STATE OF MISSOURI
PUBLIC SERVICE COMMISSION

At a session of the Public Service Commission held at its office in Jefferson City on the 30th day of May, 2006.

Staff of the Public Service Commission of the State of Missouri, Complainant, v. Cass County Telephone Company Limited Partnership, Respondent.	)	**Case No. TC-2005-0357**

ORDER APPROVING STIPULATION AND AGREEMENT

Issue Date: May 30, 2006 Effective Date: June 9, 2006

On April 8, 2005, the Staff of the Commission filed a complaint against Cass County Telephone Company Limited Partnership (CassTel). In that complaint, Staff sought authority from the Commission to seek penalties in circuit court against CassTel for violations of law by its former president, Kenneth M. Matzdorff. On December 29, Staff and CassTel filed a stipulation and agreement that would resolve all contested issues related to the complaint. Staff filed suggestions in support of the stipulation and agreement on January 6, 2006.

The Office of the Public Counsel, which is a party to this case, did not join in the stipulation and agreement. However, on December 29, Public Counsel filed a statement indicating that it does not oppose the stipulation and agreement. Commission rule 4 CSR

240-2.115(C) provides that if no party objects to a proposed stipulation and agreement, the Commission may treat a nonunanimous stipulation and agreement as a unanimous stipulation and agreement. Since Public Counsel has indicated that it does not oppose the stipulation and agreement, the Commission will treat it as a unanimous stipulation and agreement.

Staff's complaint against CassTel contains four counts. Count I alleged that Kenneth M. Matzdorff pled guilty to the federal crimes of conspiracy to commit mail fraud and wire fraud. Matzdorff conspired to defraud the Universal Service Administrative Company (USAC) and the National Exchange Carriers Association (NECA) by including, as expenses of CassTel, payments made to Overland Data Center by CassTel that were based on false or fictitious invoices. Those falsified expenses were used to qualify for unwarranted disbursement of subsidies from USAC and revenue distributions from NECA.

Count II of the complaint alleged that by relying on the false or fictitious invoices from Overland Data Center in making entries in the accounts of CassTel, Matzdorff willfully made false entries in the accounts of CassTel in violation of Section 386.560, RSMo 2000. Count III alleged that Matzdorff also violated Commission rule 4 CSR 240-30-040 by making false entries in CassTel's accounts. Finally, Count IV alleged that Matzdorff gave false or misleading testimony to the Commission on April 19, 2004, while under oath.

In the stipulation and agreement, CassTel admits as follows:

> A. CassTel admits that Staff has sufficient documentation and other information which, if duly offered and admitted into evidence at a hearing, would permit a finder of fact to reasonably conclude that Mr. Kenneth M. Matzdorff caused false entries to be made in the books of account of CassTel when he was an officer of CassTel.
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> B. CassTel admits that Staff has sufficient documentation and other information which, if duly offered and admitted into evidence at a hearing, would permit a finder of fact to reasonably conclude that on April 19,

2004, Mr. Kenneth M. Matzdorff gave false or misleading testimony to the Commission under oath in Case No. IR-2004-0534.

CassTel agrees to make a payment to the Public School Fund in the amount of one million dollars in settlement of the matters alleged in Staff's complaint and in all other potential complaints that might arise out of Staff's investigation into the affairs of CassTel. The settlement, however, specifically excludes any matters associated with Staff's ongoing investigation of, and any current or future complaint, against New Florence Telephone Company, another company associated with Matzdorff and the owners of CassTel. Furthermore, the settlement specifically does not preclude Staff from pursuing an overearnings complaint against CassTel.

In addition, the parties to the stipulation and agreement agree that CassTel has implemented sufficient financial and managerial controls to justify its certification for receipt of federal Universal Service Fund disbursements. Staff agrees to recommend that the Commission certify prospectively to the FCC that funds received by CassTel from the federal high cost support funding mechanisms will be used in accordance with Section 254(e) of the federal Telecommunications Act of 1996. Furthermore, Staff may recommend certification for Universal Service Fund disbursements for prior periods under certain, agreed upon circumstances.

The stipulation and agreement further provides that CassTel will adjust its 2005 books and records in an agreed upon manner to represent an accurate valuation of CassTel's telephone plant in service and depreciation reserve accounts for the period. The parties agree that CassTel will not restate its annual reports to the Commission for the years before 2005. However, CassTel will supplement each annual report for the years 1996 through 2004 with a statement that there are inaccuracies in those reports, with a reference to the 2005 annual report. The 2005 annual report will contain a statement regarding the inaccuracies in the earlier reports.

Finally, the stipulation and agreement indicates that it is predicated on an understanding that the present owners of CassTel will promptly present a sale of CassTel's assets to the Commission for approval. An application for approval of that sale has subsequently been filed with the Commission and is pending in Case Number TM-2006-0306. In that case, FairPoint Communications, Inc., seeks authority to purchase the assets of CassTel and to operate the telecommunications system currently operated by CassTel. The parties represent that approval of this settlement is needed to facilitate such a sale.

The Commission held an on-the-record presentation regarding the proposed settlement on January 11, 2006. At that proceeding, the Commission questioned the signatory parties about the details of the stipulation and agreement. Although not a party, the Missouri Attorney General, acting on behalf of the State of Missouri, appeared at the on-the-record presentation, and was allowed to express concerns about some aspects of the settlement.

Following the on-the-record presentation, the Attorney General filed a written motion asking that the State of Missouri be allowed to intervene. Staff and CassTel opposed the application to intervene. After considering multiple, extensive, written arguments from the parties, the Commission denied the State of Missouri's application to intervene, but invited the State to file an amicus curiae brief by March 1, if it wished to further explain its concerns about the stipulation and agreement. The State has not filed such a brief.

Although the State has elected not to file an amicus curiae brief, it did express its concerns at the on-the-record presentation and in the pleadings filed regarding its application to intervene. The Commission will address those concerns before approving the submitted stipulation and agreement.

First, the State contended that the stipulation and agreement lacks language to guarantee that CassTel's ratepayers will not eventually finance the million-dollar penalty, either directly or indirectly. The Commission is satisfied that direct recovery of the penalty through rates will not happen. CassTel is still subject to rate-of-return regulation. Thus, CassTel could recover the penalty directly from its ratepayers only if the Commission allowed the company to include that cost in its rates. While this Commission cannot control the actions of future Commissions, it is highly unlikely that such a recovery would ever be allowed.

The State is also concerned about the possibility that the penalty might be indirectly recovered from CassTel's ratepayers as a result of the sale of the company to new owners. The concern is that the new owners would ultimately pay the amount of the penalty as part of its purchase price for the company. The company's new owners could then seek to base the company's rates on a value for the company that would be inflated by the amount of the penalty.

The State's concern about indirect recovery of the penalty from ratepayers is not well founded. Once again, before the new owners of CassTel could use an inflated purchase price to justify increased rates for its customers, it would need to obtain the approval of this Commission. The Commission has consistently refused to allow regulated utilities to recover a positive acquisition adjustment through rates. Rather, the Commission has held that the cost of service a company is allowed to recover in rates must be based on the original cost of the acquired asset.[1] Under that principle, the price that the new owners pay to purchase CassTel's assets will not affect the rates that the new owners can charge their customers. It is unlikely that a future Commission would depart from this established practice to allow the new owners of CassTel to recover the cost of such a penalty in rates.

Although it is unlikely that the cost of the penalty could ever be recovered from CassTel's ratepayers, CassTel has indicated its willingness to accept language in this order specifically providing that the penalty is not to be recovered from ratepayers. Given that willingness, the Commission will include such language in this order.

The State raised a second concern about the stipulation and agreement regarding the breadth of the enforcement waiver included in the settlement. The stipulation and agreement purports to be a "full and comprehensive settlement" of this complaint, as well as any potential enforcement complaints arising from or related to Staff's investigation of CassTel or Local Exchange Carrier, LLC. The agreement also provides that it:

> resolves and settles for all time all pending or unfiled actions for any penalty or forfeiture under or by virtue of the Public Service Commission Law, including those which may be brought by third parties, for or on account of any act, transaction, matter or thing, known or unknown, concerning the subject matter of the Complaint and the Investigation against CassTel, its successors, assigns, partners, agents, managers, officers and employees and, to the extent the Commission has jurisdiction with respect thereto, LEC, its successors, assigns, members, agents, managers, officers and employees and to forever release each and all of them from any punitive adverse action associated with the matters alleged in the Complaint or which have been examined in the context of the Investigation involving CassTel.

[1] Transcript, page 99, lines 9-13.

The agreement then goes on to specifically exclude settlement of Staff's ongoing investigation of New Florence Telephone Company. In addition, it specifically allows Staff to proceed with an over-earnings complaint against CassTel.[2]

This is a fairly broad release, and Staff acknowledges that it is intended to cover any penalty actions that the Staff could have brought based on information it learned during the investigation, other than the over-earnings investigation. The State expressed particular concern about the provision of the release that would bar complaints brought by unidentified third parties. However, that provision is of doubtful effect: the agreement of these parties cannot prevent an action by a nonparty. In any event, there is no indication that any third party intends to file a complaint. In the end, the questions about the details of the release are not sufficient to cause the Commission to reject an agreement that will pave the way for the sale of CassTel's system to a company that is capable of providing high quality service to its customers.

The State was also concerned about the provision of the stipulation and agreement that commits the Commission's Staff to support the certification of CassTel for the receipt of federal Universal Service Fund disbursements, both for prospective periods, and for prior periods. CassTel has not received Universal Service funding since October 2004, due to allegations of criminal activity. The concern is that the agreement could result in CassTel once again receiving such funding while it is still owned by criminals.

This concern was greatly reduced by the filing of an agreement to sell the assets of CassTel to a buyer that is in no way associated with the criminal activities of the current

[2] Staff's over-earnings complaint against CassTel is currently pending in Case No. IR-2006-0374. CassTel has agreed to refund $4.1 million to its customers to resolve Staff's over-earnings allegations.

owners of CassTel. Any future Universal Service funding will go to the buyer, not to CassTel's current owners. Of course, the proposed sale of CassTel's assets has not yet been finalized. Nevertheless, even if that sale never occurs and CassTel's current owners continue to own the company, the stipulation and agreement merely provides that Staff will recommend prospective certification for future periods and may recommend certification for prior periods. The agreement does not require the Commission to accept such a recommendation. Therefore, under any circumstance, the Commission retains its authority to prevent any improper disbursement of Universal Service funding.

The resolution of this case is closely tied to two other cases, TM-2006-0306, in which FairPoint Communications seeks authority to purchase and operate CassTel's telecommunications system assets, and IR-2006-0374, in which CassTel has agreed to refund $4.1 million to its customers to resolve Staff's over-earnings concerns. The parties have described these three cases as the three legs of a tripod upon which the entire resolution of the CassTel problem must rest. All three cases must be resolved if the problem is to be solved. In order to consider the resolution of the entire problem, the Commission conducted an additional on-the-record presentation on May 24.

After reviewing the stipulation and agreement and after considering the related cases, the Commission finds that the stipulation and agreement should be approved as a resolution of Staff's complaint, and as a necessary part of the overall resolution of the CassTel problem.

IT IS ORDERED THAT:

1. The Stipulation and Agreement filed on December 29, 2005, is approved, and the signatory parties are ordered to comply with its terms.

2. None of the financial penalty imposed on Cass County Telephone Company Limited Partnership by terms of this order and the Stipulation and Agreement shall ever be recovered from the ratepayers of the company.

3. This order shall become effective on June 9, 2006.

BY THE COMMISSION

Colleen M. Dale
Secretary

(S E A L)

Davis, Chm., Murray, Clayton and Appling, CC., concur
Gaw, C., concurs, concurring opinion to follow

Woodruff, Deputy Chief Regulatory Law Judge