

ORIGINAL

EXCEPTION



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BEFORE THE ARIZONA CORPORATION COMMISSION

Arizona Corporation Commission

DOCKETED

MAY - 4 2009

COMMISSIONERS

KRISTIN K. MAYES, Chairman  
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PAUL NEWMAN  
SANDRA D. KENNEDY  
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IN THE MATTER OF THE APPLICATION  
OF STI PREPAID, LLC AND DIALAROUND  
ENTERPRISES, INC. FOR APPROVAL OF A  
TRANSFER OF ASSETS AND  
CERTIFICATE OF CONVENIENCE AND  
NECESSITY TO PROVIDE INTRASTATE  
TELECOMMUNICATIONS SERVICES AND  
APPROVAL OF TERMINATION OF  
SERVICE BY DIALAROUND  
ENTERPRISES, INC.

DOCKET NO. T-20517A-07-0135

DOCKET NO. T-04045A-07-0135

APPLICANTS' EXCEPTIONS  
TO STAFF REPORT

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## I. INTRODUCTION

Applicants, STi Prepaid, LLC (“STi Prepaid”) and Dialaround Enterprises, Inc. (“DEI”), by and through undersigned counsel, hereby submit the following Exceptions to the Staff Report dated January 9, 2009.<sup>1</sup> The Utilities Division Staff (“Staff”) has recommended that the Arizona Corporation Commission (“Commission”) approve the transfer of assets of DEI to STi Prepaid, grant STi Prepaid a Certificate of Convenience and Necessity (“CC&N”), and approve the cancellation of DEI’s CC&N. Applicants are gratified by Staff’s recommendation, which is consistent with the findings of all other states requiring approval and the Federal Communications Commission (“FCC”).<sup>2</sup> Exception must nonetheless be taken to Staff Report because it recommends the adoption of certain conditions that have no basis in rule or statute. Should the Commission follow Staff’s advice, and adopt these recommendations in the absence of legislative authority, the Commission would be necessarily engaged in formal rulemaking pursuant to an adjudicatory proceeding. To this end, Staff’s failure to provide for statutorily-mandated notice and comment violates the due process protections promulgated by the federal and Arizona Administrative Procedures Acts. Adoption of these recommendations would also result in discrimination of STi Prepaid under federal and state law, and violate Section 253 of the Communications Act of 1934, as amended (“Act”).<sup>3</sup> Accordingly, Applicants respectfully request that the Commission grant STi Prepaid’s Application for Certificate of Convenience and Necessity without reference to the contested recommendations and conditions.

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<sup>1</sup> Dockets Nos. T-20517A-07-0135 AND T-04045A-07-0135 - Memorandum from Ernest G. Johnson, Director, Utilities Division, to Docket Control, re: *In The Matter of The Application of STi Prepaid, LLC and Dialaround Enterprises INC. For Approval Of A Transfer Of Assets And Certificate Of Convenience and Necessity For To Provide Intrastate Telecommunications Services And Approval of Termination Of Service By Dialaround*, (Jan. 9, 2009) (“Staff Report”).

<sup>2</sup> Staff Report at 12.

<sup>3</sup> 47 U.S.C. § 253.

## II. BACKGROUND

On March 2, 2007, Applicants applied to the Arizona Corporation Commission for a transfer of DEI's assets and CC&N to STi Prepaid and a cancellation of DEI's CC&N (the "Application"). After sending seven sets of data requests to Applicants over the course of approximately fifteen months, which Applicants promptly completed and returned,<sup>4</sup> Staff tendered its Report to the Commission on January 9, 2009. The Report contained a brief summary of STi Prepaid's technical capabilities,<sup>5</sup> an overview of STi Prepaid's financial condition and that of its parent companies,<sup>6</sup> and a review of outstanding litigation and consumer complaints lodged against STi Prepaid.<sup>7</sup> Based on this extensive review, the Staff Report concludes that "STi Prepaid has demonstrated sufficient technical capability to provide the proposed services,"<sup>8</sup> "the rates to be charged by STi are just and reasonable,"<sup>9</sup> "that approval of the transfer of DEI's assets to STi Prepaid and the cancellation of DEI's CC&N is in the public interest,"<sup>10</sup> and "that STi Prepaid has the customer service capability and financial resources to provide the proposed services."<sup>11</sup>

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<sup>4</sup> Staff's First Set of Data Requests to the Applicants was dated April 3, 2007 and returned May 18, 2007; the Second and Third Sets of Data Requests to the Applicants were dated May 20 and 21, 2008 and returned June 3, 2008; the Fourth Set of Data Requests to the Applicants was dated May 28, 2008 and returned June 20, 2008; the Fifth, Sixth, and Seventh Sets of Data Requests to the Applicants were dated June 11, July 9, and August 5, 2008 and returned June 24, July 21, and September 12, 2008, respectively.

<sup>5</sup> Staff Report at 3.

<sup>6</sup> *Id.* at 3-5.

<sup>7</sup> *Id.* at 6-9.

<sup>8</sup> Staff Report at 3.

<sup>9</sup> Staff Report at 10.

<sup>10</sup> Staff Report at 12.

<sup>11</sup> Staff Report at 13.

Staff presented its endorsement as one of three sets of recommendations for Commission action<sup>12</sup> and 33 conditions for STi Prepaid's agreement.<sup>13</sup> The first two sets of recommendations encourage the Commission to order STi Prepaid to comply with various interexchange regulations, including those pertaining to cooperation with Commission investigations, participation in the Arizona Universal Service Fund, filing of conforming tariffs, procurement of a performance bond, and publication of legal notice of STi Prepaid's application.<sup>14</sup> The final set of recommendations, predicated on "protect[ing] STi Prepaid's customers from any potential deceptive practices relating to the manufacturing, advertising, promoting, selling, distributing or providing telecommunications services for prepaid phone calling cards in Arizona," concerns the filing of a second performance bond, the fulfillment of all outstanding and unused DEI prepaid calling cards, and the publication of DEI's cancellation of service authority.<sup>15</sup> The final set also prompts the Commission to order STi Prepaid, as a prerequisite to "granting authority for STi Prepaid to provide resold intrastate long distance services," to comply with 33 conditions set forth in Exhibit A to the Staff Report.<sup>16</sup>

The conditions, "which are similar to the conditions STi Prepaid agreed to comply with in its Assurance of Voluntary Compliance ("AVC") Agreement with the State of Florida,"<sup>17</sup> describe specific performance standards for STi Prepaid (and in limited circumstances, "its parents,

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<sup>12</sup> *Id.* at 13-16.

<sup>13</sup> *Id.* at Exhibit A.

<sup>14</sup> *Id.* at 13-16

<sup>15</sup> *Id.* at 15-16.

<sup>16</sup> *Id.* at 16.

<sup>17</sup> *Id.* at 13.

subsidiaries, affiliated entities, partners successors, assigns,” officers, employees, “and those other persons or entities in active concert or participation with them”) in areas ranging from advertisement and disclosure, voice prompts, network access, and customer service, to the manufacturing, promotion, and distribution of prepaid calling cards.<sup>18</sup>

### III. THE LAW DOES NOT SUPPORT THE ADOPTION OF MANY OF THE STAFF REPORT RECOMMENDATIONS AND CONDITIONS

A.R.S. § 40-282 and A.A.C. R14-2-1105 require a company that intends to provide competitive telecommunications services in Arizona to apply for a CC&N. The company must demonstrate its “technical capability to provide the proposed services,” delineate its “financial resources,” and document its formation by providing “[a] copy of its Partnership Agreement, Articles of Incorporation” or similar contract or agreement.<sup>19</sup> If the company adequately demonstrates its financial, technical, and managerial capabilities to provide telecommunications service in Arizona, and “just and reasonable” rates, “it is in the public interest for the Applicant to provide the telecommunications services set forth in its application” as a “fit and proper entity to receive a CC&N.”<sup>20</sup> As the Staff Report concludes, granting STi Prepaid a CC&N will further the public interest, convenience, and necessity in Arizona. It will also maintain the current level of competition amongst resold interexchange providers, reducing costs and improving the quality of telecommunications service in Arizona by offering a wider selection of long distance calling options.<sup>21</sup> STi Prepaid plans to improve and expand upon DEI’s existing offerings in Arizona,

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<sup>18</sup> *Id.* at Exhibit A.

<sup>19</sup> A.A.C. R14-2-1105(A) *et seq.*

<sup>20</sup> Docket No. T-20497A-06-0802, Cbeyond Communications, LLC, Opinion and Order (Dec. 17, 2008) (citing “Article XV of the Arizona Constitution, as well as the Arizona Revised Statutes” for the source of the public interest determination).

<sup>21</sup> *See Proposed Rulemaking Regarding Competitive Telecommunication Services*, 1996 WL 551471, \*1 (Ariz. C.C. 1996); Telecommunications Act of 1996, S. 652, 104th Cong., 110 Stat.

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which will further the Commission's and the FCC's stated goals of increasing the number of affordable and technologically progressive telecommunications services in the state.<sup>22</sup>

Applicants must nonetheless take exception to those portions of Staff's Report that lack legislative authority. The majority of Staff's recommendations proceed from Title 14, Chapter 2, Article 11 of the Arizona Administrative Procedure Act.<sup>23</sup> There is no such legal basis, however,

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56 (1996) ("An Act to promote competition and reduce regulation in order to secure lower prices and higher quality services for American telecommunications consumers and encourage the rapid deployment of new telecommunications technologies").

<sup>22</sup> *Id.*

<sup>23</sup> Staff recommendations generally proceed from the Commission's existing regulations on competitive telecommunication service providers. *See* Staff Report at 13-14:

1. "STi Prepaid should be ordered to comply with all Commission rules, orders, and other requirements relevant to the provision of intrastate telecommunications service" (follows A.A.C. R14-2-1101, R14-2-1106(B)(1));
2. "STi Prepaid should be ordered to cooperate with Commission investigations including, but not limited to customer complaints" (follows A.A.C. R14-2-1106(B)(5); R14-2-1115(A);
3. "STi Prepaid should be ordered to participate in and contribute to the Arizona Universal Fund, as required by the Commission" (follows A.A.C. R14-2-1106(B)(6));
4. "STi Prepaid should be ordered to notify the Commission immediately upon changes to STi Prepaid's name, address, and/or telephone number" (follows A.A.C. R14-2-1106(B)(2); R14-2-1114(K));
5. "STi Prepaid's intrastate interexchange service offerings should be classified as competitive pursuant to A.A.C. R14-2-1108;"
6. "The maximum rates for these services should be the maximum rates proposed by STi Prepaid in its proposed tariffs. The minimum rate for STi Prepaid's competitive services should not be less than STi Prepaid's total service long run incremental costs of providing those services as set forth in A.A.C. R14-2-1109;"
7. "The rates proposed by this filing are for competitive services. In general, rates for competitive services are not set according to rate of return regulation . . . while Staff considered the fair value rate base information submitted by STi Prepaid, the fair value rate base information provided should not be given substantial weight in this analysis" (follows A.A.C. R14-2-1104(C));
8. "In the event STi Prepaid requests to discontinue and/or abandon its service area it must provide notice to both the Commission and its customers. Such notice(s) shall be in accordance with A.A.C. R14-2-1107."

*See also Id.* at 14-15:

1. "The [*sic*] STi Prepaid shall file conforming tariffs with Docket Control, as a compliance item in this matter, within 365 days from the date of an Order in this matter or 30 days prior to providing service, whichever ever comes first, and in accordance with the Decision." (follows A.A.C. R14-2-1106(B)(4), R14-2-1115(C)(1));
2. "In order to protect STi Prepaid's customers, STi Prepaid shall . . . [p]rocure performance

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for two of the final set of recommendations, which advocate the filing of a second performance bond, and the enactment of the 33 conditions contained in Staff Report, Exhibit A (collectively, the “Recommendations and Conditions”) for the protection of STi Prepaid’s customers “from any potential deceptive practices.”<sup>24</sup> Nothing in the Commission’s collected competitive telecommunications rules suggest that preemptive punitive action – based largely in this matter on a questionable demographic link between Florida and Arizona consumers<sup>25</sup> - may form the basis for a conditional CC&N grant. Indeed, the opposite is true. The Staff Report notes that in light of the more than 93 million prepaid calling cards sold in Florida in 2006 and 2007, there were only five customer complaints during that time. The Staff Report concludes, the number of

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bond or irrevocable sight draft Letter of Credit equal to \$10,000 . . . [and] [f]ile the original performance bond or irrevocable sight draft Letter of Credit with the Commission’s Business Office and copies of the performance bond or irrevocable sight draft Letter of Credit with Docket Control . . . [and] [i]f at some time in the future, STi Prepaid does not collect from its customers an advance, deposit, and/or prepayment, Staff recommends that STi Prepaid be allowed to file a request for cancellation of its established performance bond or irrevocable sight draft Letter of Credit” (follows A.A.C. R14-2-1105(D), R14-2-1106(A)(5));

3. “That DEI publish legal notice of its Application to cancel its authority to provide resold interexchange services and transfer its assets to STi Prepaid. A copy of the legal notice and an Affidavit of Publication should be filed with the Compliance and Enforcement Section as proof that STi Prepaid complied with the Commission’s legal notice requirements within 30 days from the date of a Decision in this matter . . . .” (follows A.A.C. R14-2-1107(B)).

<sup>24</sup> Staff Report at 15 - 16, Exhibit A.

<sup>25</sup> *See Id.* at 7. Staff’s assertion that there exists a greater “percentage of people that may have a potential problem with prepaid calling cards/services” in Arizona than in Florida relies on the greater percentage of Latino and Hispanic residents in the former. Staff’s argument is facially invalid on two counts. First, the seven complaints Staff identified in Florida (which form a statistically insignificant sample in any case) did not contain racial or ethnic data. Pointing to a larger Hispanic and Latino population in Arizona is therefore unavailing. Second, Staff failed to present any evidence that Hispanic or Latino users, regardless of their state of residence, are somehow more likely to experience problems with STi Prepaid’s calling cards, or that STi Prepaid’s Customer Care staff would have a less successful record in resolving them as compared with the problems of other Census-designated racial, ethnic, or cultural groups.

complaints “is insignificant given the number of prepaid phone cards sold during 2006 and 2007.”<sup>26</sup>

Compliance with the rules, orders, and requirements of the Commission is assumed as a necessary prerequisite to certification.<sup>27</sup> Therefore, while A.A.C. R14-2-1107(B) discusses publication of legal notice in the context of service discontinuance, it does so without regard to the perceived merits or failings of a successor company. While A.A.C. R14-2-1105(D) notes that a CC&N grant may depend on “the procurement of a performance bond,” it states the bond’s purpose is “to cover *any advances or deposits the telecommunications company may collect from its customers,*” not as a means of protecting consumers against “potential deceptive practices.”<sup>28</sup> Though both A.A.C. R14-2-1105(D) and A.A.C. R14-2-1106(A)(5) note that a CC&N may be denied in instances where an applicant fails to provide “a performance bond,” they contain no suggestion that a *second* performance bond may be levied against any CC&N applicant for any reason.<sup>29</sup>

Staff’s extensive list of conditions - designed to mirror STi Prepaid’s “AVC Agreement with the State of Florida” - also lacks a foundation in rules and regulations.<sup>30</sup> One of Staff’s legislatively-sound recommendations directs STi Prepaid “to cooperate with Commission investiga-

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<sup>26</sup> Staff Report at 7.

<sup>27</sup> R14-2-1106(B)(1) (“Every telecommunications company obtaining a Certificate of Convenience and Necessity under this Article shall obtain certification subject to the following conditions: The telecommunications company shall comply with all Commission rules, orders, and other requirements relevant to the provision of intrastate telecommunications service.”).

<sup>28</sup> A.A.C. R14-2-1105(D) (emphasis added).

<sup>29</sup> A.A.C. R14-2-1105(D), R14-2-1106(A)(5) (emphasis added).

<sup>30</sup> Staff Report at 13.

tions including, but not limited to customer complaints.”<sup>31</sup> This language is drawn directly from A.A.C. R14-2-1106(B)(5), which requires any telecommunications company that obtains a CC&N to “cooperate with Commission investigations of customer complaints.” In contrast, eight Staff conditions concerning “Customer Service Compliance” instruct STi Prepaid to “maintain a toll-free customer service number with sufficient capacity to accommodate a reasonable anticipated number of calls . . . that is available twenty-four hours a day, seven days a week . . . [with] live operator customer service from at least 9 a.m. to at least 9 p.m. Mountain Standard time . . . [who are] knowledgeable and able to advise consumers . . . [or] utiliz[ing] a combination of live operators and interactive voice response, or digital voice recording of consumer inquiries and complaints . . . [with] reasonable effort to respond [in the case of interactive voice response or digital voice recording] within two business days from the time the customer inquiry and/or complaint was received . . .”<sup>32</sup> No Commission regulation or enabling statute provides for this level of specificity concerning the organization and operation of a competitive provider’s customer service system.<sup>33</sup> Nor can any such legislative authority be found to support the rest of

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<sup>31</sup> *Id.*

<sup>32</sup> *Id.* at Exhibit A.

<sup>33</sup> The only regulations that bear on the Staff’s conditions in this regard are A.A.C. R14-2-1114(B) (“Each telecommunications company governed by this Article . . . [s]hall be responsible for maintaining in safe operating condition all equipment and fixtures owned by and under the exclusive control of the telecommunications company that are used in providing telecommunications services to the customer [and] [s]hall make known to applicants for its service and to its subscribers any information necessary to assist the subscriber or customer in obtaining adequate, efficient, and reasonably priced service”); A.A.C. R14-2-1114(B) (“Each telecommunications company providing competitive telecommunications services pursuant to this Article shall make reasonable efforts to supply a satisfactory and continuous level of service”); A.A.C. R14-2-1114(D)(1)(c) (“The following minimum information must be provided on all customer bills . . . [t]he company’s toll-free number for billing inquiries”) and A.A.C. R14-2-1115(A) (“All customer service complaints concerning competitive telecommunications services shall be governed by the provisions of subsection R14-2-510(A),” which provides that “[e]ach utility shall make a full and prompt investigation of all service complaints made by its customers, either directly or through the Commission” and directs “[the utility [to] respond to the complainant and/or the Commission representative within five working days as to the status of the utility investigation of the complaint” and “[t]he utility [to] notify the complainant and/or the Commission representative of the

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the intricately detailed conditions concerning advertisement and disclosure, voice prompts, network access, or the manufacturing, promotion, and distribution of prepaid calling cards.<sup>34</sup>

**A. Adoption of Staff's Recommendations and Conditions Would Result in Unlawful Rulemaking**

The Staff Report Recommendations and Conditions are not merely restatements of existing Commission regulation and policy, as are typically found in CC&N grants,<sup>35</sup> but wholly new

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final disposition of each.”).

<sup>34</sup> The only regulations that pertain to these categories of conditions are A.A.C. R14-2-1114(A) (“Telecommunications companies governed by this Article shall provide quality service in accordance with this rule and with any other service quality requirements established by the Commission”); A.A.C. R14-2-1114(B) (“Each telecommunications company governed by this Article . . . [s]hall be responsible for maintaining in safe operating condition all equipment and fixtures owned by and under the exclusive control of the telecommunications company that are used in providing telecommunications services to the customer [and] [s]hall make known to applicants for its service and to its subscribers any information necessary to assist the subscriber or customer in obtaining adequate, efficient, and reasonably priced service”); A.A.C. R14-2-1114(B) (“Each telecommunications company providing competitive telecommunications services pursuant to this Article shall make reasonable efforts to supply a satisfactory and continuous level of service”).

<sup>35</sup> *See, e.g.*, Docket No. T-20497A-06-0802, Cbeyond Communications, LLC, Opinion and Order, ¶¶ 6-7 (Dec. 17, 2008) (ordering provider of facilities-based local exchange and resold long distance telecommunications services, pursuant to approval of CC&N application, to “comply with all Commission Rules, Orders, and other requirements relevant to the provision of intrastate telecommunications services . . . abide by the quality service standards that were approved by the Commission for Qwest in Docket No. T-01051B-93-0183 . . . [avoid] barring access to alternative local exchange service providers who wish to serve areas where Cbeyond is the only provider of local exchange service facilities . . . notify the Commission immediately upon changes to Cbeyond's name, address or telephone number . . . cooperate with Commission investigations including, but not limited to customer complaints . . . offer Caller ID [and] Last Call Return service . . . submit interexchange tariffs which state it does not collect advances, deposits and/or prepayments . . . be authorized to discount its rates and service charges to the marginal cost of providing the services . . . file with the Commission in this docket, copies of the certifications sent to the FCC stating the Company's compliance with the FCC's rules concerning CPNI . . . continue operating under the operating procedures established by the Company to ensure compliance with the FCC's CPNI rules . . . [promptly] docket conforming tariffs for each service within its CC&N” and procure and file “a performance bond or irrevocable sight draft Letter of Credit in the amount of \$110,000.”); *see also, e.g.*, Docket No. T-03815A-06-0747, Application Of American Fiber Network, Inc., For Approval Of A Certificate Of Convenience And Necessity To Provide Facilities-Based Local Exchange And Switched Access Telecommunications Services, Opin-

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performance standards without legal precedent. As the Commission is well aware, legislative authority is a necessary predicate to conditional licensing decisions.<sup>36</sup> Arizona statutes clearly state that an agency cannot “base a licensing decision in whole or in part on a licensing requirement or condition that is not specifically authorized by statute, rule or state tribal gaming compact.”<sup>37</sup> Specific authorization must be something greater than “[a] general grant of authority in statute . . . unless a rule is made pursuant to that general grant of authority that specifically authorizes the requirement or condition.”<sup>38</sup> Staff’s Recommendations and Conditions, while borne of the Commission’s ability to promulgate conditions pursuant to a CC&N per A.A.C. R14-2-1106(B) *et seq.*, are explicitly identified as either attempts to police STi Prepaid on infractions it has not committed, or as emulations of an agreement with the attorney general of a different state,<sup>39</sup> in which STi Prepaid admitted no liability.<sup>40</sup> They are devoid of legislative authority, and as such, cannot be promulgated as prerequisites to a CC&N award.

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ion and Order, ¶¶ 7-8 (Sept. 30, 2008); Docket No. T-04036A-07-0108, Application Of Frontier Communications Of America, Inc., For Approval Of A Certificate Of Convenience And Necessity To Provide Facilities Based Local Exchange Telecommunications Services, Opinion and Order, ¶¶ 7-8 (Mar. 20, 2008).

<sup>36</sup> See *Campbell v. W. H. Long & Co.*, 281 U.S. 610, 618 (1930) (“if the requirement of the permit is proper, it is so only because it is authorized by the act, either explicitly or otherwise”).

<sup>37</sup> A.R.S. § 41-1030(B); see also A.R.S. § 41-1001.01(A)(7) (“To ensure fair and open regulation by state agencies, a person . . . [i]s entitled to have an agency not base a licensing decision in whole or in part on licensing conditions or requirements that are not specifically authorized by statute, rule or state tribal gaming compact as provided in section 41-1030, subsection B”).

<sup>38</sup> A.R.S. § 41-1030(B).

<sup>39</sup> Given the lack of documentation in the Report concerning “Staff’s ‘Google’ Search,” it is unclear how Staff adjudged the conditions leading up to this Florida agreement or what it understood the terms of that agreement to be, especially in light of the fact that STi Prepaid was one of nine resold interexchange providers to agree to the settlement. It is also unclear whether the broad pow-

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STi Prepaid can therefore only surmise that Staff intends to address the limitations of its “general grant of authority in statute” by using the matter of STi Prepaid’s CC&N as the basis for urging the Commission to adopt new, Florida-like rules.<sup>41</sup> As the Ninth Circuit has made clear, state agencies engage in formal rulemaking when promulgating rules permitting enforcement actions against third parties in the absence of a legislative basis for doing so.<sup>42</sup> Such rulemaking “necessarily creates new rights and imposes new obligations” on these third parties.<sup>43</sup>

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ers generally accorded a state attorney general in investigative matters with specific grants of legislative authority to Florida administrative bodies. Indeed, had the Florida Public Service Commission rather than the Florida Attorney General attempted to enact the AVC, it may have very well proven unenforceable. Further, it should be noted that the AVC may have been instigated by one of STi Prepaid’s competitors, rather than solely at the discretion of the Florida Office of the Attorney General. See Gene Retske, *Florida AG Settles With Calling Card Providers*, The Prepaid Press (Jun. 15, 2008), at [http://www.prepaid-press.com/news\\_detail.php?t=paper&id=2305](http://www.prepaid-press.com/news_detail.php?t=paper&id=2305) (“There was a suspicion that [STi Prepaid competitor] IDT [America, Inc.] may have been involved in instigating the Florida Attorney General’s action. When asked about IDT’s involvement in the action, Sandie Copes, a spokeswoman for the Attorney General’s office, told TPP last year that the Attorney General’s office was aware of the IDT suit [filed on March 8, 2007 against six of its competitors] and was keeping an eye on it. She also said that IDT was ‘cooperating’ with the investigation.”).

<sup>40</sup> Case No. L07-3-1087, In The Matter Of: STi Phonecard, Inc.; Telco Group, Inc.; VoIP Enterprises, Inc., STi Prepaid, LLC., d/b/a STi, A Delaware Limited Liability Company, Assurance of Voluntary Compliance, 3 (May 27, 2008) (“Respondents are prepared to enter into this Agreement of Voluntary Compliance . . . for purposes of resolution of this matter only, and without any admission of liability or violation of any law, rule or regulation . . .”).

<sup>41</sup> See A.R.S. § 41-1001(17) (“‘Rule’ means an agency statement of general applicability that implements, interprets or prescribes law or policy, or describes the procedure or practice requirements of an agency . . .”); accord A.A.C. R1-1-101.

<sup>42</sup> *Erringer v. Thompson*, 371 F.3d 625, 630 (9th Cir. 2004) (“Specifically, the Ninth Circuit agreed that legislative rules have the ‘force of law,’ while interpretive rules do not, and adopted a three-part test for determining whether a rule has the ‘force of law’: (1) when, in the absence of the rule, there would not be an adequate legislative basis for enforcement action; (2) when the agency has explicitly invoked its general legislative authority; or (3) when the rule effectively amends a prior legislative rule.”).

<sup>43</sup> *Id.* (citing *Hemp Industries Ass’n v. Drug Enforcement Admin*, 333 F.3d 1082, 1088 (9th Cir. 2003)).

The resulting rules will, by definition, affect all licensed resold interexchange providers in Arizona, including future CC&N applicants.<sup>44</sup> Should the Commission adopt these conditions in granting STi Prepaid a CC&N, it will therefore necessarily be engaged in formal rulemaking pursuant to an adjudicatory proceeding.<sup>45</sup>

Formal rulemaking raises important due process concerns. Article 2, Section 4 of the Arizona Constitution and the Fifth and Fourteenth Amendments of the federal Constitution prohibit deprivation of liberty or property without due process.<sup>46</sup> Where an interest in liberty or property has been created by statute or license,<sup>47</sup> due process ensures that proceedings affecting it

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<sup>44</sup> *Havasu Heights Ranch & Development Corp. v. State Land Dep't.*, 158 Ariz. 552, 560 (Ariz. Ct. App. 1988) (“Stated another way, a ‘rule’ is a policy which applies to a class, which is ‘open’ in the sense that the class is described in general terms and new members which fit that description can be added.”). According to the Commission’s website, there are approximately 234 long distance resellers and 24 interexchange carriers, all of which may be providing prepaid calling card services.

<sup>45</sup> See A.R.S. § 1001.01(A)(9) (“To ensure fair and open regulation by state agencies, a person . . . [m]ay allege that an existing agency practice or substantive policy statement constitutes a rule and have that agency practice or substantive policy statement declared void because the practice or substantive policy statement constitutes a rule as provided in section 41-1033”); *Wilkinson v. State*, 172 Ariz. 597, 599 (Ariz. Ct. App. 1992) (determining that religious visitation rules passed by Department of Corrections concerned religious ministers as well as inmates, thus disqualifying rules for “inmate-only” exemption from Arizona APA, such that they were “not exempt from the formal rulemaking process of the APA, and until they or similar rules affecting religious visitation are promulgated lawfully, they are invalid pursuant to A.R.S. § 41-1030”).

<sup>46</sup> Ariz. Const. art. 2, § 4 (“No person shall be deprived of life, liberty, or property without due process of law”); U.S. Const. amend. V (“No person shall be . . . deprived of life, liberty, or property, without due process of law”); amend. XIV, § 1 (“No state shall . . . deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws”).

<sup>47</sup> See, generally *Gilbert v. Homar*, 520 U.S. 924 (1997) (tenured government employment); *Sherbert v. Verner*, 374 U.S. 398 (1963) (unemployment compensation statute); *Bell v. Burson*, 402 U.S. 535 (1971) (driver’s license); *Driggins v. City of Oklahoma City, Okl.*, 954 F.2d 1511, 1513 (10th Cir. 1992) (“The existence of a property interest is ‘defined by existing rules or understandings that stem from an independent source such as state law-rules or understandings that secure certain benefits and that support claims of entitlement to those benefits.’”) (citing *Board of Regents v. Roth*, 408 U.S. 564, 577 (1972)); *Gattis v. Gravett*, 806 F.2d 778, 780 (8th Cir. 1986)

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are performed in accordance with established procedures and protections.<sup>48</sup> In essence, this means that all individuals with an interest in the maintenance of the liberty or property at issue are afforded “a meaningful opportunity to be heard.”<sup>49</sup>

The state administrative agency, in particular, must provide for “notice of [the] time and place of hearing” in which an interested individual has “the right to produce witnesses in her own behalf, the right to examine witnesses who testify against her and a full consideration and a fair determination according to the evidence by the body before whom the hearing is had.”<sup>50</sup> As the Arizona Supreme Court has observed, “[t]he maintenance of the proper standards on the part of administrative agencies in the performance of their quasi-judicial functions is of the highest importance and in no way cripples or embarrasses the exercise of their appropriate authority. . . . if these multiplying agencies deemed to be necessary in our complex society are to serve the pur-

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(noting that “[p]roperty interests are not created by the Constitution . . . ‘they are created and their dimensions are defined by existing rules or understandings that stem from an independent source such as state law....’”) (citing *Cleveland Board of Education v. Loudermill*, 470 U.S. 532, 538 (1985)).

<sup>48</sup> *Western Gillette, Inc. v. Arizona Corp. Comm’n*, 121 Ariz. 541, 543 (Ariz. Ct. App. 1979) (“ . . . (I)n administrative proceedings of a quasi-judicial character the liberty and property of the citizen shall be protected by the rudimentary requirements of fair play. These demand ‘a fair and open hearing,’ essential alike to the legal validity of the administrative regulation and to the maintenance of public confidence in the value and soundness of this important governmental process.”) (citing *Morgan v. United States*, 304 U.S. 1, 14-15 (1938)).

<sup>49</sup> *Boddie v. Connecticut*, 401 U.S. 371, 379 (1971); see also *Forman v. Creighton School Dist. No. 14*, 87 Ariz. 329, 332 (1960) (“Due process of law requires notice and opportunity to be heard. It imports the right to a fair trial of the issues involved in the controversy and a determination of disputed questions of fact on the basis of evidence.”) (internal citation and quotation marks omitted).

<sup>50</sup> *Bennett v. Arizona State Board of Public Welfare*, 95 Ariz. 170, 173 (1964); see also *Application of Levine*, 97 Ariz. 88, 91 (1964); *Forman*, 87 Ariz. at 332 (“[T]here must be a hearing in a substantial sense. And to give the substance of a hearing, which is for the purpose of making determinations upon evidence, the officer who makes the determinations must consider and appraise the evidence which justifies them.”) (internal citation and quotation marks omitted).

poses for which they are created and endowed with vast powers, they must accredit themselves by acting in accordance with the cherished judicial tradition embodying the basic concepts of fair play.”<sup>51</sup>

Administrative statutes reflect these concerns. Both the federal Administrative Procedure Act and the Arizona Administrative Procedure Act provide for notice of proposed rulemaking and a period during which interested parties may tender comment.<sup>52</sup> Section 553 of the federal Administrative Procedure Act mandates that an agency publish a “[g]eneral notice of proposed rulemaking” that includes “a statement of the time, place, and nature of public rule making proceedings” as well as the underlying legal authority and “either the terms or substance of the proposed rule or a description of the subjects and issues involved.”<sup>53</sup> “Interested persons” are then afforded “an opportunity to participate in the rule making through submission of written data, views, or arguments with or without opportunity for oral presentation” after which “the agency shall incorporate in the rules adopted a concise general statement of their basis and purpose.”<sup>54</sup> The Arizona Administrative Procedure Act requires state regulatory agencies to “establish and maintain a current, public rule making docket for each pending rule making proceeding,”<sup>55</sup> pub-

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<sup>51</sup> *Forman*, 87 Ariz. at 332 (internal citation and quotation marks omitted).

<sup>52</sup> See *Mervyn's Inc. v. Superior Court In and For Maricopa County*, 144 Ariz. 297, 300 (1985) (“It is beyond question that any procedure which deprives an individual of a property interest must satisfy due process . . . . Due process of law sets minimum notice requirements depending on the situation of the owner or interested party”) (internal citations omitted); *Western Gillette*, 121 Ariz. at 543 (“While our State Administrative Procedure Act contains no precise counterpart [as the Federal Administrative Procedure Act’s *ex parte* rule], it does make clear that in contested cases, all parties should have the opportunity to present evidence and argument on all issues involved, and that findings must be based exclusively on the evidence and on matters officially noticed.”).

<sup>53</sup> 5 U.S.C. § 553(b) *et seq.*

<sup>54</sup> 5 U.S.C. § 553(c).

<sup>55</sup> A.R.S. § 41-1021(A).

lish the full text of proposed rules and time, date, and place for hearings concerning them in the Arizona Administrative Register,<sup>56</sup> and “afford persons the opportunity to submit in writing statements, arguments, data and views on the proposed rule, with or without the opportunity to present them orally” for a period of not less than thirty days following publication.<sup>57</sup> The Arizona Administrative Code specifies the format for agency publication of Notices of Proposed Rulemaking in the Arizona Administrative Register, including a comparison between statutory “Sections Affected” and proposed “Rulemaking Action,”<sup>58</sup> the “specific statutory authority for the rulemaking including both the authorizing statute (general) and the implementing statute (specific),”<sup>59</sup> and an explanation of the rule’s origination, purpose, necessity, and impact.<sup>60</sup> The Code also requires agencies to include “[t]he name and address of agency personnel with whom persons may communicate regarding the accuracy of the economic, small business, and consumer impact statement”<sup>61</sup> and “[t]he time, place, and nature of the proceedings for the making, amendment, or repeal of the rule or, if no proceeding is scheduled, where, when, and how persons may request an oral proceeding on the proposed rule.”<sup>62</sup>

Staff has made no allowance for these due process concerns in advocating that the Recommendations and Conditions be adopted as part of a discrete application, rather than as a sub-

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<sup>56</sup> A.R.S. § 41-1013 *et seq.*

<sup>57</sup> A.R.S. § 41-1023(B).

<sup>58</sup> A.A.C. R1-1-502(B)(1) *et seq.*

<sup>59</sup> A.A.C. R1-1-502(B)(2).

<sup>60</sup> A.A.C. R1-1-502(B)(5)-(8).

<sup>61</sup> A.A.C. R1-1-502(B)(9).

<sup>62</sup> A.A.C. R1-1-502(B)(10).

stantive change in the Commission's licensing rules. Without proper notice and comment on the attempted rulemaking, current resold interexchange providers, who have a specific interest in the limitations that may be imposed on their CC&N, will be unable to effectuate the due process property protections inherent in their service license. Other providers, who may wish to expand their service offerings in Arizona or enter the state's telecommunication market for the first time, will be unable to present their views as to the competitive ramifications of Staff's Recommendations and Conditions. If the Commission wishes to proceed with staff's proposed rulemaking, it should follow the precepts of the federal and state Administrative Procedures Act,<sup>63</sup> and its own regulations,<sup>64</sup> and afford interested parties an opportunity to be heard.<sup>65</sup>

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<sup>63</sup> See A.R.S. § 41-1030(A) ("A rule is invalid unless it is made and approved in substantial compliance with sections 41-1021 through 41-1029 and articles 4, 4.1 and 5 of this chapter, unless otherwise provided by law"); *Carondelet Health Services, Inc. v. Arizona Health Care Cost Containment System Administration*, 182 Ariz. 221, 226, 228 (Ariz. Ct. App. 1994) (determining that agency reimbursement methodology, which augmented an enabling statute concerning hospitalization "volume" by discretionary calculations and formulae, was "invalid because the agency failed to promulgate a rule as required by the APA.").

<sup>64</sup> *George v. Arizona Corp. Comm'n*, 83 Ariz. 387, 390 (1958) ("This court has held flatly that rules and regulations prescribing methods of procedure of an administrative board or commission, - and specifically the Corporation Commission, - have the effect of law, are binding on the board or commission, and must be followed by it so long as they are in force and effect"); *Arizona Department of Revenue v. Care Computer Systems, Inc.*, 197 Ariz. 414, 418 (Ariz. Ct. App. 2000) ("Care also argues that an administrative agency must follow its own rules and regulations. We agree with that general proposition"); *Gibbons v. Arizona Corporation Comm'n*, 95 Ariz. 343, 347 (1964) ("We have held that the general rules and regulations of an administrative board or commission, have the effect of law and are binding on the Commission and must be followed by it so long as they are in force and effect . . . We are of the opinion that for lack of compliance with the Commission's regulations and with the requirements of law, Decision and Order No. 34796 is void"); *Tiffany By and Through Tiffany v. Arizona Interscholastic Ass'n, Inc.*, 151 Ariz. 134, 139 (Ariz. Ct. App. 1986) ("It is hornbook law that an administrative board must follow its own rules and regulations . . . the obligation of such a body to follow its own rules and regulations is founded in principles of administrative law.").

<sup>65</sup> *Gibbons*, 95 Ariz. at 347 ("While the time of notice is a matter within the Commission's discretion, *Walker v. De Concini*, 86 Ariz. 143, 341 P.2d 933 (1959), it must provide an opportunity to be heard. Failure to give any notice whatever to petitioners in this matter, amounted to an abuse of discretion which cannot be sustained.").

## **B. Application of Staff's Recommendations and Conditions to Only STi Prepaid Would Be Unlawful Discrimination**

If Staff's Recommendations and Conditions were adopted with the intention of applying them only to STi Prepaid such action would be a violation of federal and Arizona law. Treating STi Prepaid differently than other Arizona prepaid calling card providers impermissibly discriminates against STi Prepaid. Federal law supports regulatory parity among providers because, "in a market where carriers are offering the same services and competing for the same customers, disparate treatment of different types of carriers or types of traffic has significant competitive implications" by giving other prepaid calling card providers "a competitive advantage" over STi Prepaid.<sup>66</sup> Regulatory parity is important to ensure a level playing field,<sup>67</sup> and the additional obligations proposed by the Commission to apply only to STi Prepaid undermine that goal. The Commission has presented no "rational basis" to support such disparate treatment, which is required under Arizona law.<sup>68</sup>

Adoption of the Staff Report Recommendations and Conditions would also violate Section 253 of the Act. Under that provision, states may not adopt regulations or impose requirements that "may prohibit or have the effect of prohibiting the ability of any entity to provide any

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<sup>66</sup> *Developing a Unified Intercarrier Compensation Regime*, 20 FCC Rcd 4685, ¶ 21 (2005); *see also Appropriate Regulatory Treatment for Broadband Access to the Internet over Wireless Networks*, 22 FCC Rcd 5901, ¶ 53 (2007) (noting that the "disparate treatment" of competitors "would introduce competitive distortions into the marketplace").

<sup>67</sup> *Bright House Networks, LLC et al. v. Verizon Cal., Inc. et al.*, 23 FCC Rcd 5857, ¶ 30 (2008); *Petition of ACS of Anchorage, Inc. Pursuant to Section 10 of the Communications Act of 1934, as Amended*, 22 FCC Rcd 16304, ¶ 129 (2007) ("disparate treatment of carriers providing the same or similar services is not in the public interest as it creates distortions in the marketplace that may harm consumers");

<sup>68</sup> *Ryder Truck Rental, Inc. v. City of Phoenix*, 172 Ariz. 490 (1992).

interstate or intrastate telecommunications service.”<sup>69</sup> The FCC has interpreted Section 253 as creating a Congressional mandate that no state or local authority erect legal barriers to entry that would potentially frustrate the Act’s explicit goal of opening local markets to competition.<sup>70</sup> This mandate requires the FCC to preempt both direct and indirect restrictions on entry.<sup>71</sup> For this reason, the FCC has noted its “concern” about state requirements that have the effect of prohibiting the ability of any entity to provide intrastate services.<sup>72</sup> The same CC&N requirements must be applied to all interexchange carriers seeking to offer competitive intrastate interexchange service in Arizona.<sup>73</sup>

Nor could adoption of the Recommendations and Conditions be saved under Section 253(b), which preserves states’ ability to impose “on a competitive neutral basis” requirements necessary “to preserve and advance universal service, protect the public safety and welfare, ensure the continued quality of telecommunications services, and safeguard the rights of consum-

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<sup>69</sup> 47 U.S.C. § 253(a).

<sup>70</sup> *The Public Utility Commission of Texas; The Competition Policy Institute, IntelCom Group (USA), Inc. and ICG Telecom Group, Inc., AT&T Corp., MCI Telecommunications Corporation, and MFS Communications Company, Inc.; Teleport Communications Group, Inc.; City of Abilene, Texas; Petitions for Declaratory Ruling and/or Preemption of Certain Provisions of the Texas Public Utility Regulatory Act of 1995*, 13 FCC Rcd 3460, ¶ 41 (1997) (“*Texas Preemption Order*”).

<sup>71</sup> *Texas Preemption Order* ¶ 41.

<sup>72</sup> *Petition for Commission Assumption of Jurisdiction of Low Tech Designs, Inc.’s Petition for Arbitration with Ameritech Illinois Before the Illinois Commerce Commission, et al.*, 13 FCC Rcd 1755, ¶ 38 (1997).

<sup>73</sup> STi Prepaid is willing to lend its expertise to assist the Commission with the development and processing of such a rulemaking directed at establishing rules applicable to all intrastate interexchange carriers offering prepaid calling card services in Arizona.

ers.”<sup>74</sup> A state requirement must meet all three criteria under Section 253(b) to be found permissible, including the “competitively neutral” standard.<sup>75</sup> Section 253(b) “cannot save a state legal requirement from preemption” unless “the requirement is competitively neutral with respect to, and as between, *all* of the participants and potential participants in the market at issue.”<sup>76</sup> Requiring competitive neutrality minimizes a state’s ability to create barriers to entry.<sup>77</sup> Accordingly, if applied only to STi Prepaid, given the “disparity in the treatment of classes of providers,” the CC&N Recommendations and Conditions proposed by the Staff Report violate the requirement of competitive neutrality and undermine the pro-competitive purpose of the Act.<sup>78</sup>

#### IV. CONCLUSION

Staff’s Recommendations and Conditions have no legislative foundation and do not support a conditional licensing decision in this matter. As Staff has failed to promulgate them with a proper notice and comment period, they should not be used to support formal rulemaking pursuant to an adjudicatory hearing. Accordingly, STi Prepaid respectfully requests the Commission grant it a CC&N without reference to the contested Recommendations and Conditions.

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<sup>74</sup> 47 U.S.C. § 253(b).

<sup>75</sup> *Western Wireless Corporation Petition for Preemption of Statutes and Rules Regarding the Kansas State Universal Service Fund Pursuant to Section 253 of the Communications Act of 1934*, 15 FCC Rcd 16227, ¶ 9 (2000) (“*Western Wireless Kansas Order*”).

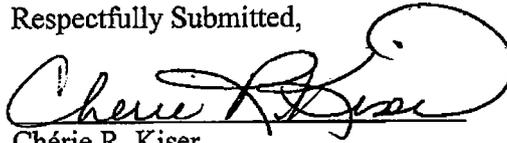
<sup>76</sup> *Western Wireless Kansas Order* ¶ 10 (emphasis in original).

<sup>77</sup> *Silver Star Telephone Company, Inc. Petition for Preemption and Declaratory Ruling*, 13 FCC Rcd 16356, ¶ 10 (1998).

<sup>78</sup> *Silver Star Telephone Company, Inc. Petition for Preemption and Declaratory Ruling*, 12 FCC Rcd 15639, ¶ 42 (1997).

Dated: May 4, 2009

Respectfully Submitted,

A handwritten signature in black ink, appearing to read "Cherie R. Kiser". The signature is fluid and cursive, with a large loop at the end.

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**CERTIFICATE OF SERVICE**

I hereby certify that on this 4th day of May, 2009, a copy of STi Prepaid, LLC's Exceptions to Staff Report in Docket Nos. T-20517A-07-0135 & T-04045A-07-0135, was served on all parties on the service list via hand delivery.

  
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