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D. Winter
B. Meyer
R. McK.
David B.
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BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Joint Application of GTE Midwest Incorporated and Ozark Telephone Company for Authority to Transfer and Acquire Part of GTE Midwest Incorporated's Missouri Franchise, Facilities or System Located in the State of Missouri.	)	**Case No. TM-95-134**
In the Matter of the Local Exchange Telecommunications Companies' Modernization Plans Pursuant to 4 CSR 240-32.100.	)	**Case No. TO-93-309**

REPORT AND ORDER

Issue Date: April 29, 1999

Effective Date: May 11, 1999

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APPEARANCES

W.R. England, III and **Sondra B. Morgan**, Attorneys at Law, Brydon, Swearengen & England, P.C., P.O. Box 456, 312 East Capitol Avenue, Jefferson City, Missouri 65102-0456, for Ozark Telephone Company.

Bruce H. Bates, Assistant General Counsel, P.O. Box 360, Jefferson City, Missouri 65102, for the Staff of the Missouri Public Service Commission.

REGULATORY LAW JUDGE: Morris L. Woodruff

REPORT AND ORDER

Procedural History

On October 21, 1994, Ozark Telephone Company (Ozark) and GTE Midwest Incorporated (GTE) filed a Joint Application with the Commission seeking authorization for the transfer of two Southwest Missouri GTE exchanges, Southwest City and Noel, to Ozark, a new company formed to acquire these exchanges from GTE. While this application was pending before the Commission, Ozark entered into a Stipulation and Agreement with the Staff of the Public Service Commission (Staff), GTE and the Office of the Public Counsel. Paragraph 6 of the Stipulation and Agreement states:

> Ozark will achieve a capital structure of at least 40 percent equity to total capital (total capital is defined as the sum of short-term debt, long-term debt, preferred stock, and common equity) within the first two years of operation. If such capital structure is not achieved after two years, then sufficient capital will be infused to reach a 40 percent equity level unless otherwise approved by the Commission. Ozark agrees to seek approval for any additional short or long-term debt or the issuance of any preferred stock that is not part of the financing of this transaction, until the 40 percent level is reached.

The Commission issued an Order Approving Sale and Order Granting Certificate on July 11, 1995. That Order approved and adopted all provisions of the Stipulation and Agreement.

The Stipulation and Agreement also required Ozark to submit a modernization plan by December 31, 1995, and complete the modernization plan by December 31, 1997. Ozark requested and was granted additional time to file its modernization plan with the Commission due to the delay in taking possession of the properties and a plan was filed on June 28, 1996. The plan called for all upgrades to be completed by December 31, 1997.

On July 21, 1997, Ozark filed a Motion for Extension of Time to Complete Modernization in which it stated that the Company would not be able to complete the modernization on time because it had not been able to obtain the necessary funds form the Rural Telephone Financing

Corporation as originally planned. The Commission granted Ozark's request and extended the deadline for completion until December 31, 1998. On June 5, 1998, Ozark filed an application with the Commission requesting approval of financing through the Rural Utilities Service (RUS). The Commission approved that application on July 22, 1998.

On September 8, 1998, the Company filed a Second Motion for Extension of Time to Complete Modernization. Staff responded to that request on October 23, 1998. Staff opposed the requested extension of time and also indicated that Ozark had failed to comply with the requirement that it achieve a 40 percent equity ratio within the first two years of operation. On November 12, 1998, Ozark responded to that portion of Staff's reply by asking that the requirement that it achieve a 40 percent equity ratio within the first two years of operation be waived.

On December 15, 1998, the Commission issued an Order Granting Second Extension of Time to Complete Modernization Plan and Setting Hearing Date. That order allowed Ozark until June 30, 1999 to complete its modernization plan. The Order also expressed concern about the failure of Ozark to achieve the required 40 percent equity ratio as required by the Stipulation and Agreement. The Commission scheduled a hearing for January 22, 1999, regarding the requirement of a 40 percent equity to total capital ratio. The date for that hearing was subsequently extended to February 17, 1999.

A hearing was convened on February 17, 1999. At the hearing Staff raised an additional issue by pointing out that Ozark was in violation of paragraph 4 of the Stipulation and Agreement. That paragraph provides that:

> Within six months after completion of its Modernization Plans and no later than July 1, 1998, Ozark will provide to Staff (Accounting Department) and AT&T a Revenue Requirement Cost of Service Study, together with a copy of Ozark's latest annual report, and cooperate with Staff in determining Ozark's cost of service to provide intrastate telecommunications services.

Staff also pointed out that Ozark was in violation of paragraph 8 of the Stipulation and Agreement in that it had failed to provide to Staff a copy of its allocation procedures for allocating specific costs between Ozark and Seneca Telephone Company and Goodman Telephone Company.

Findings of Fact

The Missouri Public Service Commission has considered all of the competent and substantial evidence upon the whole record in order to make the following findings of fact. The Commission has also considered the positions and arguments of all the parties in making these findings. Failure to specifically address a particular item offered into evidence or a position or argument made by a party does not indicate that the Commission has not considered it. Rather the omitted material was not dispositive of the issues before the Commission.

40 Percent Equity to Total Capital Ratio

On May 12, 1995, Ozark filed a Stipulation and Agreement in this case. On the basis of that Stipulation and Agreement, the Commission, in an Order issued on July 11, 1995, approved the sale of two telephone exchanges from GTE to Ozark. That Stipulation and Agreement also persuaded the Commission to grant Ozark a certificate of service authority to provide basic local telecommunications service in those two exchanges. The Stipulation and Agreement provides that Ozark will achieve a capital structure of at least 40 percent equity to total capital. If such capital structure is not achieved within the first two years of operation, then "sufficient capital will be infused to reach a 40 percent equity level."

It is not disputed that Ozark has not achieved the required forty percent equity level within the first two years of operation. In fact, Ozark's own witness, Tim Goodger, testified at the hearing that Ozark's current equity ratio is only 25.63 percent. Furthermore, Ozark projects that its equity ratio will drop to 17.62 percent in 1999 and will rebound only to 32.87 percent in 2002.

The fact that Ozark's capital structure is heavily dependent on debt leaves it vulnerable to fluctuations in the amount of revenue that it is able to collect or the costs it must pay out. A closely held company such as Ozark can avoid paying dividends to its equity shareholders and, in fact, it has not paid dividends to its shareholders. However, failure to pay interest on its debt would quickly bring Ozark into financial distress. That is a risk that Ozark's customers should not be required to face.

Ozark argues that its failure to achieve the required equity ratio can be ascribed to difficulties that it encountered in taking over and modernizing the two exchanges that it purchased from GTE. It may be that Ozark took on a larger burden than it anticipated when it purchased these exchanges. However, Ozark's failure to foresee the consequences of its business decisions does not relieve it of the obligation to comply with an important requirement of the Stipulation and Agreement into which it freely entered.

Ozark will be required to attain a 40 percent equity to total capital ratio no later than one year from the date of this order. Ozark and Staff will be directed to jointly submit a plan within 30 days that will explain in detail how Ozark will comply with the equity requirement. If Ozark does not comply with this order it will face sanctions from the Commission.

Requirement That Ozark Supply Staff With a Copy of Allocation Procedures

At the hearing, Staff alleged that Ozark failed to comply with paragraph 8 of the Stipulation and Agreement. That paragraph required Ozark, along with Goodman Telephone Company and Seneca Telephone Company, two companies that share common owners and are operated in conjunction with Ozark, to develop specific methods or procedures to allocate specific costs between the three companies. Ozark also agreed to provide a copy of the allocation procedures to the Staff for review. Ozark indicated at the hearing that it had developed the required procedures but that it had neglected to submit a copy of those procedures to Staff. A copy of those allocation procedures was submitted into evidence at the hearing. Therefore, Ozark has now complied with the requirements of paragraph 8 of the Stipulation and Agreement.

Preparation of Cost of Service Study

Paragraph 4 of the Stipulation and Agreement provides that "[w]ithin six months after completion of its Modernization Plans and no later than July 1, 1998, Ozark will provide to Staff and AT&T a Revenue Requirement Cost of Service Study . . . ." Staff argues that Ozark is in violation of this requirement in that it did not submit the revenue requirement cost of service study by July 1, 1998. Ozark counters that the cost of service study should be due six months after completion of its modernization plans. Those plans are not scheduled to be completed until June 30, 1999. Therefore, Ozark suggests that the cost of service study need not be completed until December 31, 1999.

Ozark's interpretation of this requirement of the Stipulation and Agreement is persuasive. When the Stipulation and Agreement was signed the parties anticipated that Ozark's modernization plan would be completed by January 1, 1998. Ozark was not able to meet that goal and, with the Commission's approval, the deadline for completion of the modernization was extended to June 30, 1999. The requirement that Ozark prepare a cost of cost of service study is tied to the requirement of the Stipulation and Agreement that Ozark not file or implement a general increase in rates for intrastate telecommunications services until it has completed its modernization plan. In anticipation that Ozark might seek to implement such a general rate increase after the completion of the modernization plan, Ozark was required to prepare a cost of service study. To interpret the Stipulation and Agreement as requiring Ozark to prepare a cost of service study prior to the completion of the modernization plan would require Ozark to engage in a pointless exercise. Therefore, the Commission finds that Ozark is not in violation of paragraph 4 of the Stipulation and Agreement. The cost of service study required by that paragraph will be due six months after Ozark's completion of its modernization plan, or December 31, 1999.

Conclusions of Law

The Missouri Public Service Commission has arrived at the following Conclusions of Law:

Ozark Telephone Company is a local exchange telecommunications service provider as defined under Section 392.410, RSMo Supp. 1998 and, therefore, is subject to the jurisdiction of the Missouri Public Service Commission under Chapters 386 and 392, RSMo.

Orders of the Commission must be based upon competent and substantial evidence on the record. Section 536.140, RSMo (1994).

IT IS THEREFORE ORDERED:

1. That Ozark Telephone Company shall attain a 40 percent equity to total capital ratio no later than April 29, 2000. Ozark Telephone Company and Staff are directed to jointly file a written plan no later

than May 29, 1999, that will explain in detail how Ozark Telephone Company will comply with the equity requirement. Ozark Telephone Company is notified that if it does not comply with this order it will face sanctions from the Commission.

2. That no later than December 31, 1999, Ozark Telephone Company shall submit a cost of service study in compliance with paragraph 4 of the Stipulation and Agreement approved by the Commission on July 11, 1995.

3. That this Report and Order shall become effective on May 11, 1999.

BY THE COMMISSION

Dale Hardy Roberts

Dale Hardy Roberts
Secretary/Chief Regulatory Law Judge

(S E A L)

Lumpe, Ch., Crumpton, Murray,
Schemenauer, and Drainer, CC.,
concur and certify compliance
with the provisions of
Section 536.080, RSMo 1994.

Dated at Jefferson City, Missouri,
on this 29th day of April, 1999.