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Decision 99-01-029 January 20, 1999

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of Landmark Communications, Inc., a California Corporation, for a Certificate of Public Convenience and Necessity to Resell Local, InterLata, and IntraLata Telecommunications Services Within California.

ORIGINAL

A.97-07-008
(Filed July 10, 1997)

ORDER DENYING REHEARING OF DECISION 98-11-054

An Application for Rehearing of Decision D.98-11-054 was filed by Landmark Communications, Inc. (Landmark) on December 22, 1998. In D.98-11-054, the Commission denied without prejudice Landmark's application for a certificate of public convenience and necessity (CPCN) to provide intrastate long-distance telecommunications service. We determined that William Kettle, Landmark's President and sole shareholder, was unfit to be granted a CPCN "at this time." (D.98-11-054, pg. 19.)

As more fully set forth in D.98-11-054, Landmark filed its application for a CPCN on July 10, 1997. Landmark was not eligible for the expedited registration procedure we established in D.97-06-107. Landmark's President and sole shareholder, William Kettle, was previously associated with a telecommunications carrier which filed for bankruptcy, Thrifty Tel, Inc. (Thrifty). Mr. Kettle acquired Thrifty in 1986 and was its President and Chief Executive Officer (CEO). Thrifty first filed for Chapter 11 bankruptcy (reorganization) in 1990. Thrifty emerged from bankruptcy in 1992 and

eventually went public. Less than two years later, on December 27, 1994, Thrifty filed for a second Chapter 11 bankruptcy. That bankruptcy was later converted to Chapter 7 (liquidation), and Thrifty ceased business.

Mr. Kettle had been removed as Thrifty's President and CEO on August 2, 1994, almost five months prior to the second bankruptcy. A Form 10-KSB filed by Thrifty management with the Securities and Exchange Commission (SEC) attributed the bankruptcy to Mr. Kettle's breach of a "factoring agreement" with Fidelity Funding of California (Fidelity). Thrifty claimed that it was forced to direct all available cash flow to reduction of the Fidelity debt and was unable to pay other creditors. Thrifty also claimed that after Mr. Kettle's removal, it discovered certain fees and taxes had not been remitted to the appropriate government agencies.

By contrast, Mr. Kettle attributed his ouster to his plans to sell Thrifty. Mr. Kettle claimed that Thrifty filed for bankruptcy protection from a threatened lawsuit by Fidelity. Five days after the bankruptcy, Fidelity filed a civil complaint for fraud and conversion against all the Thrifty directors except Mr. Kettle. The complaint alleged that Thrifty was diverting revenues in breach of the agreement during the time after Mr. Kettle's departure.

A hearing to assess Landmark's fitness to operate as a public utility occurred on July 1, 1998. On November 24, 1998, the Commission issued its decision denying Landmark's application without prejudice. We found a consistent lack of regard by Mr. Kettle for governmental regulation and oversight, which included the nonpayment $125,000 in Universal Lifeline Telephone Service (ULTS) surcharges and $65,000 in deaf and disabled surcharges owed by Thrifty. We conditioned Landmark's reapplication upon an affirmative showing of technical expertise by Mr. Kettle, including both business acumen and compliance with regulatory directives. We then went on to suggest various guidelines for making that affirmative showing.

In its Application for Rehearing, Landmark alleges the following legal errors: (1) the Commission admitted hearsay evidence which violated the substantial rights of

Mr. Kettle; (2) the Commission abused its discretion by ignoring four exhibits offered into evidence by Landmark; and (3) the decision is contrary to the State's telecommunications policy codified in Pub. Util. Code § 709(e). A Response in Opposition to the Application was filed by the Consumer Services Division (CSD).

We have reviewed the arguments raised by Landmark in its Application for Rehearing. We have also reviewed the arguments in the Response in Opposition to the Application filed by CSD. As discussed below, we conclude that sufficient grounds for rehearing have not been shown. Landmark has failed to demonstrate legal error, as required by Pub. Util. Code § 1732.

First, Landmark alleges that the SEC Form 10-KSB (SEC Form) was erroneously admitted into evidence. Landmark objects to the admission of the SEC Form on the ground of hearsay. Landmark disputes that the SEC Form is admissible under the business records exception to the hearsay rule, codified at Evid. Code § 1271(a)-(d). Specifically, Landmark contends that none of the criteria for the exception are satisfied. Landmark argues that an SEC form is not "the type of record which is kept in the normal course of business in the sense in which books of account, ledgers and other documents showing a series of business transactions are kept," as required in Evid. Code § 1271(a). Carroll, et al. v. United States (9th Cir. 1963) 362 F.2d 72, 77. Landmark asserts that this SEC Form was actually prepared in anticipation of bankruptcy, so as to shift the blame to Mr. Kettle. *See* Paddick v. Dave Christensen, Inc. (9th Cir. 1984) 745 F.2d 1254, 1258.

As to subsection (b), Landmark notes that the SEC Form was prepared three months after the "act" or "events" described therein. Evid. Code § 1271(b). Landmark even questions if there were "acts" or "events" described in the SEC Form as opposed to unsupported accusations. As to subsection (c), Landmark notes that CSD failed to call the individual responsible for preparing the SEC Form to testify at the hearing. Landmark complains that it was unable to question the individual concerning the contents. Because the SEC Form was filed one week after the bankruptcy, Landmark also disputes that the timing is indicative of trustworthiness. Evid. Code § 1271(d).

Landmark acknowledges that the Commission sometimes considers inadmissible hearsay. Rule[1] 64 of the Commission's Rules of Practice and Procedure states that the "rules of evidence need not be applied in hearings before the Commission." Landmark emphasizes that Rule 64 goes on to state that the "substantial rights of the parties shall be preserved." Landmark, however, contends that the admission of the SEC Form violated Mr. Kettle's substantial right of due process.

By its consideration of the accusations without calling the accuser to testify, Landmark argues that the Commission effectively denied Mr. Kettle the right to confront and cross-examine his accusers. Landmark cites Massachusetts Bonding and Ins. Co. v. Industrial Accident Comm'n (1946) 74 Cal.App.2d 911, 916, which states that the lack of opportunity to cross-examine is a due process violation in a labor hearing. Additionally, Landmark disputes that the SEC Form contents are supported by other credible evidence. Landmark notes the absence of any other evidence supporting Mr. Kettle's purported breach of the Fidelity agreement. Landmark concedes the existence of other evidence as to Mr. Kettle's responsibility for the nonpayment of fees and taxes.

CSD responds by incorporating the Commission's rationale for admitting the SEC Form into evidence. While not specifically addressing all of the business records exception criteria, the Commission stated that it "did not agree" the exception was inapplicable. We noted that the SEC Form was an authorized corporate filing and submitted to a government agency in the normal course of business. We added that there was no basis in the record to believe that SEC Form's authors were attempting to direct criticism onto Mr. Kettle. We then went to state that "hearsay is admissible in an administrative hearing and may be relied upon if supported by other credible evidence." In re North Shuttle Service, Inc., D.98-05-019, 1998 Cal. PUC LEXIS 348; Rule 64.

First, there is no error in the Commission's consideration of the SEC Form. Our decision was also corroborated by other admissible evidence. Regardless of its

[1] Unless otherwise indicated, all rule references are to the Commission's Rules of Practice and Procedure.

possible inadmissibility in court trials, "hearsay evidence is admissible in Commission proceedings." D.98-06-084, 1998 Cal. PUC LEXIS 493, *3. The technical rules of evidence, such as the hearsay rule, need not be applied in Commission proceedings. Pub. Util. Code § 1701(a) provides that "the technical rules of evidence need not be applied" in "hearings, investigations, and proceedings" before the Commission. Rule 64 similarly provides that the "rules of evidence need not be applied in hearings before the Commission" provided "the substantial rights of the parties shall be preserved."

Administrative agencies are simply given more latitude to consider hearsay evidence than are courts. Although not applicable to Commission proceedings, the California Administrative Procedures Act allows the admission of hearsay "for the purpose of supplementing or explaining other evidence but shall not be sufficient in itself to support a finding." Gov. Code § 11513(c). The federal Administrative Procedures Act is even more liberal; it allows the admission of virtually all oral and written evidence but encourages agencies to provide for the exclusion of "irrelevant, immaterial or unduly repetitious evidence." 5 U.S.C. § 556(d).

The Commission generally allows hearsay evidence if a responsible person would rely upon it in the conduct of serious affairs. D.98-05-019, 1998 Cal. PUC LEXIS 348, *18. Yet hearsay evidence is given less weight by the Commission than other evidence." *Id.* at *16. If the evidence is objectionable on the grounds of hearsay, the Commission weighs it accordingly when all of the evidence in the case is reviewed. Veytsman v. Pacific Bell (1995) 61 CPUC2d 25, 1995 Cal. PUC LEXIS 621, *8 [D.95-08-015]. Even unverified prepared testimony, for example, can be "relied on to some extent, with due consideration to the fact that its sponsor has not been subjected to cross-examination." Re American Telephone & Telegraph Company (1994) 54 CPUC2d 43, 19, 1994 Cal. PUC LEXIS 285, *8 [D.94-04-042]. Hence Administrative Law Judge Ramsey informed Landmark that he would determine the weight of the SEC Form after examining all the evidence. (7/1/98 Trans. 31:27-32:1.)

Assuming, arguendo, the SEC Form was inadmissible hearsay, there was other corroborating evidence to support our decision. *See, e.g.*, D.98-06-084, 1998 Cal.PUC LEXIS 493, *2, n.1. Apart from the SEC Form contents, there was evidence of a pattern and practice by Mr. Kettle of failing to adhere to regulatory directives. The SEC Form was but "one of the bases" for CSD's recommendation to deny Landmark's application. (7/1/98 Trans. 64:24) Mr. Kettle initially delayed 17 months after purchasing Thrifty before seeking authority for the transfer of its CPCN. (D.88-02-053) Although the late filed application was approved, we were "disturbed" with Mr. Kettle's lack of concern for "the requirement that this Commission issue a decision" before the CPCN is transferred. *Id.* at 3. We put Mr. Kettle on notice that future violations would bear directly on his fitness for the grant of a CPCN:

> We expect applicant and other telecommunications resellers to obtain and maintain necessary resources to ensure familiarity and compliance with the Public Utilities Code and the Commission's Rules of Practice and Procedure. *Failure to do so in the future will raise questions about whether the applicant has the requisite fitness to operate lawfully, a precondition to the grant of a CPCN. . . Applicant is placed on notice that future violations will not be tolerated. Id.* (Emphasis Added.)

Nonetheless, Mr. Kettle then failed to collect and/or remit ULTS surcharges in violation of Pub. Util. Code § 879. (D.98-11-054, p. 7.) The evidence showed that Mr. Kettle, prior to his departure, was the individual at Thrifty responsible for the collection and remittance of the ULTS surcharges. The Thrifty checks for the ULTS surcharges were signed by Mr. Kettle. (Exhibit 6, pgs. 70-71, 79, 84.) The ULTS transmittal forms were signed by Mr. Kettle on behalf of Thrifty. (Exhibit 6, pgs. 58-64, 78, 82-83.) An April 11, 1990 letter from the Commission to Mr. Kettle cited Thrifty for the delinquent transmittal of collected surcharges. (Exhibit 6, pg. 85.) A CSD

investigator, Mr. Patterson, testified as to conversations between Commission staff and Mr. Kettle over the remittance of ULTS surcharges. (7/1/98 Trans. 35:12-23.)

Thrifty owed $22,913 in ULTS surcharges for the period ending August 31, 1993. (Exhibit 1, Wilson-Gray Decl. ¶3e., f.) Thrifty made no payments after August 31, 1993. *Id.* In addition, there was no record of payment for a $59,989 ULTS debt listed in Thrifty's first bankruptcy. *Id.* at ¶3a. A bankruptcy form signed by Mr. Kettle listed $2,131,368 in liabilities, including $59,989 owed for ULTS surcharges. (Exhibit 2) Thrifty Tel was not publicly traded at the time of the first bankruptcy, and Mr. Kettle was its President as well as CEO. *Id.* Lastly, Mr. Kettle failed to comply with a staff data request and an assigned commissioner order even in these proceedings. (D.98-11-054, pg. 3, 15, n.2.)

Second, Landmark alleges that we abused our discretion by ignoring Exhibits 7-10. The Commission owes a "duty to consider all the facts that might bear on the exercise of that discretion. The Commission must consider the alternatives presented and factors warranting adoption of those alternatives." United States Steel Corporation v. Public Utilities Commission (1981) 29 Cal.3d 603, 608.

The decision makes no explicit references to Exhibits 7-10 submitted by Landmark. Landmark concludes that the Commission erroneously disregarded Mr. Kettle's version of events contained in Exhibits 7-10. In fact, Landmark questions whether we even weighed the evidence. The Commission must "weigh the opposing evidence and arguments. . . ." Industrial Communications Systems, Inc. v. Public Utilities Commission (1978) 22 Cal.3d 572, 582. Landmark asserts that Exhibits 7-10 are credible evidence that a threatened lawsuit by Fidelity precipitated the bankruptcy. Landmark claims that nothing cited in the decision implies that Exhibits 7-10 were not credible evidence.

CSD disputes Landmark's allegation that we ignored evidence. CSD suggests that Exhibits 7-10 were simply not persuasive enough to warrant discussion in

the decision. CSD adds that Landmark failed to produce Exhibits 7-10 in response to its Data Request and the Order of the Assigned Commissioner. Landmark first produced Exhibits 7-10 at the hearing. CSD contends that Landmark's failure to produce the documents, in and of itself, warranted a dismissal of the application. Without the documents, CSD explains that it was unable to definitely state what caused the breach and/or the bankruptcy. CSD emphasizes the undisputed fact that Mr. Kettle was responsible for collecting and forwarding the half-million of fees/taxes to the appropriate government agencies and failed to do so.

Landmark's second allegation of error is without merit. Exhibits 7-10 address the issue of Mr. Kettle's purported involvement (or lack thereof) in Thrifty's second bankruptcy.[2] Mr. Kettle attributed the bankruptcy to threatened litigation by Fidelity over a breach of the agreement which occurred after his departure. Citing Exhibit 9, Mr. Kettle claims that Thrifty breached the agreement by diverting revenues from Fidelity. Exhibit 9 is a 1994 declaration of Gerardo Gonzales, a Fidelity manager. Mr. Gonzales' declaration states that Thrifty's revenues were not being forwarded to Fidelity.

Exhibit 7 is a 1995 declaration of James Dubeck, Chief Financial Officer of Thrifty. In his declaration, Mr. Dubeck relates a statement by a Fidelity employee that Thrifty's management was a "'bunch of liars and cheats and they were going to go to jail.'" (Exhibit 7, Dubeck Decl. ¶10.) Thrifty filed for bankruptcy a week after this alleged statement. Exhibit 8 is the complaint filed by Fidelity against Thrifty management, except for Mr. Kettle, two days after the bankruptcy. Exhibit 10 is an uncertified transcript from a hearing in Thrifty's bankruptcy. The judge made a preliminary finding that a breach of the agreement occurred when Thrifty diverted revenues from Fidelity after Mr. Kettle's departure. *Id.* at 4.

[2] We note that two of the exhibits are hearsay declarations. Neither declarant was called by Landmark to testify at the hearing. As result, CSD was unable to cross-examine the declarants.

As an initial matter, Landmark misconstrues the basis for the Commission's decision. Landmark places undue emphasis on the effect of the second Thrifty bankruptcy in our assessment of Mr. Kettle's fitness. Indeed, Mr. Kettle's purported responsibility for the bankruptcy was not even the primary basis for CSD's recommendation to deny Landmark's Application for a CPCN :

> The most important evidence is the nonpayment of the ULTS surcharges as discussed by Ms. Wilson-Gray; Kettle's – Mr. Kettle's previous history of noncompliance as reported in the decision originally granting him authority; and the fact that he was put on warning by the Commission in that decision specifically to avoid future problems; third, statements by witnesses, and supported by documents, that Mr. Kettle virtually ran the company himself, that he was the sole – he and his wife were the sole signatories on the checking account; that he signed the ULTS forms and was president, chief executive officer, the – a director and a major shareholder. (7/1/98 Trans. 45:15-28.)

The Commission denied Landmark's application because of Mr. Kettle's consistent "lack of regard for complying with other governmental requirements, such as the payment of statutory charges, fees, and taxes. . . ." (D.98-11-054, pg.15.) Landmark's failure to comply with staff data inquiries and an order of the Assigned Commissioner also "demonstrated a lack of respect for Commission procedures, rules and orders, and the public policies which underlie them." *Id.* As we previously explained, "[a]n applicant's regulatory compliance history is relevant and highly probative of the applicant's prospective compliance with California authorities." D.97-06-107, 1997 Cal. PUC LEXIS 535, *20-21.

Moreover, Exhibits 7-10 are not entirely supportive of Landmark's position. None of the exhibits address Mr. Kettle's contention that he was ousted over his plans to sell Thrifty. Exhibits 7, 9 and 10 do strongly suggest that Thrifty breached the agreement after Mr. Kettle's departure. However, Exhibit 10 shows that a breach also occurred prior

to Mr. Kettle's departure on August 2, 1994. The bankruptcy judge found that an earlier breach by Thrifty in "at least July and August 1994. . . led to an overadvance to the Debtor by some one-point-four million dollars by Fidelity." *Id.* at 3. The bankruptcy judge concluded that Thrifty was "*seriously untrustworthy. . . both before the departure of Mr. Kettle and after.*" (Exhibit 10, pg. 6.) (Emphasis Added.)

Landmark's third allegation is that the decision is contrary to state policy. Landmark contends that the decision erects a barrier to an open and competitive telecommunication market, which is contrary to Pub. Util. Code § 709(e). Pub. Util. Code § 709(e) provides that the policy for telecommunications in California is to "remove the barriers to open and competitive markets and promote product and price competition in a way that encourages greater efficiency, lower prices, and more consumer choice." Landmark cites comments from the Dissent that the decision "revert[ed] back to anachronistic thinking that argues that the best way to protect consumers is to try, on the front end to weed out 'unfit' providers." (D.98-11-054, Dissent, pg. 3.)

Further, Landmark asserts that Thrifty's bankruptcy resulted in no harm to consumers. Landmark points out that no consumers lost deposits or service. Landmark therefore requests that the Commission "revisit the judgment it made on November 19, 1998 and simply modify D.98-11-054 in a fashion that incorporates the Alternate. . . ." (Rehearing Application, pg. 3.) Landmark reiterates that the Alternate addressed the Commission's concern over the nonpayment of fees and taxes by Thrifty while increasing competition in the market.

CSD responds that Pub. Util. Code § 709(e) in no way requires the grant of every CPCN application irrespective of fitness. CSD argues that the goals in Pub. Util. Code § 709(e) of "greater efficiency" and "lower prices" could otherwise not be achieved. Additionally, CSD disputes that the Commission may "revisit" the merits of the Alternate via this Rehearing Application. CSD objects that the request is not an alleged legal error and therefore inappropriate for this Application. *See* Rule 86.1. CSD also objects that the request fails to comply with the requirements for a petition to modify. *See* Rule 47.

Landmark's third allegation of error is also without merit. Nothing in the language of Pub. Util. Code § 709(e) implies that it is the State's telecommunications policy to grant every CPCN application irrespective of fitness. Rather, Pub. Util. Code § 1013(d) requires the Commission to verify the financial viability of the applicant and ensure that its corporate officers have no prior history of committing fraud on the public.

In Rulemaking on the Commission's Own Motion for the Purpose of Modifying Existing Tariff Filing Rules for Telecommunications Utilities, D.90-02-019 in R.85-08-042, 1990 CPUC LEXIS 94, *30, the Commission reaffirmed the need to protect against "the financial burden and inconveniences to customers from poorly financed" carriers such as lost deposits and the abandonment of service. *Id.* We also recognized the impact of bankruptcies on all consumers and not just the customers of the failed carrier. "California telephone service ratepayers, at large, may ultimately be in the position of bearing the risk of failure in the resale marketplace." *Id.* at *34-35.

Finally, we cannot consider Landmark's request to "revisit" the merits of the Alternate. The Commission only addresses the alleged legal errors raised by applications for rehearing. *See* Rule 86.1. None of Landmark's alleged legal errors have sufficient merit to warrant "revisit[ing]" the Alternate, as more fully set forth above.

No further discussion is required of Landmark's allegations of error. Accordingly, upon review of each and every allegation of error raised by Landmark, we conclude that sufficient grounds for rehearing of D.98-11-054 have not been shown.

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Therefore, **IT IS ORDERED** that the Application for Rehearing of D.98-11-054 filed by Landmark is denied.

1. This proceeding is closed.

This order is effective today.

Dated January 20, 1999, at San Francisco, California.

RICHARD A. BILAS
President
HENRY M. DUQUE
JOSIAH L. NEEPER
Commissioners