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STATE OF MISSOURI
PUBLIC SERVICE COMMISSION

At a Session of the Public Service Commission held at its office in Jefferson City on the 16th day of April, 1998.

In the Matter of the Application of KLM Telephone Company for Authority to Borrow an Amount not to Exceed $1,250,000 from CoBank, ACB, and in Connection therewith to Execute a Loan Agreement, Promissory Note, Deed of Trust, Security Agreement and Financing Statement	)	**Case No. TF-98-260**

ORDER APPROVING FINANCING

On December 23, 1997, KLM Telephone Company (KLM) filed an application in this case requesting authority to borrow from CoBank, ACB (CoBank) an amount not to exceed $1,250,000, and to execute a promissory note and a deed of trust, security agreement, and financing statement in connection therewith. On March 23, 1998, the Staff of the Missouri Public Service Commission (Staff) filed a memorandum recommending that KLM's application be granted.

No party to this proceeding has requested a hearing, therefore pursuant to State ex rel. Rex Deffenderfer Enterprises, Inc. v. Public Service Commission, 776 S.W.2d 494, 496 (Mo. App. 1989), the Missouri Public Service Commission (Commission) determines that no hearing is necessary. The Commission, upon consideration of the verified application, the exhibits offered in support of the application, and the recommendation of its Staff, finds and concludes as follows.

KLM is a Missouri corporation with its principal place of business located at Rich Hill, Missouri. KLM is also a public utility subject to the jurisdiction of this Commission pursuant to Chapters 386 and 392, RSMo

1994, as amended, and is engaged in providing telecommunications service to approximately 1,550 customers in four exchanges located in the counties of Vernon and Bates, Missouri.

KLM seeks approval from the Commission to borrow an aggregate principal amount of up to $1,250,000 from CoBank. KLM proposes to execute a promissory note for the repayment of the loan, which will bear interest at a national variable rate or fixed rate to be established by CoBank, and which will provide for the repayment of the indebtedness within ten years. As security for the loan, KLM proposes to execute a deed of trust, security agreement, and financing statement giving a priority lien on substantially all the assets of KLM. Interest will be payable monthly, with repayment of the principal to commence on July 20, 1999, and end on April 20, 2009. Repayment is to be made in 40 equal principal payments payable quarterly on the 20th day of each month following the end of each quarter. KLM will also covenant to CoBank that it will maintain its Leverage Ratio, Debt Service Coverage Ratio, Equity to Assets Ratio, and Current Ratio at certain predetermined levels.

Proceeds from the loan are intended to be used for the construction, completion, extension, and improvement of its facilities in order to comply with the requirements of the network modernization plan approved by the Commission in Case No. TO-97-555. More specifically, the funds are intended for use in connection with the purchase of four Mitel digital switches, so that KLM may offer both interLATA and intraLATA equal access, provide four-digit Carrier Identification Codes, and upgrade outside plant facilities necessary for the provision of single-party service. KLM states that none of the loan proceeds will be used for refunding existing indebtedness, and consequently the entire amount of the proposed financing will be subject to the fee schedule of Section 386.300, RSMo 1994.

Staff has reviewed KLM's application and appendices, including a pro-forma balance and income statement, a capital expenditure schedule, a certified copy of the resolutions of the directors of KLM, and a commitment letter by CoBank. Staff states that KLM's capital structure currently consists of 100 percent common equity, but on a pro-forma basis will consist of 62.59 percent common equity and 37.41 percent long-term debt. Staff indicates that interest coverage ratios are not meaningful because KLM does not have any outstanding debt, but on a pro-forma basis the pretax interest coverage ratio will be 1.44 times, a ratio which Staff considers low. Although the low ratio raises some concern, Staff believes that the Company's cash flow position should improve, and as new plant is installed, depreciation expense and revenue should increase.

Staff analyzed the four financial ratios which KLM is required to maintain pursuant to the commitment letter. Staff notes that KLM will be required to maintain a Leverage Ratio (total debt divided by net income plus interest expense, depreciation and amortization expense, and income tax expense) of 3.00 times or less. On a pro-forma basis KLM's Leverage Ratio will be 2.92 times. Staff points out that this comes close to not complying with the Leverage Ratio. KLM will also be required to maintain a Debt Service Coverage Ratio (net income plus interest expense plus depreciation and amortization expense divided by interest expense plus principal payment required during the year) of 1.75 times or greater. Staff states that on a pro-forma basis, KLM's Debt Service Coverage Ratio will be 3.4 times. However, Staff notes that the 3.4 times Debt Service Coverage Ratio represents the first year of the loan when the Company will only be making interest payments. Staff maintains that in year two, when KLM begins making principal payments, the denominator will greatly increase, which will drive the ratio lower. Staff states that these concerns do not warrant a denial of the application, as Staff believes that the Company's cash flow position should improve over time.

Staff concludes that the Commission should approve the proposed transaction subject to the requirements that KLM be required to file the final terms and conditions associated with the financing in the Commission's official case file, and that the Commission reserve the right to consider the ratemaking treatment to be afforded the transaction and the resulting cost of capital in a later proceeding.

The Commission has reviewed the application and appendices of KLM, and the recommendation of Staff, and determines that KLM should be granted authority to borrow an aggregate principal amount of up to $1,250,000 from CoBank, as described in the application and appendices. The Commission finds that the uses contemplated for the proceeds of the loan are reasonable and will inure to the benefit of KLM's customers as a whole. Thus the Commission finds that the contemplated loan is reasonably required for the purposes specified in this order, and such purposes are not, in whole or in part, reasonably chargeable to operating expenses or to income. The Commission also finds that Staff's conditions are appropriate.

The Commission acknowledges the legitimate concerns raised by Staff. Staff nevertheless has recommended approval of KLM's financing application, and the Commission concurs. The need for a loan by KLM in order to finance its network modernization plan was anticipated by both the Staff and the Commission at the time the plan was approved. *See* Re KLM Telephone Company's Modernization Plans Pursuant to 4 CSR 240-32.100, Case No. TO-97-555, Order Approving Network Modernization Plan, issued December 9, 1997, at 4, 7. The Commission also recognizes the difficulties experienced by companies the size of KLM when borrowing funds. The Commission concludes that KLM's financing application should be approved.

IT IS THEREFORE ORDERED:

1. That KLM Telephone Company is authorized to borrow an aggregate principal amount of up to $1,250,000 from CoBank, ACB.

2. That KLM Telephone Company is authorized to execute, deliver, and perform the necessary agreements relative to the financing authorized herein.

3. That KLM Telephone Company is authorized to do all things not contrary to law or the rules and regulations of the Missouri Public Service Commission, necessary to the performance of the acts specifically authorized in this order, including the execution of such other agreements and documents as are reasonably necessary to the furtherance of the financing authorized herein.

4. That the proceeds from the proposed financing shall be used for the purposes specified herein and no other.

5. That KLM Telephone Company is directed to file the final terms and conditions associated with this financing in the Commission's official case file, within 30 days of the documentation becoming available to KLM.

6. That KLM Telephone Company is directed to submit to the Missouri Public Service Commission's Internal Accounting Department a report verified by an appropriate official of KLM, reflecting the journal entries recorded relating to the use and application of the loan proceeds of the financing authorized herein, within 30 days after the receipt of any loan proceeds.

7. That nothing in this order shall be considered a finding by the Commission of the reasonableness of the expenditures herein involved, the value for ratemaking purposes of any properties herein involved, or as an acquiescence and the value placed on any such properties by KLM Telephone Company. Furthermore, the Commission reserves the right to consider the

ratemaking treatment to be afforded these financing transactions, and the resulting cost of capital, in any later proceeding.

8. That this order shall become effective on April 28, 1998.

BY THE COMMISSION

Dale Hardy Roberts

Dale Hardy Roberts
Secretary/Chief Regulatory Law Judge

(S E A L)

Lumpe, Ch., Murray, Schemenauer
and Drainer, CC., concur.
Crumpton, C., dissents.

Bensavage, Regulatory Law Judge