

ALJ/MAB/wav

Decision 98-06-011 June 4, 1998

MAILED 6/4/98

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application for Approval of Stock Swap Agreement Between International Standards Group, Ltd. and Total National Telecommunications, Inc. (U-5576-C).

Application 97-01-020
(Filed January 9, 1997)

Investigation on the Commission's own motion into the operations of Heartline Communications, Inc. and whether the entity, by itself or through practices including arrangements with certificated long distance carriers, conducted intrastate utility operations without holding a certificate from this Commission, and whether it switched any customers to its service without their permission.

Investigation 96-04-024
(Filed April 10, 1996)

In the matter of the Application of Heartline Communications, Inc. for a Certificate of Public Convenience and Necessity to Operate as a Provider of Interexchange Telecommunications Services Within California.

Application 94-09-025
(Filed September 19, 1994)

FINAL OPINION

On May 28, 1996, Total National Telecommunications, Inc., (TNT) (U-5516-C) entered into a stock swap transaction with International Standards Group, Inc.¹ (ISG) The transaction closed on June 12, 1996.

¹ Also known as Total World Telecommunications, Inc.

In April of 1996, the Commission opened Investigation (I.) 96-04-024 into the practices of TNT and its corporate affiliate, Heartline Communications, Inc. (Heartline) regarding transfer of customers from one long-distance carrier to another. TNT, Heartline, and ISG and the Commission's Safety and Enforcement Division (subsequently reorganized into the Consumer Safety Division (CSD)) reached an agreement settling all issues in the investigation. The agreement provided for substantial monetary restitution to California consumers as well as placing significant limitations on TNT and Heartline's operations. The Commission approved the settlement agreement on December 9, 1996, in Decision (D.) 96-12-031.

The stock swap transfer from TNT to ISG was addressed but not resolved in the settlement agreement. ISG agreed to file an application seeking either retroactive approval of the transaction or dismissal of the application because no transfer of control had occurred. ISG filed such an application on January 9, 1997, and a motion to dismiss it on January 21, 1997.

As the basis for its motion to dismiss, ISG stated that pursuant to the stock swap agreement, TNT will exchange its stock for stock of ISG as well as additional capital for TNT. At the conclusion of the transaction, TNT will be a wholly-owned subsidiary of ISG. The former owners of TNT will continue to manage TNT and will own the largest block of ISG stock, thus effectively controlling ISG. Accordingly, ISG stated that no change in control has occurred which would require Commission approval pursuant to Public Utilities (PU) Code § 854. In response to a request from the assigned Administrative Law Judge (ALJ), ISG stated that although TNT's owners currently control a majority of the voting interests of ISG, this fact could change should ISG exercise certain options under the stock swap agreement. Since the filing of this application over

A.97-01-020 ALJ/MAB/wav

a year ago, the parties have not submitted any additional information on the status of TNT's control.

In its application and motion to dismiss, ISG did not offer any argument that PU Code § 851 does not apply to the transaction at issue. At the request of the assigned ALJ, ISG amended its motion to dismiss to include an analysis demonstrating the inapplicability of PU Code § 851. ISG stated that PU Code § 851 applies only to transfers of utility property, not shares of stock in the utility which had been transferred here. For this reason, ISG stated, PU Code § 851 does not apply and the application should be dismissed.

Pursuant to the settlement agreement approved in I.97-04-024, TNT prepared restitution checks for certain California consumers. These checks were provided to CSD. On the day CSD was scheduled to mail the checks, TNT filed a Voluntary Petition for Chapter 11 bankruptcy protection in the U.S. Bankruptcy Court for the Southern District of Texas, Case No. 97-47491-H5-11.

On August 29, 1997, CSD filed a protest to TNT and ISG's application requesting approval of their stock swap agreement. CSD stated that ISG's responsibility for the consumer restitution provided in the settlement agreement should be resolved as part of the Commission's consideration of the stock swap agreement. ISG replied to the protest on September 1, 1997, arguing that the issue of ISG's responsibility for the restitution should be litigated in I.96-04-024.

On November 25, 1997, CSD filed a motion in the stock swap docket, Application (A.) 97-01-020, the investigation docket, I.96-04-024, and Heartline's CPCN docket, A.94-09-025, requesting that the issue of ISG's responsibility for TNT's restitution obligations be consolidated into the stock swap docket and pursued apart from the TNT issues. No party responded to CSD's motion.

On December 1, 1997, ISG's creditors filed an involuntary petition for Chapter 7 bankruptcy protection in the U.S. Bankruptcy Court for the Southern District of Florida.

On January 27, 1998, the assigned Administrative Law Judge issued this decision in draft form for comment. No party filed any comments. The California Association of Competitive Telecommunications Carriers, who was not a party, filed comments suggesting that portions of this decision were advisory.

Bankruptcy Automatic Stay

Federal bankruptcy law provides that the filing of a petition under the bankruptcy code automatically stays "the commencement or continuation...of a judicial, administrative, or other action or proceeding against the debtor...to recover a claim against the debtor that arose before commencement of the case under this title." 11 U.S.C. 362(a)(1). This stay provision effectively precludes the Commission from acting in any way to direct further actions of TNT or ISG to meet their financial obligations under the settlement agreement.

The stay provision does not, however, preclude the Commission from enforcing its "police or regulatory power." 11 U.S.C. 362(b)(4). Thus, while the Commission is prevented by the federal bankruptcy code from taking any further actions to secure financial restitution from TNT or ISG, the Commission may take actions which enforce its regulatory powers.

Discussion

Settlement Agreement

As noted above, the Commission is thwarted by federal law from seeking to enforce, on behalf of California consumers, the financial restitution portions of the settlement agreement. While the Commission is aware of the public policies which are furthered by the automatic stay, the Commission is

frustrated that California consumers are not likely to receive the restitution to which they are entitled.

To ensure the California consumers receive as much restitution as possible from TNT and ISG, the General Counsel is directed to pursue, to the extent possible, the Commission's claim on behalf of California consumers against TNT and ISG in the pending cases in U.S. Bankruptcy Court and any other available venue. Any funds obtained should be immediately distributed on a pro rata basis to the appropriate consumers.

Absent further action, the Commission considers the settlement agreement to be binding on the parties. We expect all parties to abide by all provisions of the agreement which do not affect financial obligations, including all prospective limits on operating authority.

Stock Swap Agreement

The stock swap agreement is pending before this Commission, but the application has apparently been abandoned by the parties, as demonstrated by their failure to respond to CSD's motion. The record is not complete, but it is sufficient to allow us to make an initial ruling on the applicability of PU Code §§ 854 and 851 to the agreement at issue here.

In considering whether a particular transfer amounts to a transfer of control subject to our approval under PU Code § 854, we carefully evaluate the facts of the transaction:

"Rather than formulating a rule specifying a percentage of ownership constituting control, our decisions have determined what constitutes 'control' based on the circumstances involved, and we consider it necessary to examine each case on its particular facts." *Pacific Bell*, 51 CPUC2d 728,746 (1993) (D.93-11-011) (quotations and citations omitted).

In our review, our guide will be the overall purpose of the statute—protecting the public from unqualified utility management.

In the facts presented when the application was filed, the owners of the existing utility, TNT, will initially obtain a majority voting interest in ISG, the new owners. As owners of the largest block of stock, they will certainly be in a significant decision-making position and will, as a group, control ISG. ISG, however, has the option of converting certain preferred stock to common stock such that the owners of TNT will not represent a majority interest. Due to TNT's failure to provide status information and lack of prosecution, and the enforcement issues present in this proceeding, the current record of this particular transaction is insufficient to allow us to conclusively determine whether or not a transfer of control has occurred and whether the Commission has jurisdiction over this stock swap agreement. While we may ultimately conclude that § 854 does not apply to this transaction, lack of information on ownership and control status warrants an initial finding that a transfer of control subject to the Commission's jurisdiction under PU Code § 854 has occurred such that Commission approval will be required. This finding is subject to modification, should the parties present additional facts.

As the application is controversial, and a protest has been filed, this case is not suitable for the Executive Director to issue an order approving the transfer. (See D.86-08-057, 21CPUC 2d 549 (1986).) The proper procedural course for the § 854 application would be to schedule a prehearing conference to set evidentiary hearings. Such an act would appear futile in this case, however, because TNT and ISG have apparently abandoned this application. Thus, we will dismiss this application for lack of prosecution without prejudice to refile should any party elect to seek our authorization for the stock swap agreement. We note, however, that because we have made the initial finding that the stock swap

agreement is subject to § 854 and it has not been approved by this Commission, the agreement is void as a matter of law. See PU Code § 854 ("Any such acquisition or control without prior authorization shall be void and of no effect.")

PU Code § 851 applies to the transfer of "property necessary or useful in the performance of [a utility's] duties to the public." As all TNT assets necessary and useful to TNT's operations will remain with TNT, no transfer implicating PU Code § 851 has occurred.

Findings of Fact

1. Notice of Application 97-01-020 appeared in the Daily Calendar on January 22, 1997.
2. CSD filed a protest on August 29, 1997.
3. Applicant states that the result of the stock swap agreement is that TNT will become a wholly-owned subsidiary of ISG, senior management of TNT will remain unchanged, and the existing owners of TNT will have a majority voting interest in ISG, unless and until ISG exercises certain options which would cause the former TNT owners to have less than majority interest.
4. Neither TNT nor ISG has submitted further information regarding the status of ownership or control.
5. Sufficient uncertainty regarding the status of this transaction warrants an initial finding that PU Code § 854 applies to this transaction, subject to the presentation of additional evidence by the parties.
6. Applicant states that no assets necessary for the performance of TNT's duties to the public will be transferred as a result of this transaction.
7. The specific facts of this transaction support a finding that PU Code § 851 does not apply to this transaction.
8. TNT filed for Chapter 11 bankruptcy protection in the U.S. Bankruptcy Court for the Southern District of Texas on July 23, 1997.

9. ISG's creditors filed an involuntary petition for Chapter 7 bankruptcy protection in the U.S. Bankruptcy Court for the Southern District of Florida.

10. The applicants have abandoned this application.

Conclusions of Law

1. Because PU Code § 854 applies to the stock swap agreement and the Commission has not authorized the parties to enter into the agreement, it is void.

2. PU Code § 851 does not apply to this transaction.

3. The Commission is prevented by 11 U.S.C. 362(a)(1) from taking any actions to direct TNT or ISG to comply with the financial restitution portions of the settlement agreement in I.96-04-024.

4. The Commission may take further actions to enforce its regulatory power as provided in 11 U.S.C. 362(b)(4).

O R D E R

IT IS ORDERED that:

1. This application is dismissed without prejudice to refile should the parties wish to obtain Commission authorization for the transaction.

2. The Consumer Services Division's motion for an order to show cause and to consolidate all issues relating to International Standards Group, Inc. into Application (A.) 97-01-020 is denied.

3. Investigation 96-04-024 and A.94-09-025 shall remain closed.

A.97-01-020 ALJ/MAB/wav

4. A.97-01-020 is closed.

This order is effective today.

Dated June 4, 1998, at San Francisco, California.

RICHARD A. BILAS

President

P. GREGORY CONLON

JESSIE J. KNIGHT, JR.

HENRY M. DUQUE

JOSIAH L. NEEPER

Commissioners