

**STATE OF ILLINOIS  
ILLINOIS COMMERCE COMMISSION**

<b>ILLINOIS COMMERCE COMMISSION</b>	)	
<b>On Its Own Motion</b>	)	
	)	<b>00-0732</b>
<b>TALK.COM HOLDING CORP</b>	)	
	)	
<b>Application to Amend its Certificate</b>	)	
<b>Of Local and Long Distance Telecom</b>	)	
<b>Services in the State of Illinois</b>	)	

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**INITIAL BRIEF OF THE STAFF  
OF THE ILLINOIS COMMERCE COMMISSION**

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The Staff of the Illinois Commerce Commission ( "Staff"), by and through its counsel, and pursuant to Section 200.800 of the Commission's Rules of Practice (83 Ill. Adm. Code 200.800), respectfully submits its Initial Brief in the above-captioned matter.

## **I. PROCEDURAL BACKGROUND**

Talk was certificated in the State of Illinois to provide resold long distance services on December 20, 1995 in ICC Docket Number 95-0447 and to provide resold local service on September 12, 1997 in ICC Docket Number 97-0172. On November 9, 2000, Talk filed its Application for a certificate to become a facilities-based local and inter-exchange telecommunications carrier in Illinois. Talk filed direct testimony in addition to its application. On September 5, 2001, Talk filed an amended application and amended direct testimony because several events took place since the November 9, 2000 date of its initial application. As a result, Talk believed that information contained in its initial application should be updated to allow the Commission Staff to evaluate the managerial, financial, and technical resources and abilities of the Company. In the interest of providing the Commission with a complete record, Staff made no objections to Talk's amendments to its application and direct testimony submitted nearly one year after its initial application was filed.

Staff filed its direct testimony on September 21, 2001. On October 9, 2001, Staff became aware of new relevant information about the Applicant in this proceeding. Such information was not available to Staff at the time Staff filed its direct testimony. In order to provide an accurate record to the Commission, on November 1, 2001, Staff filed

Supplemental Testimony. On November 14, 2001, Talk filed its rebuttal testimony in this docket. In addition, further supplemental testimony was filed by Staff on January 17, 2002 after a review of Talk records provided to Staff on January 8, 2002, in accordance with the schedule determined by the ALJ. Talk filed Supplemental Rebuttal Testimony on XX. Evidentiary hearings for this matter were held on January 7, 8, and 25, 2002.

## **II. SUMMARY OF STAFF'S POSITION**

In this proceeding, Talk America, Inc. ("Talk" or "Applicant") seeks facilities-based local and inter-exchange service authority in Illinois. The provisions of Section 13-403 and 13-405 of the Public Utilities Act pertain to the provision of facilities-based local exchange and inter-exchange telecommunications service, respectively, and have similar requirements. Section 13-403 establishes the requirements for the Commission's approval of an application for inter-exchange service authority and states, in pertinent part, the following: Section 13-405 establishes the requirements for the Commission's approval of an application for local exchange service authority and states, in pertinent part, the following:

Local exchange service authority; approval. The Commission shall approve an application for a Certificate of Exchange Service Authority only upon a showing by the applicant, and a finding by the Commission, after notice and hearing, that the applicant possesses sufficient technical, financial, and managerial resources and abilities to provide local exchange telecommunications service.  
220 ILCS 5/13-405

An applicant must provide evidence that each of the criteria identified in section 13-403 and 13-405 has been met before a certificate can be issued.

These statutory requirements are necessary to ensure that companies possess the required managerial, financial, and technical abilities and resources to operate a telecommunications company in the Illinois market. Considering the importance of providing to end-users high quality telephone service, as well as the importance of maintaining the integrity of the telecommunications network, companies that do not possess the above qualifications should not be allowed to operate in Illinois. Since over 350 competitive telecommunications carriers that have provided the required statutory information and have been granted certificates by this Commission in the past five years, it is evident that this process is not extremely stringent. Rather, the function of the process is to simply ensure that each Applicant is fit to provide the service it has requested.

Staff's position in this proceeding is that Talk has failed to satisfy two of the three requirements necessary for the Commission to approve Talk's application. Namely, Talk has not demonstrated that it possesses sufficient financial and managerial abilities and resources to provide facilities based local and inter-exchange service in the State of Illinois. Staff does not challenge the Applicant's technical resources and abilities and therefore, this brief will not address Talk's technical resources and abilities. Nevertheless, since two of the three statutory requirements have not been satisfied, Staff, therefore, recommends that Talk's application be denied.

### III. INSUFFICIENT MANAGERIAL ABILITIES AND RESOURCES

Staff witness Marshall's identified the criteria routinely applied by Staff in assessing an applicant's managerial resources and ability to provide telecommunications service. (See Staff Ex. 1.0 at 7) Many factors affect whether or not the Applicant possesses sufficient managerial resources and abilities. (Id.) In analyzing a company's application for evidence of sufficient managerial resources and abilities, Staff first examines the completeness and accuracy of the application itself and the evidence presented supporting the application. The company must provide management biographies or resumes showing that managers of the company have managerial experience within the telecommunications industry. Second, the Applicant must display managerial competence by providing a complete and correct record on which Staff can provide a recommendation to the Commission. This would include the Applicant submitting an accurate and complete application, showing that it possesses basic financial management skills, providing a Certificate of Authority to Transact Business in the State of Illinois,<sup>1</sup> and providing testimony of a key member of management to support the application. Although this is not an inclusive list, this description illustrates the basic review process to determine if the Applicant possesses the required managerial abilities and resources. (Staff Ex. 1.0)

Moreover, during the hearings, Talk identified additional general criteria for evaluating a company's managerial resources and abilities. (TR 257) Talk witnesses agreed that: (1) Compliance with applicable laws and regulations (TR 257 and 585); (2) Customer satisfaction (TR 586); (3) The Company's Sales, Provisioning, Billing and

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<sup>1</sup> If the Applicant is incorporated outside the State of Illinois, it must provide its Articles of

Customer Services processes (TR 257-8 and 466); (4) Keeping company records (TR 257); and (5) The ability to have an on-going concern (TR 256) are important factors in evaluating a company's managerial resources. Talk witness McComb also conceded that if a Commission, for example the Illinois Commerce Commission ("Commission"), finds that slamming has occurred it would be a violation of law . (TR 481).

### **A. Compliance with Illinois Laws and Regulations**

The Applicant appears unaware of or unable to comply with Illinois laws and regulations governing the provision of telecommunications service. In fact, Staff has identified several examples of this Applicant's lack of knowledge of Illinois laws and regulations regarding the provisioning of telecommunications services. For example, the Applicant appears to be completely unaware that its certificate to provide resale services is invalid pursuant to Section 13-401 of the Public Utilities Act. In Staff's opinion, such ignorance of the PUA is a clear indication of managerial incompetence and should not be overlooked by this Commission. The Applicant was authorized to provide resold local exchange services on September 12, 1997 in Docket 97-0172. Section 13-401 of the PUA states in relevant part:

"Unless exercised within a period of two years from the issuance thereof, authority conferred by a Certificate of Service Authority shall be null and void."

Staff Data Request JRM 1.03 asks, "Please provide a copy of the Company's tariffs for resold local exchange services currently in effect in Illinois." (Staff Ex. 1.0 at 3-4) Company witness McComb responds, "As stated in the Amended Application, the

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Incorporation as well as the Certificate of Authority to Transact Business in Illinois.

Company is not currently offering resold local exchange services in the State of Illinois and has not done so to date. (Id.) Accordingly, there is no tariff on file with the ICC.” (Id.)

Further, Staff Data Request JRM 1.04 asks, “If no local exchange tariffs are currently in effect in Illinois, please describe any services provided under the authority granted in ICC Docket 97-0172 since September 12, 1997.” (Id.) The applicant’s witness McComb responded, “The Company has provided no services under the authority granted in ICC Docket 97-0172 since September 12, 1977. To Date, the Company has provided only resold long distance services in the State of Illinois.”(Id.) Therefore, the service authority granted in Docket 97-0172 should be considered null and void because it was not exercised within a period of two years as required by the PUA.

Moreover, upon cross examination, Talk witness McComb was uncertain whether or not Talk’s existing certificate was valid. (TR 480). At the hearing, Ms. McComb testified that she is the associate general counsel and the department head of the regulatory department for Talk America. (TR 464) Likewise, Ms. McComb further stated that she is responsible for the Applicant’s compliance of applicable sections of the Illinois PUA. (TR 465) Clearly, the fact that the Applicant’s only witness responsible for the company’s compliance with the PUA is unaware that the Applicant’s existing certificate is invalid indicates a lack of managerial competence. Nevertheless, in order to resolve any uncertainty, the Commission should find in this docket that Talk’s prior certificate to provide re-sold local exchange services is null and void as a matter of law.

Staff has identified several other examples of this Applicant's lack of knowledge of Illinois laws and regulations regarding the provisioning of telecommunications services. Section 13-902 of the PUA, 220 ILCS 5/13-902, defines slamming as an unauthorized change in a customer's pre-subscribed local, local toll or long distance service provider. (See Staff Ex. 3.0 at 4)

Additionally, the Illinois Attorney General's Office ("ILAG") provided the Illinois Commerce Commission Consumer Service Division ("CSD") with copies of many alleged slamming complaints against the Applicant. (Staff Ex. 4.0 Attachment 1). Within these complaints, consumers alleged that unauthorized changes were made in their pre-subscribed services by the Company in association with America On Line ("AOL"). (Id.) For instance, one consumer alleged that his service was switched after another customer, whom he had never met, signed an letter of agency ("LOA") check with the listed phone number matching that of the complainant. (Id.) Another complainant alleged that she had received a response from the Applicant indicating that her service was changed when she sent an LOA check to her own credit card company. (Id.) This complainant claimed that she never sent any such check to her credit card company. In Staff's opinion, the above instances constitute slamming.

Still, another customer alleged to the ILAG that both his local toll and long distance services were switched to the Company after he used a free trial membership with AOL Internet Services. (Id.) Additionally, one consumer alleged that AOL had given her personal information and credit card number to the Applicant in order to initiate the change. (Id.) Another complainant alleged that AOL marketed the Applicant's long distance service to him, but that his local toll service was fraudulently

switched along with the legitimately authorized change in long distance service.(Id.) Furthermore, one consumer alleged that she agreed to change her long distance service to AOL, but that she never agreed to change to the Applicant. (Id.) Obviously, these complaint trends demonstrate managerial difficulties and signify an inability by the applicant to comply with Illinois laws and regulations. In fact, Talk witness Thomas even admitted that some of the complaints the company received were from customers alleging that the Applicant switched their service without the customers' authorization. (TR 277)

Moreover, Section 13-903 of the PUA defines cramming as an unauthorized billing for additional telecommunications services. 220 ILCS 5/13-903. The ILAG provided Staff with a number of cramming complaints in which several customers alleged that their credit cards had been billed by "AOL Long Distance" for services that they had neither authorized and/or received. (See Staff Ex 3.0 at 11 and Staff Ex. 4.0 Attachment 1). Similarly, two separate customers alleged that their credit cards were billed after they had cancelled their services with the Applicant. (Id.) In addition, the history of Talk's marketing arrangements with AOL is particularly troubling to Staff. In fact, Talk witness McComb testified that there were many problems with this arrangement including confusion surrounding the relationship between AOL and Talk (Talk Ex. 2.0 at 14).

Under cross-examination, Staff witness Marshall identified specific provisions of PUA Section 13-902 with which Talk has not complied. (TR 533) Specifically, Ms. Marshall identified the following Section 13-902 provisions: (1) Section 13-902(c) that provides the subscriber notification procedures; (2) Section 13-902(d) which requires

subscriber authorization; and (3) Section 13-902(e) which pertains to the letters to the subscribers. (that documentation is missing in some of the files). (TR 533) Ms. Marshall determined that Talk did not comply with these provisions based upon both customer allegations and Talk's inability to document its compliance with this section. (TR 533-5.) Talk witnesses concede that Talk is unable to document its compliance with this section of the PUA and attribute this failure to poor record keeping and discarded files. (Talk Ex. 2.0 and 3.0) Talk's failure to maintain all customer records for at least two years is a violation of 83 Illinois Administrative Code Part 705, The Preservation of Records of Telephone Utilities. 83 Ill. Adm. Code 705. Moreover, poor record keeping is itself an indication of lack of managerial resources and abilities. Staff has identified several other examples of this Applicant's lack of knowledge of Illinois laws and regulations regarding the provisioning of consumer programs. 83 Illinois Administrative Code 755, defines Telecommunications Access for People with Disabilities, 83 Illinois Administrative Code 756 defines Telecommunications Relay Service, and 83 Illinois Administrative Code 757 defines Telephone Assistance Programs. (See Staff Ex. 2.0 at 21-23).

## **B. Customer Satisfaction**

Talk's past business practices indicate a lack of managerial capabilities. Talk's history of providing telecommunications services under many different d/b/a names and subsidiaries has resulted in numerous instances in which the customer was left in doubt as to which company was providing their telecommunications service. (See Staff Ex. 2.0) In response to Staff data request CJC1.01, Talk stated that it presently offers telecommunications services through four operating subsidiaries: (1) Talk America Inc.

(f/k/a Talk.com Holding Corp.); (2) The Other Phone Company d/b/a Access One Communications, Inc.; (3) Omnicall Inc.; and (4) TelSave Holdings of Virginia, Inc. Staff witness Jackson provided testimony in response to the variation of names under which the Applicant has provided service. (See Staff Ex. 2.0, p.3) Ms. Jackson noted that the Applicant has also provided service under the following names: Tel-Save Holdings, Inc., Network Services, Network Services of New Hope, New Hope/New Hope of Pennsylvania, The Phone Company, The Other Phone Company, American Business Alliance, Group Savings Plan, Amerinet Services, Commercial Phone Group, Corporate Services, Group Long Distance, TNI, TSC, Least Cost Routing, Inc., Long Distance Charges, Inc. (Staff Ex. 2.0 Attachment 1)

The whole scheme of operating under numerous different names is likely to confuse the customer. At the hearing, the Applicant stated that Talk has had only two corporate name changes but has done business under (“d/b/a”) other names (TR 467). The Applicant explained that the reason for the many names is in relation to the marketing strategies of the company (TR 469). However, the Applicant failed to provide an explanation regarding whether or not consumers were informed of all Talk’s name changes. The applicant stated:

The Company also has d/b/a’s. The Phone Company was the d/b/a of the Company, Network Services was another one, and the other one is New Hope of Pennsylvania. That’s separate – that’s the company, though, the applicant in this situation. In the year 2000, I think it was August of 2000, Talk.com Holding Corp’s, which was then its name, parent company, Talk.com, Inc., purchased another company named Access One, and it had separate names, it was known as – it’s actual name is the Other Phone Company, doing business as Access one. (Tr. At 468)

Staff asserts that, under the totality of circumstances, a customer will think their telecommunications carrier is Access One or The Other Phone Company. In other words, the customer will be confused as to which company is providing him service. In instances where slamming is alleged, a consumer attempting to identify the carrier to which his service has been changed encounters even greater difficulties in his efforts to correct the alleged problem when that carrier operates under a variety of names and may even bill consumers under program rate names it was only supposed to use in marketing. Moreover, there is no evidence that the Applicant took measures to prevent potential customer confusion given the many names it used. Indeed, one would think a strong management team would have taken such measures. This indicates an almost total lack of managerial control on Talk's part.

In Staff's opinion, companies work hard to establish their corporate name and logo in the minds of existing and potential customers. In this proceeding, Staff believes the Applicant has relied heavily upon the many different names under which it has operated as a way to remain as anonymous as possible. In Staff's view, this is of grave concern and should not be taken lightly by this Commission.

### **C. Customer Service Processes, Provisioning, and Billing**

The management of Talk does not exhibit the ability to engage in proper customer service processes. (Staff Ex. 2.0 at 6) Staff has never encountered a company with the history of such service provisioning as displayed by the Applicant. (Id.) In fact, Talk's witnesses concede that Talk has experienced problems with its sales, provisioning, billing, and customer service processes. (Id.) Talk has been

required to meet with public utility commission Staff and/or Attorney Generals in several other states as a result of the Company's service offerings. (Id. ) In response to Staff Data Request CJ1.23, the Applicant provided a brief description of the required public utility commission staff meetings in Alabama, California, Georgia, Mississippi, and Tennessee which discusses its service offerings, billing practices, and telemarketing activities. (Id.) Additionally, West Virginia, Florida, North Carolina, and even the FCC all have initiated general investigations into the overall practices and procedures of the company. (Id.) Although such investigations are not proof that Talk violated any laws, Staff believes these are essential for the Commission to consider because they show a pattern of substandard behavior displayed by the Applicant. Indeed, such behavior shows the careless attitude of the Applicant in the current management of the company.

The Alabama Public Service Commission ("APSC") entered a Show Cause Order against the Applicant to determine whether: (1) the Company had improperly changed the provider of telecommunications services; (2) engaged in deceptive or confusing marketing practices; and/or (3) billed, charged or collected rates and charges that were not in tariffs filed with the Commission. (Staff Ex. 2.0 Attachment 2) Talk and the Alabama Attorney General reached a settlement approved by the ASPC, on May 16, 2001, a resulting settlement agreement was entered into by the Alabama Attorney General and the Applicant which included the payment of \$42,000 to the general fund of the state of Alabama as well as numerous other conditions that the Applicant was required to adhere to in the course of providing telecommunications services in Alabama. (Id.)

Similarly, the California Public Service Commission ("CPSC") Staff alleged that the Applicant violated several service Public Utility Codes which included the following: (1)

Slamming California consumers' long distance service; (2) Billing unauthorized long distance and/or international calls to consumers; (3) Misrepresenting their employment, association, or affiliation with local exchange companies; (4) Failing to verify a customer's consent to switching of their pre-subscribed telephone carrier; (5) Encumbering, selling and/or acquiring control of public utility property, stock and/or company without receiving Commission authority; (6) Reselling interstate and/or international telephone services in California without prior Commission authorization; and (7) Failing to file an annual report with the Commission. (Staff Ex. 2.0 Attachment 9)

Further, the Georgia Public Service Commission ("GPSC") conducted a review of consumer complaints and found that it had received numerous consumer complaints against the Applicant's affiliate, Access One Communications. (Staff Ex. 2.0 Attachment 5). Although Talk and the GPSC reach a Consent Agreement, one of the conditions to the Agreement was that the affiliate's certificates to provide local telecommunications services in Georgia were revoked and customers were transferred to the holding corporation. (Id.)

Moreover, the Mississippi Public Service Commission ("MPSC") entered a Show Cause and Cease and Desist Order against Talk.Com on September 25, 2000. (Staff Ex. 2.0 Attachment 11) After initiating an investigation, the MPSC discovered that the Applicant was causing local and/or long distance services to be switched to a new established company, Talk.Com, without customers knowingly authorizing such change. (Id.) In response to the alleged violation of state rules and regulations, the MPSC required the Applicant to appear to show cause why the Company's Certificate of Public Convenience and Necessity should not be cancelled. Although the MPSC ordered Talk to cease and desist from processing any additional orders for local and/or long distance

service or from engaging in any further marketing or solicitation efforts until the issues raised in the Order were resolved, Talk continued to solicit and process changes. (Id.) Talk admitted to at least 62 violations of the MPSC order and was ordered to pay a fine of \$225,000, which was classified by the MPUC, as the largest fine ever levied by the MPUC. (Id.)

Finally, the Tennessee Regulatory Authority (“TRA”) entered a Show Cause Order against the Applicant, alleging that the Applicant violated Tennessee slamming and solicitation rules and regulations. (Staff Ex. 2.0 Attachment 16) Consumer complaints received by the TRA, against the Applicant and/or its affiliated companies, allege the changing of consumer’s local and/or long distance service without proper authorization. (Id.) In fact, due to additional billing complaints received by the TRA Staff, on July 12, 2001, the TRA Staff requested that the subject matter for the existing docket be expanded to include the investigation of cramming complaints. (Id.)

There are several other items showing the Applicant’s managerial shortcomings. Ameritech has provided Staff with an Ameritech Slamming Report, which is inclusive of the following five states: Illinois, Indiana, Michigan, Ohio, and Wisconsin. (Staff Ex. 2.0 Attachment 4) Essentially, this report depicts the number of customers who contact Ameritech’s customer service representatives about being slammed. (Id.) Ameritech reported the following numbers for the Applicant to the Commission Staff:

	<u>Illinois</u>	<u>Indiana</u>	<u>Michigan</u>	<u>Ohio</u>	<u>Wisconsin</u>	<u>Total</u>
2001	*****	*****	*****		*****	****
2000	*****	*****	*****		*****	****
1999	*****	*****	*****		*****	****

\* January through July

Staff is obviously concerned about the number of slamming complaints against Talk recorded by Ameritech. Moreover, the number of slamming incidents in Illinois for the first seven months of 2001 are approximately twice as high as the total number recorded for the entire year of 2000. This dramatic increase in slamming incidents in Illinois indicates a disturbing trend in the wrong direction and is extremely alarming to Staff. (Id.) The numbers for Michigan and Ohio are equally disturbing to Staff because their slamming numbers for 1999 and 2000 are significantly higher than Wisconsin or Indiana. (Id.) Clearly, these numbers demonstrate that the Applicant's management is not taking the necessary action within the company to prohibit slamming consumers.

Staff received additional complaint information regarding the Applicant's provisioning of service. (See Talk Application Attachment 2) Attachment 2 to the Applicant's Amended Application provides a schedule of complaints divided by agency for January, 1999 to June, 2001. With the exception of New York and Florida, Staff would characterize the complaints that the Applicant received in 1999 as reasonable and indicative of any telecommunications carrier. (Id.) The schedule, however, depicts an alarming increase in complaints from 1999 to 2000. (Id.) Specifically, in most of the states in Ameritech's region, the complaints increased by ten times from the previous year. (Id.) In Staff's opinion, the year 2001, is mirroring the same trend.

Moreover, in response to a Staff data request dated January 7, 2002, Talk provided Staff with copies of what it claimed to be its complete set of complaint records for consumers in Illinois, including taped copies of its independent third party verifications. (Staff Ex. 3.1 Attachments 1-12) Staff's review of these records revealed patterns of

allegations from consumers that closely mirrored those found in the Staff analysis of the Illinois Attorney General's complaint records. (Id.) In addition, since these records also contained Talk's documentation of responses to the alleged complaints, further concerns with Talk's past behavior and lack of compliance with Illinois statutes on slamming were brought to light. (Id.)

For example, the patterns of practice by the Company with its LOA checks reveal a variety of problems. Many of the checks allegedly contained incorrect customer information such as using a phone number for one customer with the name and address of a different customer. (Id.) Nevertheless, it was alleged that these checks then, when signed, were used by the Company to change the wrong customer's pre-subscribed long distance phone services. (Id.) In one instance, the entire list of phone numbers for a hotel were allegedly changed to Talk America, Inc., even though the endorser of the check allegedly crossed out the hotel's main number on the check and replaced it with her correct number. (Id.) Additionally, the name and address on the check in the complaint records held by Talk America, Inc. did not match the hotel's name and addresses. (Id.)

#### **D. Keeping Company Records**

In Staff's opinion, the company's poor record keeping is a clear indication of a lack of managerial resources and abilities. 83 Illinois Administrative Code Part 705, The Preservation of Records of Telephone Utilities, applies to all books of account and other records prepared by or on behalf of a public utility. This section requires telephone utilities to maintain all customer records for at least two years. 83 Ill. Adm. Code 705.

Talk witnesses have conceded that their inability to document the Company's compliance with the PUA is attributable to poor record keeping and discarded files. (TR 258-260) The Applicant also acknowledges that a significant number of customer files were destroyed during construction. (Talk Ex. 5.0 at 12) Moreover, the Applicant asserts it had problems retaining third-party-verification records and LOA checks. (Talk Ex. 5.0 at 12, Staff Ex. 3.1 at 6) Fundamentally, the above examples of poor record keeping are themselves indicative of bad management. Moreover, there is no evidence that Talk will ever have sufficient record keeping abilities given its plan of operation and its varied marketing arrangements. It is Staff's impression that there seems to be a corporate attitude within Talk that the Applicant does not have to be diligent and forthright in retaining customer records and that any questions from Staff will, if ignored, go away. Staff urges this Commission to take all of this into consideration when making their decision in this case.

## **E. On-going Concern**

The ability to have an on-going concern is best addressed in the evaluation of Talk's financial resources and abilities discussed below. In Staff's opinion, to the extent that Talk does not have sufficient financial resources and ability to provide service, it will not continue to be a going concern.

## **IV. INSUFFICIENT FINANCIAL ABILITIES AND RESOURCES**

Staff witness Marshall's direct testimony explains the criteria routinely applied by Staff in assessing an applicant's financial resources and ability to provide telecommunications service. (Staff Ex. 1.0 at 7) To prove that an Applicant possesses sufficient financial resources and abilities, the company must provide an accurate balance sheet and income statement that reflect sufficient cash to provide 90 days of business (according to the Applicant's business plan) and positive net worth. In some instances, funding can be provided by an outside source (i.e., parent company), assuming that the outside source can prove that it has the financial resources to provide to the Applicant (i.e., through financial statements of the outside source) and can provide the necessary commitment to supply those funds (i.e., letter of guaranty). (Staff Ex. 1.0 at 7-8.)

Talk provided financial statements in response to Staff Data Request JRM 2.01 (Staff Cross Ex. 2.0 (McComb)) that reflect both that Talk has insufficient cash to provide 90 days of business and a negative net worth. Moreover, the financial statements for the third quarter of 2001 do not satisfy the tests routinely applied to applicants for

service authority in Illinois. Therefore, based on the submitted financial statements as well as other circumstances indicated below, Staff witness Marshall concluded that Talk does not have sufficient financial resources and ability to provide telecommunications service. (Staff Ex. 1.1 at 8.)

Talk therefore does not possess the required financial resources and abilities to provide telecommunications service in Illinois for the following reasons. First, Talk's financial statements as of September 30, 2001, indicate that Talk has a negative net worth. Staff witness Marshall reviewed Talk's balance sheet and determined that Talk's overall liabilities exceeded its assets. (Staff Ex. 1.1 at 9-10) The balance sheet submitted by Talk for the quarter ending September 30, 2001, indicates under the heading "Total Stockholder's Equity (Deficit)" a line item of negative \$84.9 million. (Id.) This line item is Talk's own calculation of its negative net worth. (Id.) The same result is shown when Staff witness Marshall compared Talk's total assets, as indicated on its September 30, 2001 balance sheet, to its total liabilities, also as indicated on its balance sheet. Talk's total liabilities exceed its total assets by \$84.9 million. (Id.) This means that, if Talk were liquidated for any reason, it is likely that it would not be able to pay its creditors. Therefore, Talk does not satisfy the test routinely applied to applicants for local service authority in Illinois. (Id.)

Talk witness Zahka concedes that Talk has a negative net worth. (Talk Ex. 6.0 at 3.). This Commission is required to analyze the information given to it by the company to support its application for certification. The submitted financial statements do not support a finding that Talk has sufficient financial resources to provide the requested

telecommunications service. Moreover, the financial statements, dated as of September 30, 2001 and submitted to Staff pursuant to a Staff data request, reveal that Talk has experienced net operating losses in the years 1997, 1998, 2000 and 2001. (Talk Com 10-K for 12/31/99 and Staff Cross Ex. 2.0 (McComb) Therefore, the financial statements do not indicate an aberrant condition. The reasonable conclusion is that Talk's operating losses, accruing over four years, will continue and that Talk's net worth will more than likely continue to decline.

Talk's financial statements also indicate that Talk possesses insufficient cash to pay for 90 days worth of operating expenses. Ms. Marshall analyzed Talk's financial statements for the quarter ending September 30, 2001 and identified that Talk's operating expenses exceed its available cash for the same period. The financial statements show cash and cash equivalents of \$24 million. (See also Talk 2.0 at 35.) The financial statements also indicate the following operating expenses for the quarter ending September 30, 2001: (1) cost of goods sold, which includes the cost of services purchased from other telecommunications carriers, in the amount of \$59 million; (2) general and administrative expenses; promotional, marketing and advertising expenses; and a provision for doubtful accounts, resulting in a total aggregate amount of \$54.6 million and (3) net Interest and Debt Coverage in the amount of approximately \$13.4 million. (Staff Ex. 1.1 at 9) Therefore, Staff witness Marshall calculated that the amount of available cash needed to fund 90 days of operational expenses is approximately \$127 million (the sum of 59 million plus 54.6 million, plus 13.4 million), an amount far in excess of the \$24 million available. (Id.) In fact, Ms. Marshall calculated that the \$24

million of cash funds available are not sufficient for even 30 days of operations, which would cost approximately \$42 million. (Id.) Clearly this financial test is not met.

Talk witness Zahka argues that the above test, which analyzes that a company has sufficient available cash to pay 90 days worth of operating expenses, is not an accurate test of whether a company has sufficient resources to provide local exchanges services in Illinois because it does not include revenue generated by a company's operations. (Talk Ex. 6.0 at 2-3) Assuming for the sake of argument that Mr. Zahka is correct, Ms. Marshall testified under cross-examination that Talk does not meet this test even when payments on Accounts Receivable are included in the calculation. (TR 562-4.)

Mr. Zahka also argued that Talk reviews its cash receipts and disbursements on a weekly basis and that this review indicates that Talk has sufficient cash to meet its obligations over the next 90 days. (Talk Ex. 6.0 at 3.) Staff notes that the review referred to was not offered as evidence in this docket. Therefore, Staff cannot provide any verification of Mr. Zahka's testimony. Moreover, since the Applicant is required to provide evidence supporting its application, Mr. Zahka's assertion, to the extent Talk desires the Commission to rely upon it, should be supported by Talk in its application. Since no cash budget or other documentation of this analysis was provided, this portion of Mr. Zahka's testimony is unsupported and should be given no weight.

During the hearings in this docket, Talk attempted to establish that it should be considered "EBITDA" (earnings before interest, taxes, depreciation and amortization) positive. Staff believes this entire argument is irrelevant. However, Staff witness Marshall disagreed that Talk was EBITDA positive at September 30,2001. (TR 574-6.)

At issue is whether a write-down in the value of Talk's goodwill account should be included in the calculation of EBITDA. Ms. Marshall testified that only interest, taxes, depreciation and amortization are excluded from net income in the proper calculation of EBITDA. In other words, there is a set formula that must be followed in this calculation. (TR 576.)

It should be noted that in an accounting sense goodwill can only be created by payment in excess of the value of physical assets being acquired. Talk paid for the goodwill that appears on its balance sheet. The write-down that occurred in 2001 was required to express the fair market value of that goodwill. Financial Accounting Standards Board ("FASB") 121 requires that the amount of goodwill on Talk's balance sheet continue to be recorded at its fair market value in all future periods. Therefore, it is likely that additional write-downs will be required in future periods.

Ms. Marshall issued data requests to obtain additional financial information and performed several additional tests. Talk's response to Staff Data Request JRM 2.05 (Staff Ex. 1.1, Attachment 7) provides an aging of Accounts Payable. This schedule demonstrates that Accounts Payable totaling \$26.6 million were not paid within 30 days and are generally considered to be past due. The past due accounts exceed Talk's available cash and cash equivalents at the same date of \$24 million. (Staff Ex. 1.1 at 10.) Obviously, an entity lacking sufficient cash or cash equivalents to pay its past due accounts is in financial difficulty. Certainly, such an entity would not have sufficient financial resources and abilities necessary to meet the requirements of Sections 13-403 and 13-405 of the Illinois Public Utilities Act.

Talk witness Zahka argues that the Commission should ignore these past due amounts because Talk's payable aging as of November 30, 2001, shows overall improvement in the level of overall payables and the aging of those payables. (Talk Ex. 6.0 at 4.) Talk, however, did not introduce the aging of accounts payable as of November 30, 2001, into the record of this case so there is no evidence to support Mr. Zahka's argument. Moreover, even if past due amounts were proven to decline, the impact on the available cash must be taken into account. Even Mr. Zahka concedes that when you make a payment and reduce a payable, cash goes down. (TR 588.) Therefore, the overall impact of reducing past due amounts is to also reduce available cash which Staff witness Marshall has shown is already too low since it is far exceeded by operating expenses.

Furthermore, the company's past practice with regard to timely payment of bills raises serious concerns not only about its financial resources but also about its ability to provide telecommunications services in a reliable manner. Continued failure to pay, on a timely basis, the underlying carriers that support Talk's provisioning of service could result in service interruptions without adequate notice to customers. (Staff Ex. 1.1 at 10-11.) Talk's response to Staff Data Request JRM 2.06 (Staff Ex. 1.1, Attachment 6) supports Staff's conclusions regarding Talk's past payment practices. It includes a schedule of uncontested amounts past due to other carriers which have been the subject of correspondence. (See Staff Ex. 1.0 Attachment 6 at 1) The total uncontested amount identified on this schedule is \$4.5 million.

Talk witness Zahka believes that Talk's vendor payment practices are adequate and that Talk is on good terms with its vendors. (Talk Ex. 6.0 at 4.) Notwithstanding

Mr. Zahka's assertions, the record in this case contains ample evidence of both Talk's late payment practices and its impaired relationships with its vendors. For example, Staff Ex. 1.1, Attachment 6 contains an internal Talk memo acknowledging that Talk has been placed on a credit watch list. Attachment 6 also contains numerous letters from carriers threatening to suspend services unless immediate payment of undisputed amounts is received.

In performing her evaluation of Talk's financial status, Staff witness Marshall also performed a comparison of current assets to current liabilities, known as the "current ratio" test, which is a test that is often used to evaluate a company's ability to pay its bills when they are due. (Staff Ex. 1.1 at 10) As Staff witness Marshall indicates in her testimony, a current ratio of 2:1 is generally considered by credit grantors as a safe ratio, while any ratio of less than 1:1 indicates a lack of ability to pay bills when due. (Id.) Talk's current ratio as of September 30, 2001, was 40:1 which indicates a serious lack of ability to pay bills when due. (Staff Ex. 1.1 at 11.) Staff urges the Commission to give more weight to this independent evidence rather than relying upon Mr. Zahka's unsupported assertions that all is well with respect to its payment practices and vendor relationships.

This opinion of Mr. Zahka that a company's current ratio is not an indicator of its ability to pay bills when bills become due (TR 588-9), is both incorrect and unsupported. In general, financial ratios are designed to help one evaluate a financial statement. Staff believes that the current ratio provides the best single indicator of the extent to which the claims of short-term creditors are covered by assets that are expected to be

converted to cash fairly quickly and, therefore, it is the most commonly used measure of short-term solvency. Talk's current ratio indicates an insolvent financial position.

Ms. Marshall's analyses are based upon Talk's complete financial statements as of September 30, 2001. As noted above, Talk argues that the Commission should focus on the November 30, 2001 accounts payable information. (Talk Ex. 6.0 at 4) Staff disagrees. Ms. Marshall testified that a balance sheet, with appropriate footnote disclosures, provides a complete picture of an entity's financial position at a particular point in time. Therefore, it is inappropriate to update just one line of the balance sheet, such as Accounts Payable, without updating the entire balance sheet because the entity's financial position would not be fairly reflected. (Staff Ex. 1.1 at 3.)

For example, if a liability such as Accounts Payable is reduced the logical assumption is that an asset such as Cash or Cash Equivalents was also reduced in a like amount. That is to say that some assets were required to be used in satisfaction of the liabilities. Even if Talk had introduced an updated schedule of Accounts Payable as of November 30, 2001, it would not be appropriate for Staff to consider this information without consideration of complete updated financial statements as of November 30, 2001. (Staff Ex. 1.1 at 3.)

The record contains evidence of a further decline in Talk's financial resources and ability to provide service. Talk disclosed a subsequent event in its September 30, 2001 financial statements. Footnote 8 to the updated financial statements (Staff Cross Ex. 2.0 (McComb) describes an arbitration award of \$6.9 million to Traffix, Inc. entered on November 12, 2001. Staff believes that this award is not accounted for in the September 30, 2001 financial statements. (Staff Ex. 1.1 at 7.)

Talk witness Zahka testified that the Traffix award was “reserved for” as of September 30, 2001. (Talk Ex. 6.0 at 6.) Staff witness Marshall explained that it is illogical that an event that had not yet occurred would be included in financial statements. She knows of no evidence that the Traffix award has been accounted for in the September 30, 2001 financial statements. (TR 543-6.) Mr. Zahka is not an accountant and is not familiar with accounting entries. (TR 582-3.) In an accounting sense, an amount reserved is an amount restricted by action of the board of directors. The amount restricted remains a part of retained earnings and should be so classified in the financial statements. Creation of a reserve has no effect on a company’s financial statements. When cash is reserved for a specific purpose, the appropriation or reserve is “funded.” This has no impact on the company’s total cash or financial statements. (Accounting Principles, eleventh edition by Niswonger and Fess at 430-2.)

Staff believes that the Commission should consider Talk’s contingent liabilities in its evaluation of Talk’s financial resources and ability to provide service. Ms. Marshall noted in her direct testimony that Talk has received over 13,000 complaints to regulatory agencies. In addition, the number of complaints continued to increase in 2001. These facts indicate that significant penalties may also be assessed by other regulatory jurisdictions. Talk’s contingent liability for penalties should be provided by Talk and considered by the Commission in this docket. Only Talk has the information necessary to calculate the amount of contingent liabilities. Talk refused to provide any information regarding contingent penalties being sought in other jurisdictions in response to Staff Data Requests on this topic. (Staff Ex. 1.1 at 6-7.)

Ms. Marshall testified further that Talk has a duty to disclose its total contingent liabilities. (Staff Ex. 1.1 at 7.) Accounting for Contingencies is addressed in FASB statement number five. FASB statements are included in generally accepted accounting principles (“GAAP”). For purposes of this statement, a contingency is defined as an existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss to an enterprise that will ultimately be resolved when one or more future events occurs or fails to occur. (Id.) If no accrual is made for a loss contingency, or if an exposure to loss exists in excess of the amount accrued, disclosure of the contingency shall be made when there is at least a reasonable possibility that a loss or an additional loss may have been incurred. (Id.) The disclosure shall indicate the nature of the contingency and shall give an estimate of the possible loss or range of loss. (Id.) Disclosure is required when it is considered probable that a claim will be asserted and there is a reasonable possibility that the outcome will be unfavorable. (FASB, statement 5) (Staff Cross Ex. 3.0 (Marshall))

Ms. Marshall’s supplemental testimony addresses Orders entered by the Florida and Tennessee Commissions related to the applicant. The Florida Commission issued an Order to Show Cause why Talk should not pay penalties in the amount of \$6.5 million. (See Staff Ex. 1.1, Attachment 1.) The Tennessee Commission issued an Order to Show Cause why Talk should not pay penalties in the amount of \$9.8 million. (See Staff Ex. 1.1, Attachment 5.) Staff believes that each of these amounts is material to the financial status of Talk, that each of these Orders constitutes assertion of a claim, and that there is a reasonable possibility that the outcome will be unfavorable to Talk.

It is Talk's position that disclosure of contingent liabilities is a matter to be decided by Talk and its accountants, therefore, disclosure should not be required. Mr. Zahka is aware that CPAs rely upon representation letters from management in order to determine whether contingent liabilities exist. He did not know, however, whether there are letters signed by company management as to whether there are any contingent liabilities. (TR 595.) In other words, there is no evidence that Talk's CPA firm is even aware of these potential penalties or that it evaluated whether or not the contingent liability should be disclosed.

Given the above discussion, there can be no doubt that Talk has not demonstrated that it possesses the required financial resources and ability to provide telecommunications service in Illinois. Accordingly, Staff urges this Commission to consider the following: Talk has failed the two tests Staff routinely applies to determine whether an applicant has sufficient financial resources and abilities to provide service, Talk provided no cash budget or analysis of its cash receipts and disbursements to Staff, Talk is not EBITDA positive (TR 574-576), Talk's current ratio indicates an inability to pay bills when due, the Traffix award discussed above, the impact of both contingent liabilities and the arbitration award discussed above on the financial tests described in Ms. Marshall's direct testimony indicate that Talk's liabilities have been underestimated. For all of these reasons, Talk's application should therefore be denied.

### **III. Conclusion**

Staff asks that Talk's application for certification be denied. The Applicant must show this Commission that it possesses the requisite managerial, financial, and technical resources and abilities mandated by statute. Talk has failed to demonstrate that it possesses the required managerial and financial resources and abilities to provide telecommunications service in Illinois. Given the current management of the company in providing information to Staff, its unfamiliarity with the rules, statutes, and laws regulating the telecommunications industry, the disorganized managerial abilities demonstrated by the applicant during cross examination, and the confusing and possibly illegal customer service schemes of the Applicant, Staff maintains its position that the application be denied.

If Talk is granted a certificate, serious potential harm to end-users could result. The evidence shows that the management of Talk does not have the ability to engage in proper provisioning, billing, and customer service processes.

Moreover, Talk has not provided sufficient evidence reflecting required financial resources and abilities. Without financial resources, Talk could be unable to remit payment to the underlying carrier(s) for utilizing its services. This could result in the barring of Talk from use of the carrier's facilities, which, in turn, cuts off the end-user of Talk from telephone service.

The evidence also shows that the management of Talk is not in compliance with the rules, statutes, and laws regulating the telecommunications industry. These regulations are in place, in part, to prevent behavior that could have a detrimental impact upon the end user. Without compliance with these regulations, end-users of Talk could suffer even if noncompliance was a result of Talk's ignorance of the rules.

Compliance and familiarity with important rules is vital to protecting end-users, and the management of Talk simply does not possess this knowledge. Furthermore, as discussed above, Talk's prior certificate to provide resold local exchange services should be declared null and void as a matter of law. For all of the reasons set forth herein, Staff recommends that Talk's application be denied.

Respectfully submitted,

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