

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

An Investigation of the Fiscal and)
Operational Reliability of Cass County)
Telephone Company and New Florence)
Telephone Company, and Related Matters)
of Illegal Activity)

Case No. TO-2005-0237

ORDER ESTABLISHING INVESTIGATION CASE

SYNOPSIS:

This order establishes a case within which the Staff of the Public Service Commission is directed to investigate all matters pertaining to the operations of two Missouri telecommunications utilities, Cass County Telephone Company ("Cass County") and New Florence Telephone Company ("New Florence"). These two utilities are either owned in part or operated by Ken Matzdorff who has recently plead, or is reportedly about to plead, guilty to certain felony fraud charges based primarily on charges of telephone cramming. As a result of this order, Staff is directed to investigate the continuing fiscal and operational reliability of telecommunications service for the customers of these companies.

FACTS:

1. On February 5, 2004, a docket was established to receive a Stipulation regarding the earnings of Cass County Telephone Company. Subsequent to the filing of the Stipulation, the Commission became aware of a federal indictment alleging that certain entities associated with Cass County shareholder and officer, Ken Matzdorff,

had been involved in a telecom cramming scheme. As a result of Commissioner concerns arising out of the indictment, an on-the-record presentation was conducted on April 19 at which Mr. Matzdorff appeared and testified. Ultimately, while it determined that the Stipulation should be allowed to go into effect, the Commission also expressed ongoing concerns regarding the allegations surrounding the Company and other companies associated with Mr. Matzdorff. As a result, the Commission noted its intentions to continue to monitor the developments regarding the allegations contained in the indictment.

2. On or about July 27, 2004, a federal arrest warrant was issued for Mr. Matzdorff. The affidavit underlying the warrant stated that Mr. Matzdorff “played an integral role, as an associate of the Gambino crime family” in a telephone cramming scheme, as well as an effort to launder the proceeds of both that scheme as well as a separate internet pornography scheme. Specifically, the affidavit indicated that Mr. Matzdorff was instrumental in establishing and operating USP&C, which was the primary vehicle used to place unauthorized charges on customer telephone bills (the cramming scheme). Furthermore, the affidavit indicates that Mr. Matzdorff was instrumental in the operation of LEC L.L.C., which was used as a vehicle for the laundering of proceeds realized as a result of the cramming scheme as well as proceeds realized as a result of the internet pornography scheme. LEC L.L.C. is the principal owner of Cass County Telephone. Finally, the affidavit indicates that Cass County overpaid for certain services provided by a company called Overland Data. The affidavit further stated that the practical effect of this overpayment was to defraud the federal Universal Service Fund (“USF”) and that these defrauded funds were ultimately

laundered by the parent company, LEC L.L.C. and were distributed to Gambino associates.

3. On July 29, 2004, based upon the information contained within the Matzdorff arrest warrant, the Commission authorized its Staff to conduct an investigation surrounding the allegations contained in the arrest warrant. Specifically, the Commission sought information regarding whether Missouri customers or their rates would be affected by the allegations contained in the arrest warrant.

4. On September 30, 2004, the Commission, primarily as result of concerns regarding the allegations contained in the Matzdorff arrest warrant, declined to certify Cass County and New Florence for receipt of high-cost service support from the federal USF. Shortly thereafter, the Federal Communications Commission directed the Universal Service Administrative Company to immediately suspend monthly USF support payments to Cass County and New Florence.

5. Although the charges against Mr. Matzdorff had been temporarily withdrawn, newspaper articles indicate that Mr. Matzdorff has recently plead guilty in Brooklyn federal court to one count of conspiracy to commit wire fraud and one count of conspiracy to launder money. Moreover, subsequent media articles have indicated that Mr. Matzdorff intends to plead guilty in Kansas City federal court to another charge of defrauding the federal USF.

6. Furthermore, the United States government has given notice of its intent to seek criminal forfeiture of certain of Mr. Matzdorff's assets in accordance with Title 18, United States Code, Section 981 (a)(1)(C) and Title 28, United States Code, Section 2461(c). Inasmuch as this forfeiture could reach to operating capital or plant used by

telecommunications companies in Missouri, any potential forfeiture concerns the Commission.

7. As a result of the investigation authorized on July 29, 2004, Staff was anticipating that it would file its Report in the immediate future. Staff and the Commission have concerns, however, that certain information requested from LEC L.L.C. and other affiliated companies may not be forthcoming. Therefore, the Commission deems it appropriate to create a docket for the formal establishment of this investigation as well as the receipt of any Staff discovery problems, for the issuance of any necessary discovery orders, and in order to take additional actions found necessary to protect the customers of the telephone companies affected by these events aforesaid.

LEGAL AUTHORITY TO INTERVENE:

Based upon the Commission's general investigatory power specified in Sections 386.320, 386.330 and 392.250, in addition to specific authority over telecommunications companies found throughout Chapter 392 and set out *infra*, the Staff of the Commission is hereby directed to investigate all matters pertaining to operations of the companies, including assessment of the continuing fiscal and operational reliability of

telecommunications service for the customers of Cass County and New Florence.¹ This investigation includes extensive on-site review and inspections² and may include the need for a change of management and control of the companies by legal means.

Staff is hereby directed to complete a financial review concerning the receipt and disbursement of Universal Service Funds. Missouri statutes provide that:

Any person who shall willfully make any false entry in the accounts, books of account, records or memoranda kept by any corporation, person or public utility governed by the provisions of this chapter, . . . or who shall willfully neglect or fail to make full, true and correct entries . . . of all facts and transactions appertaining to the business of such corporations, . . . or who shall falsely make any statement required to be made to the public service commission, . . . shall be deemed guilty of a felony, and upon conviction shall be punished by a fine of not less than one thousand dollars nor more than five thousand dollars, or by imprisonment for not less than two years nor more than five years, or by both such fine and imprisonment.³

In addition, Section 386.570 provides that any person who violates any law, or who fails to obey any order is subject to a penalty of not less than \$100 nor more than \$2,000 for each offense. Every violation is a separate and distinct offense, and each day's

¹ The commission shall have the general supervision of all telegraph corporations or telephone corporations, and telegraph and telephone lines, as herein defined, and shall have power to and shall examine the same and keep informed as to their general condition, their capitalization, their franchises and the manner in which their lines and property, owned, leased, controlled or operated are managed, conducted and operated, not only with respect to adequacy, security and accommodation afforded by their service, but also with respect to their compliance with all the provisions of law, orders and decisions of the commission and charter and franchise requirements. Section 386.320.1 RSMo 2000.

The commission may, of its own motion, investigate or make inquiry, in a manner to be determined by it, as to any act or thing done or omitted to be done by any telecommunications company subject to its supervision, and the commission shall make such inquiry in regard to any act or thing done or omitted to be done by any such public utility, person or corporation in violation of any provision of law or in violation of any order or decision of the commission. Section 386.330 RSMo 2000.

² The commission shall have power, either through its members or responsible engineers or inspectors or employees duly authorized by it, to enter in and upon and to inspect the property, equipment, building, plants, factories, powerhouses, offices, apparatus, machines, devices and lines of any of such corporations or persons. Section 386.320.2 RSMo 2000.

³ Section 386.560 RSMo 2000. Mishandling records - - false statements - - penalty - - order provisions

continuance thereof shall be and be deemed to be a separate and distinct offense. Similarly, every officer or employee who aids or abets any violation is guilty of a misdemeanor and is punishable by a fine not exceeding \$1,000, or by imprisonment in a county jail not exceeding one year, or by both.⁴ Staff shall pursue evidence of any circumstances discovered during the course of its investigation.

Staff shall also review the conduct of the officers and employees of these companies to determine whether either company has suffered a financial loss, or other damage, as a result of illegal acts. Such a loss should include, but would not be limited to, the companies' loss of USF support. Any such loss, along with attorneys fees and punitive damages, should be recoverable by the company pursuant to Section 392.350.⁵ Circumstances which might support such an action shall be reported to the Commission and the company so affected. In addition, any telecommunications company officer or employee who violates certain provisions of Chapter 392 shall forfeit to the state a sum not to exceed \$5,000 for each day of a recurring offense and this, too, shall be investigated by Staff.⁶

Lastly, the Commission may impose any condition or conditions that it deems reasonable and necessary upon any company providing telecommunications service if such conditions are in the public interest and consistent with the provisions and purposes of this chapter.⁷ This same statutory section provides that the Commission

⁴ Section 386.580 RSMo 2000 Employee of public utility guilt of misdemeanor, when

⁵ Section 392.350 RSMo 2000. See also, Overman v. Southwestern Bell Telephone Co., 675 S.W.2d 419 (Mo.App. 1984).

⁶ Section 386.360 RSMo 2000. Forfeiture - - penalties

⁷ Section 392.470 RSMo 2000 Conditions, commission may impose, when - - compensation to other companies, when, commission may order

may review any certificate of public convenience and necessity issued prior to September 28, 1987, and modify such certificate to impose any reasonable and necessary conditions authorized by this section. The certificates for these companies were both issued prior to that date.⁸

The primary concern of the Commission is the ongoing safe and reliable provision of telecommunications services to the citizens of Missouri. Staff's goal in this investigation should be to ensure the viability of those services. Furthermore, pursuant to the authority contained in Section 386.390, Staff shall be authorized to file complaints on any matters contained within the scope of this order and may further file such complaints or request the Commission authorize the filing of such complaints in this matter as it deems appropriate.

Given the scope of the investigation as set forth herein, the Commission has determined that this docket does not, at this time, meet the definition of a contested case as contained in Section 536.010. As such, the dictates of the Commission's *ex parte* rule are not applicable, and the Staff is directed to seek such additional clarification or authorization it deems appropriate to further the goals contained in this order.⁹ Furthermore, given the inapplicability of the *ex parte* rule, Staff is directed to meet with the Commission, either individually or in a properly noticed agenda session, for the purpose of bringing to light new events as they occur.

⁸ Cass County Telephone was in existence prior to establishment of the Public Service Commission, on April 15, 1913, and is deemed to be certificated as of that date. New Florence Telephone received its certificate on June 28, 1960.

⁹ To the extent that Staff seeks a resolution of a discovery matter or the issuance of subpoenas as discussed in paragraph 7, *supra*, those matters would involve a determination of legal rights and would be subject to the constraints of the *ex parte* rule.

IT IS THEREFORE ORDERED:

1. That case TO-2005-xxxx be established for the purpose of the investigation of the financial and operational status of any certificated company in which Mr. Kenneth Matzdorff has any ownership interest or any operational control or influence resulting from his role as an officer or employee of such company.

2. That the Commission Staff shall undertake any discovery, audit, investigation, or other action it deems appropriate to investigate the financial and operational status of any certificated company in which Mr. Kenneth Matzdorff has any ownership interest or any operational control or influence resulting from his role as an officer or employee of such company.

3. That the Commission Staff shall investigate any matters pertaining to the Universal Service Fund and report any irregularities to the Commission.

4. That the Commission Staff shall file a status report on February 1, 2005, and every 30 days thereafter to inform the Commission of the status of its work herein.

5. That the Commission Staff is hereby authorized to file a complaint(s) on any matters contained within the scope of this order.

6. That this order shall become effective on January 28, 2005.

BY THE COMMISSION

A handwritten signature in black ink that reads "Dale Hardy Roberts". The signature is written in a cursive, flowing style.

**Dale Hardy Roberts
Secretary / Chief Regulatory Law Judge**

(S E A L)

Roberts, Chief Regulatory Law Judge,
by delegation of authority pursuant to
Section 386.240, RSMo 2000.

Dated at Jefferson City, Missouri
on this 14th day of January, 2005.