an explanatory statement from CPSD. (¶¶2.4, 3.2.)

There is a time limit on the restitution checks. They expire 90 days after the date printed on the check, and if a check is undeliverable or the Eligible Consumer fails to deposit or cash the check within the 90-day period, Rosenthal "will cancel the Restitution Check and attempt no redelivery." (¶3.3.) The settlement agreement also provides that within 130 days after the last restitution

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[5] The fee agreement attached as Appendix A to the settlement agreement provides that Rosenthal in its capacity as settlement claims administrator "will serve as the fiduciary of the Eligible Consumers in establishing, managing, and controlling the Restitution Escrow Account."

[6] ¶8.12 defines an "Eligible Consumer" as a California customer of one of the respondents who made a complaint to the Commission's Consumer Affairs Branch (CAB) between January 1, 1999 and May 2, 2002 (the date of issuance of the OII) with respect to one or more of the following issues: "th[at] Respondents or its agents switched or caused the LEC to switch without authorization the consumer's presubscribed local, toll or long distance telephone service provider to the Respondents; charged the consumer without authorization for telephone services; or engaged in abusive marketing operations or practices."

check is mailed, Rosenthal will pay the amount representing uncashed checks to the Commission. (¶4.1.)

As a corollary of this obligation, Rosenthal is obliged to furnish the Commission with a final report covering its work from the date the escrow account is established until the time the restitution process is complete. Rosenthal's report is to set forth the balance in the escrow account for each month from the time it is opened, and to report by month on the number of restitution checks that (1) have been mailed, deposited or cashed, (2) have expired, or (3) have been returned as undeliverable. (¶4.2.)

As noted above, the third major part of the revised settlement is an agreement that for two years following its approval by this Commission, the respondents will abide by the "Call Unit Marketing and Sales Compliance Program" included in the FCC TCU Consent Decree. (¶6.1.) Under this program,[7] the respondents agreed with the FCC to undertake a variety of measures designed to ensure that the abuses associated with the marketing and billing of the TCU program would not recur.

The FCC compliance program requires, among other things, that (1) the compliance program must be reviewed and implemented by legal counsel knowledgeable in both consumer protection and telecommunications law, (2) such counsel must also review, edit, and approve all materials used for marketing, advertising, or training in connection with the TCU methodology, and (3) all officers and directors, and all managers and employees involved with marketing and customer service, must be informed of the FCC consent decree

[7] The full text of the Call Unit Marketing and Sales Compliance Program is set forth in Part IV of the FCC TCU Consent Decree, and is published at 17 FCC Rcd 26861-26863.

and furnished with written instructions regarding their responsibilities for implementing it. In addition to these requirements, all marketing management personnel must receive annual training on the TCU compliance program and a related code of conduct (which all marketing employees must sign), and the respondents are obliged to take appropriate disciplinary action against any employee or agent found to have engaged in intentionally deceptive conduct in marketing or selling any TCU program.

Other provisions in the revised settlement agreement concern such things as cooperation with law enforcement agencies and the effect of any changes the Commission might order in the agreement. For example, while CPSD has agreed that it will "initiate no enforcement action [and] seek no administrative or other penalties against the Respondents based on the evidence in this case," CPSD reserves the right to provide information to, or to cooperate with, law enforcement agencies, courts of law or other federal or state administrative agencies in any investigation relating to the issues here. (¶¶5.5, 5.6.) If the Commission wishes to modify any provision in the settlement agreement, all parties have 15 days within which to file a written objection to the proposed modification, and if that objection is not withdrawn within 10 days thereafter, the settlement will be deemed rescinded, and respondents will be entitled to the return of any settlement funds they have already paid. (¶¶7.3, 1.4.)[8]

[8] The parties have also agreed to request that "in the decision approving this Settlement, the Commission should order full cooperation from the pertinent Billing Agents, Underlying Facilities Based Providers, LECs, and any other Persons or Corporations subject to the jurisdiction of the Commission that are necessary to implement this Settlement." (¶5.8.)

Finally, enforcement and breach are the subjects of several provisions in the agreement. ¶5.1 provides that "each material breach of this Settlement will constitute a separate violation and will entitle the Commission to take any necessary action to enforce its orders." Similarly, although CPSD has agreed not to initiate enforcement actions or seek penalties against the respondents based on the facts of this case, this limitation "will not apply if the Respondents jointly or severally materially breach this Settlement or violate the Commission order approving it." (¶5.5.)

C. Discussion

As the description of terms set forth in the preceding section indicates, the key provisions of the revised settlement agreement are virtually identical to those relating to this investigation that the Commission approved in D.04-06-017. The settlement sum and schedule for paying it are the same, the restitution provisions and duties of the settlement claims administrator (Rosenthal) are the same, and the undertaking by respondents to abide by the terms of the FCC TCU Consent Decree is the same. (*Mimeo.* at 10-14.) We expressly concluded in D.04-06-017 that these terms satisfied the requirements of Rule 51.1(e) of our Rules of Practice and Procedure, and we see no reason to depart from that conclusion here. (*Id.* at 19-21.)

In addition, the revised settlement agreement addresses the concerns expressed in D.04-06-017 about the restitution process and any future applications by respondents. First, the fee agreement with Rosenthal (Appendix A to the revised settlement agreement) has been modified to state that Rosenthal's compensation for acting as settlement claims administrator shall not exceed $7,825. (*See,* D.04-06-017, *mimeo.* at 22.) Second, ¶5.10 has been added to the settlement agreement; it requires that if any of the respondents in this

proceeding (or any of their corporate affiliates) file an application pursuant to Pub. Util. Code §§ 851-854, 1001 or 1013, such applicant shall disclose "(a) the fact that this proceeding was filed, (b) the fact that this proceeding was settled pursuant to the settlement agreement approved herein, and (c) the relationship between the applicant and this proceeding." This new language responds to the concerns expressed on page 27 of D.04-06-017.

In addition, in a memorandum concerning the revised settlement agreement that was filed on April 1, 2005, CPSD and the respondents have confirmed their intent that Conclusion of Law (COL) 7 in D.04-06-017 should be incorporated into the revised settlement agreement. That COL, which was based on the discussion appearing at pages 21-22 of the decision, stated:

> "The settlement agreement should be modified to provide that once the restitution process (including preparatory work by Rosenthal) has begun, neither the Commission nor CPSD will have any obligation for any reason to return to respondents the $50,000 payment intended for restitution purposes, as described in ¶1.2.1 of the settlement agreement."

The other reservations about the December 9, 2003 settlement agreement expressed in D.04-06-017 concerned CPSD's promise that upon the withdrawal of its protest to the Blue Ridge application, "the Commission agrees . . . to resolve A.01-12-013 as an unopposed application." These reservations have now been addressed in D.04-12-021. In that decision, we noted that Blue Ridge had filed the supplement to its application required by D.04-06-017, and that this supplement "state[d] unambiguously that no litigation, investigation or administrative proceeding has been brought, or is pending against or related to, Blue Ridge, NOS or any of their respective affiliates in connection with the marketing or provision of local exchange services." (*Mimeo.* at 9-10.) In view of this representation, and the apparent absence of complaints about the marketing

of long distance service by NOS and its affiliates since the signing of the so-called Winback Consent Decree in October 2003,[9] we concluded in D.04-12-021 that "the management of Blue Ridge, which will be the same as that of the NOS companies, has sufficient integrity so as to be fit to render the services proposed here." (*Id.* at 22, Finding of Fact No. 22.)

We also concluded in D.04-12-021 that the CPCN granted to Blue Ridge should be conditioned upon the approval of a new settlement in this proceeding. With respect to this question, OP 1 of D.04-12-021 stated:

> "On the same date, if any, that the Commission issues a decision approving a settlement agreement in Investigation (I.) 02-05-001 that supersedes the settlement agreement submitted by the parties therein on December 9, 2003, a certificate of public convenience and necessity (CPCN) shall be granted to Blue Ridge Telecom Systems, LLC (Applicant) to provide limited facilities-based and resold local exchange services in the service territories of Pacific Bell Telephone Company, Verizon California Inc., Citizens Telecommunications Company of California, Inc., and Surewest Telephone, subject to the terms and conditions set forth below."

With the approval herein of the revised settlement agreement of January 19, 2005, we deem this condition to be satisfied, so that the effective date of this decision will also be the date of issuance of Blue Ridge's CPCN.

The final issue remaining in this proceeding is the application for rehearing of D.04-06-017, which as a practical matter has been rendered moot by

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[9] As noted in footnote 14 of D.04-06-017, the Winback Consent Decree has not been published but can be found on the FCC's website. The formal citation for the order to show cause that launched the Winback proceeding is *NOS Communications, Inc., Affinity Network Incorporated and NOSVA Limited Partnership,* Order to Show Cause and Notice of Opportunity for Hearing, EB Docket No. 03-96, 18 FCC Rcd 6952 (April 7, 2003).

the approval herein of the parties' revised settlement agreement. On the question of how to handle the application for rehearing, the parties' memorandum of April 1, 2005 states:

> "[A]fter the Commission approves the settlement in I.02-05-001, at which point the CPCN will be deemed issued to Blue Ridge, the Respondent will withdraw its application for rehearing of D.04-06-017."

We accept this representation by respondents, and find it an acceptable method of disposing of the application for rehearing of D.04-06-017.

D. Comments on Draft Decision

The draft decision of the ALJ in this matter was mailed to the parties in accordance with Pub. Util. Code § 311(g)(1) and Rule 77.7. No comments were received.

E. Assignment of Proceeding

Geoffrey F. Brown is the Assigned Commissioner and A. Kirk McKenzie is the assigned ALJ in this proceeding.

Findings of Fact

1. The settlement agreement appended hereto as Attachment A, which is dated January 19, 2005, supersedes the settlement agreement dated December 9, 2003 that was considered in D.04-06-017.

2. The January 19, 2005 settlement agreement is unopposed.

3. When implemented, the January 19, 2005 settlement agreement will achieve customer restitution, because approximately 1,400 Eligible Consumers will each receive a restitution payment of $25.00, for a total of $35,000.00.

4. As found in D.04-06-017, the restitution payments described in the preceding finding are consistent with those in other settlements the Commission

has approved in recent years for telecommunications customers allegedly victimized by deceptive marketing, cramming and slamming.

5. When implemented, the January 19, 2005 settlement agreement will help to protect the public from unscrupulous marketing practices by telecommunications carriers, will serve to obtain refunds for customers allegedly injured by respondents' actions, and will help to promote a robust telecommunications market free from unfair competition.

6. In their memorandum concerning this proceeding filed on May 1, 2005, CPSD and respondents have stated that it is their intention that the requirements of Conclusion of Law (COL) 7 of D.04-06-017 should be incorporated into the January 19, 2005 settlement agreement.

7. The other modifications to the December 9, 2003 settlement agreement in this proceeding required by D.04-06-017 have been addressed either in the January 19, 2005 settlement agreement, or in D.04-12-021.

8. In the memorandum concerning this proceeding filed on May 1, 2005, respondents have represented that upon Commission approval of the January 19, 2005 settlement agreement and the issuance of the CPCN conditionally authorized in D.04-12-021, respondents will withdraw the application for rehearing of D.04-06-017 filed on July 13, 2004.

Conclusions of Law

1. The proposed restitution payments described in Finding of Fact (FOF) 3 are reasonable.

2. The proposed fee of $7,825.00 to be paid to Rosenthal for its services as settlement claims administrator pursuant to the January 19, 2005 settlement agreement is reasonable.

3. The $2,900,000.00 that respondents have agreed to pay to the Commission to settle this proceeding, in addition to the restitution to be paid to Eligible Consumers, is reasonable and lawful for the reasons stated in D.04-06-017.

4. The provision in the January 19, 2005 settlement agreement requiring respondents to abide by the Call Unit Marketing and Sales Compliance Program included in the FCC TCU Consent Decree, for a period of two years following the Commission's approval of the January 19, 2005 settlement agreement, is reasonable.

5. The requirements of COL 7 of D.04-06-017, which CPSD and respondents have stated should be incorporated in the January 19, 2005 settlement agreement, are reasonable.

6. The January 19, 2005 settlement agreement appended hereto as Attachment A, with the addition of the provisions of COL 7 of D.04-06-017, is reasonable in light of the whole record, consistent with law, and in the public interest.

7. With the addition of the provisions of COL 7 of D.04-06-017, the January 19, 2005 settlement agreement appended hereto as Attachment A should be approved.

8. Upon the Commission's approval of the January 19, 2005 settlement agreement herein as set forth above, the condition in Ordering Paragraph 1 of D.04-12-021 should be deemed satisfied.

9. Today's order should be made effective immediately.

O R D E R

IT IS ORDERED that:

1. Subject to the addition of Conclusion of Law (COL) 7 of Decision (D.) 04-06-017, the settlement agreement appended to this decision as Attachment A is approved.

2. Pursuant to the foregoing paragraph, the condition set forth in Ordering Paragraph (OP) 1 of D.04-12-021 is deemed satisfied.

3. All billing agents, facilities-based providers, local exchange carriers, and all other persons and corporations subject to the jurisdiction of this Commission that provide services or facilities of any kind to any one or more of the respondents in this proceeding, shall cooperate fully in carrying out the provisions of the settlement agreement approved herein.

4. Within 45 days after the issuance date of this decision, the respondents shall execute the fee agreement with Rosenthal & Company LLC referenced in paragraph 2.1 of the settlement agreement approved herein, and shall make the payment specified in paragraph 1.2.1 thereof.

5. The Commission preliminarily determined that hearings would be required in this proceeding. Hearings have not been held, and the preliminary determination has been changed from "Yes" to "No."

6. This investigation remains open for the purpose of dealing with the application for rehearing of D.04-06-017 filed on July 13, 2004.

This order is effective today.

Dated _____, at San Francisco, California.