The Staff's Initial Report Regarding the Impact of the Allegations of Criminal Activities by Kenneth Matzdorff on Missouri Utility Consumers

January 31, 2005

**** <u>Denotes HIGHLY CONFIDENTIAL Information</u> ****

NP

Table Of Contents

Disclaimer

While the Staff has endeavored to verify all of the information disclosed in this report and accurately disclose that information, some of the statements made in this report are based on allegations and others are based on the Staff's best understanding of the information available to it at the present time. The Staff has endeavored to provide citations or source information that it relies on for the statements it makes in this report.

Attachment Description

1. Mr. Matzdorff Guilty Plea in United States Eastern District Court of New York

1a. Mr. Matzdorff Guilty Plea in United States Western District Court for the District of Missouri Western Division

2. Companies/Organizations Noted in Staff's Investigation

3. Individuals/Trusts Noted in Staff's Investigation

4. Missouri Utilities Noted in Staff's Investigation

5. States Noted in Staff's Investigation

6. Addresses Noted in Staff's Investigation

7. Mr. Matzdorff Investigation Chronology

8. Federal Indictment in United States Eastern District Court of New York

9. Description of Cramming Scheme

10. Description of Internet Fraud Scheme

11. Mr. Lovern's March 29, 2004 Memorandum

12 Fidelity Communications, Inc. Organizational Structure

13. Mr. Matzdorff MoPSC Testimony on April 19, 2004

14. Cass County Telephone Company LP's November 30, 2004 response to Staff Data Request No. 22.

15. Cass County Telephone Company LP's November 30, 2004 response to Staff Data Request No. 6.

16. Cass County Telephone Company LP's November 30, 2004 response to Staff Data Request No. 8.

17. Southwestern Bell Telephone Company Brief

18. Mr. Matzdorff's Federal Arrest Warrant

19. Oregon Farmers' Comments to the Staff's Report

20. New Florence Telephone Company's Comments to the Staff's Report

21. Cass County Telephone's Comments to the Staff's Report

Section 1. Summary

This is the initial report by the Staff of the Missouri Public Service Commission on the its investigation into the activities of certain telecommunications providers regulated by the Missouri Public Service Commission and their business relationships with certain other entities. The investigation began after public dissemination of federal allegations of organized crime involvement in the telecommunications industry in Missouri. Both Kenneth Matzdorff and Local Exchange Company, LLC were specifically mentioned in the federal allegations. Both are involved in the telecommunications industry in Missouri and have ownership interests in one or more telecommunications providers regulated by the Commission. Recently Mr. Matzdorff pled guilty to federal charges of telephone cramming, internet-activity based fraud (See Attachment 1) and a conspiracy to defraud the National Exchange Carriers Association and the Universal Service Administrative Company, the administrator of the Federal Universal Service Fund (See Attachment 1a).

The Staff began investigating the activities of Missouri telecommunications providers and their business relationships with certain other entities for the direct or indirect involvement of Kenneth Matzdorff and/or Local Exchange Company, LLC. As its investigation progressed, the Staff expanded the list of involved persons and entities it used as a screen for determining which business relationships to further investigate. Further, the Staff considerably expanded the scope of its investigation as new information it obtained warranted further investigation and review.

The Staff plans to file a final report after it completes its investigation; however, the Staff notes that, thus far, new developments have continually arisen as federal investigations and litigation have progressed. Activity significant to the Staff's investigation has occurred in New York, Washington D.C. and Missouri. The Staff continues to monitor this activity for new developments, including those that arise from grand jury proceedings, criminal proceedings and plea agreements.

The Staff provided pertinent sections of the Staff's Draft Report to Oregon Farmers Mutual Telephone Company, New Florence Telephone Company and Cass County Telephone Company, LP, seeking review and feedback from each company.

Attachments 19, 20 and 21, respectively, provide the companies' responses to the Staff's Draft Report.

Several Staff members and attorneys from the General Counsel's Office support the Staff investigation. Craig Branum, Natelle Dietrich, Steve Dottheim, Wess Henderson, Dan Joyce, Bob Schallenberg, John VanEschen, Nathan Williams, Dave Winter and Toni Charlton played significant roles in the development of the content for this report.

Background

The catalyst for this investigation was a February 14, 2004 article in the *Kansas City Star* that notes the implication of Kenneth M. Matzdorff in nationwide phone and Internet schemes linked to organized crime. Mr. Matzdorff, who held officer positions with several Missouri telephone companies, was cited for holding or having held positions "with a web of little-known Missouri and Kansas companies" including firms "that figure prominently in a criminal indictment returned earlier this week in New York." The article specifically mentions that USP&C, Inc. and Local Exchange Company, LLC "were at the heart of the scheme, according to the indictment and other court documents." The article also mentions "a call center affiliated with USP&C to handle complaints" from customers regarding unauthorized charges. The article later identifies this call center as Telecom Operator Services Inc. Ken Matzdorff had relationships with USP&C, Inc., Local Exchange Company, LLC, and Telecom Operator Services, Inc.

Cass County Telephone Company is a limited partnership, and Local Exchange Company, LLC is the managing partner. The Staff, the Office of the Public Counsel and two representatives for Cass County Telephone Company, Trip England and Ken Matzdorff, met on February 23, 2004 to discuss the *Kansas City Star* article regarding the criminal investigations and their impact on a rate reduction agreement reached in a pending case, Case No. IR-2004-0354, *In the Matter of the Investigation into the Earnings of Cass County Telephone Company*. After holding an on-the-record presentation by the parties on April 19, 2004 regarding the agreement, the Commission issued an order on April 29, 2004, approving that agreement.

On February 18, 2004 the outside auditor for Local Exchange Company, LLC and the Cass County Telephone Company partnership, Mize, Houser & Company, discussed with

Ken Matzdorff, the president of Local Exchange Company, LLC their status as an independent auditor for Local Exchange Company, LLC, the Cass County Telephone Company LP and CassTel LD. Local Exchange Company is required by its lender, CoBank, to annually submit an independent auditor's report. The Staff was unaware of these discussions.

On February 23, 2004, Mize, Houser & Company formally notified Mr. Matzdorff that, as of that date, it would not perform any additional audit or other professional services to Local Exchange Company, LLC, Cass County Telephone Company LP or CassTel LD. The auditor's decision was related to the issues raised in the federal indictment referenced in the February 14, 2004 *Kansas City Star* article regarding the current ownership of Local Exchange Company, LLC. Individuals named in the federal indictment comprise a majority interest in Local Exchange Company, LLC. The Staff was never informed of Mize, Houser & Company's withdrawal as auditor[1].

During the April 19, 2004 on-the-record presentation the Commission held in Case No. IR-2004-0354, *In the Matter of the Investigation into the Earnings of Cass County Telephone Company,* addressing certain matters, including the criminal allegations known at that time, Mr. Matzdorff testified about his relationship and involvement with firms and individuals named in the February 14, 2004 *Kansas City Star* article.

On April 29, 2004, the Missouri Public Service Commission approved the agreement between the parties in Case No. IR-2004-0354 that required Cass County Telephone Company to reduce its revenues by about $320,000 per year. Although the Commission's order approved the settlement, the Commission noted its concern over "the allegations surrounding the company" and stated that it would "consider opening a separate case to monitor developments regarding those allegations."

On June 10, 2004, Local Exchange Company, LLC issued a request for proposal to five audit firms approved by its lender, CoBank, for bids to perform audit services for Local Exchange Company, LLC, Cass County Telephone Company LP and CassTel LD.

On July 14, 2004, Warinner, Gesinger & Associates, apparently the only offeror, submitted a proposal to conduct financial statement audits of Local Exchange Company, LLC, Cass County Telephone Company LP and CassTel LD[2].

On July 22, 2004 the Federal Department of Justice filed a complaint against Kenneth Matzdorff and obtained a warrant for his arrest. On July 27, 2004 the Federal Bureau of Investigation (FBI) arrested him. The affidavit in support of the arrest warrant included allegations of telephone- and internet-based criminal fraud and allegations that the criminal fraud was ongoing since 1996 and includes transactions involving Cass County Telephone Company, LP and its affiliates. On October 27, 2004 the complaint was dismissed without prejudice. As stated below, in January of 2005, Mr. Matzdorff pled guilty to charges based on the same activities that were alleged in the affidavit supporting the arrest warrant.

On or about October 28, 2004, the Department of Justice filed a fifth superceding indictment in the United States Eastern District Court of New York naming ten (10) individuals from the New York area and one business involved in a phone cramming and Internet pornography schemes. These ten individuals are: Salvatore Locascio, Richard Martino, Zef Mustafa, Norman Chanes, Daniel Martino, Andrew Campos, Thomas Pugliese, Lawrence Nadell, Yitzhak Levy, and Kenneth Schaeffer. USP&C, Inc. was the business named in the indictment. A November 3, 2004 *Kansas City Star* article reported that three of these defendants pleaded guilty in October 2004 to charges of obstruction of justice or concealing evidence of a crime. Lawrence Nadell, Yitzhak Levy and Kenneth Schaeffer pleaded guilty to superseding charges on November 11, 2004 and were scheduled at that time to be sentenced on January 19, 2005. The remaining defendants face more serious charges under the federal Racketeer Influenced and Corrupt Organizations Act ("RICO") and are scheduled to go to trial February 7, 2005.

On September 30, 2004, the Missouri Public Service Commission declined to certify that either Cass County Telephone Company or New Florence Telephone Company are using their high-cost service support in accordance with Section 254 (e) of the Telecommunications Act of 1996.

On October 15, 2004, the Federal Communications Commission directed the Universal Service Administrative Company to immediately suspend monthly support payments both to Cass County Telephone Company LP and to New Florence Telephone Company.

On December 1, 2004 New Florence Telephone Company appealed the suspension of federal Universal Service Fund payments. On December 17, 2004 the Federal

Communications Commission (FCC) released its notice seeking comments on New Florence Telephone Company's appeal, and the Staff of the Missouri Public Service Commission filed comments on January 4, 2005.

Similarly, on January 4, 2005, Cass County Telephone Company appealed the suspension of its Universal Service Fund payments.

On January 7, 2005, Mr. Matzdorff pled guilty in New York to federal charges of conspiracy to commit mail fraud and money laundering based on telephone cramming and internet-activity based fraud.

On January 18, 2005, Mr. Matzdorff pled guilty to a federal charge of conspiracy to commit mail and wire fraud based on a conspiracy to defraud both the National Exchange Carriers Association and the Universal Service Administrative Company, the administrator of the Federal Universal Service Fund.

Mr. Matzdorff has had overall management responsibility for the Missouri and Kansas operations of Cass County Telephone Company, LP since the limited partnership acquired Missouri exchanges from GTE of the Midwest in 1996. Mr. Matzdorff was also the president of Local Exchange Company, LLC (doing business in Missouri as LEC LLC), and the general partner of Cass County Telephone Company, LP. Cass County Telephone Company, LP is a local exchange carrier with local telephone operations regulated by both the Missouri Public Service Commission and the Kansas Corporation Commission as well as the FCC.

Prior to the arrest of Mr. Matzdorff, the FBI brought similar telephone- and internet-criminal fraud charges against individuals who are alleged to be associates and members of the Gambino Family [3]of La Cosa Nostra. Those charges included allegations involving Local Exchange Company, LLC. On July 9, 2004 the United States District Court for the Eastern District of New York entered a restraining order prohibiting the transfer of assets of those individuals, including their interests in Local exchange Company, LLC.

Mr. Matzdorff has pled guilty to three charges (two in New York and one in Missouri). When he was arrested, in addition to his position at Cass County Telephone Company, LP and LEC LLC, he held various officer positions in other Missouri telephone companies. Mr. Matzdorff has been active and prominent in the Missouri telephone industry for a number of years and has many relationships with other companies in the industry.

Initial Conclusions

The Missouri Commission, on July 29, 2004, ordered its Staff to investigate the issues surrounding the allegations made in the federal indictment and the affidavit supporting the arrest warrant issued against Mr. Matzdorff, and inform the Commissioners of whether Missouri customers or their rates would be affected if the allegations were true. Sections 2 and 3 of this report will provide details regarding the Staff's current recommendations and conclusions.

This initial report will show that there has been a negative impact on service provided to Missouri consumers served by Cass County Telephone Company and New Florence Telephone Company. There remain outstanding questions relative to the legitimacy of the cost data used to set rates for these Missouri telephone companies. There could be long-term negative impacts on customer service depending on the results of the continuing federal prosecutions and investigations.

The Commission further ordered its Staff to establish processes to cooperate with federal investigations of these matters. The Commission instructed its Staff to investigate this matter, establish processes to address related activities, and develop recommendations regarding future courses of action. The objective of these activities was to move the Missouri Public Service Commission from a reactive mode to negative news regarding this matter to a position of assessment and action. These processes have been established and appear to be operating satisfactorily at this time. The Staff has established individuals as point of contacts with external entities regarding this matter. The specifics of this process are contained in Section 14 of this report. The Staff discusses the status of its activities related to this matter with the Commission during the Commission's agenda sessions—generally held each Tuesday and Thursday.

In light of allegations of criminal conduct made by the United States against owners of telecommunications carriers regulated by the Missouri Public Service Commission, including Mr. Matzdorff, who ultimately pled guilty to telecommunications industry related fraud charges, the Staff designed the initial scope of its investigation to uncover actual and potential negative impacts on both telecommunications carriers and telecommunications customers in Missouri, if the allegations were true. The Staff also included in the original scope of its investigation an examination of the extent of Mr. Matzdorff's activities directly and indirectly related to Missouri utilities. This report will disclose that Mr. Matzdorff was involved in significantly more of these types of activities than the Staff knew of at the time he was arrested. Mr. Matzdorff engaged in extensive business dealings beyond his activities as President of Cass County Telephone Company. The details of his business relationships known to Staff are detailed in Section 5 of this report.

The Staff searched for links, direct and indirect, between Mr. Matzdorff and: 1) Companies, 2) Utilities, 3) Individuals, and 4) States. The steps that the Staff took in conducting its investigation are discussed in Section 4 of this report. To manage the wealth of information Staff has been obtaining, the Staff created several databases to track the relationships between different individuals and entities that the Staff learns of during its investigation. The current status of these databases, as well as known links to Mr. Matzdorff or the federal activities, are contained in Attachments 2 through 6 of this report. The Staff also has created a chronology of events to disclose relationships that appear from the timing of events. The current chronology is contained in Attachment 7 of this report.

During the investigation, William M. Lovern, Sr., a prior associate of Mr. Matzdorff, contacted the Commission on several occasions regarding his assertions of a secret telephone billing system operating in Missouri and Mr. Matzdorff's experience and knowledge of the use of that system. Section 6 of this report details Mr. Lovern's assertions and includes Southwestern Bell's explanation regarding his assertions and associated litigation. Mr. Lovern's assertions are found in a letter from him that is included in this report as Attachment 11. Recently, the Commission received a similar letter. Mr. Lovern's concerns have been known for over a decade and reported to agencies and groups with some authority to address his concerns on a criminal or civil basis to the extent these organizations determine that his concerns justify such action. Mr. Lovern has demonstrated a pattern of threatening litigation for those that do not do as he wishes or disagree with his position. At this time, the Staff recommends that the Commission take no action in response to Mr. Lovern's assertions of a secret telephone billing system operating. No further action is recommended regarding his issues at this time.

In conducting its investigation, the Staff first isolated specific concerns then traced their impacts on Missouri. The Staff identified five potential categories of inappropriate conduct. These were: 1) telephone cramming, 2)credit card/internet fraud, 3) money laundering, 4) overpayment for goods and services, and 5) anti-trust/Modified Final Judgment (MFJ) violations (i.e. Mr. Lovern's issue). Detailed descriptions of the alleged phone and internet frauds are contained in Attachments 9 and 10, respectively. Activities related to this investigation are detailed in Section 13 of this report. These activities include investigations as well as litigation.

The alleged conduct that would most likely impact operations under the jurisdiction of the Commission is fraud through money laundering and overpayment for goods and services. The Staff identified three conditions that would be conducive to allowing this type of fraud to take place. The possibility of this type of fraud is greater where there are individual(s) that are: 1) knowledgeable to conduct the fraud and cover its detection, 2) able to approve receipt and disbursement of funds, and 3) in a position to personally benefit from the transaction. The investigation identified five Missouri local exchange companies with that exposure with respect to Mr. Matzdorff. Of these companies, Cass County Telephone Company LP and New Florence Telephone Company have the greatest exposure. Sections 10 and 11 of this report provide additional details regarding Cass County Telephone Company LP and New Florence Telephone Company. The other Missouri telephone companies that the Staff examined are discussed in Section 12 of this report.

Based on federal allegations of criminal conduct, Local Exchange Company, LLC (LEC LLC) significantly exposes Missouri utilities to the possibility of inappropriate conduct. LEC LLC has significant ownership interests in both Cass County Telephone Company LP and New Florence Telephone Company. It also has had significant transactions with both of these companies. Based on documentation and information uncovered to date, LEC LLC is largely owned, directly or indirectly, by individuals indicted in New York for the telephone and internet fraud schemes. Additional details regarding LEC LLC's relationship to Cass County Telephone Company LP and New Florence Telephone Company and the indicted individuals are discussed in Section 9 of this report. Two firms, USP&C, Inc. and Overland Data Center, were heavily involved in the telephone fraud. The indicted individuals are also alleged to play prominent roles with these firms. USP&C and Overland Data Center are discussed in Sections 7 and 8 of this report.

Despite public release of the federal allegations, neither Cass County Telephone Company LP nor New Florence Telephone Company have conducted internal reviews or audits to perform risk assessments of their exposure to harm due to the activities disclosed by the allegations or the activities of persons named in them. Both Cass County Telephone Company and New Florence Telephone Company have conducted significant transactions with entities affiliated with their officers that approved those transactions. Both Cass County Telephone Company and New Florence Telephone Company receive NECA settlements and Universal Service Fund payments based on their actual costs. The investigation has shown certain inconsistencies between Mr. Matzdorff's testimony before the Commission on April 19, 2004 and other information the Staff has obtained. The inconsistencies are detailed in Sections 5 and 7 of this report as they relate to Mr. Matzdorff and USP&C, respectively.

Section 2. Recommendations

1. Kenneth M. Matzdorff relinquish all managerial and financial authority for Cass County Telephone Company L.P.

2. Rebecca Matzdorff be suspended by the Company from all managerial and financial authority for Cass County Telephone Company LP pending the completion of the Staff's investigation as directed by the Commission in Case No. TO-2005-0237.

3. Controller Debi Long relinquish all authority regarding any receipts and disbursements of Cass County Telephone Company LP funds pending the completion of the Staff's investigation as directed by the Commission in Case No. TO-2005-0237.

4. The Staff explore all options to eliminate the role of LEC LLC regarding the ownership, financing, operation and financial affairs of Cass County Telephone Company LP and New Florence Telephone Company.

5. The Staff initiate an earnings review and audit of New Florence Telephone Company.

6. The Staff initiate an earnings review and audit of Cass County Telephone Company.

7. The Staff initiate management audits of both Cass County Telephone Company and New Florence Telephone Company, to include but not be limited to: 1) quality of service, 2) the operations of the business office, and 3) related party transactions safeguards and controls.

8. The Staff monitor the operation of the Oregon Farmers under its new ownership arrangement and examine the reasonableness of internal controls relative to prior related party transactions.

9. The Staff ensure that Century Tel and Spectra have in place an audit program and overall internal controls sufficient to detect possible wrongdoing and report the results of these efforts.

10. The Staff explore Joint Audit option(s) with NECA, Federal Communications Commission, Universal Service Administrator Company, and other interested entities to minimize duplication of effort and improve overall knowledge of the audits and investigations of these matters.

11. The Staff depose Kenneth Matzdorff, Rebecca Matzdorff and Controller Debi Long regarding the scope of their non-Missouri regulated telephone company activities, current Cass County operations, relationship and operation of LEC LLC, relationship and operation of Haug Construction, relationship and operation of Local Exchange Carriers, LLC, relationship and operation of the other firms identified in Section 5,

and identification of other firms related to Mr. Matzdorff that have not yet been identified.

12. The Staff initiate discussions with Missouri LECs and Missouri Telephone Industry Association (MTIA) regarding development of a whistleblower program for Missouri telecommunications activities.

13. The Staff initiate discussions with interested parties to develop an affiliate transaction rule for small Missouri telephone companies.

14. The Staff modify the Missouri telephone company annual report format to include identification of related party transactions above a specified threshold and the amount of the transaction.

15. The Staff continue to work with federal agencies involved in the investigation of these matters.

16. The Staff investigate as part of Case No. TO-2005-0237 other employees of Cass County Telephone Company LP, New Florence Telephone Company and LEC LLC for possible removal.

Section 3. Initial Conclusions

1. Mr. Matzdorff engaged in extensive activities beyond those required to be an officer of a Missouri local exchange company.

2. Mr. Matzdorff has several business dealings with Robert D. Williams.

3. Mr. Matzdorff has a background and experience in many of the telephone areas linked to the activities at issue in the federal investigation.

4. Cass County Telephone Company LP and New Florence Telephone Company have the greatest exposure to potential wrongdoing at this time.

5. Spectra and CenturyTel have minimal exposure to potential wrongdoing at this time.

6. Oregon Farmers have adequate controls or third-party assurances to keep its exposure to potential wrongdoing at acceptable levels at this time.

7. Southwestern Bell Telephone had adequate controls in place to terminate doing business with USP&C by December 1999 to minimize Missouri exposure to cramming activities.

8. Mr. Matzdorff's April 19, 2004 testimony to this Commission was inconsistent with his other testimony and/or other known facts.

9. A significant portion of the ownership of LEC LLC is tied to individuals under indictment in New York.

Section 4. Investigation Approach

I. Audit Steps

The Staff organized its investigation into a series of steps. First, the Staff collected data it believed would be useful for finding and examining relationships between Mr. Matzdorff and the other defendants to companies, individuals, and Missouri utilities. Then the Staff examined the data collected to determine any relationships between companies/individuals to addresses, states, or registered agents. To obtain the data the Staff utilized free Secretary of State searches, selective fee-based Secretary of State searches, specific requests to the Missouri Secretary of State, and responses the Kansas Corporation Commission received to requests it made to the Kansas Secretary of State. The Staff analyzed this data in conjunction with information from available: 1) federal indictments, 2) federal arrest warrants, 3) specific data requests to Missouri companies, and 4) prior case information under this Agency's control.

The Staff expanded its first step to include exploration and analysis of Mr. Lovern's allegations that were received and discussed verbally over the telephone and supplemented with material provided through e-mail and facsimile transmissions. The Staff expended considerable time and resources in dealing with Mr. Lovern's issues. The Staff discussed those issues with Southwestern Bell to obtain its response. Mr. Lovern offered a Mr. James Shields, Jr. as an additional source of support for his positions. Although the Staff attempted to contact Mr. Shields, he was unavailable and the Staff left a voice mail for him with his firm. A firm assistant returned the call stating that Mr. Shields was involved in a significant trial and would contact the Staff following the conclusion of the trial. The Staff still has not had direct contact with Mr. Shields.

Second, the Staff organized the data it collected together with the other information it had into specific areas of concern. These areas of concern will be discussed in detail later in this section. The purpose of this step was to identify the areas of concern that could directly adversely impact utility services under the Commission's jurisdiction. There are allegations of inappropriate actions (i.e., internet fraud) that involve activities beyond the jurisdiction of the Missouri Commission. The Staff has attempted to identify the organization in the best position to investigate and address issues it has uncovered that are beyond the jurisdiction of the Commission.

Third, the Staff identified the Missouri companies that had exposure to the areas of concern impacting Commission regulated activities with potential relationships to Mr. Matzdorff or the activities mentioned in the federal criminal actions. Each Company was then examined for: 1) risk exposure to the areas of concern; 2) existence of any safeguards to minimize the occurrence of actual negative consequences; and 3) independent third-party reviews.

II. Activities of Concern - Federal Indictment-Activities

1. Telephone Cramming

Cramming is defined as the practice of placing unauthorized or improper charges on consumer bills with the expectation that the customer will pay the inappropriate amounts. The source of the information for the telephone cramming scheme is "The USP&C Telephone Cramming Fraud Scheme" described beginning on page 7 of the US Eastern NY District Court Superceding Indictment 03-304 (S-4) (CBA) contained in is entirety as Attachment 8 to this report. In that indictment Richard Martino, Norman Chanes, Daniel Martino, Andrew Campos, Thomas Pugliese, Lawrence Nadell, Yitzhak Levy, and USP&C are accused of devising and executing a scheme to defraud consumers by placing unauthorized charges on their local telephone bills and collecting payment of those unauthorized charges. This practice is referred to as a "cramming" scheme. Attachment 9 provides details regarding the telephone cramming scheme that is subject of the federal litigation. Lawrence Nadell, Yitzhak Levy and Kenneth Schaeffer pleaded guilty to superseding charges on November 11, 2004 and were scheduled at that time to be sentenced on January 19, 2005.

The following statements is based on allegations in the federal indictment: The federal defendants are alleged to have engaged in this scheme by advertising free samples of adult entertainment services, such psychic hotlines, dating services, and sexually oriented talk-lines using

“1-800” telephone numbers. This advertising was provided through a firm named Harvest Advertising, Inc. This firm would create scripts for two sets of pre-recorded programs and retain voice professionals to make recordings of both scripts. The recordings were then provided to a firm called Mical Properties, Inc. The first set of recordings would be used related to the actual processing the calls to the “1-800” numbers. Harvest Advertising, Inc. placed advertisements in various media, including adult magazines, promising free samples of the promoted entertainment services. The purpose of the second set of materials will be discussed later.

The following statements are also based on allegations in the federal indictment. A series of companies were established to offer the “1-800” telephone services. These companies include ASP Communications, Inc. (“ASP”), Benchmark Communications (“Benchmark”), Lunar Tel, Inc. (“Lunar”), Spring Telcom, Inc. (“Spring”), Special Comtel, Ltd. (“Special Comtel”), Enhanced Phone Services (“Enhanced Phone”), Messenger Com (“Messenger”) and Voice Delivery Service Inc. (“Voice Delivery”). These companies are referred to as the “Campos Companies” in the federal indictment. It is alleged that Andrew Campos operates these companies. The companies have no employees or physical office space other than rented mailboxes around the country. Each company registered multiple “1-800” telephone services under multiple fictitious names with their billing aggregator and the various local exchange carriers that would actually be expected to place their charges on customer telephone bills.

According to the federal allegations: Individuals that called the “1-800” numbers to avail themselves of the alleged free samples heard pre-recorded programs that, without their knowledge, consent or authorization, triggered a recurring monthly charge on their local telephone bill for voice-mail service. A firm called Overland Data Center received and processed consumer calls to the various “1-800” telephone numbers on behalf of the Campos Companies. This firm is located in Overland Park, Kansas. This firm operated telephone lines and voice response units, which processed consumer calls, and played the pre-recorded programs that trigger the unauthorized charges on customer bills. Mical Properties, Inc. provided the pre-recorded programs used by Overland Data Center.

USP&C was formed to perform a billing aggregator function. USP&C was initially located in Kansas City, Missouri. The billing aggregator function is a billing and collection service that is described in detail in the background portion contained in Section 7 of this report that addresses USP&C. According to the federal allegations, the Campos Companies entered into contracts with USP&C to provide billing aggregation services. Overland Data Center would provide to USP&C the actual customer information obtained through customers calling the free sample "1-800" numbers. This customer information would include the unauthorized charges generated by the customer's use of the "free sample" "1-800" numbers. USP&C would submit this information to the customer's local exchange company for inclusion on the customer's telephone bill, after formatting the information in manner acceptable to the relevant local exchange company.

The United States has alleged that to conceal and implement this scheme, a second set of advertisements, pre-record program text, and voice-mail related materials were created. This material appeared to properly seek consumer authorization to charge a recurring fee for a voice-mail service, whose features were fully described. The second set of material was not actively marketed to the public. The second set of material was used with local exchange companies, regulatory bodies, law enforcement agencies and complaining customers to justify the charges placed on customer bills. This information was submitted to USP&C and the local exchange companies to show the legitimacy of charges being placed on customer bills. In the federal indictment the United States alleges that during 1997 to 2001 between ** _______ ** and ** ________ ** in gross revenues were placed daily on local exchange company telephone bills related to these unauthorized charges.

A large portion of the customers that received these unauthorized charges on their telephone bills complained about them. Telecom Operator

Services, Inc. was a call center created to handle customer complaints, and received a large volume of these complaints. Telecom Operator Services, Inc. was affiliated with USP&C and they were both located in the same building. Telecom Operator Services, Inc. employed telephone operators to handle customer complaints. It was important that the local exchange companies did not learn, or were delayed in learning, about the actual volume of customer complaints so they did not take action to prevent the continued placement of the unauthorized charges on their customers' bills. The operators at Telecom Operator Services, Inc. were directed to initially attempt to persuade customers that the charges were indeed valid by using the second set of materials, if needed. If a customer continued to complain, then the operator was to offer a partial refund. A full refund was only offered after it became apparent that the customer would not accept anything less.

The operators were also instructed to provide a "1-800" number that used the second set of material in the event that the customer requested the number that had triggered the unauthorized charge. Overland Data Center would process the calls to the "1-800" numbers that used the second set of materials, if the customer called the "1-800" number that the operator had provided. The practice of providing the new "1-800" number and offering full refunds had the effect of reducing the number of customers that would contact local exchange companies or governmental agencies regarding their issues. The federal indictment alleges that, on average, approximately 50% of the unauthorized charges were refunded to complaining customers.

These practices for handling customer complaints were not successful in preventing a significant number of customers from contacting their local exchange company, state regulatory body, or state Attorney General. As awareness of the problem grew enforcement actions were taken in California, Massachusetts, New York, Ohio and Wisconsin. Initially, USP&C sought to mollify those who raised the issue and were in a position to take action by canceling billing privileges to the Campos Company or companies that had come to the attention of the governmental entity or local exchange company and create new shell companies as replacement USP&C clients. Thomas Pugliese was the nominal owner and president of these new shell companies. Southwestern Bell Telephone Company (now Southwestern Bell Telephone, LP) initiated litigation and discontinued the provision of billing services to USP&C in its service territory after it became aware of the problem.

One of these new shell companies, Invesco Telecommunications, Inc., did business as "Southwest Region Bill" in order to send bills containing unauthorized charges to customers in the five states where Southwestern Bell operates. These bills strongly resembled the Southwestern Bell's bill formats, in that used nearly identical typeface, font size, item placement, color and size. The Invesco bills were mailed out by USP&C. The Missouri Attorney General and other regulators acted to stop the Southwest Region Bill practice. These lawsuits and investigations are described in further detail in Section 13 of this report. Section 7 of the report provides additional detail regarding operations started after USP&C lost billing capability in Missouri.

Some customers did pay the unauthorized charges to their local exchange company. In turn the local exchange company would send the payments to USP&C. USP&C remitted the payments to the Campos Companies or their replacements, net of USP&C expenses and refunds. The Campos Companies or their replacements paid the bulk of the proceeds they received to Overland Data Center and Fairfax Telecommunications, Inc. Overland Data Center paid the vast bulk of the proceeds it received to Mical Properties, Inc. (until approximately mid-2000) and then to Telcom Online, Inc. (after mid-2000). Overland Data Center also paid some of the proceeds it received to LEC LLC, the majority owner (i.e., 99%) of Cass County Telephone Company LP and a one-third owner of New Florence Telephone Company. Fairfax Telecommunications, Inc. paid the proceeds it received to Baseline Telecommunications, Inc., Dynamic Telecommunications, Inc., Mical Properties, Inc. and Harvest Advertising, Inc. Dynamic Telecommunications, Inc., in turn, paid a portion of the proceeds it received to Mical Properties, Inc. and Harvest Advertising, Inc. In mid-2000 Mical

Properties, Inc. changed its name to Telcom Online, Inc. Mical Properties, Inc. (then Telcom Online, Inc.) paid a portion of these telephone cramming proceeds to Creative Program Communications, Inc. In the federal indictment the United States alleges that these payments were made to satisfy an organized crime obligation to funnel a portion of illegal proceeds to persons in the Gambino family who were not directly involved in the telephone-cramming scheme.

2. Missouri Consumer Exposure to Telephone Cramming Scheme

The cramming scheme only affected those consumers who paid the USP&C charges that were placed on their bills by their local exchange carrier. The Staff inquired of Southwestern Bell as to the amount of revenue that it collected, if any, on USP&C's behalf in Missouri. This amount should represent a majority of the adverse impact on Missouri consumers from the Cramming scheme. Mr. Paul Lane, General Counsel-Missouri and Kansas for Southwestern Bell provided the following response:

** ____

____

____

____

____

____

____

____

____

____

______________________________ **

This information is considered as confidential pursuant to the provisions of Section 386.480 RSMo.

Southwestern Bell's December 1999 termination of its contract with USP&C significantly reduced Missouri consumer exposure to the telephone cramming scheme. Southwestern Bell serves five states: Arkansas, Kansas, Missouri, Oklahoma and Texas. The largest portion of Southwestern Bell's business is conducted in the state of Texas. Southwestern Bell's action terminated USP&C's right to insert a USP&C bill page in Southwestern Bell's local telephone bills.

After Southwestern Bell terminated its contract in December 1999, USP&C developed a direct bill approach to bill customers in Southwestern Bell's operating territory. With the direct bill approach, a bill is created and sent directly to the customer, instead of having the local exchange carrier place the charges on the telephone bill it sends to its customers. By bypassing the local exchange carriers, the direct bill approach also allowed the capability to make unauthorized charges to Southwestern Bell customers.

A new firm, Invesco Telecommunications, Inc., was used with the direct bills approach. Invesco Telecommunications, Inc. was created on March 9, 2000. It had the same principal place of business or headquarters address as USP&C. Public corporate records of Invesco Telecommunications, Inc. show Thomas Pugliese as president and is a named defendant in the current federal criminal litigation.

Invesco Telecommunications, Inc. did business as "Southwest Region Bill." USP&C mailed the direct bills to Missouri consumers on behalf of Invesco Telecommunications, Inc. using the fictitious name "Southwest Region Bill." The name on the bills confused some Southwestern Bell's customers into believing that the direct-billed charges were legitimate and were for costs arising from their local phone service. Apparently, to aid the confusion, the design of the bill page and mailing envelope were similar to those used by Southwestern Bell for its legitimate telephone bills.

The Southwest Region Bill telephone bills strongly resembled Southwestern Bell's bill formats, in that: a) the Southwest Region Bill invoice used a nearly identical typeface and font size to the Southwestern Bell invoice; b) the placement of items on the Southwest Region Bill invoice such as account summaries, current charges, total amounts due and due dates were very similar to those used by Southwestern Bell; and c) the Southwest Region Bill invoice also copied the light blue stripe down the left margin of the Southwestern Bell invoice in a nearly identical color and size. The Southwest

Region Bill invoice also stated that if recipient did not pay the charges assessed on that bill, the company would "begin procedures to cancel all service to you," which could easily be interpreted as suggesting that the recipient's telephone service would be shut off.

In the federal indictment the United States, it states that: "Numerous victims were defrauded into paying the invoiced charges. Numerous other recipients of these bills, however, complained to regulators and to Southwestern Bell. These entities rapidly took legal action to induce USP&C to stop mailing the fraudulent invoices." The Staff is aware that the Missouri Attorney General took action as a result of the "Southwest Region Bill" activity in Missouri. Additional detail regarding the Missouri Attorney General's actions are contained in Section 13 of this report. Staff is still in the process of acquiring further information on this matter including any possible quantification of the amount of unauthorized charges collected from Missouri customers.

Currently, the Commission is not receiving the significant number of cramming complaints that would be likely if a USP&C substitute was presently operating in the State. In the federal indictment the United States alleges that LEC LLC received from Overland Data Center funds derived from the telephone cramming scheme. Salvatore Locascio, Richard Martino, Zef Mustafa, Norman Chanes, and Daniel Martino own the majority of Local Exchange Company, LLC, directly and indirectly through trusts. These individuals are defendants in the federal criminal litigation in New York. LEC LLC is currently the majority owner (i.e. 99%) of Cass County Telephone Company LP and a one-third owner of New Florence Telephone Company. Mr. Matzdorff also owns one-third of the New Florence Telephone Company and was president of LEC LLC until he pled guilty to federal charges.

3. Internet

Except as otherwise noted, the source for the following is primarily, or exclusively, allegations made by the United States in a criminal indictment. The internet scheme is similar to the telephone cramming scheme to the extent that it was designed to attract individuals to visit adult entertainment websites through offers of a free tour of each website. The websites were designed and operated in a manner that would require the visitor to provide credit or debit card information to obtain the "free tour." Once obtained that information was used to bill the card without the visitor's knowledge or consent. The visitors' credit or debit card information was obtained under the guise of needing the information as proof of the visitors' age and included a representation that the card would not be billed.

According to the indictment, Crescent Publishing Group, Inc. made the final decisions regarding the design and operation of the websites. Lexitrans, Inc. hosted the websites on servers located in Kansas. Lexitrans, Inc. is located in the same building as USP&C, after USP&C relocated to Kansas from Missouri. Lexitrans, Inc. is still listed as a tenant in the building, although USP&C is not. Credit card companies (i.e., VISA) and banks performed the major billing and collection functions related to the unauthorized charges arising from this scheme. As customers complained to the bank that issued their credit or debit card, "chargebacks" were made to the customers' bills with corresponding reductions made in amounts due Crescent Publishing. During 1999, Crescent Publishing had the third highest chargeback rate among the millions of merchants participating in the VISA program in the United States. This high chargeback rate subjected Crescent Publishing, and the internet scheme, to additional fees and possible termination of credit card privileges from VISA. In 1999, Crescent Publishing returned, through either chargebacks or refunds, an average of one out of every three dollars it billed. In or about July 1999, Crescent Publishing Inc. created Luna, S.A., a new corporation having merchant accounts with a

Montserrat bank in Guatemala. This arrangement provided the Internet scheme offshore credit card processing capability.

In April 2000, in response to the high level of chargebacks it was incurring, VISA terminated the rights of Crescent Publishing, its president and its chief financial officer from participating in the VISA program in the United States. When excessive chargebacks to Crescent Publishing continued, VISA discovered the offshore credit card processing activity. In September 2000, VISA terminated the rights of Crescent Publishing, its president and its chief financial officer from participating in the global VISA program.

Crescent Publishing Group, Inc. received funds from merchant banks derived from the processing of VISA credit cards as payments for the cost of website memberships. Crescent Publishing Group Inc. pooled these monies into the accounts of an affiliate company, Multimedia Forum, Inc., that were maintained at a branch of the North Fork Bank located on Long Island, New York. Crescent Publishing Group, Inc. deducted website costs and payments made to Harvest Advertising and other companies from the proceeds obtained from the Internet activities. Crescent Publishing Group, Inc. then provided 50% of the remaining proceeds to Lexitrans, Inc., Dynamic Telecommunications, Inc. and Westford Telecommunications, Inc. through the Multimedia Forum, Inc. bank account. Lexitrans, Inc., Dynamic Telecommunications, Inc. and Westford Telecommunications, Inc. sent millions of dollars of these proceeds to Mical Properties, Inc., either directly or through various companies, including Overland Data Center. Multimedia Forum, Inc. also sent some of the proceeds to Local Exchange Carriers, LLC through a series of intermediary companies.

Salvatore Locascio, Richard Martino. Zef Mustafa, Norman Chanes, Daniel Martino, and Andrew Campos own Local Exchange Carriers, LLC in part, both directly and indirectly through trusts. These individuals are defendants in the ongoing federal criminal litigation in New York.

4. Missouri Exposure to Internet Cramming Scheme

Missouri's exposure to the Internet Cramming Scheme is beyond the ability of the Commission's Staff to assess. The Commission does not regulate the Internet providers or the banks related to the credit cards used in this scheme. Staff will continue to monitor developments in this area for information that would quantify the dollar impact to Missouri Internet users. In July 2000, Local Exchange Carriers, LLC had a 20.72% ownership in Spectra Communications Group, LLC. CenturyTel has since purchased this equity interest. Local Exchange Carriers, LLC has no known ownership position in a Missouri utility at this time.

II. Fraud

This term is used as an intentional perversion of truth for the purpose of inducing another in reliance upon it to either part with something of value or to surrender a legal right.

A. Excess Costs

1. Incentive to incur greater costs than necessary.

There are certain regulatory approaches that can provide an incentive for a company to pay more for a good or service or to purchase a good or service not necessary for the provision of service. These approaches occur when the a company receives revenues based on the amount it pays for the good or service, regardless of the fact that the good or service could have been purchased at a lower price or the purchase was not needed. This concern is high in the area of affiliate transactions, where the profitability of the overall entity can be increased by the utility engaging in unnecessary purchases from affiliates or paying a higher price from the affiliate than can be realized elsewhere. Affiliate safeguards (such as rules) have been developed in the utility industry to help protect from affiliate abuse.

Individual employees can have an incentive to pay more for a good or service or purchase a good or service when they have the opportunity for personal gain based on the results of the transaction.

This is a situation that almost any organization must protect against and will do so through the implementation of internal controls. One example of such an internal control is to not allow any employee with purchase or approval authority to have a personal interest in any firm that conducts business with the company.

The possibility that increased costs will increase the amount of cash received by a telephone company through funds such as NECA or the Federal Universal Service Fund based upon the cost levels that it incurred and records creates such an incentive.

2. Missouri Exposure to Overpayment for Goods and Services

Cass County Telephone Company LP and New Florence Telephone Company have had significant transactions with affiliates and entities in which those in, direct or indirect, control of the operations of Cass County Telephone Company LP and New Florence Telephone Company have an ownership or other interest such that malfeasance could have occurred that would have influenced each companies' cost structure. These matters are discussed in detail in Sections 10 and 11 of the report addressing Cass County Telephone Company LP and New Florence Telephone Company, respectively.

B. Money Laundering

This term is used to describe the investment or other transfer of money flowing from illegal transactions into legitimate channels so that its original source cannot be traced. Money laundering is a federal crime. The federal indictment mentions specific firms involved in the movement of funds from illegal activity that are the subject of that indictment. The Staff investigation looked for evidence involving those firms. Sections 7, 8, 9 and 12 of this report discuss in detail the magnitude and impact of transactions between USP&C, Overland Data Center, Local Exchange Company LLC, Local Exchange Carriers, LLC and any Missouri utility.

III. Billing and Collection Overcharges - Anti-Trust Violation

During the investigation, Mr. Lovern brought forth an antitrust issue regarding the quality and cost of billing and collection services offered subsequent to breakup of the Bell system. This issue will be discussed in detail in Section 6 regarding Mr. Lovern and his issues.

Section 5. Kenneth Matzdorff

At different times, Mr. Matzdorff has held several officer positions with regulated Missouri telecommunications carriers. Mr. Matzdorff is currently the president of Local Exchange Company, LLC , and Cass County Telephone Company LP. He resigned from his positions with Spectra Communications Group, LLC and CenturyTel in July 2004. He also resigned his officer position with New Florence Telephone Company on August 12, 2004. These resignations occurred subsequent to his arrest on July 28, 2004. Attachment 18 of this report is a copy of the federal arrest warrant. According to allegations in the affidavit supporting the arrest warrant, Mr. Matzdorff was involved in the telephone cramming scheme and money laundering the proceeds from illegal activities.

The telephone cramming scheme described in Section 4 and Attachment 9 to this report continues to draw media attention to the allegations of Gambino crime family ownership of Cass County Telephone Company LP located in Peculiar, Missouri. On November 17, 2004, *USA Today* posted an article that mentioned the Gambino relationship to the Missouri utility. Kenneth Matzdorff is the president of Cass County Telephone Company, LP as well as a former president of USP&C, Inc., the only firm involved in the current federal indictment in New York.

Mr. Matzdorff was accused of being an associate of the Gambino crime family and playing a role in their illegal telephone cramming and money laundering schemes. The New York criminal complaint against Mr. Matzdorff was dismissed on October 27, 2004 without prejudice. A November 3, 2004 *Kansas City Star* article reported that a federal grand jury in Kansas City has been investigating Mr. Matzdorff's activities in addition to the investigation in New York. The article also reported that several Cass County Telephone executives have been subpoenaed to testify before the grand jury.

In January 2005 Mr. Matzdorff pled guilty to federal charges based on telephone cramming, internet-activity based fraud and a conspiracy to defraud the National Exchange Carriers Association and the Universal Service Administrative Company, the administrator of the Federal Universal Service Fund.

The Missouri Commission attempted to inquire into this situation early in 2004. The Commission held an on-the-record presentation on April 19, 2004 in Case No.

IR-2004-0354. Attachment 13 to this report is a copy of the transcript from that proceeding. Mr. Matzdorff testified at this proceeding regarding matters raised in a February 14, 2004 *Kansas City Star* article. These matters included Mr. Matzdorff's former relationship with USP&C. Some of Mr. Matzdorff's testimony regarding USP&C is contradicted by data the Staff collected in its investigation. Mr. Matzdorff was more involved in USP&C, Inc. operations than his testimony indicated. His relationship with USP&C was longer than he indicated at this proceeding. Specifically, Mr. Matzdorff testified that he: 1) sold his interest in USP&C in 1998[4]; 2) never held an active function with USP&C or as an officer of the Company[5], and 3) was simply a shareholder of USP&C[6].

Southwestern Bell Telephone Company deposed Mr. Matzdorff on May 5, 2000 in a lawsuit in the District Court of Dallas County, Texas—*Southwestern Bell Telephone Company and Pacific Bell Telephone Company vs. Telecom Operator Services, Inc., d/b/a USP&C Operator Services, INVESTCO TELECOMMUNICATIONS, INC., d/b/a SOUTHWEST REGION BILL, USP&C, INC., and KENNETH MATZDORFF*. In this deposition, Mr. Matzdorff testified that he was the initial owner of USP&C[7]; that USP&C was formed in the fall or winter of 1996[8]; that he created USP&C because he thought there was an opportunity for third-party billing and had experience in that area;.[9] that he was the sole owner in USP&C[10]; that he hired people to work at USP&C, Inc. and its sister company Telecom Operator Services, Inc.; that he did not initially hire an executive to run the companies; that he hired subject matter experts and spent time getting the firms established; that after this initial period, he contracted with some personnel with executive experience in early 1998 to run USP&C, Inc. and Telecom Operator Services, Inc. approximately six to seven months after the date of start for the firms; that he was actively involved in the running of USP&C, Inc. for its first six to seven months; and that after that time, was less involved in the running of USP&C, Inc.[11].

The allegations in the Affidavit supporting Mr. Matzdorff's arrest warrant, contained in Attachment -18 of this report, also contradict Mr. Matzdorff's April 19, 2004 testimony to the Missouri that he never held an active function with USP&C and never was an officer of USP&C. The affidavit of the Federal Bureau of Investigation (FBI) agent supporting the arrest warrant states that Mr. Matzdorff was instrumental in establishing and operating

USP&C. The agent bases this assertion on information provided to the FBI by confidential sources and corroborated by other sources, documentation, and cooperating witnesses. Five (5) confidential sources, all previous 1996 to 1999 USP&C employees, informed the FBI that Mr. Matzdorff held himself to be USP&C's president.[12]

According to Mr. Matzdorff's testimony in his Texas deposition by Southwestern Bell in January 1999 or earlier, Mr. Matzdorff began to think of selling USP&C and its sister company, Telecom Operator Services, Inc. because of cramming issues.[13] These companies were sold to Mr. Mike Lauro, a man he never met personally, on December 17, 1999.[14] This date is a year later than the date he testified to before the Missouri Commission on April 19, 2004. Section 7 of this Report will provide additional details regarding Mr. Matzdorff's sale of his interest in USP&C.

According to Mr. Matzdorff's deposition testimony in Texas, he sold these two companies for ** ________ **, or a net of ** _______ ** after paying ** ________ ** for an outstanding note payable when the company had ** _________ ** in it, a ** ________ ** note receivable and existing contracts. Mr. Matzdorff received no money from the sale after paying the legal bills from Piper & Marbury related to the sale.[15]

Mr. Matzdorff signed a stipulation with the Wisconsin Attorney General on December 18, 1999. Wisconsin had initiated litigation regarding cramming activities in their state. The Wisconsin litigation is addressed in greater detail Section 13 of this report. Mr. Matzdorff was involved in the USP&C operations to the extent that he was signing a stipulation to resolve litigation in Wisconsin on USP&C, Inc.'s behalf approximately one year later than the date he testified to the Missouri Commission that he had sold his interests in USP&C, Inc. and one day after he had actually sold his interest in the firm. Mr. Matzdorff signed contracts on USP&C's behalf with at least two Local Exchange Companies for billing and collection services.

Mr. Matzdorff also testified before the Missouri Commission on April 19, 2004 that he knew nothing of the ownership of Overland Data Center.[16] The investigation has uncovered that Mr. Matzdorff did have experience and knowledge that would indicate that he knew the owner of Overland Data Center on April 19, 2004, when he testified before the Commission.

Overland Data Center was the firm that actually had the equipment that processed the "1-800" number calls that are the subject of the telephone cramming scheme in the federal indictment. Section 8 of this report addresses Overland Data Center in greater detail. Overland Data Center would then transmit data to USP&C, Inc. so that billings for the calls could actually be put on consumers' local telephone bills. Records from the Kansas Secretary of State indicate that the owner and president of Overland Data Center is Wayne Weir who is also one of the owners of Local Exchange Company, LLC. Mr. Matzdorff is the president of Local Exchange Company, LLC. Mr. Matzdorff testified before the Commission in April 2004 that the investors in Local Exchange Company, LLC were either acquaintances or referred to him by individuals that he found to be very trustworthy and of high integrity…people that he felt he knew and trusted.[17] Mr. Matzdorff was the president of USP&C, Inc. during a period when USP&C. Inc. and Overland Data Center engaged in business with each other. Mr. Weir is described as the president of Overland Data Center and a former Sprint programmer in the February 14, 2004 *Kansas City Star* article. Mr. Matzdorff acknowledged that he read this article.[18] Mr. Matzdorff also testified that he chose to do business with Overland data Center because many of its employees had experience in Sprint billing.[19] Staff believes that it is doubtful that Mr. Matzdorff knew nothing about the ownership of Overland Data Center when he testified before the Missouri Commission on April 19, 2004.

The investigation has shown that Mr. Matzdorff was involved in significantly more activities directly and indirectly related to Missouri utilities than the Staff knew of at the time Mr. Matzdorff was arrested. These relationships appear to have been established in the period following his employment with Fidelity Communications Company and its affiliated companies. Attachment 7 to this report will provide a current version of the chronology of Mr. Matzdorff and related events. This Attachment is updated as new information is discovered in Staff's investigation. The following chart reflects the state of the Staff's current knowledge of Mr. Matzdorff's relationship with specific companies:

Company Name	Relationship	Period
Cass County Telephone Company Limited Partnership d/b/a CassTel	President, Chief Executive Officer	1994-
CenturyTel of Missouri LLC	Vice President Missouri Region Vice President and Special Advisor	9/1/02-3/13/04 3/14/04-8/02/04
Haug Construction, Inc.	Secretary, Director, Vice President,	1999, 2002
Garden City Bancshares	Director	2003-2004
Garden City Bank	Director	2001-2004
Kansas City Consultants, L.L.C.	Organizer & initial member	2000-
Local Exchange Carriers, L.L.C.	President and Chief Executive Officer, Minority membership interest,	July 6, 1999
LEC, L.L.C.	Founder, President	1994-
LEC Long Distance, Inc. d/b/a CassTel Long Distance; LEC Long Distance; CassTel LD; and Cass County Telephone Long Distance.	President/Chairman of the Board, Secretary	1997-
MATZCO, L.L.C.	Organizer	2000-
New Florence Telephone Company	President, Director	1999-8/12/04 1999-
NRPT Communications, Inc.	President	2004
Pegasus		
Spectra Communications Group, LLC	Chief Operating Officer *per employment agreement* Chief Operating Officer	7/8/99-7/31/00 8/01/00 - 12/31/03
Tiger Telephone, Inc.	President, Director	1998-8/2004 1998
Telecom Operator Services, Inc.	President, Director, Owner	1996-12/17/99
USP&C	President, Director, Owner ,	1996-12/17/99
VIDEONET LLC	Organizer, Initial Member	2003-current
Williams Holdings, L.L.C.		
Wilmat, L.L.C.		

In the federal indictment, the United States has alleged that two of these firms, Local Exchange Company, LLC. (LEC LLC) and Local Exchange Carriers, LLC have been involved in money laundering activities and are largely owned by members involved in organized crime. Local Exchange Company, LLC is alleged to be involved in the movement of funds from the telephone cramming scheme while Local Exchange Carriers, LLC is alleged to be involved in the movement of funds from the Internet fraud scheme. Money laundering would need to move funds between firms where the proceeds would still be under the control of the principals involved in the illegal activity. At times, the principals involved in the illegal activity will engage others to handle the fund transfers to disguise their involvement in the transaction and reduce the possibility of detection of the true purpose of the transfer.

Staff's investigation has revealed that Cass County Telephone Company, LP makes significant payments to firms that have a business relationship with Mr. Matzdorff. Cass County Telephone Company, LP has objected to providing additional information identifying the full extent of the firms that have a business relationship with Mr. Matzdorff in response to Staff Data Request No. 20. The Staff will continue to examine this area to more fully learn the extent that Cass County Telephone Company, LP is doing business with firms that have a business relationship with Mr. Matzdorff, its president and chief executive officer. It is known at this time that, during the last three years, Cass County Telephone Company, LP has transferred funds to Haug Construction; Local Exchange Company, LLC; LEC Long Distance, Inc.; New Florence Telephone Company; Pegasus Communications, Inc.; and Videonet, LLC. Each of these firms has a business relationship with Mr. Matzdorff. Cass County Telephone Company, LP has paid approximately 60% of the funds paid to vendors that receive over $10,000 annually to firms with a business relationship with Mr. Matzdorff. Cass County Telephone Company, LP has also paid funds to Overland Data Center in the past (e.g. 2002). This firm is also mentioned in the federal indictment as being involved in the money laundering of the telephone cramming scheme proceeds.

The fact that a firm does business with another firm that could benefit its owners or managers is not in and of itself proof of an inappropriate transaction. It is a situation ripe for abuse, thereby creating the need for a firm to institute safeguards to prevent that abuse. These safeguards commonly require special disclosure so that the transaction can be scrutinized for its legitimacy. Usually, these transactions are not allowed without special approval by senior management and/or directors without any business relationship with the firm in question. This issue will be discussed in greater deal in Section 10 of this report addressing Cass County Telephone Company, LP.

Section 6. William M. Lovern, Sr. with Southwestern Bell Telephone Company Comments

I. Relationship with Kenneth Matzdorff

Mr. Lovern contacted the Missouri Commission Chairman's office after the Staff began its investigation. Mr. Lovern had business dealings with Mr. Matzdorff when Mr. Matzdorff was associated with Fidelity Communications and its affiliates. Those dealings began in late 1991. There has been no assertion that Mr. Lovern had business dealings with Mr. Matzdorff after he left Fidelity Communications in August 1994. Mr. Lovern's primary concern centers on an alleged difference in the billing and collection process being provided to AT&T in 1992 compared to the billing and collection service being provided to other interexchange carriers (IXCs).[20] Mr. Lovern's firm, American TeleDial Corporation, became a customer of a billing and collection service offered by Fidelity Systems Plus, a non-regulated company in the Fidelity Communications Company corporate family. This billing and collection service was based on a concept developed by Mr. Matzdorff. His concept was to purchase accounts receivables from interexchange carriers (IXCs), reformat the data to make it look like a local exchange carrier (LEC) call, sell the receivables to a local exchange company (LEC), and then use an LEC-to-LEC reciprocal settlement process for third number and credit card calls to ultimately bill the IXC's receivables and collect the related proceeds. Fidelity Systems Plus entered into a contract with Fidelity Telephone Company, a regulated affiliated company, to buy its IXCs receivables and submit them to Southwestern Bell Telephone Company for LEC-to-LEC billing and collection. Southwestern Bell Telephone hosts many LECs in Arkansas, Kansas, Missouri, Oklahoma and Texas. These LECs submitted their billing information to CMDS and BOC CATS, the systems[21] that actually transmitted the information to other LECs throughout the country to get the charges incurred for use of the LEC's network placed on consumers' local telephone bill, issued by the consumer's serving LEC.

According to information obtained from litigation in the Western Division of the United States District Court for the Western District of Missouri in 1992 from the case *Fidelity Telephone Company v. Southwestern Bell Telephone Company*, No. 92-4326-CV-W-8, and depositions taken in that case, Mr. Matzdorff first conceived the idea of using the LEC-to-LEC settlement system for IXC messages, instead of individual long distance billing and collection contracts, in 1990 when he was still employed at Contel, another independent LEC. While at Contel, Mr. Matzdorff developed familiarity with the LEC-to-LEC settlement system in the area of LEC billing and collections and also had occasion to work with Alex Abjornson while Mr. Abjornson was still employed by Bellcore and in charge of the CATS system [(the LEC-to-LEC settlement system)]. Mr. Abjornson was later retained by Matzdorff as a consultant on his billing project at Fidelity.

Mr. Matzdorff began his employment with the Fidelity corporate family on April 1, 1991. The Fidelity corporate organization at that time is contained in Attachment 12 of this report. Fidelity Telephone Company is a telecommunications carrier regulated by this Commission. Fidelity System Plus was a nonregulated affiliate. Fidelity Systems Plus owned a computer and provided data processing service to Fidelity Telephone and other Fidelity subsidiaries. Fidelity Systems Plus accepted and developed messages that Fidelity Telephone actually transmitted to Southwestern Bell Telephone for processing.[22]

Three months after he began his employment with Fidelity, Mr. Matzdorff brought his idea to use the CATS system for IXC traffic to the attention of Fidelity's president, Mr. John Davis. Fidelity contracted with Abjornson, as a consultant, concerning the parameters of CATS. One of Abjornson's primary consulting roles was to assist Fidelity in reformatting its IXC messages for inclusion in the LEC settlement systems denominated CMDS and CATS. According to Southwestern Bell, the CMDS settlement system was available to IXCs for distribution of messages, while the CATS system was a reciprocal system limited to use for LEC-to-LEC settlements, primarily messages created for calling card and third-number calls placed by an end user while using the network of an LEC other than the end user's own local service provider.

Mr. Abjornson brought Mr. Lovern into contact with Fidelity and Mr. Matzdorff in January 1992. Their initial contact was by phone, which was followed by a personal meeting in Dallas approximately seven to ten days later. Mr. John Davis, Fidelity's president, also attended the meeting. Mr. Lovern was the president and chief operating officer of American Teledial Corporation, Inc., a Delaware corporation. Richard F. Smith and Melvin Tublin were the other corporate officers of American Teledial. American Teledial Corporation, Inc. entered into a purchase of accounts receivables contract with Fidelity Systems Plus on

March 17, 1992 for billing and collection services. American Teledial Corporation, Inc. was authorized to do business in New York, Texas, and Nevada. Missouri's Secretary of State website shows no record of American Teledial Corporation's authorization to do business in Missouri as a separate business entity. Under this contract, Fidelity Systems Plus was purchasing accounts receivable from American Teledial.

On June 5, 1992, American Teledial, Fidelity Systems Plus, and Fidelity Telephone entered into a supplemental agreement to the March 17, 1992 agreement. Mr. Lovern testified[23] that this contract placed American Teledial in control of the situation as far as litigation with third parties over the rights of American Teledial, Fidelity Systems Plus and Fidelity Telephone regarding their original agreement for billing and collection services. He testified[24] that control of the litigation rested with him. This agreement will play a role in the following five lawsuits:

1. *Fidelity Telephone Company vs. Southwestern Bell Telephone Company, et al.,* Cause No.92-4326-CV-W-8 (Western District-Missouri)

2. *Fidelity Telephone Company vs. Sprint Corporation, et al*., Cause No. 3-92-CV-2141-X (Northern District-Texas)

3. *Fidelity Telephone Company vs. Southwestern Bell Telephone Company*, Cause No.CV192-706-CC (Franklin County, Missouri)

4. *Fidelity Telephone Company vs. Southwestern Bell Telephone Company*, Appeal No. 62463 (Eastern District Missouri Appellate Court)

5. *Fidelity Telephone Company vs. Shields, Britton & Fraser, et al*. Cause No.CV193-540-CC (Franklin County, Missouri) removed to federal court as *Fidelity Telephone v. Shields, Britton, et al.*, Case No. 4:93-cv-01237-GFG (U.S. District Court, Eastern District of Missouri).

All of the above cases were either dismissed or settled through a stipulation between the parties. Staff is still the process of acquiring all of the stipulations and court orders in these cases to determine the precise details related to the termination of each of the above cases. Staff has reflected the information in this report that it has received to date.

After Southwestern Bell discovered that Fidelity was submitting recoded IXC messages into BOC CATs, Southwestern Bell placed a block to prevent additional recorded messages from being submitted. On June 15, 1992 Fidelity Telephone Company filed a "Petition and Request for Temporary Restraining Order" against Southwestern Bell

Telephone Company in the Missouri Franklin County Circuit Court to seek to lift the block. The Honorable Judge John Brackman issued a Temporary Restraining Order (TRO) after a non-evidentiary hearing held that same day. In early July the injunction was dissolved after a complete evidentiary hearing where Fidelity failed to demonstrate its right to use the BOC CATs system in such a manner. At that time, Southwestern Bell reinstituted the block of IXC messages into BOC CATs.

On or about September 11, 1992, Mr. Loverns's firm, American Teledial Corporation, without written permission of Fidelity Telephone Company, caused the filing of a lawsuit in the Circuit Court for Dallas County, Texas, which was then removed to the United states District Court for the Northern District of Texas and styled as: *Fidelity Telephone Company v. Sprint Corporation and Southwestern Bell Telephone Company*.

On October 7, 1992, Mr. Richter, a Southwestern Bell attorney, facsimile transmitted a letter to James Shields, an attorney purportedly representing Fidelity Telephone Company. Mr. Richter noted that Mr. Lovern discussed a settlement proposal conditioned upon Mr. Lovern obtaining all of Fidelity's interest in regard to the pending litigation. Mr. Richter noted the appearance of a possible significant dispute between Mr. Lovern and Fidelity in regard to litigation issues. Mr. Richter noted that he understood that Mr. Lovern had received no assignment of Fidelity's interest in the litigation. Finally, Mr. Richter noted that he had been advised that Mr. Lovern had told Rich Taylor of Southwestern Bell of his intent to contact Senator Jack Brooks, the Texas Attorney General and/or the United States Attorney General, if Southwestern Bell did not settle the various Fidelity lawsuits on his terms. This conversation is noted as one in the latest in a long series of threats by Mr. Lovern to contact various public officials or file multiple lawsuits against Southwestern Bell or its individual employees, if his demands were not met.

In a telephone conference on October 7, 1992[25], Mr. Shields advised Mr. Sheldon Stock, of the law firm of Greensfelder, Hemker, & Gale, P.C., who was also representing Fidelity, that a dispute had arisen between Fidelity Telephone and American TeleDial regarding the payment of certain monies relating to messages sold to Fidelity by American TeleDial. Mr. Stock was an attorney representing Fidelity Telephone in this dispute.

On October 14, 1992, Mr. Lovern facsimile transmitted a letter to John Davis notifying Mr. Davis that his lawyers would be advised as to action against Fidelity, John Davis and Ken Matzdorff.

On October 30, 1992, in a letter, Mr. Shields stated that a dispute had arisen between Fidelity telephone Company and American TeleDial Corp. that impacted both the billing and collection agreement and the litigation contract. Mr. Shields noted that in his opinion the dispute was materially damaging both lawsuits and raised the question of Mr. Shield's status in the pending litigation.

On November 4, 1992, David Harris, an associate of Mr. Stock, also of the law firm of Greensfelder, Hemker, & Gale, P.C., representing Fidelity Telephone, notified Mr. Shields that he is to continue to take only those actions minimally necessary to avoid default, sanction, and to comply with court orders. Mr. Davis also sent a letter to Mr. Lovern on this same day calling into question the financial condition of American TeleDial Corporation, since American had failed to pay some or all of its attorney fees as well as not paying its consultants in full.

On November 9, 1992, a Daniel L. Lovern sent a letter to John Davis indicating that he is Chief Executive Officer for American TeleDial Corporation and responding to Mr. Davis' November 4, 2004 letter.

On December 12, 1992, David Harris notified Mr. Shields that Fidelity can no longer consent to his representation of Fidelity in any capacity or in any proceeding. This letter withdraws the November 4, 1992 limited consent.

On January 18, 1993, the law firm of Greensfelder, Hemker & Gale, P.C. representing Fidelity systems Plus, Inc. and Fidelity Telephone Company sent Mr. Lovern a letter notifying him that these companies were terminating the June 2, 1992 Litigation Management Agreement.

Staff is still in the process of acquiring and examining additional information regarding the ultimate result from all the foregoing litigation and disputes. Staff is aware that there is no ongoing relationship between Mr. Lovern and Mr. Davis of Fidelity Communications Company. To the Staff's knowledge, Mr. Lovern never had a direct business relationship with Southwestern Bell Telephone Company, directly or through an entity he owned. Therefore, it is difficult to understand Mr. Lovern's civil claims against

Southwestern Bell Telephone Company. There is no indication that Fidelity Telephone Company ever assigned any of its rights to claims against Southwestern Bell Telephone Company to Mr. Lovern or his firm, American TeleDial Corporation.

II. Missouri Consumer Exposure

It is difficult at this time to assess the impact, if any, to Missouri consumers of Mr. Lovern's claims. He has never provided the Missouri portion of the total damages that he alleges occurred from the billing activity he argues was unlawful. Mr. Lovern initiated actions against Southwestern Bell over ten years ago in conjunction with the previously discussed Fidelity Telephone Company litigation. The state court proceeding resulted in a decision in favor of Southwestern Bell. The later federal court action was settled for a nominal sum. On July 10, 1992, American Teledial notified Southwestern Bell of its intent to file a shareholder derivative suit. It later withdrew that notice. On July 10, 1992, National Teleprocessing officially notified the directors and senior officers of Southwestern Bell of its intent to file a shareholder derivative suit based on the action pending in Kansas City between Fidelity and Southwestern Bell. Mr. Lovern was president and chief operating officer of National Processing, Inc. The shareholder derivative action was purportedly to be based on an antitrust violation. The Staff is unaware if this action was ever filed. Mr. Lovern's antitrust claims have been circulated widely since that time.

Staff is aware that Mr. Lovern has also contacted the SBC Audit Committee, Federal Communications Commission, Department of Justice, Security and Exchange Commission, and Federal Bureau of Investigation. He has also contacted the National Association of Regulatory Utility Commissions (NARUC). They have taken no action in response to Mr. Lovern's issues. This is noteworthy since these groups have more significant relationships and responsibilities for the matters relating ton Mr. Lovern's issues than the Missouri Public Service Commission.

Mr. Richter, an attorney for Southwestern Bell, has related to the Staff that he has received inquires from the Security and Exchange Commission, Federal Communications Commission, Justice Department, Department of the Navy, Texas Commission, Illinois Commission, Seattle Police Department and Internal Revenue Service regarding matters related to Mr. Lovern. His information would indicate that more organizations have been made aware of Mr. Lovern's issues and have taken no action.

On March 29, 2004, Mr. Lovern sent a 15-page letter to SBC Communications Inc., Verizon Communications Inc., BellSouth Corporation, Qwest Communications International Inc. Cincinnati Bell Inc., AT&T Corp., National Exchange Carriers Association (NECA), Federal Communications Commission (FCC), Frost Brown Todd LLC, AT&T Wireless Services Inc., Cingular Wireless LLC, Science Applications International Corporation, and Telcordia Technologies Inc. A copy of the letter is contained in Attachment 11 to the report. These entities were addressed as "Dear Defendants." At the end of the letter, Mr. Lovern stated, "Keep in mind the ICS is the focal point in the ongoing Gambino Crime Family criminal indictment, whereby they used the ICS, via USP&C, to overcharge consumers up to $800,000 per day." The ICS is an acronym for the Intercompany Settlement System that Mr. Lovern first mentions on page two of his letter. The addressees were given a noon, March 31, 2004 deadline. Copies of the letter were sent to the United States Senate Committee on Commerce, Science & Transportation Sub-Committee on Communications and United States House Committee on Energy & Commerce Sub-committee on Telecommunications & Internet. No public action was taken by any of these organizations in response to this letter.

A. Concerns

Mr. Lovern has engaged in several activities in the past in his attempt to get the money he believes he was denied from his failed relationship with Fidelity Systems Plus. Although Southwestern Bell offered American Teledyne the standard billing and collection agreement available at that time to all IXCs, American Teledyne never entered into any business relationship with Southwestern Bell Telephone Company. Mr. Lovern's only known relationship with a Missouri utility was the litigation contract between Fidelity Telephone Company, and Fidelity Systems Plus and Mr. Lovern's American TeleDial Corporation that was discussed previously. Mr. Lovern complains about a relationship between Fidelity Telephone Company and Southwestern Bell Telephone Company, but Mr. Lovern was never a party to this relationship. Mr. Lovern recently threatened lawsuits against this

Commission, the Commissioners and other employees of this agency. This behavior is consistent with the pattern of behavior Mr. Lovern has used for over a decade.

Mr. Lovern also alleged that Southwestern Bell's billing and collection activity, even as Bellcore's contract administrator, was under the jurisdiction of the Missouri Public Service Commission. In response to this allegation, the Staff researched the Commission's authority regarding the billing and collection function. Specifically Mr. Lovern asserted that the Missouri Public Service Commission has authority over billing and collection activities, even wholesale billing and collection, because these activities appear in tariffs. For instance, Section 8 of Southwestern Bell's Access Services Tariff, PSC Mo No 36, sets forth the rates, terms and conditions for billing and collection. Although this service appears to be a "tariffed" service, the first paragraph of the Section states, "The Telephone Company may, at the option of an IC or end user, provide Billing & Collection services **as specified by contract**." (Emphasis added) In addition to this general qualifier, which makes the billing and collection services subject to contracts not submitted to or reviewed by the Commission, many of the rates are "ICB" indicating individual case basis pricing based on negotiations and the terms of contracts. In short, simply because a service, or language, appears in a tariff does not mean the service or activity is subject to state regulation. For instance, it is not uncommon for a company to place in a tariff generic liability or tax, fee and surcharge language that is not subject to Commission's jurisdiction.

Southwestern Bell indicated that the September 11, 1992 Post-Hearing Brief it filed in the United States Western District Court reflects its position on these billing and collection activity matters. Attachment 17 to this report is a copy of this brief.

Section 7. USP&C/Telecom Operator Services/Billing Management Services, Inc.

I. Company Operations

A. Background

A number of billing clearinghouses or more commonly known as “billing aggregators” came into existence as a result of the Telecommunications Act of 1996. Billing aggregators compiled charges such as those for interchange services (long distance charges), voice mail, paging services, beeper services and Internet Service Provider (ISP) services for delivery to and placement on local carrier telephone bills. To get the charges onto local telephone bills the billing aggregators, such as USP&C Inc. (USP&C), established billing and collection contracts with most of the nation’s incumbent local exchange carriers (ILECs) that allowed the billing aggregator to submit charges from client telecommunications vendors for inclusion on an end user’s local telephone bill. USP&C, Inc. became a party to some billing and collection contracts (e.g., USP&C contracted with Southwestern Bell and PacBell) through assignment of existing contracts from Info Access, Inc.

Billing aggregation services such as those USP&C provided worked in the following manner: 1) the billing aggregator’s client vendor would provide its electronic billing data to the billing aggregator; 2) the billing aggregator would reformat the electronic billing data it received into the format that each ILEC required for billing purposes under their respective contracts; 3) the billing aggregator would then forward the reformatted records to the appropriate ILEC for inclusion on the telephone bills that ILEC sends to its end user customers; 4) the ILEC then placed the charges on the appropriate customers’ bills and remitted back to the billing aggregator the funds collected, minus any billing and collection charges and any adjustments; 5) the billing aggregator in-turn would forward to the client vendor the proceeds it received, minus the billing aggregator’s fees.

B. USP&C, Inc.

USP&C, Inc. is the only defendant in the federal criminal litigation in New York that is not an individual. USP&C, Inc. is accused of knowingly and intentionally participating in a telephone cramming scheme targeted to obtain money and property from certain "1-800" number users under false and fraudulent pretenses, representations, and promises in the 1996 to 2002 time frame. Kenneth Matzdorff was the president of USP&C, Inc. from its inception to the sale of his interest to Mr. Michael Lauro on December 17, 1999.

The scope of Mr. Matzdorff's involvement with USP&C Inc.'s activities was a subject of the Missouri Commission's April 19, 2004 on-the-record presentation in Case No. IR-2004-0354, as well as a part of this investigation. During the on-the-record presentation Mr. Matzdorff testified that he established USP&C due to his belief that "there was an opportunity for third-party billing.[26]" This contrasts with allegations in the Federal Grand Jury indictment that stated "Defendants RICHARD MARTINO, CHANES and DANIEL MARTINO, together with others, caused the formation of USP&C and secretly controlled it for the purpose of placing the unauthorized charges generated by the fraudulent front-end programs onto the victims' local telephone bills.[27]"

USP&C was incorporated in the State of Delaware on May 6, 1996[28] and registered as Foreign Corporation in the State of Missouri on October 7, 1996[29]. The Jefferson City, Missouri law firm of Brydon, Swearingen & England was used to incorporate USP&C in Delaware and to register it as a Foreign Corporation in the State of Missouri. From its inception at least until he executed a contract to transfer an interest to Mr. Lauro in December 1999, Mr. Matzdorff has represented himself to be the president and the sole owner/stockholder of USP&C.

Mr. Matzdorff created on January 31, 1996[30] a Missouri corporation known as Telecom Operator Services, Inc. ("TOS"). Mr. Matzdorff was the only officer of Telecom Operator Services, Inc. until he sold the firm on

December 17, 1999. Telecom Operator Services, Inc. is a sister company to USP&C, Inc. Telecom Operator Services, Inc. had a bank of operators to provide customer service. W.R. England, III, was TOS's initial registered agent. As in the case of USP&C, from at least its inception until before he executed a contract to transfer an interest to Mr. Lauro in December 1999, Mr. Matzdorff has represented himself to be the president and the sole owner/stockholder of TOS. TOS provided the customer inquiry service, or what is more commonly referred to as a "call center" to field customer complaints, exclusively for USP&C. TOS employees would respond to inquiries from customers who questioned or disputed charges included on the customer's local telephone bill. TOS maintained a toll free service for local telephone customer contact regarding the charges put on their bills by USP&C and provided some information about service offerings of the USP&C's vendor clients in order to respond to customers' questions. Telecom Operator Services, Inc. did its work for USP&C clients. USP&C subleased space from Telecom Operator Services, Inc. On March 10, 1997, TOS registered its business in the state of Missouri under the fictitious name "USP&C Operator Services."

Both USP&C and TOS were located at 8800 Blue Ridge Boulevard in Kansas City, Missouri. On December 17, 1999 both companies were sold to Mr. Michael Lauro, an individual from the east coast.

Mr. Matzdorff testified in a deposition taken by Southwestern Bell in the Invesco Telecommunications litigation that for the "first six to seven months"[31] after the incorporation of USP&C and TOS, he was actively involved in the management of both companies. That management included "establishing the systems and identifying the process, I was involved in that step."[32] Mr. Matzdorff further testified that he was less involved "when we started ramping up and actually getting call volume and those things as the company grew, we brought in a group of three men from an Atlanta, Georgia company called CGM that had expertise in these areas." The three men were

Kevin Murphy, Chuck Campbell, and Bob Gulledge. CGM was involved in managing the day-to-day operations for approximately a year.

The foregoing information obtained from the deposition transcript of Mr. Matzdorff contrasts with data that was provided to the Staff by Cass County Telephone Company in Case No. IR-2004-0354. In Supplemental Data Request No. 2 issued in that case, Staff requested the following information: "Did Ken Matzdorff ever have an affiliation with USP&C? If so, please provide the background or history, including current status." In response, Cass County stated:

> Mr. Matzdorff held stock in the company in 1996. He did not have a management role with the company during anytime of his ownership, nor did he hold any compensated position in the company. As part of the company registration process during its founding, Mr. Matzdorff was listed as its president. In early 1997 a president was hired to start up operations. In 1998, Mr. Matzdorff sold his interest in the company and has not had any relationship with the company since that time.

Further, in that case the Staff requested in Supplemental Staff Data Request No. 10, "Did Ken Matzdorff ever have an affiliation with Telecom Services Inc. and Telecom On Line Inc? If so, please provide the background or history including current status." Cass County responded as follows:

> Mr. Matzdorff has never had an affiliation with Telecom On Line Inc. Mr. Matzdorff was a stockholder in 1997 through 1998 of Telecom Operator Services Inc. He sold his interest at that time. Mr. Matzdorff did not have a management role with the company during anytime of his ownership, nor did he hold any compensated position in the company. As part of the company registration process during its founding, Mr. Matzdorff was listed as its president. In early 1997 a president was hired to start up operations.

The arrest of Mr. Matzdorff in July 2004 based on allegations of mail and wire fraud further raised questions regarding the real ownership and management of USP&C and whether Mr. Matzdorff knew of its alleged illegal activities.

Per the Affidavit in Support of ARREST WARRANT of Mr. Matzdorff, Beth Ambinder, Special Agent for the Federal Bureau of Investigation (Attachment18) stated:

> MATZDORFF… was instrumental in establishing and operating USP&C, which…was the primary vehicle that the Gambino family used to submit false billing charges to the LECs…In sum, five confidential sources . . ., all of whom previously worked at USP&C, have informed me that at all times during their employment at USP&C, which spanned the period from in or about and between 1996 and 1999, Matzdorff held himself out as President of USP&C. . . . MATZDORFF also falsely represented himself to the owner of USP&C. …My investigation has revealed that, in fact, all important decisions regarding the business of USP&C were ultimately made not by MATZDORFF, but by Richard Martino, Norman Chanes and others.

Special Agent Ambinder stated that:

> MATZDORFF knew that USP&C as being used to circumvent LEC regulations regarding billing for adult entertainment services.

During Mr. Matzdorff's "active" management of USP&C, Southwestern Bell Telephone Company's (now Southwestern Bell Telephone LP d/b/a SBC Missouri) and PacBell's billing and collection contracts with Info Access were assigned by Info Access to USP&C on August 12, 1996 and September 11, 1996, respectively. Mr. Matzdorff stated that an attorney named Randy Lowe put him in contact with Info Access. Staff suspects that this is the same Randall B. Lowe who is listed as a stockholder (1.0 shares) of LEC LLC. Staff is unsure if this is the same InfoAccess that was associated with Mr. Daniel Martino who was indicted in original fraud and money laundering proceeding.[33] Mr. Martino's company, InfoAccess, was instrumental in the purchase by Mr. Matzdorff of Cass County Telephone.

In 1998, USP&C brought in new management that included: James E. Brown, vice president and chief information officer; Webb Roberts, vice president and chief financial officer; and Linda Benito, vice president of sales and marketing with additional responsibilities for client services, carrier relations and regulatory compliance.[34] Somewhere around January 1998, Mr. Matzdorff hired Jim Brown as general manager to run USP&C.

Also during 1998, the attorneys general for the states of Wisconsin and Ohio filed lawsuits that involved USP&C and TOS for the placement of unauthorized charges on customers' phone bills.

On the Federal Communications Commission's ("FCC") December 1998 "Telephone Consumer Complaint Scorecard," USP&C had 523 cramming complaints processed by the Enforcement Division of the FCC's Common Carrier Bureau for the first six months of 1998. Further, USP&C was confronted with additional litigation from SWBT, PacBell, Ameritech, GTE, Bell Atlantic and US West for a variety of billing and collection agreement violations.

In early 1999, USP&C entered into a management arrangement with a company named Billing Management Services, Incorporated ("BMSI"). Jim Brown negotiated the contract for BMSI and Mr. Matzdorff negotiated the contract for USP&C. Piper & Marbury provided legal services to USP&C for this matter. USP&C agreed to pay BMSI ** ________ ** monthly for the services of Jim Brown, Web Roberts, Terry Stock, and others. Some of these employees were employed by USP&C. BMSI was incorporated in the state of Delaware on December 8, 1998 and authorized to due business as a Foreign Corporation in the State of Missouri on February 1, 1999. The officers and directors of BMSI listed in records of the Missouri Secretary of State were James E. Brown, Webb Roberts and Linda Benito. BMSI was located at 8800 Blue Ridge Boulevard in Kansas City, Missouri.[35] Staff does not know at this time why USP&C, Inc. hired a "management team" from BMSI.

During this same time period, Mr. Matzdorff has stated that he let it be known that he was interested in exiting USP&C and TOS. His stated reasons for exiting the two companies were that:

> …The industry changed and the concept of third-party billing, and there was an introduction of an industry term cramming, and what it essentially did is it created a lot of pressure on the local exchange companies that they in turn started looking at

> tightening who they were providing billing services with as clients, and it looked to be like…like there wasn't any future in this industry.[36]

There is documentation that Mr. Matzdorff sold USP&C and TOS to Mr. Michael Lauro of USP&C Acquisition Corporation, a Delaware incorporated company on December 17, 1999 and that Mr. Matzdorff resigned as both officer and director of these companies effective December 17, 1999. However, Mr. Matzdorff, as the president of USP&C, Inc., signed a Stipulation with the State of Wisconsin that is dated December 20, 1999. The State of Wisconsin had charged USP&C with violation of Wisconsin's Telecommunications Services statute that prohibits billing for services which were not affirmatively ordered by a customer. In the Stipulation, USP&C agreed to a number of provisions, including a civil forfeiture of $50,000.

On March 28, 2000, the Attorney General of the State of Missouri sued BMSI and Invesco Telecommunications Inc. in Jackson County Circuit Court for sending out thousands of phony telephone bills designed to look like legitimate bills from SWBT. Invesco Telecommunications, Inc. was one of USP&C's clients. The fraudulent bills, labeled as coming from "Southwest Region Bill" ranging from $16 to $27, were sent to consumers in several states, including Missouri, Kansas, Oklahoma and Texas. The invoices billed for telephone services such as "Extensor Systems – Call Manager" and "Invesco Telemail." The United States has been alleged that Invesco Telecommunications, Inc. was secretly controlled by Richard Martino, Norman Chanes and Daniel Martino."[37]

The Jackson County Circuit Court on August 30, 2000 ordered, as a result of a settlement, BMSI and Invesco to pay $11,400 in restitution to consumers in several states, including $5,000 to the State of Missouri, to cover the costs of investigating and prosecuting the case and another $2,000 to the Missouri Merchandising Practices Revolving Fund.

In April 2001, the California Public Utility Commission (CPUC) found that USP&C had failed to comply with CPUC billing requirements and ordered USP&C to pay a fine of $1.75 million, and also ordered all California

ILECs to permanently cease providing billing and collections services to USP&C and its affiliates.

The CPUC found that from:

> …*January 1998 to June 1999*, respondent, USP&C, Inc. (USP&C), served as the billing agent for $51.5 million of billings to California customers. USP&C presented billings for service providers that conducted business under several different unregistered aliases, and that also used up to four different names for identical services. Of the total amount billed by USP&C during this period, $27 million (52%) was refunded at the customer's request. The remaining $24.5 million, however, was collected by USP&C, and was forwarded to the service providers, net of the fees charged USP&C.[38] (emphasis added)

A Federal Grand Jury in the Eastern District of New York in February of 2004 charged that between 1996 and 2002…USP&C…knowingly and intentionally devised and executed a scheme to defraud consumers by causing USP&C to place unauthorized charges on local telephone bills…and collecting payment on those unauthorized charges.[39]

Mr. Michael Lauro is still listed in the records of the Missouri Secretary of State as the registered agent of USP&C Inc. and it is listed at the same street address in the state of Kansas, though different suites, as TelData Consultants, Inc., which was formerly registered as BMSI.

II. Firm's Involvement in Inappropriate Activities and Impact on Missouri Consumers

A United States Grand Jury has accused USP&C of engaging in a telephone cramming scheme and being controlled by members associated with organized crime in New York. The Staff is unable to render an opinion on these allegations independent of developments in the federal cases. The placement of unauthorized charges on Missouri consumer telephone bills was curtailed by the actions of Southwestern Bell Telephone Company and the Missouri Attorney General. Additional details regarding these actions will be contained in the Missouri portion of Section 13 of this report

Staff has not discovered any existing direct relationship between USP&C, Inc. and a Missouri telephone company. Staff is aware that, at least until the end of 2004, LEC LLC was providing billing and collection services to at least two Missouri telephone companies—Cass County Telephone Company LP and New Florence. Staff is still investigating whether LEC LLC has a relationship with USP&C, Inc. or a successor to USP&C that it uses to pass costs onto Cass County Telephone Company LP or New Florence. In light of LEC LLC's refusal to provide information[40] regarding its provision of this function in the Cass County Telephone Company, LP and the Commission's establishment of Case No. TO-2005-0237, the Staff plans to formally pursue this information.

Section 8. Overland Data Center

I. Company Operations

Though not a federal criminal defendant, the United States has alleged that Overland Data Center, Inc. ("Overland") played a prominent role in the telephone cramming and related money laundering schemes. Overland actually processed the "1-800" numbers involved in the cramming scheme. Records from the Kansas Secretary of State indicate that Overland was incorporated in the State of Kansas sometime in 1995. A reference in an advertisement for a firm identified as Macomber Communications Computer Technology ("MCCT"), a call center service and support company, indicates that Overland may have been in existence since 1991. The stockholders of Overland are not identified in the incorporation documents. Overland's Kansas Articles of Incorporation states that the:

> …purpose of the corporation is to engage in any lawful act or activity for which corporations may be organized under the corporation laws of the State of Kansas.

Overland's 2003 Kansas Secretary of State Corporate Annual Report ("Annual Report") dated February 17, 2004, is signed by "Wayne Weir, president and *owner of 5% or more of Overland's capital stock*." (Emphasis added) Mr. Weir indicated in the 2003 Annual Report that the corporation was engaging in "Data Processing." In the Federal Grand Jury indictment, the United States alleges that:

> …Defendants RICHARD MARTINO, NORMAN CHANGES AND DANIEL MARTINO, together with others, caused the formation of Overland Data Center ("Overland")…and secretly controlled it for the purpose of receiving and processing consumers' calls to the various "1-800" telephone numbers used in the Cramming Scheme…Overland's finances were managed by DANIEL MARTINO through FSE Consulting, of which, of which DANIEL MARTINO was president. Through this position, DANIEL MARTINO assisted RICHARD MARTINO and CHANES in exercising secret control…

According to the information that the Staff has, Overland is located at the same address in Kansas as USP&C, Inc., Cyber Data Processing, Inc., (registered only in Kansas) formerly Lexitrans, and TelData Consultants, which was formerly only registered with the Missouri Secretary of State as BMSI.

A. Overland and LEC LLC

The federal FBI agent affidavit in support of the ARREST WARRANT of Mr. Matzdorff states that:

> …between 1998 and 2002, approximately $6.6 million was transferred from bank accounts held by Overland Data to bank accounts held by LEC L.L.C. These funds were ostensibly paid by Overland to LEC L.L.C. as "management and consulting fees.

The agent further states in the affidavit that:

> …LEC performed no management or consulting service for Overland during the period 1996 to 2003 that would justify the payment of anything more than nominal fees, and performed no services at all for Overland since 1997…In addition, MATZDORFF, through LEC L.L.C. received substantial fees for "consulting and management services" from Overland.

B. Overland and Cass County Telephone

In the federal agent affidavit in support of the arrest warrant for Mr. Matzdorff that issued in July 2004 the agent states that:

> …in or about 1997 and 2003, Overland Data Center performed certain computer consulting work for Cass County…however, the amount that Cass County paid Overland for this work was approximately five to ten times the true value of the invoiced services…these funds were first transferred from Cass County to FSE Consulting, a consulting company owned operated by Richard Martino's Brother, Daniel Martino, and then from FSE Consulting to Overland. Examination of subpoenaed documents reveals that these funds were then sent back to Cass County.

In response to Staff Supplemental Data Request No. 9 in Case No. IR-2004-0354, Cass County stated the following regarding its financial transactions with Overland:

> Cass County Telephone has used Overland Data Center to provide data support services for its operations. Cass County Telephone and LEC, LLC do not have IT staff with expertise in software development or personnel with hardware or computer expertise. These services have been contracted out to vendors and Overland Data Center has provided some of these services. The company has not utilized Overland Data's service since *June of 2002*. In the test period used for calculating the earning of Cass County Telephone the company paid

** _________ ** in fees for the provision of data and systems support services. (Emphasis added)

In response to questions from Chair Gaw regarding Overland during the April 19, 2004 on-the-record presentation in Case No. IR-2004-0354, Mr. Matzdorff testified as follows:

> Q. (Chair Gaw) And you're saying that except for the $970,000, to your knowledge, the only monies that were transferred were for services?
>
> A. (Mr. Matzdorff) Okay. To my knowledge, CassTel is only paid out for services rendered to the company.
>
> Q. And what period of time were those services rendered, if you know?
>
> A. They -- the company started on April 1st, 1996 and they continued until June, at which time I became aware of alleged improprieties and I terminated the functions.
>
> Q. In June of what year?
>
> A. 2003.
>
> Q. 2003. Do you know anything about the ownership of Overland Data Center?
>
> A. No, I do not.
>
> Q. Do you know if it's a corporation or something else?
>
> A. I really don't.
>
> Q. And you're not familiar with any -- you don't know any of the owners?
>
> A. I only -- I only know of the services and the personnel that's responsible for providing the services to me really.

C. Firm's Involvement in Inappropriate Activities

The United States has alleged that Overland Data Center was actively involved in the telephone-cramming scheme and in money laundering process. The following paragraphs are based on those allegations.

> In the federal indictment the United States alleges that the president and owner, Tom Weir, does not control Overland Data Center. Instead, in the federal indictment the United States alleges that defendants RICHARD MARTINO, NORMAN CHANES and DANIEL MARTINO, together with others, caused the formation of Overland Data Center ("Overland"), located in Overland Park, Kansas, and secretly controlled it for the purpose of receiving and processing consumers' calls to the various "1-800" telephone numbers used in the Cramming Scheme. Overland operated telephone lines and voice response units ("VRUs"), which processed the consumers' calls and played the front-end programs. At the direction of RICHARD MARTINO, NORMAN CHANES, DANIEL MARTINO, LAWRENCE NADELL, YITZHAK LEVY and KENNETH SCHAEFFER, Overland employees programmed the VRUs to play the front-end programs and thereby trigger the unauthorized charges on the consumers' telephone bills. DANIEL MARTINO through FSE Consulting, of which DANIEL MARTINO was president, managed Overland's finances. Through this position, DANIEL MARTINO assisted RICHARD MARTINO and CHANES in exercising secret control over Overland and other companies.
>
> Defendants RICHARD MARTINO and NORMAN CHANES, together with employees of Harvest Advertising, Inc. acting under their direction, created scripts for both the "approval" and "marketing" versions of the front-end programs, and retained voice-professionals to make recordings of the scripts. The recordings were then provided to employees of Mical Properties, Inc, where, at the direction of defendants RICHARD MARTINO, LAWRENCE NADELL, YITZHAK LEVY, KENNETH SCHAEFFER and others, they were transmitted to Overland for use in the front-end programs. In this way, Overland Data Center actively participated in the telephone-cramming scheme. Overland Data Center transmitted the billing data for the unauthorized charges to USP&C, Inc. for ultimate delivery to local exchange companies for inclusion on end user consumer telephone bills.

> The shell companies that were established to provide the "1-800" numbers processed by Overland Data Center received funds collected from the unauthorized charges from USP&C, Inc. These shell companies transmitted their funds to Overland Data Center, Inc. or Fairfax Telecommunications, Inc. Overland Data Center, Inc. transmitted its funds to Mical Properties, Inc. and Local Exchange Company LLC. The majority of these funds were then transferred to Mical Properties, Inc.

II. Impact on Missouri Consumers

Missouri consumers could be negatively impacted by these alleged Overland Data Center activities. First, consumers could have paid the unauthorized charges placed on their bills by the telephone cramming scheme. The exact quantification of this impact is not known. The impact of the cramming scheme on Missouri consumers was limited by the actions of Southwestern Bell and the Missouri Attorney General to stop these activities. The details of the actions by Southwestern Bell and the Missouri Attorney General are discussed in the Missouri portion of Section 13 of this report. Second, the alleged money laundering activities related to the telephone cramming scheme would not directly impact Missouri consumers negatively. The greater threat to Missouri consumers would be the overstatement of cost of service by Missouri telephone companies due to inclusion of improper and excessive Overland Data Center charges.

Staff is aware that Cass County Telephone Company LP made direct payments to Overland Data Center. The legitimacy of these payments is still under review. To the Staff's knowledge Overland Data Center did not provide any data functions to New Florence Telephone. However, New Florence Telephone and Cass County Telephone Company LP could indirectly be making payments for Overland Data Center charges through the payments they make to LEC LLC. The Staff is still investigating whether this occurred. LEC LLC has objected to providing responses[41] to the Staff informal requests for information regarding its relationship with Overland Data Center and what charges it was passing on to Cass County Telephone Company LP. In light of LEC LLC's refusal to provide information regarding the pass through of charges and the Commission's establishment of Case No. TO-2005-0237, the Staff plans to formally pursue this information.

New Florence has responded to requests by the Staff that it cannot provide any copies of agreements between Overland Data Center and LEC LLC as that information is not in its possession or control,[42] and Cass County Telephone Company LP has objected to providing this data. In light of Cass County's refusal to provide this information and the Commission's establishment of Case No. TO-2005-0237, the Staff plans to formally pursue this information.

Section 9. Local Exchange Company, L.L.C.

I. Company Operations

Mr. Matzdorff left his position at Fidelity Communications when he had an opportunity to purchase some telephone properties from GTE Corporation. He testified that he formed a limited liability corporation called Local Exchange Company or LEC. LEC, in turn, formed a limited partnership called Cass County Telephone Company LP.[43] This partnership purchased the exchanges from GTE Corporation. LEC LLC has a 99% ownership interest in the Cass County Telephone Company LP. Mr. Matzdorff is one of the owners of LEC LLC. Both LEC LLC and Cass County Telephone came into existence before USP&C.

LEC LLC owns 99% of the Cass County Telephone Company LP and is the managing partner of Cass County Telephone Company. LEC LLC also owns 100% of LEC, Inc., a Delaware corporation and the general partner of Crawford Telephone Company. Attachment 14 to this report is a copy of Cass County Telephone Company LP's November 30, 2004 response to Staff Data Request No. 22. This response provides details regarding the relationships between LEC LLC and its affiliates, as well as information regarding LEC LLC's employees. This response also provides details regarding the employees of Cass County Telephone Company LP and New Florence Telephone Company as of late 2004. The following chart shows the LEC LLC investment accounts shown on the Company's April 30, 2004 Balance Sheet:

Investment in:	$ Invested at April, 30, 2004
Cass County Telephone	** ______________**
Cass-Min INT	** __ **
Tiger Telephone Company, Inc.	** ___________ **
LEC Long Distance, Inc.	** _____________ **
McHenry telephone Company, Inc.	** _____________ **
Missouri Network Alliance, LLC	** _____________ **
ANPI	** _____________ **
Local Exchange Carriers, LLC	** ___ **
Non-regulated Investment	** _____________ **

The above assets are classified as non-current assets on LEC LLC's balance sheet. LEC LLC's largest investment, by far, is in Cass County Telephone Company LP. The Company had a significant investment, ** ___________ **, in Local Exchange Carriers,

NP

LLC on April 30, 2004. This investment has been reduced to zero in the succeeding nine-month period. LEC LLC's investment in McHenry Telephone Company, Inc. and ANPI, have remain unchanged over the same nine-month period. The investment in Tiger Telephone Company, Inc. ultimately represents a ** _____ ** ownership in New Florence Telephone Company. LEC LLC's investment in non-current assets represents approximately ** ____ ** of its assets at April 30, 2004. LEC LLC had approximately ** ________ **invested assets classified as Telecom Plant in Service at this same point in time.

LEC LLC maintains a significant portion of its investment in assets other than non-current assets in cash or cash equivalents. At April 30, 2004, LEC LLC had approximately ** __________ ** in cash or certificates of deposit. These cash and certificates of deposit represent approximately ** ____ ** of LEC LLC's assets at April 30, 2004. LEC LLC also maintains an approximate ** ____ **. This bank is owned by a holding company—Garden City Bancshares. Garden City Bancshares has been noted in news articles and the federal agent affidavit in support of Mr. Matzdorff's Arrest Warrant (Attachment 18 to this report, page 18) as having a majority of its ownership purchased by Mr. Matzdorff, the LEC LLC president, and his wife, with money provided by LEC LLC. Garden City Bank is also reported to have established a merchant account needed to support the Internet fraud scheme that is discussed in more detail in Section 4 of this report.

LEC LLC has ** ____________ ** of member's capital as of April 30, 2004. This amount has remained unchanged over the prior twelve-month period. This level of investment supports ** _____ ** partnership units at this point in time and indicates that ** ___ ** units have been liquidated since December 31, 2002. LEC LLC has earned ** _____________ ** through April 30, 2004 and distributed ** _____________ ** of those earnings to its members. Cass County Telephone Company LP has provided ** _____________ ** of earnings to LEC LLC through April 30, 2004.

Local Exchange Company, L.L.C (LEC LLC) is a Maryland limited liability company. The Company was formed on November 2, 1994. InfoAccess, Inc. and Lexicom, Inc. were the original members of the company. Daniel Martino, a defendant in the federal indictment, is associated with InfoAccess, Inc. On March 1, 1996, LEC LLC created an

Operating Agreement by and among its managers, withdrawing member, InfoAccess, Inc., and the members of the Company as identified on its books and records. Members are those persons that subscribe for units in the Company. A unit represents a cash capital contribution of ** _______ ** per unit in the firm. The Operating Agreement defined the following purposes for LEC LLC:

> ** ____
> ____
> _________ **
>
> ** ____
> _________ **
>
> ** ____
> ____
> ____ **
>
> ** ____ **
>
> ** ____
> ____
> ____
> ____ **
>
> ** ____
> ____
> ____ **
>
> ** ____
> ____
> ____
> ____________________ **
>
> ** ____
> ________________________ **
>
> ** ____
> ____
> ____
> ____
> ____
> _________________________ **

** ____ **

** ____ **

** ____ **

Cass County Telephone Company LP does not possess a signed version of a formal service agreement with LEC LLC. Cass County Telephone Company LP asserts in its November 30, 2004 response to Staff Data Request No. 6, that a service agreement existed in 1995. Cass County Telephone LP did produce to the Staff an unexecuted draft of a service agreement between Cass County Telephone Company LP and LEC LLC. Cass County

NP

Telephone Company LP asserts that the unsigned version provided in this response was developed using the 1995 agreement as a guideline. The original agreement was allegedly misplaced during the development of the draft agreement. Cass County Telephone Company represents that the draft agreement documents the agreement for the services rendered to Cass County Telephone Company, LP by LEC LLC. Attachment 15 to this report contains a copy of the November 30, 2004 Cass County Telephone Company LP response to Staff Data Request No. 6. LEC LLC's fees for the services in this draft agreement are discussed in Article II of the draft agreement. Schedule A of the draft agreement lists the fees Cass County Telephone Company, LP is to pay for LEC LLC's services. These fees were to remain in effect for two years after and thereafter be subject to renegotiation through mutual consent of the parties. Attachment A was not provided in Cass County Telephone LP's November 30, 2004 response to Staff Data Request No. 6 as shown in Attachment 15 to this report. Attachment 14 to this report shows that there is no Cass County Telephone Company, LP employee position that can effectively negotiate fees with LEC LLC. The LEC LLC fees are basically established by LEC LLC and imposed on Cass County Telephone Company, LP.

II. Firm's Involvement in Inappropriate Activities

The allegation in the federal indictment limit the actual actions of LEC LLC to its involvement in movement of the illegal proceeds from the telephone cramming scheme. The focus of the allegations in the indictment are on the owners of LEC LLC. On January 25, 2005 a Kansas City grand jury indicted Daniel and Richard Martino on USF (Universal Service Fund) and NECA (National Exchange Carriers Association) fraud-related charges. A majority of LEC LLC is owned, directly or indirectly, by individuals facing or convicted of federal charges as shown in the following table:

Individual/Trust	Units	Percentage of Total
** ________ **	** ________ **	** ________ **
** ________ **	** ________ **	** ________ **
** ________ **	** ________ **	** ________ **
** ________ **	** ________ **	** ________ **
** ________ **	** ________ **	** ________ **
** ________ **	** ________ **	** ________ **
** ________ **	** ________ **	** ________ **
** ________ **	** ________ **	** ________ **
** ________ **	** ________ **	** **
** ________ **	** ________ **	** ________ **
** ________ **	** ________ **	** ________ **
** ________ **	** ________ **	** ________ **
** ________ **	** ________ **	** ________ **
** ________ **	** ________ **	** ________ **
** ________ **	** ________ **	** ________ **
** ________ **	** ________ **	** ________ **
** ________ **	** ________ **	** ________ **
** ________ **	** ________ **	** ________ **

** ____ ** LEC LLC has objected to the Staff's informal requests for information regarding this owner. The Staff sought this information to determine whether there exists any relationship to these individuals. In light of LEC LLC's refusal to provide the information and the Commission's establishment of Case No. TO-2005-0237, the Staff plans to formally pursue obtaining this information.

On February 23, 2004, Mize, Houser & Company suspended any additional audit or professional services to LEC LLC and its majority-owned subsidiaries—Cass County Telephone Company LP and Cass Tel LD. Mize, Houser & Company was the independent auditor for all of these entities. Based on information obtained by the Staff, the suspension of services was related to disclosure of the current ownership of LEC LLC and the then pending federal criminal actions. Mize, Houser & Company became aware of allegations made in federal grand jury indictments against several individuals who comprise a majority of the ownership of LEC LLC.

** **

** **

III. Impact on Missouri Consumers

The greatest potential negative impact on Missouri consumers from the foregoing are the questions that have been raised regarding the validity of the cost structures of the Missouri telephone companies that are involved with LEC LLC. Staff is aware that, at least until very recently, Cass County Telephone Company LP, New Florence Telephone Company, and Oregon Farmers have business relationships with LEC LLC. The financial controls that the Staff is aware of at Cass County Telephone Company LP, and New Florence Telephone Company are not adequate to permit reliance upon their current books and records. The position of LEC LLC regarding the disclosure of its business dealings and the impact of those dealings on the charges it imposes on these two Missouri telephone companies complicates regulatory monitoring regarding the reasonableness of the charges. The details of the direct impacts on Cass County Telephone Company LP, New Florence

Telephone Company are discussed in Sections 10 and 11 of this report, respectively. The important item to note in this Section is the fact that LEC LLC can engage in a transaction with any firm or individual and cover the transaction through a billing to Cass County Telephone Company LP or New Florence Telephone Company as an LEC LLC charge.

LEC LLC derives income from three separate functions. These functions are service provision, investment income and billing center operations. This statement is based on an examination of one LEC LLC monthly financial statement. This area of the investigation has been delayed due to data acquisition problems. Staff had requested LEC LLC for audited financial statements and monthly financial statements. Cass County Telephone Company LP objected to the provision of this material on the basis of possession and relevancy. In light of the Commission's establishment of Case No. TO-2005-0237 and the directives given by the Commission in its order establishing the case, the Staff plans to formally pursue collection of this information. The Staff has received a copy LEC LLC's monthly financial report for April 30, 2004 in the Cass County Telephone Company LP's November 30, 2004 response to Staff Data Request No. 26 which requested information provided to the Kansas Corporation Commission. The LEC LLC financial material was included in this response since it had been provided to the Kansas Corporation Commission.

The LEC LLC financial statement shows that the company receives operating income from its service provision function. The statement shows for the first four months of 2004, LEC LLC charged approximately ** ___________ ** in service revenues related to approximately ** _________ ** in related expenses, thereby, creating ** _________ ** of income for LEC LLC in this period. LEC LLC was charging a significant markup over its actual expenses for its service activities. It is likely that Cass County Telephone Company paid a majority of these charges.

Investment income is LEC LLC's second source of income. LEC LLC shows potential investment income from six sources. The information available to the Staff uses abbreviations, but these sources are believed to be LEC LLC's investment in Cass County Telephone Company, LP, Lake Livingston Telephone, Inc., Tiger Telephone, Inc., LEC Long Distance, Inc., Missouri Network Alliance, LLC, and Local Exchange Carriers, LLC. A majority of the investment income ** ___________ ** for the first four months of 2004 was derived from Cass County Telephone Company, LP—** ___________ **. Tiger

NP

Telephone, Inc. and LEC Long Distance, Inc. are the only other entities that reported income. Tiger Telephone, Inc. owns New Florence Telephone Company Inc.

Billing Center operations is LEC LLC's third source of income. LEC LLC has four billing customers. These customers are Cass County Telephone Company, LP, Lake Livingston Telephone, Inc., New Florence Telephone Company Inc. and Oregon Farmers Mutual Telephone Company. The billing center operations had approximately ** ________ ** of revenue for the first four months of 2004 with ** _______ ** of related expenses for the same period. Cass County Telephone Company, LP is responsible for approximately ** ____ ** of LEC LLC's billing center revenues.

Staff's investigation sought the safeguards used to assure that transactions between LEC LLC and its affiliates were appropriate. Cass County Telephone Company LP's November 30, 2004 response to Staff Data Request No. 24 stated:

> Cass County used various methods to review transactions with affiliated entities. These methods included independent audits by third parties; comparison of charges similarly situated companies and price negotiations conducted by Cass County employees who have no financial interest in the resulting price.[44]

Attachment 14 to this report shows that the employees of Cass County Telephone Company, LP do not hold positions that one would expect would allow them to be capable of or have the time to perform a comparison of charges of similarly situated companies or conduct price negotiations. Such work activities would likely be performed by LEC LLC employees.

Staff requested from LEC LLC audited financial and monthly financial statements since 1996. Cass County Telephone Company LP objected to providing this information on the basis that the information is not: 1) in its possession and control; and 2) not relevant to the operations of Cass County Telephone Company LP. The objection also noted that LEC LLC is not a Missouri-regulated company subject to the Commission's jurisdiction. LEC LLC is the general and managing partner of the Cass County Telephone Company limited partnership. In light of the Commission's establishment of Case No. TO-2005-0237 and the directives given by the Commission in its order establishing the case, the Staff plans to formally pursue collection of this information.

Section 10. Cass County Telephone Company Limited Partnership

I. Company Operations

A. Scope of Operations

Cass County Telephone Company Limited Partnership is a Maryland limited partnership, formed to own the local telephone system in Cass County, Missouri. LEC L.L.C. owns 99% of the limited partnership. At least until 2005, based on an unexecuted service agreement, LEC LLC charged Cass County Telephone Company LP over ** ________ ** annually in excess of LEC LLC's costs to provide those services. On February 5, 1999, Mr. Matzdorff filed a "Registration of Fictitious Name" with the Missouri Secretary of State for Cass County Telephone Company, LP to do business in Missouri under the name, CassTel.

There was a Kansas City grand jury investigation of Mr. Matzdorff's activities reported in a November 3, 2004 *Kansas City Star* article. The article states that several "Cass County Telephone executives have been subpoenaed to testify before the grand jury, which appears to be focusing on money that the company, better known as CassTel, received from a federal program designed to assist high-cost and rural telephone service providers." There are no Cass County Telephone executives that are not LEC LLC employees. In January 2005 Mr. Matzdorff pled guilty to federal wire fraud and money laundering conspiracy charges in New York and to federal mail and wire fraud conspiracy charges in Missouri.

The employees of LEC LLC and Cass County Telephone are identified on pages 4 and 5 of Attachment 14 to this report. The employees of Cass County Telephone consist of seven technician positions. Cass County Telephone Company's executive, accounting, financial, and purchasing functions are performed by LEC LLC employees. The Staff's investigation has revealed that the level of Cass County Telephone Company's costs can influence the amounts that the company receives from the National Exchange

NP

Carrier Association (NECA) revenue pool and from the Universal Service Fund. The following section from Cass County Telephone Company LP's 2002 annual report describes the relationship of the Company's costs to the amount of NECA pool revenues that it receives and details regarding Universal Service Fund payments it receives:

> Network Access Service Revenue
>
> Revenues from interstate network access services are received through tariffed access charges filed by the National Exchange Carrier Association (NECA) with the Federal Communications commission (FCC) on behalf of its member companies. These access charges are billed by the Partnership to the interstate long distance carrier and pooled with like revenues from all NECA member companies. **The portion of the pooled access charge revenue received by the Partnership is based upon its actual cost of providing interstate long distance service, plus a return on investment dedicated to providing that service**. These revenues for the year ended December 31, 2002 and 2001 are subject to final review and approval by NECA. Partnership policy is to record any adjustments of these revenues in the period in which the adjustments become known. Management believes that revenues recorded at December 31, 2002 and 2001 represent reasonable estimates of the final amounts to be received under the agreement referre to in this paragraph. (Emphasis added)

The Partnership includes its Universal Service Fund (USF) payments in network access and long distance service revenues. For the years ended December 31, 2002 and 2001, payments received from the fund approximated 24% and 23%, respectively, of operating revenues. USF payments provide assistance with the cost of providing telecommunications service to high cost areas.

Cass County Telephone Company has received $15,544,295 from the Universal Service Fund since 1996. Cass County Telephone Company has received the following USF payments by year[45]:

Year	HCL	SNA	Total
1996	$ 542,036		$ 542,036
1997	48,679		48,679
1998	218,622		218,622
1999	1,396,324		1,396,324
2000	2,721,709		2,721,709
2001	2,830,091		2,830,091
2002	3,075,067		3,075,067
2003	3,006,411	$ 115,224	3,121,635
YTD 2004	1,532,520	57,612	1,590,132
Total	$15,371,459	$ 172,836	$15,544,295

The amount of the USF payments Cass County Telephone receives is influenced by the amount of the costs it has recorded in specific plant or expense accounts. USF payments are intended to offset the costs incurred to provide telephone services in high cost areas. The challenge for this arrangement is to prevent excessive costs from being incurred or fraudulent claims of costs being made under the guise of the high costs required to provide service to a specific area. Transactions with affiliated or related parties are high risk with regard to cost minimization, because of the absence of the normal safeguards found in arms-length transactions between unrelated parties; each acting in their own self interests.

II. Related and Affiliate Party Transactions

At least until January 2005 Cass County Telephone Company had two officers with authority to approve purchases or fund disbursements that also have a separate business relationship with third party vendors that have engaged in business transactions with Cass County Telephone Company LP that total more than $10, 000 annually. These individuals are Kenneth Matzdorff and Rebecca Matzdorff.

In its investigation the Staff examined third-party vendors related to Kenneth or Rebecca Matzdorff and received more than $10,000 from Cass County Telephone Company in one year. The details from that effort are shown in the following chart[46]:

Vendors	Jan.-July 04 Business	YTD 2003 Business	2002 Business	Officer Affiliation
Cass County Telephone		** __________ **	** __________ **	Kenneth Matzdorff
Haug Construction	** ___________ **	** ___________ **	** ___________ **	Kenneth Matzdorff
Local Exchange Company, LLC	** _____________ **	** _____________ **	** _____________ **	Kenneth Matzdorff
LEC Long Distance Inc.	** ___________ **	** ___________ **	** ___________ **	Kenneth Matzdorff
New Florence Telephone	** ___________ **	** __________ **	** __________ **	Kenneth Matzdorff
Overland Data Center			** _____________ **	
Pegasus Communications, Inc.			** ___________ **	Kenneth Matzdorff
Videonet	** __________ **			Kenneth & Rebecca Matzdorff
Total Affiliated Business	** _____________ **	** _____________ **	** _____________ **	
Total Business over $10,000 annually with vendors	** _____________ **	** _____________ **	** ______________ **	
% of Affiliated Business	** ______ **	** ______ **	** ______ **	

Overland Data Center is included in the above chart because of its alleged involvement in the telephone cramming scheme that is discussed in Section 8 of this report. In the federal indictment the United States alleges an affiliation between the real owners of Overland Data Center and LEC LLC. Mr. Matzdorff holds an officer position in LEC LLC as discussed in Section 5 of this report.

The Staff's examination of affiliated or related party transactions is incomplete at this time. Two affiliates, LEC LLC and New Florence Telephone Company that are known to conduct business with Cass County Telephone Company LP on the above chart were asked in Staff Data Request No. 24 to describe the safeguards that they use when entering into transactions with affiliates. Cass County Telephone Company LP objected to the request as vague, overbroad and seeking information not in the possession and control of the Company.

Cass County Telephone Company LP also stated that the safeguards employed by these companies is irrelevant to Cass County's regulated operations despite the amount of the payments that Cass County is making to these affiliates. Cass County has done business with other companies at a level greater than $10,000 annually. The Staff is unsure whether these companies are related to any of the owners or employees of LEC LLC. The Staff also inquired as to the entities having ties to Mr. Robert Williams, Mr. Matzdorff or Debi Long to compare a list of those entities with the entities that did business with Cass County Telephone Company, LP. Some of the entities that Cass County did business with could not be found through a search of the Missouri Secretary of State website, (i.e., they appear not to have authority to do business in this state). Cass County Telephone Company, LP has objected to the provision of the list of entities with ties to these individuals in its November 30, 2004 response to Staff Data Request Nos. 20 and 21 for various reasons including relevancy. In light of the Commission's establishment of Case No. TO-2005-0237 and the directives given by the Commission in its order establishing the case, the Staff plans to formally pursue collection of this information.

Cass County Telephone Company LP identified the safeguards that it used regarding affiliated transactions or with entities that have a business relationship with company employee(s) in the following statement[47]:

> [Cass County Telephone Company LP] used various methods to review transactions with affiliated entities. These methods included independent audits by third parties; comparison of charges of similarly situated companies and price negotiations conducted by Cass County employees who have no financial interest in the resulting price.

Cass County Telephone Company LP does not hire its independent auditor. LEC LLC hires the independent auditor. The prior independent auditor has suspended provision of audit services to Cass County and others. Attachment 16 to this report is a copy of the Company's November 30, 2004 response to Staff Data Request No. 8 that contains the letter from the prior independent auditor suspending any additional audit or professional services to LEC LLC, Cass County Telephone Company LP, and CassTel LD until the current LEC LLC ownership issues are resolved. Attachment 14 to this report shows that Cass County Telephone Company, LP employees do not hold positions that one would expect to be capable of or have the time to perform a comparison of charges of similarly situated companies or to conduct price negotiations. It appears that such work activities would likely be performed for Cass County Telephone Company by LEC LLC employees.

III. Firm's Involvement in Inappropriate Activities

The Staff has no indication that Cass County Telephone Company LP had any involvement in the activity cited in the federal indictments in New York, with the possible exception of money laundering. Cass County Telephone Company LP is controlled by LEC LLC and makes significant payments to LEC LLC. Cass County Telephone Company, at least until January 2005, was heavily dependent on the integrity and honesty of Kenneth Matzdorff. To the Staff's knowledge Cass County Telephone Company has not initiated any internal investigation to assess its exposure to malfeasance by Mr. Matzdorff or others, after news of the federal investigation linking Mr. Matzdorff to organized crime figures became public. Mr. Matzdorff either directly or indirectly has significant business dealings with Cass County Telephone Company. The Staff does not know that it has uncovered all of the entities in which Mr. Matzdorff has an interest. Objections have been made to providing such information to the Staff. It is impossible to determine definitively the full extent of Cass County Telephone Company's financial connections to Mr. Matzdorff without this information. Certain vendors doing business with Cass County Telephone Company could not be found on the Missouri Secretary of State's website. Cass County Telephone Company does not have formal safeguards in place to ensure that all of the transactions with its vendors are appropriate and reflect the best terms and price for Cass County Telephone Company.

IV. Impact on Missouri Consumers

There is evidence of a significant risk to Missouri consumers due to questions regarding the reliability of cost information and the integrity of Cass County Telephone Company LP's books and records since: 1) owners of the company are under federal indictment or have significant transactions with indicted individuals; 2) Cass County Telephone Company has had substantial transactions with firms that are owned by or associated with individuals under federal indictment, and 3) there is no independent external auditor or third party report that represents that there are no issues for Cass County Telephone Company regarding these matters.

Section 11. New Florence Telephone Company

I. Company Operation

On July 31, 1998, Tiger Telephone, LLC purchased New Florence Telephone Company from the individual stockholders. Tiger Telephone, LLC was formed by LEC LLC, Kenneth Matzdorff and Robert Williams to purchase New Florence Telephone Company and provide management and support services to New Florence Telephone Company. LEC LLC, Kenneth Matzdorff and Robert Williams each own one-third interests in Tiger Telephone, LLC.

On November 19, 1998, Tiger Telephone, LLC merged with Bengal Communications, Inc. The surviving entity was Bengal Communications, Inc., which had the same owners prior to the merger as Tiger Telephone, LLC. On December 16, 1998 Bengal Communications, Inc. changed its name to Tiger Telephone, Inc. Until August 12, 2004, Kenneth Matzdorff was president and director of New Florence Telephone Company, while Robert Williams was secretary and treasurer. On this date, Mr. Williams replaced Mr. Matzdorff as president of New Florence Telephone Company.

New Florence Telephone Company has represented that on January 1, 2005, New Florence Telephone Company ceased all payments to LEC LLC and that LEC LLC no longer provides any services to New Florence Telephone Company.

New Florence Telephone Company has two employees. A majority of its needs are met through services provided by LEC LLC employees. New Florence Telephone Company does not have a Service Agreement with LEC LLC. Likewise, there is no Service Agreement between Tiger Telephone, Inc. and LEC LLC.[48]

The Staff's investigation has revealed that the levels of New Florence Telephone Company's costs can influence the amounts that the company receives from the National Exchange Carrier Association (NECA) revenue pool and from the Universal Service Fund. The following section from New Florence Telephone Company's 2002 annual report describes the relationship of the company's costs to the amount of NECA pool revenues that it receives and details regarding the Universal Service Fund payments it receives:

Network Access Service Revenue

Revenues from the provision of interstate long distance network service are based on amounts received under agreements with the National Exchange Carrier Association (NECA). These amounts are based on access charges filed by NECA on the Company's and other local exchange carriers' behalf with the Federal Communications Commission. These access charges are pooled and, for periods through June 30, 2001, the Company received its settlements based on the average costs and return on investment for providing interstate access for all NECA member companies. **Effective July 1, 2001, the Company began receiving its settlements based on its actual cost of providing interstate long distance service, plus a return on the investment dedicated to providing that service**.

Final determination of the revenues received under the pooling arrangements with NECA is not made until review and approval of data submitted by the Company. It is the Company's policy to record those adjustments (if any) in the period in which they become known. Management does not expect final income amounts to differ significantly from those reflected in the financial statements.

Revenues from Intrastate/Intralata and Intrastate/Interlata network access services are received through tariffed access charges filed with the Missouri Public Service Commission. These access charges are billed to the appropriate long distance carrier and retained by the Company. (emphasis added)

The above statement shows that New Florence Telephone Company's revenues from the NECA pool are influenced by the levels of both its cost and the investment that the company incurs to provide interstate access service. The validity of the company's cost levels are suspect to the extent that they include a significant amount of dollars from transactions with affiliated entities or firms in which employees of the company have a business interest. Transactions with affiliated or related parties are high risk in regard to cost minimization of the transaction because of the absence of the normal safeguards found in arms-length transactions between unrelated parties; each acting in their own self interests.

Affiliate/Related Party Transactions

Tiger Telephone, LLC provided management and support services to New Florence Telephone Company. Similarly, Tiger Telephone, LLC had a management and support services agreement with LEC LLC under which LEC provided management and support services to Tiger Telephone LLC. New Florence Telephone Company did not directly have a Service Agreement with LEC LLC. Likewise, there was no Service Agreement between Tiger Telephone, Inc. and LEC LLC[49].

New Florence Telephone Company identified two officers (Kenneth Matzdorff and Robert Williams) with authority to approve purchases or fund disbursements to third party vendors that have a separate business relationship with these officers. Staff specifically examined transactions with third- party vendors doing more than $10,000 in business annually with New Florence Telephone Company. Staff examined these transactions to identify any activity between New Florence Telephone Company and vendors with a business relationship with Mr. Matzdorff or Mr. Williams. Documents related to the transfer of funds to Garden City Bank indicate that Rebecca Matzdorff and Debi Long had management roles at New Florence Telephone Company as general manager and chief financial officer, respectively. Rebecca Matzdorff is the wife of Kenneth Matzdorff. The Staff has been advised by New Florence Telephone Company that, as of August 12, 2004, Mr. Matzdorff ceded all financial authority for New Florence Telephone Company.

Third party vendors with a relationship with Messrs. Matzdorff or Williams that did business with New Florence Telephone Company and that the Staff has identified are listed below[50]:

Vendors	Jan.-July 04 Business	YTD 2003 Business	2002 Business	Officer Affiliation
Cass County Telephone		** __________ **	** __________ **	Matzdorff
Garden City Bank			** __________ **	Both
Haug Construction			** __________ **	Both
Local Exchange Company, LLC	** __________ **	** __________ **	** __________ **	Matzdorff
MATZCO, Inc.	** __________ **	** __________ **	** __________ **	Matzdorff
South Holt Communications	** __________ **	** __________ **	** __________ **	Williams
Total Affiliated Business	** __________ **	** __________ **	** __________ **	

Vendors	Jan.-July 04 Business	YTD 2003 Business	2002 Business	Officer Affiliation
Total Business over $10,000 annually with vendors	** __________ **	** __________ **	** __________ **	
% of Affiliated Business	** ______ **	** ______ **	** ______ **	
Total Operating Expense	** __________ **	** __________ **	** __________ **	
% Affiliated Business to Total Operating Expense	** ______ **	** _______	** ______ **	

The above chart shows a significant portion of the Company's cost of service is derived through affiliated or related party business. The dollar ratio of business with affiliates to total operating expense should be viewed with two considerations in mind. First, not all affiliate expenditures are charged to operating expense. Some expenditures are capitalized. This fact would tend to overstate the significance of affiliated or related party transactions, as certain of these expenditures are related to construction activity. Second, total operating expenses include depreciation, a significant non-cash item. This fact would tend to understate the significance of the amount of affiliate business being conducted at New Florence Telephone. While these percentages could be further refined to take into consideration these factors, the result of the simple ratio itself indicates that a significant percentage the Company's expense is the result of transactions with firms that have a business relationship with either Mr. Matzdorff and/or Mr. Williams.

New Florence Telephone Company did receive a December 31, 2003 invoice from Haug Construction, Inc. for ** ________ **. This invoice was approved and scheduled to be paid on January 14, 2004.[51]. Haug Construction, Inc. also sent an August 31, 2003 invoice to New Florence Telephone Company for ** ________ **[52]. This information could indicate that the above chart should include approximately ** _______ ** of additional affiliated business in 2003. Both Messrs. Matzdorff and Williams have ownership interests in Haug Construction, Inc.

The largest affiliate expenditures made by New Florence Telephone Company were made to LEC LLC. New Florence Telephone Company provided copies of LEC LLC invoices in its November 16, 2004 response to Staff Data Request No. 16. These invoices can

NP

be grouped into the following four categories, and fall into the time periods shown in the chart below:

Category	Time Period	Monthly Amount
Support Services	8/98 thru 12/01	** ______________________________ **
	12/03 thru 8/04	** ______________________________ **
Management Support Services	7/01 thru 12/01	** _______________**
	01/04 thru 8/04	** _______________ **
Data Processing & Carrier Billing	10/00 thru 11/01	** ____________________________ **
	11/03 thru 9/04	** ____________________________ **
Employee Insurance	6/01 thru 12/01	** ________________ **
	01/04 thru 11/04	** ________________ **

LEC LLC provided billing and collection services to New Florence Telephone Company. Expenses incurred for the years ended December 31, 2002 and 2001 were ** _______ ** and ** _______ **, respectively. The Staff has not found a Service Agreement with LEC LLC for these billing and collection services.

During the year ended December 31, 2001, LEC LLC began providing management and support services directly to New Florence Telephone Company. The company incurred ** _______ ** and ** _______ ** of expenses for those services during the years ended December 31, 2002 and 2001, respectively. Historically, New Florence Telephone Company has paid the following annual amounts to LEC LLC:

YEAR	AMOUNT
1999	** ___________ **
2000	** ___________ **
2001	** ___________ **
2002	** ___________ **
2003	** ___________ **
Ytd, 7/04	** ___________ **

New Florence Telephone Company was unable to provide much detail regarding the nature of the charges that it receives from LEC LLC. The information supplied by the Company indicates that New Florence is provided the breakdown of the LEC LLC charges by the Uniform System of Accounts. No description regarding the nature or purpose of the underlying charges is provided to New Florence Telephone Company. New Florence does not know the methodology LEC LLC used or whether there is an assignment of common expenditures between New Florence and other entities. New Florence could not provide the percentage and amount of the LEC LLC costs that were allocated to New Florence since 1999. It is likely that such a practice is used given the number of LEC LLC employees common to both companies. New Florence asserted that this information is not available to it. The amounts reflected in the chart above are taken from New Florence's response to a November 16, 2004 Staff Data Request No. 19, which also references a prior response to Staff Data Request No. 1.

New Florence Telephone Company provided copies of MATZCO invoices in its November 16, 2004 response to Data Request No. 16. According to information obtained by the Staff, Kenneth Matzdorff is the owner of MATZCO. New Florence Telephone Company was unable to provide additional written documentation related to the management services that it pays for under this transaction with MATZCO. New Florence provided copies of invoices covering two time periods that are very similar in format and identical in amount to the South Holt Communications' invoices discussed later. These periods were August 2001 through November 2001 and December 2003 through July 2004. The first period includes MATZCO invoices numbered 1 through 4 for ** ______ ** each, while the second period includes MATZCO invoices numbered 29 through 38 for ** ______ ** each. The monthly amounts appear to be evenly charged 50% to account 6534, Plant Operation Administration and 50% to 6711, Executive. MATZCO invoices 5 through 28 were not provided in the response, but would appear to correspond exactly with months missing between November 2001 and December 2003. This factor may indicate that MATZCO only bills New Florence for services and performs no other activity. New Florence has indicated that ** ______ ** and ** ______ ** was paid to MATZCO annually in 2002 and 2003, even though no invoices have been provided to support these amounts.

New Florence provided copies of invoices from South Holt Communications in its November 16, 2004 response to Staff Data Request No. 16. South Holt Communications is associated with Robert Williams, indirectly a one-third owner of New Florence. New Florence Telephone Company was unable to provide additional written documentation related to the management services that it pays to South Holt Communications under this transaction. New Florence provided copies of invoices covering two time periods that are very similar in appearance and identical in amount to the MATZCO invoices. These periods were August 2001 through November 2001 and December 2003 through September 2004. The first period includes South Holt Communications invoices numbered 1 through 4 for ** ______ ** each, while the second period includes South Holt Communications invoices numbered 29 through 38 for ** ______ ** each. The monthly amounts appear to be evenly charged 50% to account 6534, Plant Operation Administration and 50% to 6711, Executive. South Holt Communications' invoices 5 through 28 were not provided in the response but would appear to correspond exactly with months missing between November 2001 and December 2003. This factor may indicate that South Holt Communications only bills New Florence for services. However, unlike MATZCO, the Staff is aware that South Holt Communications also charged Oregon Farmers Mutual Telephone Company for services. This is discussed in greater detail in Section 12 of this Report. New Florence Telephone Company has indicated that ** ______ ** and ** ______ ** were paid to South Holt Communications in 2002 and 2003, even though no invoices have been provided to support these amounts.

To the Staff's knowledge, Overland Data Center did not provide any data functions to New Florence. New Florence could not provide copies of agreements between it and Overland Data Center or LEC LLC responding that that information is not in its possession or control[53]. New Florence Telephone Company asserts that there were no direct charges from Overland Data Center to New Florence. New Florence has further represented to Staff that there is no evidence that LEC LLC, as part of its allocation process, has charged any costs associated with Overland Data Center to New Florence.

The Staff's examination of affiliated or related party transactions is incomplete at this time. The Staff asked LEC LLC, which had conducted business with New Florence Telephone County as shown on the previously discussed charts, (Staff Data Request No. 24) to describe the safeguards that are used when entering into affiliate transactions. LEC LLC, Cass County Telephone Company LP's general and managing partner, objected to the request as vague, overbroad and seeking information not in its possession and control. The safeguards employed by LEC LLC were described as irrelevant to New Florence Telephone Company's regulated operations in spite of the fact of that New Florence Telephone Company is making payments to LEC LLC in excess of ** ________ ** annually. In light of the Commission's establishment of Case No. TO-2005-0237 and the directives given by the Commission in its order establishing the case, the Staff plans to formally pursue collection of this information. New Florence Telephone Company enters into loans to affiliated companies and its owners, in addition to the transactions already discussed. New Florence has entered into a note receivable with CassTel (Cass County Telephone Company LP), an entity affiliated by common ownership. Interest on the note is payable monthly at ** _____ ** and the principal balance was due on June 17, 2003. The note balances as of December 31, 2003, 2002 and 2001 were ** ________ **. Interest income related to this note for the years ended December 31, 2002 and 2001 was ** _______ ** and ** _______ **, respectively. CassTel also owed ** _______ ** and ** ______ ** to New Florence as of December 31, 2002 and 2001, respectively, related to advances made by New Florence on CassTel's behalf. CassTel paid the outstanding balance to New Florence Telephone Company in March 2004.

At December 31, 2002 and 2001, New Florence had notes receivable with two Tiger stockholders, Mr. Matzdorff and Mr. Williams, in the sum of ** ________ ** and

NP

** ________ **, respectively. These balances were ** __________ ** at December 31, 2003 (Matzdorff) and ** __________ ** at August 31, 2004 (Williams). These notes were issued on March 7, 2001 for ** ________ ** each with a due date of March 7, 2003. Interest is payable quarterly at ** _____ ** and any unpaid interest is due with the principal upon demand. Interest income recognized for the years ended December 31, 2002 and 2001 for these notes was ** _______ ** and ** _______ **, respectively. The notes were extended beyond their due date, without any formal request or approval.

Companies controlled by stockholders of Tiger provided administrative and support services to New Florence in the amounts of ** ________ ** and ** _______ ** during the years ended December 31, 2002 and 2001, respectively. The balances due these companies by New Florence were ** _______ ** and ** _______ ** at December 31, 2002 and 2001, respectively.

An entity controlled by stockholders of Tiger sold equipment to New Florence for a total of ** ________ ** during the year ended December 31, 2001. The balance due this entity at December 31, 2001 relating to this purchase was ** ________ **.

At this time, Staff is not sure whether all these related transactions are separate transactions or there is some duplication in the above narrative regarding affiliated or related party transactions. This is an area that would require additional inquiry. It is known that New Florence Telephone Company has significant transactions with firms related to individuals that are defendants in federal criminal proceedings or who have pleaded guilty to Federal offenses.

II. Investments

New Florence has a ** ___ ** ownership interest in the Missouri RSA #8 Partnership (RSA #8) which provides cellular service in several rural counties extending from St. Louis to Columbia, Missouri. This investment is accounted for by the equity method whereby New Florence recognizes its proportionate share of the income and losses under the terms of the partnership agreement. For the years ended December 31, 2002 and 2001, New Florence recognized income from the partnership of ** ________ ** and ** ________ **, respectively.

The following is a summary of condensed financial information pertaining to the partnership described above at December 31:

	2002	2001
Total assets	** _________ **	** _________ **
Total liabilities	** ________ **	** **
Partners' equity	** _________ **	** __________ **
Revenues	** _________ **	** _________ **
Expenses	** __________ **	** __________ **
Net income	** _________ **	** _________ **

During the year ended December 31, 2001, RSA #8 formed Missouri RSA #8 Tower Holdings LLC (Towers). New Florence received a ** ___** membership interest in Towers when RSA #8 transferred assets to Towers to facilitate a leasing arrangement related to those assets.

The investment in Towers is accounted for by the equity method, and the following is a summary of New Florence's investment in Towers during the years ended December 31:

	2002	2001
Capital balance at beginning of year	** _________ **	** _____ **
Capital contribution with a transfer of assets from RSA #8 to Towers	** _ **	** ______ **
Equity in earnings of Towers	** _____ **	** _____ **
Distributions received	** _ **	** _________ **
Capital balance at end of year	** _________ **	** _________ **

New Florence is liable for restoration of any negative capital account balance generated by distributions from Towers. The distribution New Florence received during 2001 related to cash flow generated by lease prepayments received by Towers under the leasing arrangement referred to above.

During 2003, the owners of New Florence received ** ________ ** in distributed earnings. They received ** ________ ** in distributed earnings through the first eight months of 2004.[54]

NP

III. Firm's Involvement in Inappropriate Activities

There is no indication that New Florence Telephone Company had any involvement in the activities alleged in the federal indictments in New York, with the possible exception of money laundering. New Florence is not mentioned in any of the indictments. New Florence Telephone Company is controlled by LEC LLC and makes significant payments to LEC LLC. New Florence is heavily dependent on the integrity and honesty of its three owners—LEC LLC, Kenneth Matzdorff and Robert Williams. New Florence has not initiated any known internal investigation after news of the ties between the federal criminal investigation and CassTel became public. Messrs. Williams and Matzdorff, either directly or indirectly, have significant business dealings with New Florence. The Staff does not know the full extent of the entities in which these individual have business relationships. Objections have been made to providing such information to the Staff. It is impossible for the Staff to determine definitively the full extent that business dealings of New Florence are financially connected to these individuals without this information. Certain vendors doing business with New Florence could not be found on the Missouri Secretary of State's website which may indicate that they are not authorized to do business in Missouri. New Florence does not have formal safeguards in place to ensure that all these transactions are appropriate and reflect the fair terms and prices for New Florence.

IV. Impact on Missouri Consumers

On November 16, 2004, the Federal Communications Commission suspended all monthly support payments to New Florence. New Florence is pursuing all legal and regulatory avenues to protest this suspension, as it believes the action is unwarranted. The Staff has been informed that Mr. Matzdorff voluntarily resigned as CEO and removed himself from management functions of New Florence in August of 2004. At that time, Mr. Robert Williams became President and CEO of New Florence. New Florence is holding up all expenditures for broadband and other discretional spending until the issue of Universal Service Funding is resolved. As of January 1, 2005, New Florence moved its Billing and Collection, and all other services now being provided by companies associated with Local Exchange Company, LLC, to a third-party vendor. New Florence has also stated that it is considering making a request for rate relief to the Missouri Commission[55].

New Florence has not issued any Requests For Proposals ("RFPs") since July 1998, when Tiger Telephone, Inc. purchased the stock of New Florence and took over management of the company. To the Staff's knowledge, New Florence did not issue RFPs before Tiger Telephone purchased the stock. New Florence has represented that it has only used Haug Construction for work on a "unit" basis.[56]

New Florence does not have bidding procedures. New Florence does not bid a project unless it is a large project, and it has not undertaken a large project since 1998 when the current owners acquired control. No company other than Haug Construction obtains services or bids construction projects for New Florence

There is evidence of a significant risk to Missouri consumers due to questions regarding the reliability of cost information and the integrity of New Florence Telephone Company's books and records since: 1) owners of the company are under federal indictment or have significant transactions with indicted individuals; and 2) New Florence Telephone Company has had substantial transactions with firms that are owned by or associated with individuals under federal indictment.

Section 12. Other Missouri Telephone Companies

Oregon Farmers

I. Company Operations

Oregon Farmers Mutual Telephone Company, Inc. (OFMTC) provides local telephone service to Oregon, Missouri and the surrounding rural areas in Holt County, Missouri. In addition, OFMTC provides access both to and from the long distance network for its customers. Interexchange carriers, primarily American Telephone and Telegraph, MCl/Worldcom, Southwestern Bell Telephone, and Sprint, reimburse OFMTC for the provision of these access services.

Oregon Farmers Mutual Long Distance, Inc. (OFMLD), which began operations during 1999, provides long distance telephone service to Oregon, Missouri and the surrounding rural areas in Holt County, Missouri.

On February 13, 2004, the owners of OFMTC and OFMLD entered into a stock purchase agreement whereby all of their outstanding common stock would be sold to another telecommunications company. The new owners have no known relationship with LEC LLC or Kenneth Matzdorff. The sale closed on September 23, 2004. As a result, Mr. Robert Williams no longer holds any ownership interest in OFMTC nor is he an elected officer or director of the company. It has been represented by counsel for OFMTC to the Staff that Mr. Williams has retained "the honorary title of 'President'."

The Staff's investigation has revealed that the level of OFMTC's costs can influence the amounts it receives from the National Exchange Carrier Association (NECA) revenue pool and from the Universal Service Fund. The following section from OFMTC's 2003 annual report describes the relationship OFMTC's costs to the amount of the NECA pool revenues that it receives:

> <u>Network Access Service Revenues</u>
>
> Revenues from the provision of interstate long distance network service are based on amounts received under agreements with the National Exchange Carrier Association (NECA). These amounts are based on access charges filed by NECA on the Company's and other local exchange carriers' behalf with the Federal Communications Commission. These access charges are pooled, and **the Company receives its settlements based on its actual cost of providing**

> **interstate long distance service, plus a return on the investment dedicated to providing that service.** Revenues from intrastate long distance access services are received through tariffed access charges as filed with the Missouri Public Service Commission. These access charges are billed to the appropriate long distance carrier and retained by the Company. Interstate revenues received for the years 2003 and 2002 are subject to final review by NECA". (Emphasis added)

The above statement notes that the amount interstate settlements that OFMTC receives are affected by the total costs and investments it assigns to interstate activity. The validity of the levels of OFMTC's costs are suspect to the extent that these cost levels could include significant amounts of dollars from transactions with affiliated entities or firms in which employees of OFMTC have a business interest. Transactions made with affiliated or related parties are high risk in regards to cost minimization because of the absence of the normal safeguards found in arms-length transactions between unrelated parties; each acting in their own self interests.

OFMTC also received billing services from LEC LLC, a firm which has a majority of its owners facing federal criminal charges in New York. The LEC LLC billing services to OFMTC are discussed in greater detail in Section 9 of this report. The Staff has been informed by OFMTC's attorney that, as of January 1, 2005, LEC LLC no longer performs billing services for OFMTC.

II. Affiliate and Related Party Transactions

OFMTC bills and collects payments from customers on behalf of South Holt Cablevision, Inc. At December 31, 2003 and December 31, 2002, OFMTC owes ** ______ ** and ** ______ **, respectively, to South Holt Cablevision, Inc. for these collections and that amount is included in accounts payable-related parties. The principal owner (Robert Williams) of South Holt Cablevision, Inc. was a former officer and majority stockholder of OFMTC. As part of the recent sale of OFMTC and related entities, Mr. Williams sold South Holt Cablevision. Mr. Williams no longer has an ownership interest in South Holt Cablevision, Inc.

During 2003 and 2002, OFMTC incurred certain upgrade expenditures with Haug Construction, Inc. (Haug) in the amount of ** _______ ** and ** ________ **, respectively. The former majority owner of OFMTC (i.e. Robert Williams) has an ownership interest in

Haug Construction, Inc. Kenneth Matzdorff also has an ownership interest in Haug Construction, Inc.

OFMTC contracted with South Holt Communications, Inc. (SHC) for plant maintenance, administrative, and management services. OFMTC incurred expenses related to these services of ** ________ ** for each of the years ended December 31, 2003 and 2002. Robert Williams is the owner of South Holt Communications, Inc. Since the payment of dividends or any other distribution of capital was restricted by the provisions of mortgage notes when these transactions occurred, the amounts of the transactions and whether the transaction is designed in any way to circumvent the dividend restrictions contained the mortgage notes is an issue. Since Mr. Williams sold his interest in OFMTC, Oregon Farmers no longer contracts with South Holt Communications for these services and, to the extent these issues remain for past years, they are not present on a going forward basis. Included in accounts payable records of OFMTC at December 31, 2003 and 2002 are accrued dividend distributions of ** _______ ** and ** _______ **, respectively.

III. Investments in Partnerships

OFMTC entered into a limited partnership agreement on September 8, 1989, to provide cellular telephone service to rural areas in northwest Missouri. OFMTC holds a general partnership interest of ** ______ ** in Northwest Missouri Cellular Limited Partnership. This investment is accounted for under the equity method.

OFMTC has invested in a limited liability company (Missouri Network Alliance) that has the business purpose of providing telecommunication-related services to its members. OFMTC holds a ** ________ ** interest at December 31, 2003 in Missouri Network Alliance, L.L.C., which investment is accounted for under the equity method. OFMTC held a ** ________ ** interest at year ended December 31, 2002. LEC LLC is also an investor in the Missouri Network Alliance, L.L.C. The Staff has not identified all of the other investors in Missouri Network Alliance, L.L.C. This is an area under review for additional future inquiry.

IV. Firm's Involvement in Inappropriate Activities

There is no evidence that OFMTC has any involvement in any of the activities alleged in the federal indictments in New York. Nor is there any mention of Oregon Farmers or Mr. Williams in any of those indictments. LEC LLC's only known involvement with OFMTC is in the billing function. It should be noted that OFMTC is the only local exchange company that the Staff is aware of that used LEC LLC for this service where LEC LLC did not have an ownership interest in the local exchange company. OFMTC did not initiate any known internal investigation after news of the federal criminal investigation tying alleged members of organized crime to telephone companies in Missouri became public. Mr. Williams, the Company's former majority owner, has joint business dealings with Mr. Matzdorff. Because Mr. Matzdorff has engaged in inappropriate activities, concerns regarding Mr. Williams' activities have elevated. The Staff plans to examine further the South Holt Communications, Inc. transaction regarding its impact on OFMTC in conjunction with any related review of New Florence Telephone Company. New Florence also has significant expenditures with South Holt Communications, Inc. Transactions with South Holt Communications, Inc. have a common linkage to telephone companies owned by Mr. Williams. This transaction is discussed in greater detail in Section 11 of this report.

V. Impact on Missouri Consumers

There is a risk to Missouri consumers that certain cost of service rates may be too high due to inclusion of inappropriate costs. This risk is lower today than the risk that exists at Cass County Telephone Company LP and New Florence Telephone Company since: 1) OFMTC is not owned, directly or indirectly, by individuals under federal indictment or individuals significantly engaged in transactions with these indicted individuals; 2) although there were material transactions with firms associated with individuals under federal indictment, or individuals significantly engaged in transactions with these individuals, now OFMTC is under the control individuals with no known ties that raise self-dealing concerns; and 3) OFMTC has independent external auditor reports that raise no issue regarding these matters.

CenturyTel of Missouri LLC

I. Company Operations/Ownership

CenturyTel of Missouri LLC was formed to own and operate certain Missouri telephone exchanges purchased from GTE-Midwest, Inc. CenturyTel of Missouri LLC was incorporated in Louisiana on October 17, 2001. CenturyTel of Missouri LLC purchased its assets from GTE Midwest. Inc. on October 22, 2001. Kenneth Matzdorff had no ownership interest in this entity, but was a Vice President with CenturyTel of Missouri until 2004.

II. Related Party Transactions

CenturyTel's March, 2003 Corporate Compliance Program handbook contains a section 2, (b) Conflicts of Interest and Corporate Opportunities and 2 (l) Outside Employment and Business Activities. Like all CenturyTel managers, Mr. Matzdorff signed an annual certification to CenturyTel "to the effect that he was unaware of any violations of the Company's Compliance Program, including Section 2 of the handbook which describes the Company's principles of business conduct." CenturyTel has provided a copy of Mr. Matzdorff's 2004 certification.

Other than inter-carrier relationships with Cass County Telephone, CenturyTel has represented that it was not aware that Mr. Matzdorff engaged in transactions with some of the entities in which he had a business relationship until after his resignation in July 2004. The Staff's investigation has found that CenturyTel of Missouri LLC did engage in transactions with firms in which Mr. Matzdorff had a business relationship. The third party vendors that have a relationship with Mr. Matzdorff that are known to have done business with CenturyTel of Missouri LLC are[57]:

Vendors	Jan.-July 04Business	YTD 2003 Business	2002 Business	Officer Affiliation
Cass County Telephone			$0	Matzdorff
Haug Construction	** _________ **	** __________ **	$0	Matzdorff
Total Affiliated Business	** _________ **	** __________ **	$0	
Total Business over $10,000 annually with vendors	** __________ **	** ___________ **	** __________ **	
% of Affiliated Business	** ______ **	** ______ **	0%	

The above chart shows that CenturyTel of Missouri LLC did not engage in significant activities with firms that had a business relationship with Mr. Matzdorff.

IIII. Firm's Involvement in Inappropriate Activities

There is no evidence that CenturyTel engaged in any inappropriate activity. CenturyTel did initiate an internal investigation after it learned of the federal criminal investigation. Mr. Matzdorff's activities were limited by the internal controls exercised by CenturyTel operations in Monroe, Louisiana. CenturyTel reduced Mr. Matzdorff's authority in March 2004 and ultimately took action in July 2004 that led to his resignation. CenturyTel's external auditor is aware of the situation and investigated its impacts on CenturyTel's operations. There is no report of impropriety within the firm.

IV. Impact on Missouri Consumers

There is no evidence of a significant risk to Missouri consumers by actions at CenturyTel Missouri since: 1) there is no ownership of CenturyTel Missouri by individuals under federal indictment or that have been convicted of federal criminal charges, or individuals significantly engaged in transactions with these indicted or convicted individuals; 2) there are no significant transactions with firms associated with the individuals under federal indictment or criminally convicted, or individuals significantly engaged in transactions with these indicted or convicted individuals is minimal; and 3) CenturyTel Missouri's independent external auditor is aware of and raised no significant issue regarding

NP

these matters. Preliminary discussions with CenturyTel indicate that the company has in place sufficient controls to prevent and detect any inappropriate payments to vendors, whether affiliated or not.

Spectra Communications Group, LLC

I. Company Operations/Ownership

On July 7, 1999, Spectra Communications Group, LLC was incorporated in Delaware for the purpose of purchasing local telephone exchange assets in Missouri in accordance with the terms of an asset Purchase Agreement, dated July 8, 1999, by and between the company and GTE Midwest, Inc. and thereafter to provide local telephone exchange services directly or through one or more subsidiaries in the state of Missouri. In July 2000, Spectra Communications Group, LLC acquired the GTE Missouri exchanges. Initially, five distinct groups owned Spectra Communications Group, LLC. These groups were CenturyTel, 56.9%, Local Exchange Carriers, LLC, 20.72%, Spectronics, 14.8%, Management Shares (i.e. Kenneth Matzdorff), 7.50%, and two individuals, .078%. To the Staff's knowledge CenturyTel dealt exclusively with Mr. Matzdorff as representative of Local Exchange Carriers, LLC and was never aware of the individual owners of Local Exchange Carriers, LLC. The Staff has not identified all of the owners of Local Exchange Carriers, LLC. LEC LLC owned 35.06% of Local Exchange Carriers, LLC. The Management Shares 7.50% ultimately were under the control of Kansas City Consultants, LLC, a Kenneth Matzdorff controlled company.

In January 2001, Spectronics sold its ownership interest in Spectra Communications Group, LLC resulting in Spectra Communications Group, LLC being owned by four groups. These groups were CenturyTel, Inc. 75.65492%, Local Exchange Carriers, LLC, 18.67341%, Kansas City Consultants, LLC., 5.59271%, and two individuals, .07896%. On November 20, 2003, CenturyTel purchased the interests of Local Exchange Carriers, LLC and Kansas City Consultants, LLC. In 2004, CenturyTel became the 100% owner of Spectra Communications Group.

Kenneth Matzdorff was Chief Operating Officer of Spectra Communications Group, LLC from January 22, 2001 at least through March of 2004. In mid 2003, Mr. Matzdorff informed CenturyTel that some of the individuals associated with Local Exchanges Carriers, LLC were under investigation for credit card and Internet fraud and, in response, conducted an internal investigation. Mr. Matzdorff was no longer an employee of Spectra Communications Group, LLC as of July 2004.

II. Related Party Transactions

Other than intercarrier relationships with Cass County Telephone, CenturyTel was not aware that Mr. Matzdorff engaged in transactions with entities in which he had a business relationship until after his resignation in July 2004. Staff's investigation found that Spectra Communications Group, LLC did engage in transactions with firms in which Mr. Matzdorff had a business relationship. The third party vendors that have a relationship with Mr. Matzdorff that did business with Spectra Communications Group, LLC are as follows[58]:

Vendors	Jan.-July 04 Business	YTD 2003 Business	2002 Business	Officer Affiliation
Cass County Telephone		$	** ________ **	Matzdorff
Haug Construction			** _________ **	Matzdorff
Total Affiliated Business	$0	$0	** _________ **	
Total Business over $10,000 annually with vendors	** _________ **	** _________ **	** _________ **	
% of Affiliated Business	** ___ **	** ___ **	** _____ **	

The above chart shows that firms known to be associated with Mr. Matzdorff or LEC LLC did an insignificant amount of business with Spectra Communications Group, Inc. In 2000 and 2001, CenturyTel paid USP&C, Inc. ** ________ ** and ** ________ ** respectively for real estate leasing and maintenance services. These payments relate to office subleases established by Mr. Matzdorff for Spectra Communications Group, LLC group during the first eighteen months of its operations in Missouri. In 2001, operations were moved to a different facility and all payments ceased at that time.

III. Firm's Involvement in Inappropriate Activities

There is no evidence that CenturyTel engaged in any inappropriate activity. CenturyTel did initiate an internal investigation after it learned of the federal investigation. Mr. Matzdorff's activities were limited by the internal controls exercised by CenturyTel operations in Monroe, Louisiana. CenturyTel reduced Mr. Matzdorff's authority in March 2004 and ultimately took action in July 2004 that led to his resignation. CenturyTel's external auditor is aware of the situation and investigated its impacts on CenturyTel's operations. There is no report of impropriety within the firm.

IV. Impact on Missouri Consumers

There is no evidence of a significant risk to Missouri consumers since: 1) there is no longer any firm ownership by individuals under federal indictment or individuals significantly engaged in transactions with these individuals; 2) transactions with firms associated individuals under federal indictment or individuals significantly engaged in transactions with these individuals is minimal; and 3) the firm's independent external auditor is aware of and has raised no significant controls to prevent and detect any inappropriate payments to vendors, whether affiliated or not.

Section 13. Other Investigations/Litigation

California:

On October 21, 1999, the Public Utilities Commission of the State of California (California PUC) instituted an investigation of USP&C, Inc., Investigation Number 99-10-024, to determine whether California telephone companies should be ordered to cease providing billing and collection services to USP&C, Inc.

USP&C, Inc. is a Delaware corporation with its principal place of business in Kansas City, Missouri at the time of the California PUC investigation. USP&C, Inc. is an aggregator of billings for telecommunications-related services, and acts as a billing agent between these service providers and local exchange companies (e.g. Pacific Bell) that actually bill the customer for the service. The local exchange companies in California provide billing and collection services to billing agents such as USP&C, Inc. pursuant to California PUC approved tariffs, which require all transactions to be accurate and consistent. These tariff provisions obligated USP&C, Inc. to submit only accurate and authorized charges to California local exchange companies.

The California investigation examined USP&C, Inc.'s activities during the January 1998 to June 1999 period. USP&C, Inc. aggregated \$51.5 million of service provider billings during the period that were billed to California consumers. A total of \$27 million of these billings (52%) were refunded to customers at their request. The remaining \$24.5 million was collected from customers and ultimately forwarded to the service providers, net of the fees charged by USP&C.

In terms of its relationship with various service providers, USP&C, Inc. contracted with companies that conducted business under different unregistered aliases and used up to four different names for identical services. For example, USP&C, Inc. acted as a billing agent for Spring Telecom, Inc., which sold 800 number service under four different product names ("Call Mgr Plus," "Dial Plan," "Gateway Svc," and "Call Plan"), as well as four different provider names ("Progressive Technologies," "Voicer Telecom," "Voice Processing Systems," and "United Voice").

In an April 23, 2001 order, the California PUC found that USP&C, Inc. violated provisions of the State's Public Utilities Code and imposed a fine of \$1,750,000. The California PUC ordered all California Local Exchange Carriers (LECs) to cease permanently providing USP&C, Inc. billing and collection services. The California PUC also ordered USP&C to show cause why it: 1) should not be required to disgorge all amounts retained from unauthorized billings, and 2) should not be fined for failing to comply with other statutory provisions.

On April 23, 2003 the California PUC denied USP&C, Inc.'s application for rehearing of this decision and ordered USP&C, Inc. to pay the fine. USP&C, Inc. unsuccessfully appealed the California PUC's decisions through the state court system, culminating in the California Supreme Court denying USP&C, Inc.'s petition for review on March 30, 2004. *USP&C, Inc. v. Public Utilities Commission, Cal. Supreme Court Case No. S122022, 2004 Cal. LEXIS 2947*. On May 24, 2004, the Superior Court for the County of San Francisco granted the Commission's motion for judgment on the pleadings and entered judgment for $1.75 million, plus interest, against USP&C, Inc. On August 19, 2004, the California PUC closed the proceeding.

Kansas:

The Kansas Corporation Commission opened an investigation of Cass County Telephone Co. on August 11, 2004 which it docketed as Docket No. 05-GIMT-094-GIT "*In the Matter of an Investigation to Monitor the Criminal Proceedings Involving the President of Cass County Telephone Company to Ensure Continued Service to Cass County's Kansas Customers.*" The Kansas Corporation Commission stated that the purpose of the docket is to monitor developments in an ongoing investigation into Kenneth Matzdorff, the president of Cass County Telephone Co. While the commission noted that Cass County does most of its business in Missouri, the company also serves about 400 customers in eastern parts of Kansas. The KCC opened the investigation to ensure that its Kansas customers continue to receive "sufficient and efficient" telephone service. Meanwhile, the KCC issued a number of questions and directed Cass County Telephone Company to provide specific information to the KCC staff by August 25, 2004 to enhance the KCC's knowledge of the investigation, including what impact it may have on its Kansas customers.

The KCC also directed Cass County Telephone Company to update the KCC on a monthly basis with reports summarizing the status of any criminal or civil investigations, indictments, trials, or other government activity relating to the company or any of its officers. (Docket 05-GIMT-094-GIT)

The Missouri Commission's Staff monitors the KCC data requests and related responses. The Staff exchanges public information with the KCC staff working on the Kansas investigation. Ms. Sandy Reams has been the primary point of contact with the KCC staff. Most of the information exchanged between the two Commission staffs has been material from their respective Secretary of State offices. Ms. Reams has been extremely helpful in acquiring Kansas information regarding firms operating or registered in that state.

Federal Bureau of Investigation/ Universal Service Administrative Company[59]:

The Federal Bureau of Investigation has been involved in the indictment of certain LEC LLC owners in New York. The Bureau was involved in the arrest and convictions of Mr. Matzdorff in Kansas City. The Staff has included all information that it has from this Agency in the report.

The Federal Bureau of Investigation contacts the Staff periodically with questions. Answers are provided to the FBI and reported to the Commission.

Federal Communications Commission

Cass County Telephone Company LP objected to the provision of all correspondence related to the FCC's Enforcement Bureau's audit of CassTel on the basis that the request was vague, overbroad and irrelevant to the intrastate regulated operations of CassTel. The FCC's Enforcement Bureau's audit relates to costs allocated to the interstate jurisdiction which are matters exclusively within the jurisdiction of the FCC, and not within of the Missouri Public Service Commission. This information is contained in the Cass County Telephone Company LP's November 30, 2004 response to Staff Data Request No. 28. In light of the Commission's establishment of Case No. TO-2005-0237, the Staff is pursuing further acquisition of this information.

Massachusetts

The General Counsel's office has contacted the author of an article who makes reference to cases brought by officials in Massachusetts, New York and California against firms in partnership with Richard Martino, but has been unable to uncover any information of relevant litigation in Massachusetts.

Michigan

The General Counsel's office is pursuing inquiries regarding relevant litigation in Michigan.

Missouri

After Southwestern Bell Telephone terminated its billing and collection contract with USP&C, Inc., bills similar in format and appearance to Southwestern Bell's bills were sent to Southwestern Bell customers seeking to collect charges for 800/900 calls. These bills stated that they were from "Southwest Region." An investigation ultimately determined that these bills were sent by USP&C, Inc. The Missouri Attorney General's office became involved, and on March 28, 2000, BMSI and Invesco Telecommunications Inc. were sued in Jackson County Circuit Court by the Attorney General of the State of Missouri for sending out thousands of phony telephone bills designed to look like legitimate bills from Southwestern Bell. Invesco Telecommunications, Inc. was a client of USP&C. The fake bills, labeled as coming from "Southwest Region Bill" and ranging from $16 to $27, were sent to consumers in several states, including Missouri, Kansas, Oklahoma and Texas. The invoices billed for telephone services such as "Extensor Systems – Call Manager" and "Invesco Telemail."

The action brought by the Missouri Attorney General in Kansas City was ultimately resolved by an agreement in which no further "Southwest Region" bills were to be sent. The Staff is trying to obtain a copy of the settlement agreement through the Missouri Attorney General's office.

New York

The General Counsel's office has contacted the author of an article who makes reference to cases brought by officials in Massachusetts, New York and California against firms in partnership with Richard Martino, but has been unable to uncover any information of relevant litigation in New York.

Ohio

On October 30, 1998, the Ohio State Attorney General filed a lawsuit against Telecom Operator Services d/b/a USP&C Operator Services, Inc. and other firms as a result of its investigation into the alleged illegal practice of "cramming." The other firms in this civil action were New World Telecommunications, Inc. and Lunar Tel, Inc. d/b/a Traceform Eastern and Commandnet Systems. This action was taken in the Court of Common Pleas of Franklin County, Ohio. Customers in Ohio noticed unfamiliar charges on their telephone bills. All of the complaining customers denied having requested or authorized those services. Complaining customers called USP&C personnel that often would play back or claim to possess a tape recording which USP&C asserted verified that the customer had authorized the charges. Complaining customers who listened to the tape reported that the tape was not of their voice and was largely inaudible. Over 300 consumers complained to the Public Utilities Commission of Ohio since January 1998 of these unauthorized charges on their telephone bills. Complaining customers experienced difficulty in contacting USP&C and the customer service personnel of the other defendants.

On December 3, 1999, the lawsuit was terminated through an agreement between USP&C and the Ohio attorney general. USP&C voluntarily substituted itself as a defendant for Telecom Operator Services. Telecom Operator Services was an affiliate of USP&C, Inc. USP&C was required to implement or maintain measures to ensure compliance with the Ohio Consumer Sales Practices Act. USP&C did not admit to any of the allegations or conclusions contained in the Complaint. USP&C was permanently enjoined from knowingly forwarding unauthorized and/or fraudulent billing information to local exchange carriers for inclusion on consumer bills or knowingly representing to consumers that they are responsible for payment of disputed charges when USP&C is not in possession of information sufficient to establish that the services in question were ordered and/or authorized by the consumer in connection with providing billing aggregation or consumer inquiry services.

USP&C agreed to provide a full refund or credit to any Ohio consumer who was billed for a product or service within two years prior to the date of the filing of the action and who contested the validity of the charge. USP&C agreed to contribute $5,000 to the Consumer Protection Enforcement Fund.

New World Telecommunications, Inc. and Lunar Tel, Inc. agreed to be permanently enjoined from engaging in consumer transactions in Ohio, pay $3,000 to the Consumer Protection Enforcement Fund, and provide refunds or credits to customers on terms similar to those that USP&C agreed to.

Texas

In 1999, Southwestern Bell Telephone Company (now Southwestern Bell Telephone LP) and Pacific Bell Telephone Company (PacBell) filed a lawsuit in the District Court of Dallas County, Texas against Telecom Operator Services, Inc., d/b/a USP&C Operator Services, INVESCO TELECOMMUNICATIONS, Inc., d/b/a Southwest Region Bill, USP&C. Inc. and Kenneth Matzdorff essentially seeking a declaratory ruling that Southwestern Bell and PacBell be authorized to cease performing billing and collection functions for USP&C, Inc. Southwestern Bell and PacBell took this action because of customer complaints concerning items that Southwestern Bell had included on local telephone bills that had been submitted to them by USP&C, Inc.

The USP&C, Inc. billing and collection contract with Southwestern Bell was terminated in December 1999. The litigation was resolved by a settlement agreement. The Staff is pursuing obtaining a copy of the settlement agreement.

Wisconsin

On March 27, 1998, the then Wisconsin Attorney General, James Doyle, filed in Milwaukee County Circuit Court a civil complaint against Telecom Operator Service, which was doing business as USP&C Operator Services. Telecom Operator Service is a Kansas City, Missouri firm. The complaint alleged that USP&C violated the Wisconsin telecommunications services law by charging subscribers for unordered services.

On August 16, 1999, the Wisconsin Attorney General's office filed its third amended complaint. This complaint named USP&C, Inc. as the defendant in the case. USP&C, Inc.'s affiliated corporation, Telecom Operator Services, received numerous complaints and requests for credits or refunds from end users for charges placed on their local telephone bills that they had not authorized or affirmatively ordered. USP&C, Inc. continued to provide billing aggregation services for its customers, despite the fact that a significant number of their charges resulted in end user complaints and credit requests. The State of Wisconsin alleged that some end users continued to receive charges for unordered, disputed services after receiving assurances that the disputed charges would be removed from their bills and that future billings would not include such charges.

On December 20, 1999, Kenneth Matzdorff signed a stipulation in this litigation as president for USP&C, Inc. The Circuit Court entered a judgment consistent with the stipulation on January 10, 2000. Under the judgment USP&C is enjoined from engaging in inappropriate billing practices, required to review all filed complaints and issue credits and refunds to customers where appropriate, and is ordered to pay the sum of $50,000 to the State of Wisconsin.

Section 14. Process for Handling Inquiries and Status of Other Activities

I. Federal Subpoena for Records

All requests have been satisfied. There are no outstanding requests.

II. Forfeiture of Assets Questions

The Staff has been informed by a member of The Organized Crime Strike Force Unit of Criminal Division of the United States Attorney's Office for the Western District of Missouri that $2.5 million of the money that Kenneth Matzdorff has agreed to remit as part of his plea agreement will be used for restitution to the Universal Service Fund and the National Exchange Carrier Association. At this time assets of defendants facing federal criminal charges in New York are subject to a court order issued to preserve those assets. Representatives from the City of Peculiar have discussed with the Staff the concept of purchasing CassTel. It is likely the City of Peculiar will be in a monitoring mode at this time, as statutory restrictions regarding their possible ownership of CassTel are being evaluated by these representatives.

III. USF Certification Issues

FCC/USAC

Pursuant to Section 54.316 f the FCC's rules, state commissions are required to certify that telecommunications carriers are using federal high cost Universal Service Funds in accordance with 47 U.S.C. 254. (On September 30, 2004, the Commission, under signature of the Chairman, sent letters to the FCC and USAC declining to certify Cass County Telephone Company and New Florence Telephone Company for the 2005 funding year pending further inquiry of these companies and pending receipt of third party verified audits.)

On October 15, 2004, the FCC submitted a letter to USAC directing it to immediately suspend all monthly payments (including Lifeline, High Cost Loop, Interstate Common Line, Local Switching and any safety net additive) to Cass County and New Florence.

Subsequently, by letter dated October 22, 2004, the FCC directed that USAC should continue to disburse support payments to both companies for the Lifeline program.

On December 1, 2004, New Florence filed an appeal with the FCC seeking review of USAC's immediate suspension of USF payments. On December 17, 2004 the FCC issued a notice seeking comments in response to the appeal in CC Docket No. 96-45, and the Staff filed such comments on January 4, 2005.

On January 4, 2005 Cass County Telephone Company also filed an appeal with the FCC seeking review of USAC's immediate suspension of USF payments. The FCC has not issued a notice seeking comments in response to that appeal.

One of Staff's recommendations in this Report is that the Commission authorize and direct the Staff, together with the FCC and/or USAC should they agree to do so, complete a thorough audit of both Cass County Telephone Company and New Florence Telephone Company for the adequacy of their books and records for ratemaking purposes, which would include support for USF payments, support for NECA payments, review of transactions with companies affiliated with persons in control of these companies, etc.

Section 15. Report References

[1] November 30, 2004 Cass County response to Staff Data Request Numbers 7 & 8.

[2] November 30, 2004 Cass County response to Staff Data Request No. 7.

[3] According to docket entry no. 488, the Court ordered these words stricken from the fifth superseding indictment.

[4] Matzdorff, Transcript, April 14, 2004 on-the-record presentation, pp. 60-61.

[5] Matzdorff, Transcript, April 14, 2004 on-the-record presentation, p. 68.

[6] Matzdorff, Transcript, April 14, 2004 on-the-record presentation, p. 68.

[7] Matzdorff Southwestern Bell Deposition, p. 4, ll. 20-24.

[8] Matzdorff Southwestern Bell Deposition, p. 5, ll. 6-10.

[9] Matzdorff Southwestern Bell Deposition, p. 5, ll. 13 to p. 8, l. 23.

[10] Matzdorff Southwestern Bell Deposition, p. 24, l. 9.

[11] Matzdorff Southwestern Bell Deposition, p. 27, l. 20 to p. 33, l. 1.

[12] Affidavit in Support of Arrest Warrant, paragraph 15.

[13] Matzdorff Southwestern Bell Deposition, p. 44, ll. 3-20).

[14] Matzdorff Southwestern Bell Deposition, p. 43, ll. 10-23; p. 133, l. 1.

[15] Matzdorff Southwestern Bell Deposition, p. 99, l. 9; p. 121, l. 4; p. 123, l. 16; p. 124, l. 7; and p. 133, l. 23 to p. 134, l. 9).

[16] Matzdorff, Transcript, April 14, 2004 on-the-record presentation, p. 59, l. 18 through p. 60, l. 4.

[17] Matzdorff, Transcript, April 14, 2004 on-the-record presentation, p. 65, l. 2 through p. 66, l. 23.

[18] Matzdorff, Transcript, April 14, 2004 on-the-record presentation, p. 55, ll. 4-7.

[19] Matzdorff, Transcript, April 14, 2004 on-the-record presentation, p. 64, ll. 5-12.

[20] From SBC Missouri's perspective, the dispute involves whether the BOC CATs systems, which was designed and operated for LEC to LEC calls, could be used for IXC calls by reformatting the data to make it look like a LEC-LEC call.

[21] These billing systems were divested to Bellcore and the former Regional Bell Operating Companies from AT&T in 1984.

[22] Matzdorff deposition in Fidelity Telephone vs. Southwestern Bell Telephone Company and Bell Communications Research Inc. in United States Western District Court of Missouri; pp. 95-97.

[23] July 30, 1992 deposition, p. 15, ll. 13-18.

[24] July 30, 1992 deposition , p. 15, l. 22 thru p. 16, l. 6.

[25] Source: October 7, 1992 Letter from James Fields to Sheldon Stock.

[26] Source: page 5, lines 14 and 5. Oral Deposition of Kenneth M. Matzdorff – DV-99-09749-1, Southwestern Bell Telephone Company and Pacific Bell Telephone Company vs. Telecom Operator Service, Inc. d/b/a US&C Operator Services, INVESCO Telecommunications, Inc., d/b/a Southwest Region Bill, USP&C, Inc., and Kenneth Matzdorff.

[27] P. 12 United States v. Salvatore LoCascio et al., 03-CR-304 (S-3)(CBA).

[28] Source: Schedule 5.7 of the Sale and Purchase of Common Stock of USP&C, Inc. and Telecom Operator Services, Inc. dated as of December 17, 1999.

[29] Source: Schedule 5.7 of the Sale and Purchase of Common Stock of USP&C, Inc. and Telecom Operator Services, Inc. dated as of December 17, 1999.

[30] Source: Articles of Incorporation as filed with the Missouri Secretary of State's Office.

[31] Source: Kenneth M. Matzdorff deposition, Case No. DV-99-09749-1, *Southwestern Bell et al v. Telecom Operator Services, et al,* May 5, 2000, p. 32, ll. 14-15.

[32] Source: Kenneth M. Matzdorff deposition, Case No. DV-99-09749-1, *Southwestern Bell et al v. Telecom Operator Services, et al,* May 5, 2000, p. 32, ll. 9-10.

[33] United States v. Salvatore LoCascio et al., 03-CR-304 (S-3)(CBA).

[34] http:///phoneplusmag.com/articles/8b1busin.html.

[35] On October 22, 2001, BMSI changed its name to TelData Consultants, Inc. with Webb Roberts listed as president.

[36] Source: page 44, lines 12 through 20. Oral Deposition of Kenneth M. Matzdorff – DV-99-09749-1, Southwestern Bell Telephone Company and Pacific Bell Telephone Company vs. Telecom Operator Service, Inc. d/b/a US&C Operator Services, INVESCO Telecommunications, Inc., d/b/a Southwest Region Bill, USP&C, Inc., and Kenneth Matzdorff.

[37] P. 6 United States v. Salvatore LoCascio et al., 03-CR-304 (S-3)(CBA).

[38] California Public Utility Commission Opinion and Order to Show Cause dated April 23, 2001.

[39] P. 8 United States v. Salvatore LoCascio et al., 03-CR-304 (S-3)(CBA).

[40] (November 30, 2004 response to Staff Data Request No. 18.

[41] Source: November 30, 2004 response to Staff Data Request No. 17.

[42] Source: November 16, 2005 New Florence response to Staff Data Request No. 20.

[43] May 5, 2000 Matzdorff Deposition in Case No. DV-99-0749 in lawsuit in the District Court of Dallas County, Texas with Southwestern Bell Telephone Company and Pacific Bell Telephone Company vs. Telecom Operator Services, Inc., d/b/a USP&C Operator Services, INVESTCO TELECOMMUNICATIONS, INC., d/b/a SOUTHWEST REGION BILL, USP&C, INC., and KENNETH MATZDORFF. p. 17, ll. 9 through p. 18, l. 13.

[44] November 30, 2004 response to Staff Data Request No. 24.

[45] Source: Cass County Telephone Response to Staff Data Request No. 11, S/B Cass County Telephone Letter to Mr. John VanEschen, MoPSC, dated August 20, 2004.

[46] September17, 2004 Company Response to Staff data Request No. 1 Proprietary.

[47] November 30, 2004 response to Staff Data Request No. 24.

[48] November 16, 2004 New Florence response to Staff Data Request No. 13.

[49] November 16, 2004 New Florence response to Staff Data Request No. 13.

[50] September17, 2004 response to Staff Data Request No. 1 PROPRIETARY and November 16, 2004 New Florence response to Staff Data Request No. 14 Highly Confidential.

[51] November 16, 2004 New Florence response to Staff Data Request No. 16.

[52] September 28, 2004 New Florence response to Staff Data Request No. 7.

[53] November 16, 2005 New Florence response to Staff Data Request No. 20.

[54] November 16, 2004 New Florence response to Staff Data Request No. 14.

[55] November 16, 2004 New Florence response to Data Request No. 18.

[56] November 16, 2004 New Florence response to Data Request No. 15.

[57] September 21, 2004 response to Staff Data Request No. 1 HIGHLY CONFIDENTIAL

[58] September 21, 2004 response to Staff Data Request No. 1 HIGHLY CONFIDENTIAL.

[59] Cass County Telephone Company August 20, 2004 responses (Federal Communications Commission statement) to Staff Data Request No. 17.