

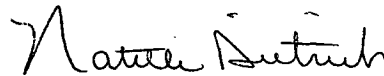
**BEFORE THE PUBLIC SERVICE COMMISSION**  
**OF THE STATE OF MISSOURI**

In the Matter of the Application of Chariton Valley  
Telephone Corporation for Authority and Approval )  
to Issue a Note, Loan Agreement, Mortgage, )  
Security Agreement, and Financing Statement, to ) Case No. IF-2007-0278  
borrow funds from the Rural Utility Services of the )  
United States of America, and for interim )  
financing. )

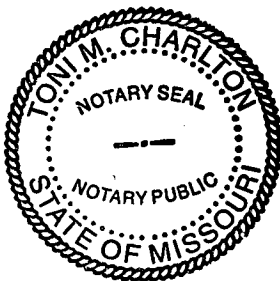
AFFIDAVIT OF NATELLE DIETRICH

STATE OF MISSOURI     )  
                                  )  
COUNTY OF COLE     )     ss.

Natelle Dietrich, of lawful age, on her oath states: that she has participated in the preparation of the following Staff Memorandum; that the information is given by her; that she has knowledge of the matters set forth; and that such matters are true and correct to the best of her knowledge and belief.

  
\_\_\_\_\_  
Natelle Dietrich

Subscribed and sworn to before me this 13<sup>th</sup> day of March 2007.



  
\_\_\_\_\_

TONI M. CHARLTON  
Notary Public - State of Missouri  
My Commission Expires December 28, 2008  
Cole County  
Commission #04474301


**BEFORE THE PUBLIC SERVICE COMMISSION**  
**OF THE STATE OF MISSOURI**

In the Matter of the Application of Chariton Valley  
Telephone Corporation for Authority and Approval )  
to Issue a Note, Loan Agreement, Mortgage, )  
Security Agreement, and Financing Statement, to ) Case No. IF-2007-0278  
borrow funds from the Rural Utility Services of the )  
United States of America, and for interim )  
financing. )

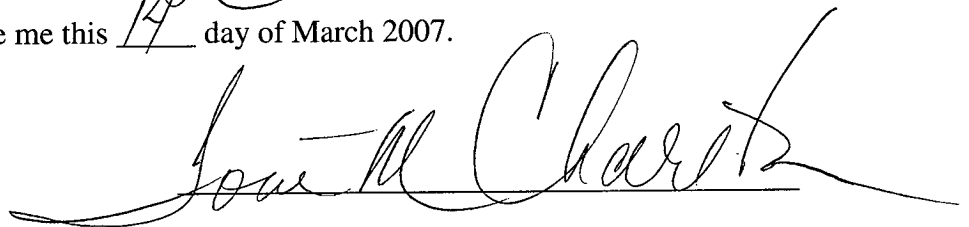
AFFIDAVIT OF RONALD L. BIBLE

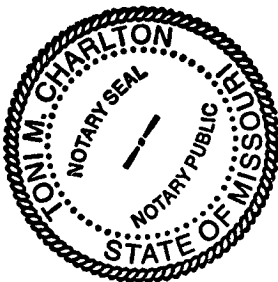
STATE OF MISSOURI     )  
                                  )     ss.  
COUNTY OF COLE     )

Ronald L. Bible, of lawful age, on his oath states: that he has participated in the preparation of the following Staff Memorandum; that the information is given by him; that he has knowledge of the matters set forth; and that such matters are true and correct to the best of his knowledge and belief.

  
\_\_\_\_\_  
Ronald L. Bible

Subscribed and sworn to before me this 14<sup>th</sup> day of March 2007.

  
\_\_\_\_\_



TONI M. CHARLTON  
Notary Public - State of Missouri  
My Commission Expires December 28, 2008  
Cole County  
Commission #04474301

**BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF MISSOURI**

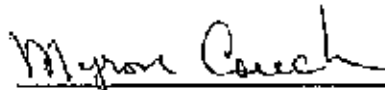
In the Matter of the Application of Chariton  
Valley Telephone Corporation for Authority  
and Approval to Issue a Note, Loan Agreement,  
Mortgage, Security Agreement, and Financing  
Statement, to borrow funds from the Rural Utility  
Services of the United States of America, and  
for interim financing.

)  
)  
)  
)  
)  
)  
)

Case No. IF-2007-0278

**AFFIDAVIT OF Myron Couch**

Myron Couch, employee of the Staff of the Missouri Public Service Commission, being of lawful age and after being duly sworn, states that he has participated in the preparation of the accompanying Memorandum, and that the facts therein are true and correct to the best of his knowledge and belief.

  
\_\_\_\_\_  
Myron Couch

Subscribed and affirmed before me this 12<sup>th</sup> day of March, 1007. I am commissioned as a  
Notary Public within the County of Callaway, State of Missouri, and my commission  
expires on 9-21-10.



SUSAN L. SUNDERMEYER  
My Commission Expires  
September 21, 2010  
Callaway County  
Commission #06942086

  
\_\_\_\_\_  
NOTARY PUBLIC

## MEMORANDUM

- TO:** Missouri Public Service Commission Official Case File  
Case No. IF-2007-0278, Chariton Valley Telephone Corporation
- FROM:** Ron Bible, Utility Regulatory Manager - Financial Analysis Department  
Natelle Dietrich, Regulatory Economist III - Telecommunications Department  
Myron Couch, Technical Specialist II - Telecommunications Department
- /s/ Ron Bible 03/14/07                      /s/ Jennifer Heintz 03/14/07
- 
- Project Coordinator / Date                      General Counsel's Office / Date
- SUBJECT:** Staff Recommendation for Approval to Issue a Note and Enter into a Loan Agreement, Mortgage, Security Agreement and Financing Statement.
- DATE:** March 14, 2007
1. (a) **Type of Issue:** Note, Loan Agreement, Mortgage, Security Agreement and Financing Statement
- (b) **Amount:** Up to \$42,960,000
- (c) **Rate:** According to the Loan Agreement dated December 7, 2006, Section 3.1(b): "The portion of the Telecommunications Loan specified in Schedule 1 hereto will bear interest at the Cost-of-Money Interest Rate determined by the Government pursuant to 7 U.S.C. 935(d)(2)(A) of the Act and its implementing regulations, as amended from time to time (7 C.F.R. 1735.31(c)) and the portion of the Telecommunications Loan specified in Schedule 1 hereto will bear interest at the rate of five percent (5.00%) per annum."
- (d) **Other Provisions:** Section 5.12 of the Loan Agreement states, "From the date of this Agreement until the date specified in Schedule 1, the Borrower will maintain a Times Interest Earned Ratio (TIER) of at least 1.0. Thereafter, starting on the date specified in Schedule 1 (hereinafter called the "TIER Commencement Date") the Borrower shall maintain the TIER level(s) as specified in Schedule 1."
- (e) **Schedule 1:** Article V Affirmative Covenants
3. Section 5.12, TIER: 1.50
4. Section 5.12, TIER Commencement Date: January 1, 2011
2. **Proposed Date of Transaction:** As soon as Commission approval is granted.
- (a) **Statement of Purpose of the Issue:** The general terms and conditions to be contained in the note and loan agreement provide for a loan in a total amount up to \$42,960,000 with a repayment term and interest rate as set forth in the attached loan

agreement. The construction schedule calls for installation of a Next Generation Switch; new fiber-fed electronic sites; new buried exchange fiber facilities; Broadband Loop Carrier electronics; Fiber to the Premise equipment; copper replacement lines; replacement of GigE electronics; new standby generators and testing equipment. There will also be a need for initial temporary or interim financing until receipt of the initial Rural Utility Service (RUS) loan draw down amount.

- (b) **From a financial perspective, does Staff deem this purpose reasonable?**  
Yes   X   No

3. **Type of Transaction:** The Applicant proposes to borrow certain sums, not to exceed \$42,960,000 from the RUS in order to fund capital improvements.

4. **Copies of executed instruments defining terms of the proposed securities:**

- (a) If such instruments have been previously filed with the Commission, a reference to the Case Number in which the instruments were furnished.  
  X   (b) If such instruments have not been executed at the time of filing, a statement of the general terms and conditions to be contained in the instruments which are proposed to be executed.  
       (c) If no such instruments are either executed or to be executed, a statement of how the securities are to be sold.

5. **Certified copy of resolution of the directors of applicant, or other legal documents authorizing the issuance of the securities reviewed:**

Yes   X   No

6. **Pro-forma Balance Sheet, Cash Flow and Income Statement reviewed:**

Yes   X   No

7. **Capital expenditure schedule reviewed:**

Yes   X   No

8. **Journal entries are required to be filed by the Company to allow for the Fee Schedule to be applied:**

Yes   X   No

9. **Recommendation of the Staff:**

- X   Grant by session order (see Comments)  
       Conditional Approval granted pending receipt of definite terms of issuance (see Comments)

- \_\_\_ Require additional and/or revised data before approval can be granted (see Comments)
- \_\_\_ Formal hearing required (see Comments)
- \_\_\_ Recommend dismissal (see Comments)

**COMMENTS:**

Chariton Valley Telephone Corporation provides basic local and exchange access telecommunications services. Chariton Valley Telephone Corporation is a small rural telephone company providing service to approximately 8,000 customers in 18 exchanges in north central Missouri. The Company has filed an Application with the Missouri Public Service Commission (Commission) to obtain approval to execute a Note, Loan Agreement, Mortgage, Security Agreement and Financing Statement in an amount not to exceed \$42,960,000.

The Company's Application states:

Chariton Valley is a Missouri corporation in good standing and has been incorporated for the purpose of, and in fact is engaged in the business of, operating an incumbent local exchange telecommunications company, and other business operations.

Chariton Valley provides basic local telecommunications services, and exchange access services, to customers within the state of Missouri, pursuant to prior orders of the Commission granting Chariton Valley certificates of authority, approving tariffs, as has been routinely provided to an incumbent local exchange company.

Chariton Valley has determined to construct new service facilities to improve service, replace existing plant, and to bring broadband capability closer to its customers' premises. The new facilities and improvements will include: Next Generation Switch; new fiber-fed electronic sites; new buried exchange fiber facilities; Broadband Loop Carrier electronics; Fiber to the Premise equipment; copper replacement lines; replacement of GigE electronics; new standby generators and testing equipment.

In order to perform the work described above, Chariton Valley has determined that such work will require a loan in order to equitably distribute the costs of such work among present and future customers, and in order to maintain debt to equity ratios within generally acceptable ranges.

Chariton Valley has secured a loan commitment from the Rural Utility Service, United States Department of Agriculture (RUS), the finalization of

which is subject to this Commission's approval. Chariton Valley is in need of this Commission's approval of the note, loan agreement, mortgage, security agreement and financing statement. RUS has approved the construction plan, the loan application, and has executed the loan documents.

## **FINANCIAL ANALYSIS**

### **Total Debt to Total Capital Ratio**

This financing will make a significant change in the Company's consolidated capital structure, but the change will not threaten the Company's overall financial integrity for the long-term. The Company's pro forma Total Debt to Total Capital Ratio would \*\* \_\_\_\_\_  
\_\_\_\_\_ \*\* and Total Equity to Total Capital Ratio would \*\* \_\_\_\_\_  
\_\_\_\_\_, based on the company's projections (see Attachment A). This means that, in spite of borrowing this amount of money from RUS, the company still projects it will have over twice as much equity as long-term debt on its balance sheet at the end of its projections. Standard and Poor's comparable key ratio for Rural Local Exchange Companies averages 72.8 percent (see Attachment D). Chariton Valley's ratio of \*\* \_\_\_\_\_ \*\* results in less debt than the Standard and Poor's Rural Local Exchange Companies, and better overall credit quality.

### **Times Interest Earned Ratio (TIER)**

RUS requires Chariton Valley Telephone Corporation to maintain a minimum Times Interest Earned Ratio (TIER) coverage ratio of 1.00 as one of the covenants in the loan agreement until December 31, 2010. As of January 1, 2011, the loan covenants require Chariton Valley Telephone Corporation to maintain a minimum TIER coverage ratio of 1.50. The TIER coverage ratio calculation equals total net income plus interest on long-term debt payable in such year, divided by interest on long-term debt payable for such year. The TIER ratio indicates how much money the company generates in a given year that is available to pay interest on long-term debt due in that year  
\*\*

\_\_\_\_\_ \*\* (see Attachment B). This means that, in spite of borrowing this amount of money from RUS, the company still projects it will be able to generate enough money from operations at the end of its projections to pay interest \*\* \_\_\_\_\_ \*\*. Standard and Poor's comparable key ratio for Rural Local Exchange Companies averages 1.3 times (see Attachment D). Chariton Valley's ratio of \*\* \_\_\_\_\_ \*\* results in greater coverage of interest expense than the Standard and Poor's Rural Local Exchange Companies, and better overall credit quality.

### **Debt Service Coverage (DSC)**

Chariton Valley provided pro forma projections for the Debt Service Coverage (DSC) ratio. The DSC ratio calculation equals total net income plus depreciation and amortization expense and interest on long-term debt payable for such year, divided by principal and interest on long-term debt payable in such year, calculated on a consolidated basis. The DSC ratio indicates how much money the company generates in a given year that is available to pay principal and interest due in that year.  
\*\*

---

---

\*\*

## **TELECOMMUNICATIONS**

### **Chariton Valley Telephone Company Facilities**

The Telecommunication Department Staff made on-site inspections in eleven (11) Chariton Valley exchanges examining both inside and outside plant. In general, Staff found the company's existing outside plant facilities are at the end of their useful life with a significant portion of the company's cable installed prior to the 1950's. The attached pictures illustrate some of the cable conditions observed during Staff's inspection. Attachment E shows an existing working cable that was spliced using the twist method, a method used prior to the 1960's. Pictures in Attachment F show closures of the same vintage. Pictures in Attachment G show buried air core cable that is defective in different sections of buried plant. Cable pairs are transported by stringing wires on the ground or changing pairs in sections at cut-around points at existing cable pedestals. Attachment H pictures illustrate aerial facility problems that are violating the National Electric Safety Code by not providing proper power clearance. Pictures in Attachment I show protectors rather than network interfaces being used to serve customers. In addition, Staff observed protectors not bonded common with the premise power ground rod. Digital line carrier providing service in the exchanges has been discontinued by the manufacturer. These observations appear to be consistent throughout Chariton Valley's exchanges.

The Telecommunications Staff has reviewed Chariton Valley Telephone Company's proposed plans to upgrade and modernize their network facilities. The proposed facility replacement plan will occur over a ten year time period. The company's proposed expenditures total \$42,959,500. This amount is broken-down on an exchange-specific basis in the attached spreadsheet in Attachment J entitled Total Expenditures per Exchange and is categorized on plant expenditures, test equipment expense and engineering costs. The plant expenditures are further broken-down on an exchange-specific basis on Attachment K in the spreadsheet Plant Expenditures Itemized. The proposed plant expenditures include a variety of items with some of the more significant expenses being broadband loop carrier, outside plant copper cable expense, and outside plant fiber cable expense. A soft switch will be installed in Huntsville to support existing features in some exchanges and additional features in other exchanges. The equipment at each central office and toll routes to Huntsville will be upgraded from 1 gigabit data capacity to a 10 gigabit capacity.

From a technical operations perspective the proposed plan appears reasonable in addressing problems associated with Chariton Valley's existing facilities. Problems observed in the company's plant facilities should be corrected upon completion of this project. Rural Utilities Service approval of the loan should ensure installation of telecommunications equipment complies with standards established by the Commission rules, the National Electric Code, and the National Electric Safety Code.



### **USF and intercarrier compensation discussion for recommendation**

In its Application, Chariton Valley states it “has determined to construct new service facilities to improve service, replace existing plant, and to bring broadband capability closer to its customers’ premises.”<sup>1</sup> Universal service funds are to be used for the provision, maintenance and upgrade of facilities and services for which support is intended<sup>2</sup>. To date, broadband capability has not been added as a supported service although Congress, the Federal Communications Commission and the Joint Board on Universal Service are currently considering proposals to expand the definition of qualified services to include broadband. Since Chariton Valley plans to construct facilities to bring broadband closer to its customers’ premises, Staff submitted data requests seeking information related to the financing request and Chariton Valley’s universal service fund receipts.

Since Chariton Valley indicated it would construct new service facilities to bring broadband capability closer to its customers’ premises, Staff asked how much of the loan will be used for the “provision, maintenance or upgrade” of facilities to provide broadband services. Chariton Valley responded, “It is very difficult, if not impossible to separate the costs of broadband services from POTS when using current BLC [broadband loop carrier] technology. The estimated construction costs in the loan application for broadband loop carrier [are] \$7,748,500.”

In response to a Staff data request about the effect of the financing transaction on USF, Chariton Valley states, “under the planned deployment schedule, assuming federal USF disbursements continue as they are provided today, there will be substantial increases in USF disbursements of approximately \$3,000,000 a year.” When asked whether federal USF would be used to repay the loan, Chariton Valley responded, “Federal USF disbursements will increase because Chariton Valley’s investment in plant and associated costs will increase. The federal USF disbursements are not directly used to repay the loan. The increased USF receipts will enhance Chariton Valley’s ability to repay the loan.”

Staff also asked generally how Chariton Valley planned to repay the loan. Chariton Valley responded, “Chariton Valley and it[s] affiliates will offer “triple play” services including voice, video and high speed data. In addition to revenue provide[d] by voice services, local exchange and access revenue from interexchange service, affiliate companies will pay Chariton Valley access charges for the use of its network to deliver video and high speed data services.”

As indicated by its responses, Chariton Valley plans to rely, at least partially, on intercarrier compensation as a repayment method for the loan. The Federal Communications Commission (FCC) has been considering issues related to intercarrier compensation for at least 5 years.

---

1 Application of Chariton Valley Telephone Corporation for Authority and Approval to Issue a Note and Enter into a Loan Agreement, Mortgage, Security Agreement, and Financing Statement to Borrow Funds from the Rural Utility Services of the United States of America, and for Interim Financing. Para. 6.

2 “Services for which support was intended” includes: (1) Voice grade access to the public switched network; (2) Local usage; (3) Dual tone multi-frequency signaling or its functional equivalent; (4) Single-party service or its functional equivalent; (5) Access to emergency services; (6) Access to operator services; (7) Access to interexchange service; (8) Access to directory assistance; (9) Toll limitation for qualifying low-income consumers. 47 C.F.R. 54.101(a).

Therefore, Staff asked Chariton Valley to address the effect of the FCC's intercarrier compensation docket, and more specifically the Missoula Plan, on its ability to repay the loan. Recognizing the FCC has yet to act, Chariton Valley responded, "As Chariton Valley understands the Missoula Plan as originally presented, revenue reductions resulting from access rate reductions by Chariton Valley as a Track 3 Carrier will be recovered via the Restructure Mechanism and by increases in interstate subscriber line charges. If the Missoula Plan as originally presented to the FCC is adopted, it should not negatively impact Chariton Valley's ability to repay the loan."

While Chariton Valley states the Missoula Plan as proposed would not negatively impact Chariton Valley's ability to repay the loan, the continued sustainability of the federal USF, a source that will "enhance" Chariton Valley's repayment ability, is a cause for concern. The Joint Board on Universal Service and the FCC are considering various means to either cap or reduce the size of the fund.

Chariton Valley is a telephone cooperative. As such, the Commission's jurisdiction over rates is limited to rates associated with exchange access service.<sup>3</sup> However, if Chariton Valley should determine additional revenue is needed in the future, it should not automatically assume those revenues will be generated by an increase in switched access rates.

### **Recommendation**

Chariton Valley Telephone Corporation has been approved to borrow **up to** \$42,960,000 from RUS. Chariton Valley Telephone Corporation, as part of that process, also needs Commission approval.

Based upon its separate review, Staff recommends that the Commission approve the Application submitted by Chariton Valley Telephone Corporation as not detrimental to the public interest in this case subject to the following conditions:

1. That nothing in the Commission's order shall be considered a finding by the Commission of the value of this transaction for rate making purposes, and that the Commission reserves the right to consider the rate making treatment to be afforded these financing transactions and their results in cost of capital, in any later proceeding; and
2. That the Company file with the Commission any information concerning deviations from all final terms and conditions on this financing, as set forth in paragraph 9 of its Application including, but not limited to, the aggregate principal amount to be sold or borrowed, price information, estimated expenses, portion subject to the fee schedule and loan or indenture agreement concerning each issuance; and
3. That the Company file with the Commission any information concerning deviations from its stated use of the funds, as set forth in paragraph 6 of its Application, that would materially change the pro forma capitalization and financial ratios submitted with its Application.

4. That the company submit a verified report to the Commission's Budget and Fiscal Services department documenting the issuance of the note, the use of any associated proceeds, and the applicability and measure of fees under Section 386.300.2.

**Chariton Valley Telephone Corporation filed a motion requesting expedited treatment of this Application. The Staff therefore respectfully requests that this matter be placed on the Commission's Agenda as soon as possible.**

Attachments: A Pro Forma Capital Structure (HC)  
B Pro Forma TIER Coverage Ratio (HC)  
C Pro Forma DSC Ratio (HC)  
D S&P Key Ratios  
E Picture of Chariton Valley cable splices using twist method  
F Pictures of Chariton Valley closures  
G Pictures of defective Chariton Valley plant  
H Pictures of Chariton Valley aerial facility problems  
I Pictures of Chariton Valley protectors  
J Total Expenditures per Exchange (HC)  
K Plant Expenditures Itemized (HC)

**ATTACHMENTS A, B AND C**  
**ARE DEEMED**  
**HIGHLY CONFIDENTIAL**  
**IN THEIR ENTIRETY**

Chariton Valley Telephone Corporation  
IF-2007-0278

**Standard and Poor's Key Ratios**

--Average of past three fiscal years--

(\*) As of Sept. 7, 2006.

	Corp. credit rating(*)	Total debt/ capital (%)	EBIT interest coverage (x)
Consolidated Communications Holdings Inc.	BB-/Negative/--	72.8	1.3
D&E Communications Inc.	BB-/Negative/--	57	1.5
FairPoint Communications Inc.	BB-/Negative/--	98.9	1
Iowa Telecommunications Services Inc.	BB-/Negative/--	69.6	1.9
Madison River Capital LLC	B+/Stable/--	<u>92.6</u>	<u>0.9</u>
Median		72.8 (%)	1.3 x
			1.32

Source: September 29, 2006 S&P CreditStats and June 12, 2006 S&P Industry Report









Attachment F-1













Attachment G-2





Attachment G-3





Attachment G-4





Attachment H-1





Attachment H-2





Attachment H-3





Attachment H-4





Attachment H-5





Attachment I-1





Attachment I-2











**ATTACHMENTS J AND K**  
**ARE DEEMED**  
**HIGHLY CONFIDENTIAL**  
**IN THEIR ENTIRETY**