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Decision 91-10-041 October 23, 1991

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Rulemaking on the Commission's own)
motion for the purpose of modifying)
existing tariff filing rules for)
telecommunication utilities, other)
than local exchange carriers and)
AT&T-C, and for the purpose of)
addressing other issues concerning)
the regulation of these utilities.)

ORIGINAL

R.85-08-042
(Filed August 21, 1985)

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OPINION MODIFYING DECISION 90-08-032I. Armour, Goodin, Schlotz & MacBride's (AGS&M) Request

On February 15, 1991, AGS&M, a private law firm, which frequently represents clients who seek certificates of public convenience and necessity (CPC&N) to become nondominant interexchange carriers (NDIECs) in California, filed a petition for modification of Decision (D.) 90-08-032 dated August 8, 1990. AGS&M seeks modification of D.90-08-032 to liberalize a financial requirement for new applicants seeking a CPC&N, which would permit consideration of projected revenues as part of the demonstration of the necessary financial support.

D.90-08-032 adopted a minimum requirement of \$400,000 in uncommitted cash or equivalent financial resources for new applicants seeking CPC&Ns to become NDIECs.¹

The decision stated:

"Any applicant who can make a rare case showing that \$400,000 of cash is not needed for his proposed first year of operation, in absence of revenues during that period, may be granted a CPC&N with a lesser amount. A sufficient showing must be made, however, that applicant can meet all demands for wages, rents, wholesale IEC [interexchange carrier] and LEC [local exchange company] services, equipment, and supplies and any applicable taxes and insurance for the first full year of operation with any lesser amount of cash available in lieu of the \$400,000 minimum standard."

(D.90-08-032, 37 CPUC-2d 130, 148, emphasis in original.)

¹ D.90-08-032 further directed that the \$400,000 minimum standard be increased by 5% each year starting in 1991 to account for increases in costs of business operations.

Specifically, AGS&M asks that the phrase, "in absence of revenues during that period," of the above quoted paragraph be deleted. AGS&M also suggests some additional editing of that paragraph for streamlining and clarity as follows: Replace the phrase "make a rare case showing" in the first line with a single word, "demonstrate," and add the words "(or the equivalent)" after the words "cash available" in the next to the last line of the paragraph.

AGS&M also requests that Conclusion of Law 18 be revised to be consistent with the narrative changes suggested above, and to include the following deletion and addition, respectively:

~~"...excepting only as provided for in the narrative and/or the findings of fact in this order. However, applicants who are able to sufficiently demonstrate that a minimum \$400,000 of cash or the equivalent, is not needed for his proposed first year of operation, may be granted a CPC&N with a lesser amount."~~ (Pet. for Mod., p. 13.)

II. Background

AGS&M contends that the phrase "in absence of revenues" makes the provision unworkable and does not represent the intent of the parties or the Commission in adopting a financial requirement."

Earlier in this rulemaking proceeding, two parties commented on the Commission's proposed decision to adopt a \$400,000 minimum cash requirement for new NDIEC CPC&N applications, the requirement that was adopted in D.90-08-032. These parties, GTE California, Incorporated (GTEC) and California Association of Long Distance Telephone Companies (CALTEL), supported the proposal to require a \$400,000 minimum cash balance. Nonetheless, CALTEL contended then, as it does now, that the Commission should maintain some flexibility with regard to the \$400,000 requirement (CALTEL comments, March 12, 1990, p. 14).

AGS&M's petition for modification now seeks similar flexibility to that recommended in CALTEL's March 12, 1990 comments.

A. Correspondence, Protests, and/or Comments Received

No protests were received in response to AGS&M's petition for modification during the 30-day protest period.

In reviewing the language changes that AGS&M sought in its petition, the administrative law judge (ALJ) concluded that the revised language could lead to further ambiguity and differing treatment of applicants by different ALJs. Accordingly, the ALJ asked AGS&M to provide a more detailed proposal to allow the Commission to satisfactorily assess the financial stability of new applicants.

On May 3, 1991, AGS&M responded with a letter making two suggestions, the first for applicants who have a track record for a similar telecommunication business and the second for applicants who are entering this market as a new and unproven activity. AGS&M recommends the following treatment for the two categories:

"1. Applicants with a 'track record':

"As part of the certification review for carriers which have already been providing similar telecommunication services in other states or have been providing some type of telephone related service not requiring certification in California, we suggest that the Commission require that the carrier meet the requirements outlined in California Corporation Code (CCC) Section 500(b) ('Section 500(b)'). Section 500(b) outlines the circumstances under which a corporation may make distributions to its shareholders and sets forth a basic solvency test to determine if the corporation would, if it made distributions to its shareholders, remain solvent in the equity sense.

"Section 500(b) states in pertinent part:

"(b) The distribution may be made if immediately after giving effect thereto:

"(1) The sum of the assets of the corporation (exclusive of goodwill, capitalized research and development expenses and deferred charges) would be at least equal to 1-1/4 times its liabilities (not including deferred taxes, deferred income and other deferred credits); and

"(2) The current assets of the corporation would be at least equal to its current liabilities or, if the average of the earnings of the corporation before taxes on income and before interest expense for the two preceding fiscal years was less than the average of the interest expense of the corporation for such fiscal years, at least equal to 1-1/4 times its current liabilities...."

AGS&M contends that it is advantageous to use the CCC § 500(b) criteria because "...it is an already widely used test, the criteria have already been legislatively approved, and the criteria are already familiar to corporations."

"2. Applicants without previous experience:

"For new applicants without past experience in offering telecommunications services, we suggest that the Commission require that the applicant submit: (1) a cash flow analysis for the first year of operation, (2) a detailed list of assumptions to support the cash flow analysis, and (3) proof that it has sufficient cash on hand or line of credit to meet the higher of all of the expenses which might be incurred during the first three months of operation or the maximum cumulative negative cash flow shown on the cash flow analysis.

"Attached² is a suggested model of a cash flow analysis for an interexchange carrier which was designed to reflect the typical expenses and charges a carrier will incur in the provision of telecommunications services. Below is a suggested list of assumptions which the applicant should also be required to provide to the Commission in support of the cash flow analysis:

- "a. Number of customers estimated by month:
- "b. Projected retention rate of customers:
- "c. Number of lines to be billed by month:
- "d. Number of minutes to be billed by month:
- "e. Billing costs by month:
- "f. Percentage of uncollectibles used in the cash flow analysis."

AGS&M also suggests that the Commission give consideration to a pro forma cash flow analysis for applicants who have a "track record" but do not meet the CCC \$ 500 test.

B. Switchless Resellers

On May 23, 1991, AGS&M forwarded a second letter to the ALJ containing the following detailed definition of a "switchless reseller."³

² Model cash flow analysis form omitted for purposes of this narrative.

³ This category of reseller has no investment in switching equipment or leased physical telephone plant and presumably would not need significant amounts of uncommitted cash to commence operations as a reseller of communications services.

"The 'traditional reseller' is defined by the Federal Communications Commission ('FCC') as a carrier which leases all of the circuits it uses to provide service to its customers from underlying carriers. (85 FCC 2d at 29.) A traditional reseller is a certified common carrier providing service under its own tariffs. It gathers originating traffic into its own switch over access facilities that it purchases directly from the local exchange carrier ('LEC'). It then terminates that traffic over transmission facilities that it leases from an underlying, typically larger, carrier.

"In the past few years, the telecommunications industry has experienced a growth in switchless resellers. Switchless resellers are also certified common carriers providing service under their own tariffs; from a regulatory viewpoint in California, they stand in MCI's shoes. They also terminate traffic over the facilities of another carrier. There are two significant differences, however, between the traditional reseller and a switchless reseller. While the traditional reseller operates its own switch, the switchless reseller employs the switch of another carrier, typically the carrier that provides the circuits over which the traffic is terminated. Secondly, while a traditional reseller purchases access services directly from the LEC, the switchless reseller employs the access circuits that are purchased from the LEC by the underlying carrier.

"The distinction between traditional and switchless resellers is of regulatory significance in California for one principal reason, the financial fitness standards announced in D.90-08-032. Because switchless resellers do not incur the costs of operating their own switches or purchasing originating access service from the LECs, they are able to operate with significantly lower costs than is required of the traditional reseller. Moreover, whatever risk is borne by the LEC with regard to the payment of access charges depends on the financial condition of the underlying carrier (the LEC's access customer)

rather than the financial condition of the switchless reseller.

"Switchless resellers are also distinguishable from 'agents' which merely market the underlying carrier's service to customers under the underlying carrier's name pursuant to the underlying carrier's tariffs and/or, in some instances, act as the underlying carrier's billing agent. By contrast, a switchless reseller is a certified carrier providing service under its own name and in accordance with its own tariffed rates." (Emphasis in original.)

AGS&M, in its letter, also asserts that this Commission treats all NDIECs the same for regulatory purposes; however, it more stringently regulates AT&T Communications of California (AT&T-C), the one dominant interexchange carrier (IEC). While AGS&M established that a "Switchless Reseller" will not likely face the financial risk of a traditional reseller, it did not propose that the Commission create a new class or subclass of NDIECs for "Switchless Resellers."

In the course of preparing a proposed decision on AGS&M's petition, the assigned ALJ noted the importance of AGS&M's letters of May 3 and 23, 1991, and the need to address the concerns raised by those letters in any proposed decision for consideration by the Commission. Contemporaneously, the ALJ also reviewed the service list used by AGS&M in serving its petition and the letters, and noted that AGS&M had served the petition and the May 3, 1991 letter on a dated service list, and had not served the May 23, 1991 letter. At that point, the ALJ determined that broader notice of AGS&M's petition and letters was appropriate.

Accordingly, on September 6, 1991, he issued a ruling to all LECs, NDIECs, and other parties who had been involved with Rulemaking (R.) 85-08-042, or who had requested and received a copy of D.90-08-032, giving them an opportunity to file and serve comments on AGS&M's petition and letters by September 26, 1991.

Only one round of comments was solicited, and AGS&M was permitted to file and serve its exceptions to the comments by October 2, 1991.

To reduce the burden of serving the comments and exceptions on a very lengthy service list, the ALJ noted in the ruling that parties wishing to be served with copies of these comments must send a letter requesting such service to our Process Office by no later than September 13, 1991. Five parties requested service in response to the ruling, and by a subsequent ruling dated September 18, 1991, the ALJ reduced the required service of comments and exceptions to those five parties.

C. Comments Received in Response to the ALJ Ruling

Timely comments were received from the following six parties:

1. The Interexchange Reseller's Association (IRA).
2. Telecommunications Marketing Association (TMA).
3. World Wide Communications Limited Partnership (World Wide).
4. Marin Telemanagement Corporation (MTC).
5. MidCom Communications, Inc. (MCCI).
6. The Commission's Division of Ratepayer Advocates (DRA).

IRA, TMA, MCCI, and World Wide generally support AGS&M's petition and the specific relief requested in the petition. This is understandable as these entities are either associations representing resellers and favoring the expansion of reseller services, or individual entities seeking entry into the California market.

The above parties all agree that "Switchless Resellers" should not be required to demonstrate the same financial

responsibility showing as switched resellers. They contend that a "Switchless Reseller" has greatly reduced expenses as compared to traditional resellers.

IRA, TMA, and World Wide also support AGS&M's proposed use of revenue projections to support the financial responsibility requirement for new NDIEC applicants for CPC&Ns.

MTC commented that there is "...no need to change the language [of D.90-08-032] concerning the \$400,000 requirement." MTC also argues that AGS&M's petition is in the wrong form and that AGS&M will stand to benefit directly from the proposed changes if enacted.

MTC opposes any proposal to subject "Switchless Resellers" to regulation, since "the so called switchless resellers have not dedicated property for public use and cannot be subject to regulation." (MTC Comments, p. 3.) MTC's opposition to utility treatment of "Switchless Resellers" is a new issue which was not part of AGS&M's petition, and was not raised by any other party.

DRA in its comments objected to the use of a projected cash flow statement in support of the D.90-08-032 financial requirement. Specifically DRA asserts that:

"AGS&M proposed to apply section 500 (b) to applicants with a 'track record.' Earlier in this document, DRA has offered a superior test for those applicants with a track record. The test equates those applicants that are able to meet current certification requirements with those deemed to have an adequate track record. We do not believe that the test proposed by AGS&M is an adequate standard for the issuance of CPC&Ns.

"Next, AGS&M proposed to justify a capital requirement of less than the \$420,000 for new companies based upon a cash flow statement. The cash flow statement would forecast cash needs for the next year or two, and reduce the cash required by the projected amounts.

"In summation, DRA believes that there is no reasonable justification for treating reseller NDIECs differently from other applicants for a CPC&N. DRA does not believe that a specific cash requirement is absolutely necessary in order to issue a certificate. However, DRA believes that one of a number of tests or standards should be applied to the applicant that would establish that financial resources amounting to at least \$420,000 are available before the certificate is issued." (DRA Comments, pp. 5-6.)

D. AGS&M's Exceptions to Filed Comments

AGS&M asserts that "...it did not and does not support establishing a separate category of NDIEC known as a Switchless Reseller." It opines that the sole purpose for which the Commission should acknowledge the existence of "Switchless Resellers" would be to recognize the lower costs attendant to that type of service when evaluating an applicant's financial requirements.

Specifically AGS&M pleads its position as follows:

"Petitioner agrees that all NDIEC applicants should be required to establish some minimal level of financial fitness. The Commission should not certify carriers that obviously do not possess the financial resources to survive the start-up period. All the Petition asks is that in applying this single standard, the Commission recognize particular cost characteristics attendant to operation as a 'switchless reseller' just as the Commission would recognize that cellular resellers do not construct cell sites and that 'on call' passenger stage carriers do not bear the capital expenses of scheduled service. To that extent, Petitioner concurs with DRA." (AGS&M's Exceptions, pp. 6-7.)

AGS&M also took exception to MTC's comments focused against AGS&M and its petition, and to MTC's expressed belief that the Commission should not grant CPC&Ns to "Switchless Resellers." We will address those issues in our discussion.

III. Discussion

We will address the concerns regarding "Switchless Resellers" before addressing the specific issues raised by AGS&M in its petition.

A. Switchless Resellers

AGS&M presumes and accordingly recommends that a communications services "Switchless Reseller" should not need a significant amount of uncommitted cash to commence operations. AGS&M presumes that by definition the "Switchless Reseller" has no investment in switching equipment or leased physical telephone plant. We agree and will reduce the first year financial requirement to \$75,000 for such applicants.⁴ We do so with the understanding that the "Switchless Reseller" does not construct, operate, or lease utility property and accordingly it does not switch telephone lines. In addition, it does not subscribe to telephone service under the LECs' access tariffs. Therefore, the \$75,000 cash requirement should allow for opening and staffing and supplying the needs of a business office for six months to a year as its business develops. However, these same facts cause MTC to raise questions about the necessity and propriety of requiring certification of any business which operates purely as a "Switchless Reseller."

A strict interpretation of PU Code §§ 216, 233, and 234 would limit the definition of "public utility" to only a business entity that owns, controls, operates, or manages a telephone line.

⁴ This minimum required amount should cover office rent, management, sales and clerical salaries, vehicle expenses, insurance, office supplies and necessary business forms, utilities, postage, and other routine expenses for the first six months of operation in anticipation of revenues. Without hard recorded data from actual start-up operations, it would be difficult to establish a higher or lower number with any degree of precision.

The "Switchless Reseller" may be viewed as a marketer of the services of the underlying carrier. Under this example, arguably only the underlying carrier owns, operates, switches, manages, and maintains the telecommunications services involved. If the "Switchless Reseller" were to disappear from the scene, the service could easily continue from the underlying carrier without any changes in physical plant or connections.

This view apparently is the basis for MTC's contention that "Switchless Resellers" are not utilities. This contention surfaced for the first time in its comments to AGS&M's petition, and since some "Switchless Resellers" are already certificated to do business in California, it would be inappropriate to summarily act to deny CPC&Ns to prospective applicants.

At this point we will continue to process applications for CPC&Ns for "Switchless Resellers." However, we are interested in assessing the merits of possible changes to the current regulation of business entities which engage solely in switchless reselling of telecommunications services furnished through the facilities of a certificated underlying utility. Should we pursue this issue further, it is likely that we would do so in a newly instituted combined rulemaking and investigatory docket, since this would permit the many parties interested in the regulation of "Switchless Resellers" to participate and be heard prior to any change in the regulatory status of these entities.

B. AGS&M's Petition to Modify D.90-08-032

AGS&M considers the rule of D.90-08-032 which requires a strong financial showing from new applicants for CPC&Ns as telecommunications resellers to be a reasonable requirement; however, it urges a much broader scope for ways to meet the requirement than that adopted by the Commission.

We concur that our position should be made clearer and broadened as well. We do, however, have serious concerns over the use of projected revenues as the determinative element of any

financial showing of an applicant for a CPC&N. We will address those concerns last after broadening the scope of acceptable financial showings.

Although the dollar amount (\$420,000 in 1991) of the financial requirement is not being challenged by AGS&M, it does warrant some discussion to explain why it is needed to support such utility operations in the formative stages of a new utility. As noted below, this type of utility business is capital intensive, and a showing of adequate capitalization is vital to the well-being of the applicant as well as to the confidence of its customers in the new utility venture.

To illustrate this point we call attention to the highly competitive nature of interLATA communications utility services, where any new entrant into this business must be prepared to render service at rates at least 10% below⁵ those of AT&T Communications of California (AT&T-C), MCI Telecommunications Corporation (MCI), or US Sprint Communications Company Limited Partnership (US Sprint) and still net 5% or greater revenue after meeting all expenses of its business operations.

To persons knowledgeable in these operations it becomes clear that it is difficult to purchase the necessary services in bulk, then switch the services, maintain accurate billing procedures, give attention to uncollectibles, and derive the necessary revenues to pay for all of the IEC access services and the underlying IEC's bulk service and still retain a margin of 5% or more after providing end users the necessary discount of 10% or more from the IEC's rates to compete for business.

Since AT&T-C, MCI, and US Sprint are already competing vigorously, it becomes even more difficult for a new reseller to

⁵ See e.g., Exhibit 7, Application 90-07-015, AT&T-C for Additional Regulatory Flexibility, Testimony of Dr. George John.

quickly grow to a billings volume of \$70,000 per month in a new business venture to compete with them. With gross revenues of \$70,000 in this illustrative case, the owner would net 5% or \$3,500 per month when this volume of business is reached.⁶ This is hardly adequate compensation for the work and risk involved. It would likely take at least six months to achieve the \$70,000 per month illustrative volume of business. During those six months, with all the startup costs of opening a business, establishing an office with all the necessary switching equipment, supplies, and forms, paying deposits to an underlying carrier, and obtaining installation of access services from an LEC, the new applicant could easily incur \$420,000 in expenses without yielding earnings sufficient to provide a reasonable salary for even the owner, let alone to compensate any technical employees, salespersons, or clerical help. Accordingly, while a greater amount than \$420,000 may be appropriate to support the first full year of operation for a switched service reseller, we will maintain that level for 1991 and the 5% annual escalator for each future year.

1. Acceptable Financial Support

We believe that any of the following unencumbered financial instruments will adequately support the financial requirements of D.90-08-032 under a broadened definition of the \$420,000 minimum cash requirement for 1991:

- a. Cash or cash equivalent, including cashier's check, sight draft, performance bond proceeds, or traveler's checks;
- b. Certificate of deposit or other liquid deposit, with a reputable bank or other financial institution;

⁶ This would result in a gross salary of \$3,041 after payment of the current 15.3% Social Security (FICA) tax rate for self-employed persons (Source: 1990 IRS form 1040-SE) and prior to any other deductions for taxes or benefits.

- c. Preferred stock proceeds or other corporate shareholder equity, provided that use is restricted to maintenance of working capital for a period of at least twelve (12) months beyond certification of the applicant by the Commission;
- d. Letter of credit, issued by a reputable bank or other financial institution, irrevocable for a period of at least twelve (12) months beyond certification of the applicant by the Commission;
- e. Line of credit or other loan, issued by a reputable bank or other financial institution, irrevocable for a period of at least twelve (12) months beyond certification of the applicant by the Commission, and payable on an interest-only basis for the same period;
- f. Loan, issued by a qualified subsidiary, affiliate of applicant, or a qualified corporation holding controlling interest in the applicant, irrevocable for a period of at least twelve (12) months beyond certification of the applicant by the Commission, and payable on an interest-only basis for the same period;
- g. Guarantee, issued by a corporation, copartnership, or other person or association, other than the applicant, irrevocable for a period of at least twelve (12) months beyond certification of the applicant by the Commission;
- h. Guarantee, issued by a qualified subsidiary, affiliate of applicant, or a qualified corporation holding controlling interest in the applicant, irrevocable for a period of at least twelve (12) months beyond the certification of the applicant by the Commission.

ALL INFORMATION CONTAINED HEREIN IS UNCLASSIFIED DATE 08-21-2008 BY 60321 UCBAW/STP/STP

2. Cash Flow Statements of Applicants Who Have Profitable Interstate Businesses

We will also accept an audited Balance Sheet and Income Statement of a company which does a profitable business as a going concern reseller outside of California and which proposes expansion of its operations to provide intrastate services in California under its own corporate name. If the going concern has sufficient cash flow, its subsidiary or affiliate may apply for a CPC&N, with the out-of-state reseller acting as a guarantor with the proviso that it will pledge \$420,000 of that cash flow to its new operations in California (see Item h. above).

To further clarify the definition of certain instruments listed above and our intent on nondiscriminatory application of these definitions we note that:

- o For purposes of this order, a qualified subsidiary, affiliate, or corporation holding a controlling interest in the applicant must be either (1) a certificated going concern with active NDIEC operations in California, or (2) a going concern with active NDIEC operations outside California.
- o All unencumbered instruments listed in 1.a. through 1.h. above will be subject to verification and review by the Commission prior to and for a period of twelve (12) months beyond certification of the applicant by the Commission. Failure to comply with this requirement will void applicant's certification or result in such other action as the Commission deems in the public interest, including assessment of reasonable penalties. (See PU Code §§ 581 and 2112.)
- o Applicants for CPC&Ns as resellers shall assure that every issuer of a letter of credit, line of credit, or guarantee to applicant will remain prepared to furnish such reports to applicant for tendering to the Commission at such time and in such form as the Commission may reasonably require to verify or confirm the financial responsibility of applicant for a period of

at least twelve (12) months after certification of the applicant by the Commission.

- o All information furnished to the Commission for purposes of compliance with this requirement will be available for public inspection or made public, except in cases where a showing is made of a compelling need to protect it as private or proprietary information.

3. Application of California Corporations Code § 500(b) Test

AGS&M suggests that the financial responsibility requirement for a going concern, which is active outside of California and which proposes expansion of its operations to provide intrastate services in California under its own corporate name, should parallel the requirements of California Corporations Code (CCC) § 500(b). CCC § 500(b) outlines the circumstances under which a corporation may make distributions to its shareholders and sets forth a basic solvency test to determine if the corporation would, if it made distributions to its shareholders, remain solvent in the equity sense. But this section has never before been cited by this Commission as a valid basis for measuring financial responsibility, nor does this section seem to address the true matters of concern in establishing financial responsibility.

While we are not constrained by our prior practices, we are bound to ensure that fairness, reason, and the public interest are served by our decisions. Using the CCC § 500(b) solvency test as a financial responsibility indicator does not appear to be in harmony with this obligation. The Commission has imposed a financial responsibility requirement upon NDIECs applying for Commission certification. D.90-02-019, our "Opinion Directing the Filing of Further Comments," in this proceeding, discussed several reasons for imposing the financial responsibility requirement upon

NDIECs entering the California intrastate interLATA marketplace.

These include:

- a. To comply with Rule of Practice and Procedure 18, subsections (g) and (o)(2)(D),
- b. To avoid increasing bankruptcies of undercapitalized NDIEC operations,
- c. To curb unfair business practices, and
- d. To maintain a positive public image of NDIECs in general. (D.90-02-019, mimeo. at pp. 19-21.)

Note: These reasons seem equally applicable to both start-up and going concern applicants presently active outside of California.

A CCC § 500(b)-type test could not effectively promote all of the above reasons. That type of test would be particularly ineffective in avoiding undercapitalization of California intrastate interLATA operations. CCC § 500(b) measures the ratios between a corporation's tangible assets and its liabilities, and between its current assets and its current liabilities. It does not measure the actual amount of those assets and liabilities.

Thus, in an extreme illustrative case, if an applicant corporation had \$1.25 in assets (exclusive of goodwill, capitalized research and development expenses and deferred charges), and \$1.00 in liabilities (not including deferred taxes, deferred income and other deferred credits), and if its current liabilities were not greater than its current assets, then under a CCC § 500(b) test a certificate would be granted. A quarter (\$0.25) is not much unencumbered working capital for either a start-up company or an expanding going concern. Debt-to-equity and liquidity ratios alone are not a sufficient measure of financial responsibility. This is one reason why we will not adopt AGS&M's suggestion.

It should also be noted that the CCC § 500(b) test never claims to be an indicator of financial responsibility. It was designed to measure the proportionate capacity of a going corporate concern to remain solvent after releasing a portion of its assets to its shareholders. CCC § 500(b) protects only the interests of the corporate shareholders, not the users of the corporation's services or commodities. This Commission, however, has a constitutional mandate to serve not only the interests of shareholders, but those of customers as well. This cannot be accomplished by adopting a CCC § 500(b) test.

Accordingly, we will require the same minimum unencumbered cash or cash equivalent showing of both start-up and going concerns expanding their operations into the California intrastate interLATA marketplace. This is consistent with our constitutional mandate and the financial responsibility provisions set forth elsewhere in the state statutes.⁷

4. Cash Flow Statement for the New Entity (Reseller) Not Accepted

AGS&M offers a projected cash flow statement in support of new applications for NDIEC CPC&Ns where there is insufficient cash to meet the \$420,000 requirement. In any business, the main purpose of the cash flow statement is to perform cash planning; that is, to plan for the timing of cash inflows to agree with cash outflows. In most cases cash shortages are made up from loans,

⁷ Service and commodity user protection is generally maintained in other regulated businesses by imposition of either security bond, minimal unencumbered asset, or other insurance showing. See California Business and Professions Code §§ 1628, 6158, 7210.6, 8690-8693, 8695, 9717, 9783, 9889.36, 17765.8, 18665, and 19233. See also PU Code §§ 3572, 3597.5, 3631.5, 5135, 5374, 5375, 5391, 5391.2, 5392, 5504, 24230-24400.3, and 24410. California Vehicle Code §§ 16000 et seq. imposes what may well be the most ubiquitous user protection financial responsibility requirement.

usually short-term, or the liquidation of short-term investments. All of these cash flows are based upon an established stream of cash inflows and outflows. An established cash stream is a pattern of cash inflows and outflows that have actually been experienced in the recent past, with adjustments for known increases or decreases that have a high probability of occurring. Thus, a cash flow statement is a tool of a business that is already providing goods or services. A projected cash flow statement prepared for a business that has no established revenue cycle is simply a wish list of what the applicant hopes will happen. Even with an established business frequent adjustments of cash flow estimates are necessary. In some cases such adjustments are made on a daily basis.

While there is merit in analyzing and accepting cash flow statements in the form of audited Balance Sheets and Income Statements from going concerns, there is simply no justification to do so for any new applicant which is entering a business venture for the first time and for which the projected cash flow statement has no underlying support. Accordingly, we must deny AGS&M's suggested use of projected cash flow statements as support for the \$420,000 financial requirement of new NDIEC applicants who have no other financial support from other established business entities.

Findings of Fact

1. D.90-08-032, among other things, established requirements for applicants seeking CPC&Ns to become NDIECs, including a financial requirement of \$400,000 in uncommitted cash or equivalent financial resources for calendar year 1990.
2. D.90-08-032 further required that the \$400,000 minimum uncommitted cash standard be increased by 5% each year beginning with 1991 to account for increases in costs of business operations. Accordingly, the minimum cash standard for 1991 is \$420,000.

3. D.90-08-032 left a possibility for granting a CPC&N to any applicant who can make a rare case showing that \$400,000 is not needed during the first year of operation in absence of revenues.

4. AGS&M in its Petition to Modify D.90-08-032 seeks further clarification of the option of using revenue projections to support the financial requirement by deletion of the phrase "in absence of revenues during the period," and replacing the phrase "make a rare case showing" in the order with the word "demonstrate." In addition, it asks that the words "cash available" be expanded to include "or the equivalent" to further clarify the required provisions.

5. Revenue projections for "Applicants with a 'track record'" and for "Applicants without previous experience" are too speculative to meet the requirement for minimum financial support. Certain audited financial statements of applicants with a track record are reasonable to use for meeting established financial requirements for CPC&Ns.

6. AGS&M's petition seeks a lesser cash requirement for a "Switchless Reseller" based on a clear definition of that category of reseller.

7. "Switchless Resellers" only market the services of underlying carriers who are certificated to construct and maintain the physical plant for intrastate communications services in California.

8. It is reasonable to assume that a "Switchless Reseller" can operate for a year with a far lower cash requirement than is needed for any NDIEC reseller of services which are switched by the reseller.

9. It is reasonable to reduce the financial responsibility requirement to \$75,000 for applicants who seek authority as resellers of telecommunications service, and who do not plan to own, control, operate, or manage telephone lines ("Switchless Resellers").

10. It is reasonable to apply the same 5% annual escalator to the \$75,000 uncommitted cash standard for applicants seeking CPC&Ns as "Switchless Resellers" as is presently applied to the \$420,000 (1991) standard for other applicants seeking reseller CPC&Ns.

11. If a switchless reseller subsequently desires to own, control, operate, or manage telephone lines and to offer the expanded services of a facilities-based reseller, it is appropriate to require that it demonstrate to the Commission at that time its ability to meet the higher financial responsibility requirement.

12. It is reasonable to expand and clarify the criteria to be met by NDIECs seeking CPC&Ns to include equivalents to "cash available."

13. The use of audited Balance Sheets and Income Statements for "Applicants with a 'track record'" is a reasonable basis for meeting NDIEC CPC&N financial requirements within the broader conditions set forth and defined by this order.

14. The operations of a switched reseller are subject to significant business risk and substantial ongoing expenses that continue to justify the need for our \$420,000 cash or cash equivalent requirement for 1991 established by D.90-08-032.

15. The ways of meeting the cash requirement standard of D.90-08-032 need better definition and further clarification as discussed herein.

16. Revenue projections of a new applicant without prior related business activity have no basis beyond a wish or hope list of what may occur under idealized conditions. Such projections do not guarantee available cash to meet projected expenses and are therefore not a reasonable surrogate for cash or cash equivalent resources.

Conclusions of Law

1. The narrative discussion of D.90-08-032 (37 CPUC 2d 130 at 148) should be modified as requested by AGS&M by replacing the phrase "make a rare case showing," in the third full paragraph, with the single word "demonstrate," and by adding the words "or the equivalent" after the words "cash available" in the next to the last line of that paragraph.

2. AGS&M has not advanced any reasonable argument for reducing the \$420,000 minimum cash requirement (for 1991) for resellers other than "Switchless Resellers" and no other exception should be granted.

3. AGS&M's recommendation that the minimum cash requirement of D.90-08-032 be reduced for "Switchless Reseller" applicants should be adopted.

4. Absent a specific evidentiary record, the minimum cash requirement for a "Switchless Reseller" applicant should be reduced from \$420,000 to \$75,000 for 1991. A 5% annual escalator should apply to the \$75,000 for computing the specific minimum cash requirement in future years.

5. D.90-08-032 should be modified to recognize the reduced financial requirement for "Switchless Reseller" applicants.

6. Conclusion of Law 18 of D.90-08-032 (37 CPUC 2d at 157) should be modified to clarify the differing financial requirements for applicants seeking CPC&Ns as traditional NDIEC resellers versus "Switchless Resellers."

7. Any certificated switchless reseller who desires to own, control, operate, or manage telephone lines, and to offer the expanded services of a facilities-based reseller should file an advice letter demonstrating that it meets the standard financial requirement (\$420,000 for 1991).

8. An ordering paragraph should be added to D.90-08-032 to clarify the means by which an applicant for a CPC&N as an NDIEC may

establish the minimum uncommitted cash requirement or equivalent financial resources, consistent with the narrative of this order.

9. AGS&M's petition for modification of D.90-08-032 dated February 15, 1991, as further clarified by its letters to the assigned ALJ of May 3 and 23, 1991, is reasonable in part and should be adopted to the extent set forth in the following order, and in all other respects should be denied.

10. This order should be made effective today to permit pending applications for NDIEC CPC&Ns with alternative showings of financial support to be processed without further delay.

O R D E R

IT IS ORDERED that:

1. D.90-08-032 dated August 8, 1990, 37 CPUC 2d 130, is modified as follows:

a. The third full paragraph on p. 148 is changed to read:

"Any applicant who can demonstrate that \$400,000 of cash is not needed for his first year of operation, in absence of revenues during that period, may be granted a CPC&N with a lesser amount. A sufficient showing must be made, however, that the applicant can meet all demands for wages, rents, wholesale IEC and LEC services, equipment, and supplies and any applicable taxes and insurance for the first full year of operation with any lesser amount of cash available or the equivalent in lieu of the \$400,000 minimum standard.

"Note: Revenue projections may not be used as part of that showing."

b. Two new paragraphs should be inserted on p. 148, between the fourth and fifth full paragraphs as follows:

"Any applicant who does not own, control, operate, or manage telephone lines

(Switchless Reseller) may be granted a CPC&N based on a financial showing of \$75,000 of cash available or the equivalent thereof. Any certificated switchless reseller who desires to own, control, operate, or manage telephone lines, and to offer the expanded services of a facilities-based reseller, shall file an advice letter demonstrating that it meets the standard financial requirement (\$420,000 in 1991). The advice letter will require Commission approval.

"The \$75,000 standard for the 'Switchless Reseller' is a base figure for 1991 to be escalated 5% each year thereafter."

- c. Finding of Fact 21 on p. 156 is changed entirely to read:

"21. It is reasonable to reduce the minimum 1991 uncommitted cash standard supporting the financial requirements of 'Switchless Reseller' applicants to \$75,000, with an annual 5% escalation of that amount after 1991."

- d. Conclusion of Law 18 on p. 157 is changed to read:

"18. All new applicants seeking CPC&Ns for authority to become NDIECs should be required to demonstrate that they possess a minimum of \$400,000 of unencumbered cash, to carry out the first full year of their NDIEC operations, excepting 'Switchless Resellers' as discussed in the narrative and/or the findings of fact in this order."

- e. Conclusion of Law 19 on p. 157 is changed to read:

"19. The \$400,000 amount set forth in Conclusion of Law 18 above should be escalated by 5% for calendar year 1991 and again by a similar 5% for each year thereafter

to help cover rises in expenses due to general inflation."

- f. A new Ordering Paragraph 5.1 is added on p. 158 as follows:

"5.1. New applicants for CPC&Ns as NDIECs shall be permitted to use any of the following financial instruments to satisfy the applicable unencumbered cash requirements established by this order.

"(a) Cash or cash equivalent, including cashier's check, sight draft, performance bond proceeds, or traveler's checks;

"(b) Certificate of deposit or other liquid deposit, with a reputable bank or other financial institution;

"(c) Preferred stock proceeds or other corporate shareholder equity, provided that use is restricted to maintenance of working capital for a period of at least twelve (12) months beyond certification of the applicant by the Commission;

"(d) Letter of credit, issued by a reputable bank or other financial institution, irrevocable for a period of at least twelve (12) months beyond certification of the applicant by the Commission;

"(e) Line of credit or other loan, issued by a reputable bank or other financial institution, irrevocable for a period of at least twelve (12) months beyond certification of the applicant by the Commission; and payable on an interest-only basis for the same period;

- "(f) Loan, issued by a qualified subsidiary, affiliate of applicant, or a qualified corporation holding controlling interest in the applicant, irrevocable for a period of at least twelve (12) months beyond certification of the applicant by the Commission, and payable on an interest-only basis for the same period;
- "(g) Guarantee, issued by a corporation, copartnership, or other person or association, other than the applicant, irrevocable for a period of at least twelve (12) months beyond certification of the applicant by the Commission;
- "(h) Guarantee, issued by a qualified subsidiary, affiliate of applicant, or a qualified corporation holding controlling interest in the applicant, irrevocable for a period of at least twelve (12) months beyond the certification of the applicant by the Commission.

"The definitions of certain of the financial instruments listed above and our intent on nondiscriminatory application of these definitions are clarified as follows:

- "(1) For purposes of this order, a qualified subsidiary, affiliate, or corporation holding a controlling interest in the applicant must be either (1) a certificated going concern with active NDIEC operations in California, or (2) a going concern with active NDIEC operations outside California.

"(2) All unencumbered instruments listed in 6.a. through 6.h. above will be subject to verification and review by the Commission prior to and for a period of twelve (12) months beyond certification of the applicant by the Commission. Failure to comply with this requirement will void applicant's certification or result in such other action as the Commission deems in the public interest, including assessment of reasonable penalties. (See PU Code §§ 581 and 2112.)

"(3) Applicants for CPC&Ns as resellers shall assure that every issuer of a letter of credit, line of credit, or guarantee to applicant will remain prepared to furnish such reports to applicant for tendering to the Commission at such time and in such form as the Commission may reasonably require to verify or confirm the financial responsibility of applicant for a period of at least twelve (12) months after certification of the applicant by the Commission.

"(4) All information furnished to the Commission for purposes of compliance with this requirement will be available for public inspection or made public, except in cases where a showing is made of a compelling need to protect it as private or proprietary information."

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SAN FRANCISCO
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g. A new Ordering Paragraph 5.2 is added on p. 158 as follows:

"5.2. Applicants who do not directly own, control, operate, or manage any conduits, ducts, poles, wires, cables, instruments, and appliances in connection with or to facilitate communications by telephone (Switchless Resellers) shall be permitted to apply for CPC&Ns with a reduced unencumbered cash requirement as discussed in the narrative, findings of fact, and conclusions of law of this order."

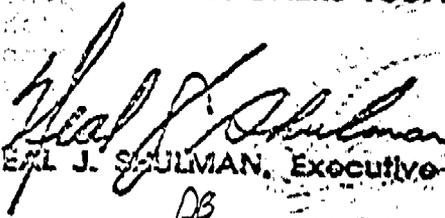
2. The ordering paragraphs and other requirements of D.90-08-032 dated August 8, 1990, except as expressly modified here, continue to apply in full force after the effective date of this order. Appendix A to this order restates the currently applicable ordering paragraphs of D.90-08-032 as modified by this order.

This order is effective today.

Dated October 23, 1991, at San Francisco, California.

PATRICIA M. ECKERT
President
JOHN B. OHANIAN
DANIEL Wm. FESSLER
NORMAN D. SHUMWAY
Commissioners

I CERTIFY THAT THIS DECISION
WAS APPROVED BY THE ABOVE
COMMISSIONERS TODAY


NEAL J. SCHULMAN, Executive Director
AB

APPENDIX A
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DECISION 90-08-032 ORDERING PARAGRAPHS
AS REVISED BY DECISION 91-10-041

IT IS ORDERED that:

1. All respondents and interested parties to this OIR and all non-dominant interexchange (NDIEC) telecommunications utilities with utility identifying numbers U-5001-C to U-5218-C (and subsequent) are hereby placed on notice that hereafter their recordkeeping, reporting requirements, tariff filings, financing transactions and new and transfer applications, before this Commission, will be processed in accordance with the narrative, findings of fact, and conclusions of law set forth in this order, except as may be later changed or amended by further order of this Commission.

2. All NDIECs operating in California with utility identifying numbers U-5001-C through U-5218-C and subsequent are hereby directed to revise their tariff schedules, within 120 days after the effective date of this order to conform with the deposits, interest on deposits, and discontinuance and restoration of service provisions of this order as set forth in the narrative, findings of fact, and conclusions of law of this order.

3. The Commission Advisory and Compliance Division (CACD) is hereby directed to prepare and assemble, within 90 days after the effective date of this order, copies of sample standard tariff schedules, with rules and special conditions consistent with the narrative, findings of fact, and conclusions of law contained in this order, and make such sample standard tariff schedules available, at the Commission's standard per page charge, to any NDIEC, or prospective applicant for a CPC&N as an NDIEC, requesting same.

4. The CACD shall on or before January 1, 1991 and at least one time each year thereafter, prepare a list of all current NDIECs in good standing operating in California, including addresses,

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phone numbers and the name of the responsible contact person at each such utility, similar to Appendix C to this order, and then disseminate that list to all other telecommunications utilities including the local exchange companies and NDIECs and will be provided at the Commission's standard per page charge, to any other interested party having requested such list.

5. All NDIECs are hereby placed on notice that their California tariff filings will be processed in accordance with the following effectiveness schedule:

- a. Inclusion of FCC-approved rates in California Public Utilities Commission tariff schedules shall become effective on one (1) day notice.
- b. Uniform rate reductions for existing services shall become effective on five (5) days' notice.
- c. Uniform rate increases for existing services shall become effective on thirty (30) days' notice, and shall require bill inserts or first class mail notice to customers of the pending increased rates, and
- d. Advice letter filings for new services and for all other types of tariff revisions shall become effective on forty (40) days' notice.

5.1. New applicants for CPC&Ns as NDIECs shall be permitted to use any of the following financial instruments to satisfy the applicable unencumbered cash requirements established by this order.

- a. Cash or cash equivalent, including cashier's check, sight draft, performance bond proceeds, or traveler's checks;
- b. Certificate of deposit or other liquid deposit, with a reputable bank or other financial institution;

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- c. Preferred stock proceeds or other corporate shareholder equity, provided that use is restricted to maintenance of working capital for a period of at least twelve (12) months beyond certification of the applicant by the Commission;
- d. Letter of credit, issued by a reputable bank or other financial institution, irrevocable for a period of at least twelve (12) months beyond certification of the applicant by the Commission;
- e. Line of credit or other loan, issued by a reputable bank or other financial institution, irrevocable for a period of at least twelve (12) months beyond certification of the applicant by the Commission, and payable on an interest-only basis for the same period;
- f. Loan, issued by a qualified subsidiary, affiliate of applicant, or a qualified corporation holding controlling interest in the applicant, irrevocable for a period of at least twelve (12) months beyond certification of the applicant by the Commission, and payable on an interest-only basis for the same period;
- g. Guarantee, issued by a corporation, copartnership, or other person or association, irrevocable for a period of at least twelve (12) months beyond certification of the applicant by the Commission;
- h. Guarantee, issued by a qualified subsidiary, affiliate of applicant, or a qualified corporation holding controlling interest in the applicant, irrevocable for a period of at least twelve (12) months beyond the certification of the applicant by the Commission.

The definitions of certain of the financial instruments listed above and our intent on nondiscriminatory application of these definitions are clarified as follows:

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- (1) For purposes of this order, a qualified subsidiary, affiliate, or corporation holding a controlling interest in the applicant must be either (1) a certificated going concern with active NDIEC operations in California, or (2) a going concern with active NDIEC operations outside California.
- (2) All unencumbered instruments listed in 6.a. through 6.h. above will be subject to verification and review by the Commission prior to and for a period of twelve (12) months beyond certification of the applicant by the Commission. Failure to comply with this requirement will void applicant's certification or result in such other action as the Commission deems in the public interest, including assessment of reasonable penalties. (See PU Code §§ 581 and 2112.)
- (3) Applicants for CPC&Ns as resellers shall assure that every issuer of a letter of credit, line of credit, or guarantee to applicant will remain prepared to furnish such reports to applicant for tendering to the Commission at such time and in such form as the Commission may reasonably require to verify or confirm the financial responsibility of applicant for a period of at least twelve (12) months after certification of the applicant by the Commission.
- (4) All information furnished to the Commission for purposes of compliance with this requirement will be available for public inspection or made public, except in cases where a showing is made of a compelling need to protect it as private or proprietary information.

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5.2. Applicants who do not directly own, control, operate, or manage any conduits, ducts, poles, wires, cables, instruments, and appliances in connection with or to facilitate communications by telephone (Switchless Resellers) shall be permitted to apply for CPC&Ns with a reduced unencumbered cash requirement as discussed in the narrative, findings of fact, and conclusions of law of this order.

6. The Executive Director is hereby directed to include the applicable changes to GO 96-A from the narrative, findings of fact, and conclusions of law, of this order as applicable to NDIEC telecommunications utilities operating in California, in the next revision and printing of GO 96-A.

7. This proceeding is closed.

8. The Executive Director shall mail copies of this order to the respondents and interested parties listed in Appendices A, B, and C to this order.

(END OF APPENDIX A)