

Decision 04-09-007 September 2, 2004

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Investigation into the Operations and Practices of Verizon (formerly GTE California Incorporated) with respect to its Individual Case Basis Contracts.

Investigation 02-04-027
(Filed April 22, 2002)

Henry Weissmann and Elaine Duncan, Attorneys at Law, for Verizon California Inc., respondent.
Carol Dumond, Attorney at Law, for Consumer Protection and Safety Division, interested party.

OPINION ADOPTING SETTLEMENT

Summary

By its Order Instituting Investigation in this proceeding, the Commission directed its Consumer Protection and Safety Division (CPSD, formerly Consumer Services Division) to conduct a review of Verizon's¹ operations and practices in connection with Individual Case Basis (ICB) contracts. The Commission ordered CPSD to retain and supervise consultants for the review, and Verizon to reimburse the Commission for the consultants' costs.

¹ "Verizon" is defined in the Order Instituting Investigation (OII) only as "the successor corporation to GTE California Incorporated." Verizon California Inc. is that successor within the meaning of the OII and this order, and is signatory to the settlement agreement along with Verizon West Coast Inc. and CPSD. (See note 9 below.)

Verizon and CPSD have arrived at an uncontested settlement agreement under which Verizon will pay \$4,836,000 to the state General Fund in satisfaction of any fines or other remedies that could have been sought or imposed for violation of the Public Utilities Code and of Commission rules relating to ICB and express contracts. The Commission adopts the settlement, the full text of which is set forth in Appendix A, as resolving all issues in the investigation, and closes the proceeding.

Background

By Decision (D.) 91-07-010 the Commission modified General Order (G.O.) 96-A to eliminate preapproval requirements for governmental agency contracts, and in so doing added fine and penalty provisions as safeguards against below-cost contracting by telecommunications utilities operating under the new regulatory framework. D.91-07-010 also established late-filing penalties applying to any telecommunications utility that does not file its governmental agency contracts within a specified time after execution.

In 1998 GTE California Incorporated (GTEC, Verizon's predecessor corporation) filed an advice letter requesting authority to provide service to UCLA under a government contract. During the course of the staff evaluation of GTEC's advice letter, GTEC revealed that it had determined there were other services being provided in violation of G.O. 96-A, and that it had contracted with an outside auditing firm to conduct a compliance audit of all of its governmental agency contracts to ensure compliance with D.91-07-010 and G.O. 96-A.

Commission Resolution T-16218 in December 1998 approved the UCLA filing, accepted GTEC's calculation of \$809,289 in late filing and undercharging penalties,² placed GTEC on three years' probation, and warned GTEC that it was at risk of losing its authority to execute government contracts if it were to commit further violations of the Commission's G.O. 96-A rules pertaining to government contracting. The Resolution excluded from that warning any historical violations that GTEC might disclose in its outside auditor's report due to be submitted to Telecommunications Division in March 1999 (later extended to May 1, 1999).

In March 1999, the company reported: (i) the preliminary results of its auditor's review; (ii) that it had discovered instances of potential contract date alteration that would give the inaccurate appearance of compliance with Commission filing requirements, as well as other potential violations of Rule 1 of the Commission's Rules of Practice and Procedure;³ (iii) that it had undertaken an intensive review of all ICB contracting practices; and (iv) that it had engaged the services of a law firm to conduct an investigation of non-compliant activity and root causes, and to voluntarily report on them to the Commission.

² Resolution T-16218 described the \$809,289 total as \$86,352 for a late-filing penalty and a \$20,000 fine to cover the Commission's costs, both payable to the state General Fund, and a contract undercharge penalty of \$702,937 to be refunded to GTEC's ratepayers in its next new regulatory framework price cap filing.

³ Rule 1: "Any person who signs a pleading or brief, enters an appearance at a hearing, or transacts business with the Commission, by such act represents that he or she is authorized to do so and agrees to comply with the laws of this State; to maintain the respect due to the Commission, members of the Commission and its Administrative Law Judges; and never to mislead the Commission or its staff by an artifice or false statement of fact or law."

According to the settlement, Verizon timely submitted the auditor's and law firm's reports, as well as supplemental reports, to the Commission.

The record in this proceeding does not detail what activities subsequently took place, but we informally understand that Verizon and Commission staff representatives continued to review and discuss Verizon's reports and its ICB contracting practices. The Commission filed this OII into Verizon's ICB contracting practices on April 22, 2002,⁴ defining the issues as: "(1) whether there have been violations; (2) if there have been violations, how many there have been; (3) whether it is appropriate to adopt sanctions against Respondent (including whether Verizon should be placed under different rules for entering ICB contracts, or whether the probation should be modified and/or extended); and (4) whether the utility should continue to have ICB contracting flexibility under existing rules." The order directed CPSD to retain and supervise consultants for its review, and required Verizon to reimburse the Commission for the consultants' costs.

On June 5, 2002, the assigned Administrative Law Judge (ALJ) held a prehearing conference, and on June 18, 2002, the Assigned Commissioner issued his scoping memo establishing a schedule that would complete the proceeding within the 12-month requirement of Pub. Util. Code § 1701.2(d) for adjudication cases expected to require hearing.

CPSD was to mail its prepared testimony on October 15, 2002, and evidentiary hearings were set for November 18. However, on September 12,

⁴ There was some question as to the date the OII was subsequently mailed and from which the various deadlines should run. That date was May 10, 2002, as stipulated by the parties.

CPSD filed a motion asking the Commission to either issue an order under § 1701.2(d) extending the 12-month deadline or dismiss the proceeding without prejudice while at the same time ordering Verizon to underwrite the cost of outside consultants to complete the investigation under CPSD's direction.

With the parties unable to timely proceed, the ALJ held a second prehearing conference on November 15, 2002, at which he directed CPSD to prepare and file a proposed revised proceeding schedule. CPSD filed that schedule the following month, estimating that it would require at least three more years to complete the proceeding. For its part, Verizon opposed either extending the proceeding or closing it with an order requiring it to pay for continuing consultant studies, preferring instead to have it dismissed with prejudice. "As an alternative," Verizon suggested, "the Commission should direct the parties to enter into discussions toward a negotiated settlement based on the existing record..." The ALJ then issued a ruling directing CPSD and Verizon to meet to discuss the possibility of settling on a mutually acceptable outcome, and the Commission issued D.03-04-020, Order Extending Statutory Deadline.⁵ CPSD and Verizon did meet, and subsequently entered into the settlement agreement attached as Appendix A to this decision.

The Settlement

Settlement Overview

The settlement begins by summarizing the ICB contracting-related requirements of G.O. 96-A, D.91-07-010, and Rule 1. It then describes the

⁵ § 1701.2(d) applies only to adjudication cases which the Commission determines require a hearing. While it was initially thought that a hearing would be needed in this case, our order today determines that no hearing is required, and thus § 1701.2(d) does not apply.

background leading up to Resolution T-16218's imposing \$809,289 in penalties and placing Verizon on probation, and the results of the 1999 follow-up outside auditor's reports revealing additional violations. According to the settlement, CPSD believes Verizon's conduct as described in the auditor's reports constitutes numerous and serious instances of non-compliance with Commission rules and regulations, including Rule 1. Verizon does not dispute those charges and the parties' motion for adoption describes the funds Verizon will pay as "a substantial penalty on Verizon for previous violations." However, the parties are also careful not to include any explicit conclusions of guilt or innocence.⁶

Under the settlement's terms, Verizon agrees to pay \$4,836,000 to the state General Fund in satisfaction of any fines or other remedies that could have been sought or imposed for violation of the Public Utilities and of Commission rules relating to ICB and express contracts through its effective date, to obey all Commission rules and regulations and all state laws including, but not limited to, Rule 1 and all statutes and rules governing ICB and express contracts, and to continue monitoring its compliance with those requirements. The parties agree

⁶ Verizon acknowledges voluntarily reporting to the Commission in March 1999 "that it had discovered instances of potential contract date alteration that, as altered, would give the inaccurate appearance of compliance with Commission filing requirements as well as other potential violations of Commission Rule 1." (Settlement pages 2 and 3.) However, the settlement also states, "The positions taken herein, and the actions taken in furtherance of this Settlement Agreement, are in settlement of disputed claims and do not constitute admissions. The Parties agree that the actions required to be taken by them pursuant to this Settlement Agreement are taken without prejudice to positions each party has taken, or may take hereafter, in any proceeding." (Settlement page 5.)

the settlement resolves and concludes all Commission compliance enforcement efforts in connection with Verizon's ICB and express contracts, as specified.⁷

Standard of Review

Verizon and CPSD have tendered an "uncontested settlement" as defined in Rule 51(f) , *i.e.*, a settlement that is "filed concurrently by all parties to the proceeding in which such ... settlement is proposed for adoption by the Commission...." Rule 51.1(e) requires that settlement agreements be reasonable in light of the whole record, consistent with the law, and in the public interest.

This settlement is tendered pursuant to Rule 51, and it is under this standard of review set forth in Rule 51.1(e) that we will evaluate it.

Reasonable in Light of the Whole Record

The settling parties spent considerable time and effort both before and during the formal proceeding to develop their positions. As they note, at the time of Resolution T-16218 Verizon had already begun an outside review of its ICB contracts through an outside consultant. Verizon subsequently engaged the services of a law firm to conduct an intensive review of all ICB contracting practices, to investigate non-compliant activity and its root causes, and to report back to the Commission.

The Commission attached as two appendices to the OII an inventory of the relevant materials then in its possession and a second inventory of materials

⁷ CPSD does reserve the right to take future enforcement action against Verizon "[i]f subsequent disclosure reveals contracting or reporting behavior which in its nature or scope cannot reasonably be considered to have been as aspect of the behavior addressed in this Settlement Agreement." (Settlement page 5.)

Verizon was directed to produce within 30 days.⁸ CPSD reviewed those voluminous documents, most of which were the result of Verizon's intensive review, as well as additional work papers before entering into the settlement agreement. CPSD had also reviewed Verizon's presentation of the changes it had implemented to properly manage its ICB contracts and ensure compliance with Commission requirements. Thus, CPSD entered settlement discussions with a good understanding of the scope of the problem and the changes Verizon had made to prevent their recurrence, and the settlement it negotiated reflects the record.

The \$4,836,000 penalty payment required under the settlement is also reasonable in light of the record and consistent with applicable law. Pub. Util. Code § 2107 provides for penalties ranging from \$500 to \$20,000 for each offense. The parties have not indicated how they actually derived the final penalty figure, but they do show how it likely falls within the range called for by § 2107. Verizon's auditors had calculated that penalties for the 80 non-compliant ICB contracts enumerated in their report ranged from \$1.6 million to \$2.8 million, depending on how § 2107 was applied. Applying the § 2107 maximum \$20,000 per occurrence to the additional 61 offending service arrangements not accounted for in the auditors' calculations would yield additional penalties of \$1.28 million, for a total penalty in the range of \$2.8 million to \$4.0 million. Thus,

⁸ In I.02-04-027, Ordering Paragraph 7, the Commission ordered the Appendix A materials already in its possession be made public 30 days after that order's effective date. Verizon filed a motion to have certain information in those documents redacted before their release, and the date to comply with Ordering Paragraph 7 was subsequently extended twice by the Executive Director under Rule 48(b). Verizon's motion became moot when the second extension was allowed to lapse without further action.

the settlement requires Verizon to pay a greater fine than would be required if a \$20,000 penalty were to apply to each violation identified in Verizon's May 1999 reports. This, the parties point out, is reasonable in light of the record because the settlement encompasses an unspecified number of further instances of possible non-compliance reported by Verizon during 1999 through the effective date of the settlement and not included in the earlier penalty calculations. We conclude that the \$4,836,000 penalty the parties propose reflects the likely number of violations and is consistent with § 2107.

Verizon does not dispute the seriousness of the violations detailed in its May 1999 reports to the Commission. We agree, however, that its conduct in reporting and remedying those violations must also be considered as a mitigating factor. As the parties' joint motion points out, Verizon did first voluntarily report its violations in 1998 and initiated an independent investigation before the Commission required it to do so in Resolution T-16128. It then expanded the scope of that investigation beyond the requirements of the resolution to include a review of all then-current ICB contracts, government and non-government alike, and reported the results to the Commission. Since that time it has continued to make periodic, voluntary compliance reports, and has included in its reports compliance issues associated with its California-regulated affiliate Verizon West Coast.⁹

⁹ Verizon West Coast is a third signator to the settlement agreement. Verizon West Coast is neither a respondent to our investigatory order nor a party in this proceeding, and there is little or nothing regarding it in the proceeding record. Thus, we adopt the settlement without further comment on Verizon West Coast's role or how its participation in the settlement is to be interpreted.

The proposed settlement agreement is founded on the record the parties have developed, and the remedies it proposes are commensurate with the problems documented. We conclude that it is reasonable in light of the whole record.

Consistent with the Law

We explained in the previous section how the penalty the settlement proposes is consistent with § 2107. The settlement deals exclusively with ICB and express contracting violations that have occurred in the past. Nothing in the settlement purports to relieve Verizon of its responsibility for abiding by all applicable laws and the Commission's orders and rules, nor would we approve it if it did. Verizon itself remains responsible for adopting any and all necessary changes to ensure it is for the future in full compliance with all legal requirements.

The Parties assert that the settlement agreement is consistent with the law. After reviewing it, we agree.

In the Public Interest

In their joint motion to adopt the settlement, the parties briefly describe their aims as they negotiated this settlement. At the outset, they generally agreed that the key considerations in resolving the issues of the OII were to determine the appropriate penalties for Verizon's past violations of ICB contracting rules based on the record, and to determine whether Verizon's current practices are adequate to prevent recurring problems in the future.

During the course of its investigation, CPSD reviewed the voluminous reports Verizon had submitted as a result of its own investigation, and avers that Verizon cooperated in that review. Where there were problems with Verizon's practices that harmed the public, those problems have been exposed and

measures taken to ensure they do not recur. Where there were violations of law, those violations have been exposed and an appropriate penalty applied.

As CPSD noted when it filed a revised schedule in December 2002, “[I]t appears that the cost of the audit ordered in I.02-04-027 may exceed the potential benefit that would be derived by Verizon’s customers from the audit.... Given the difficult circumstances outlined above, the Commission would be wise to consider this case in a way that makes maximum use of work that has already been done, that carries out the Commission’s enforcement responsibilities, but does not lead to a protracted review process.” We agree. One of the important advantages a settlement may provide is avoiding the time, the expense and the uncertainty of continued litigation. It would make little sense to continue an investigation that would produce less public benefit than the cost that went into it. The public interest is best served when the Commission and its staff are able to carry out their responsibilities in the most efficient way possible, as was done here. Our approval of this settlement recognizes that Verizon has implemented corrective measures aimed at preventing further violations, and allows our staff to pursue consumer protection needs in other areas.

For these reasons, we find the proposed settlement to be in the public interest and will approve it.

Procedural Matters

The preliminary scoping memo included in the OII categorized this as an adjudicatory proceeding to be set for evidentiary hearing. Neither party appealed the categorization as permitted under the Rules of Practice and Procedure, Rule 6.4(a), so we see no need to disturb that designation. Because we have decided to approve the settlement and close the proceeding without evidentiary hearing, § 1701.2 does not apply.

Comments on Draft Decision

The draft decision of the ALJ was not issued for public review and comment, since this investigation as of the close of the record is no longer a contested matter, and the decision grants relief requested, *i.e.*, approval of the settlement. In those circumstances, the Commission is authorized to waive public review and comment. (*See* Pub. Util. Code § 311(g)(2).)

Assignment of Proceeding

Michael R. Peevey is the Assigned Commissioner and James McVicar is the assigned ALJ in this proceeding.

Findings of Fact

1. Verizon has acknowledged instances of potential ICB and express contract date alteration that, as altered, would give the inaccurate appearance of compliance with Commission filing requirements as well as other potential violations of Rule 1.
2. The total number of Verizon's potential violations of the Commission's filing requirements and/or Rule 1 has not been precisely quantified, but it is substantial.
3. Verizon has voluntarily taken steps to investigate, report and remedy problems with its ICB and express contracting activities.
4. The cost of the audit ordered in I.02-04-027 may exceed the public benefit it would produce.
5. The proposed settlement agreement is based on the record the parties have developed, and the remedies it proposes are commensurate with the problems they have documented.
6. The settlement presents a reasonable resolution of all of the issues in this proceeding.

7. There is no known opposition to the settlement.
8. No hearing is required.

Conclusions of Law

1. The proposed settlement proffered by Verizon and CPSD is an uncontested settlement as defined in Rule 51(f).
2. The \$4,836,000 penalty Verizon has agreed to pay into the state General Fund is consistent with the limitations set forth under Pub. Util. Code § 2107.
3. The settlement is reasonable in light of the whole record, consistent with law, and in the public interest.
4. The settlement should be approved.
5. Pub. Util. Code Section 1701.2 does not apply to this proceeding.
6. Public review and comment regarding ALJ's draft decision should be waived pursuant to Pub. Util. Code § 311(g)(2).
7. For administrative efficiency, this order should be made effective today.

O R D E R

IT IS ORDERED that:

1. The Joint Motion of Consumer Protection and Safety Division and Verizon California Inc. (Verizon) for Adoption of Settlement is granted. Public review and comment regarding the draft decision is waived, and the settlement agreement attached to this decision as Appendix A is approved.
2. Verizon shall pay a fine of \$4,836,000 to the California Public Utilities Commission for deposit to the General Fund, and shall remit said amount to the Commission's Fiscal Office at 505 Van Ness Avenue, Room 3000, San Francisco, California 94102, within 30 days of the effective date of this order. The number of this decision shall be included on the face of the check.

3. The Commission originally determined that hearings would be required in this proceeding. Because we have decided to approve the settlement, the Commission herein determines that no hearings are needed in this proceeding.

4. This proceeding is closed.

This order is effective today.

Dated September 2, 2004, at San Francisco, California.

MICHAEL R. PEEVEY
President
GEOFFREY F. BROWN
SUSAN P. KENNEDY
Commissioners

I reserve the right to file a dissent.

/s/ CARL WOOD
Commissioner

I reserve the right to join the dissent of Commissioner Wood.

/s/ LORETTA LYNCH
Commissioner

[ATTACH A to JCM I0204027](#)