

1 STATE OF MISSOURI
2 PUBLIC SERVICE COMMISSION
3
4 TRANSCRIPT OF PROCEEDINGS
5 On-the-Record Presentation
6 May 24, 2006
7 Jefferson City, Missouri
8 Volume 3

8 Staff of the Missouri Public Service)
Commission of the State of Missouri,)
9)
Complainant,)
10 v.) Case No.
) TC-2005-0357
11 Cass County Telephone Company)
Limited Partnership,)
12)
Respondent.)

13
14 In the Matter of the Joint Application)
of Cass County Telephone Company,)
Limited Partnership, LEC Long Distance,)
15 Inc., d/b/a CassTel Long Distance,)
FairPoint Communications, Inc.,)
16 FairPoint Communications Missouri, Inc.,)
d/b/a FairPoint Communications, and ST)
17 Long Distance, Inc., d/b/a FairPoint)
Communications Long Distance for)
18 Authority to Transfer and Acquire Cass)
County Telephone Company, Limited) Case No.
19 Partnership's and LEC Long Distance,) TM-2006-0306
Inc.'s Facilities or Systems Located in)
20 the State of Missouri; 2) for Issuance)
of Certificates of Service Authority to)
21 FairPoint Communications and ST Long)
Distance, Inc., d/b/a FairPoint)
22 Communications Long Distance; and 3) to)
Designate FairPoint Communications)
23 Missouri, Inc., d/b/a FairPoint)
Communications as a Telecommunications)
24 Carrier Eligible to Receive Federal)
Universal Service Support)
25

1 In the Matter of the Investigation into)
the Earnings of Cass County Telephone) Case No.
2 Company) IR-2006-0374

3 MORRIS L. WOODRUFF, Presiding,
4 SENIOR REGULATORY LAW JUDGE.

5 JEFF DAVIS, Chairman,
6 CONNIE MURRAY,
7 STEVE GAW,
8 ROBERT M. CLAYTON,
9 LINWARD "LIN" APPLING,
10 COMMISSIONERS.

11 REPORTED BY:

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1 P R O C E E D I N G S

2 JUDGE WOODRUFF: Good morning, everyone.
3 Looks like we have a full house today. We're here today
4 for an on-the-record presentation concerning three
5 different cases all involving Cass County Telephone
6 Company. The first case is TC-2005-0357, which is Staff's
7 complaint against Cass County Telephone Company. Second
8 case is TM-2006-0306, which is the application of Cass
9 County Telephone Company and FairPoint Communications to
10 transfer the assets of CassTel to FairPoint and for
11 FairPoint to receive certification to operate that phone
12 system. And the third case is IR-2006-0374, which is an
13 investigation into the earnings of Cass County Telephone
14 Company.

15 And we're here basically to take questions
16 from the Commissioners, but before we do that, I'll go
17 ahead and take entries of appearance from the various
18 parties, beginning with CassTel.

19 MR. ENGLAND: Thank you, your Honor. Let
20 the record reflect the appearance of W.R. England, Paul
21 Boudreau and Sondra Morgan on behalf of Cass County
22 Telephone Company for all three matters. Our mailing
23 address is the law firm of Brydon, Swearingen & England,
24 Post Office Box 456, Jefferson City, Missouri 65102.

25 JUDGE WOODRUFF: Thank you. And for

1 FairPoint?

2 MR. DORITY: Good morning, your Honor.
3 Appearing in Case Nos. TM-2006-0306 and IR-2006-0374,
4 please let the record reflect the appearance of Larry W.
5 Dority and James M. Fischer, Fischer & Dority, PC. Our
6 address is 101 Madison, Suite 400, Jefferson City,
7 Missouri 65101, appearing on behalf of FairPoint
8 Communications, Inc., FairPoint Communications Missouri,
9 Inc., doing business as FairPoint Communications, and ST
10 Long Distance, Inc., doing business as FairPoint
11 Communications Long Distance. Thank you.

12 JUDGE WOODRUFF: Thank you. And for AT&T?

13 MR. LANE: Thank you, your Honor. Paul
14 Lane on behalf of Southwestern Bell Telephone, LP, doing
15 business as AT&T Missouri. My address is One AT&T Center,
16 Room 3520, St. Louis, Missouri 63101, and we are appearing
17 only in Case No. IR-2006-0374.

18 JUDGE WOODRUFF: And for Staff?

19 MR. WILLIAMS: Nathan Williams, Robert B.
20 Franson and William K. Haas. We're appearing in all three
21 cases. P.O. Box 360, Jefferson City, Missouri 65102.

22 JUDGE WOODRUFF: Thank you. Public
23 Counsel?

24 MR. DANDINO: Thank you, your Honor.
25 Michael Dandino, Office of the Public Counsel, Post Office

1 Box 2230, Jefferson City, Missouri 65102, representing the
2 Office of the Public Counsel and the public in all three
3 cases. Thank you.

4 JUDGE WOODRUFF: Thank you. And I believe
5 that's all the parties. Is there anyone I missed?

6 Yes, Mr. England?

7 MR. MIRAKIAN: Pete Mirakian for Local
8 Exchange Company, LLC, from Spencer, Fane, Britt & Browne
9 in Kansas City, 1000 Walnut, Suite 1400, Kansas City,
10 Missouri 64106, appearing in all three cases.

11 JUDGE WOODRUFF: All right. Then one
12 preliminary matter I want to bring up, and that concerns
13 AT&T's application to intervene in IR-2006-0374. That
14 company applied to intervene. No one opposed it. The
15 Commission has not actually ruled on it at this point.
16 Since AT&T is here, I will at this point grant that
17 motion, and AT&T is made a party to IR-2006-0374.

18 All right. Any other matters that anyone
19 wants to bring up as preliminaries?

20 (No response.)

21 JUDGE WOODRUFF: All right. Then we are
22 ready to begin questions from the Commission, and Chairman
23 Davis, did you want to go first?

24 CHAIRMAN DAVIS: I'll pass.

25 COMMISSIONER GAW: I'll pass, too.

1 JUDGE WOODRUFF: Commissioner Clayton,
2 then?

3 COMMISSIONER CLAYTON: Good morning,
4 everyone. Judge, before I get started, just to have an
5 idea, who is available for providing factual testimony
6 today?

7 MR. WILLIAMS: Actually, I have a list for
8 Staff.

9 CHAIRMAN DAVIS: Is Mr. Matzdorff
10 available?

11 MR. ENGLAND: No, he's not, your Honor.

12 JUDGE WOODRUFF: Let me go ahead and ask
13 CassTel, who is available from CassTel?

14 MR. ENGLAND: Bob Schoonmaker is here, as
15 is Scott Smith.

16 JUDGE WOODRUFF: And for FairPoint?

17 MR. DORITY: Your Honor, on behalf of the
18 FairPoint companies, Mr. Peter Nixon, chief operating
19 officer; Thomas Griffin, treasurer; and Mr. Pat Morris,
20 senior vice president for government affairs are all here.

21 JUDGE WOODRUFF: And for AT&T?

22 MR. LANE: No witnesses, your Honor.

23 JUDGE WOODRUFF: Does LEC, LLC have any
24 witnesses?

25 MR. MIRAKIAN: Yes. Dan Trampush from Moss

1 Adams.

2 JUDGE WOODRUFF: Thank you.

3 MR. DANDINO: Your Honor, just for the
4 record, Public Counsel has no witnesses.

5 JUDGE WOODRUFF: I'm sorry. I overlooked
6 you.

7 MR. DANDINO: That's fine.

8 COMMISSIONER CLAYTON: Well, from my
9 perspective -- and I apologize. I've got all the
10 stipulations, both stipulations and the Staff suggestions
11 in front of me, and I don't have them organized in a
12 manner that will be very helpful to move forward, so I'm
13 just going to get started here and see where it leads.

14 I'd like to ask some questions about the
15 funds that are set aside for customers, which I believe
16 are part of the rate case, is that correct, Mr. Williams?

17 MR. WILLIAMS: You're talking about the
18 earnings case, the investigation?

19 COMMISSIONER CLAYTON: The Stipulation &
20 Agreement which makes reference to credit qualifying
21 customers and cash distribution qualifying customers,
22 that's the rate case?

23 MR. WILLIAMS: That's the investigation
24 case, yes, the earnings investigation.

25 COMMISSIONER CLAYTON: The earnings

1 complaint, as opposed to the penalty complaint?

2 MR. WILLIAMS: Actually, there was never a
3 complaint filed. There was an investigation. The case
4 was initiated with a settlement formally in front of the
5 Commission.

6 COMMISSIONER CLAYTON: But there is a
7 separate case number that is pending which also has a
8 Stipulation & Agreement included within that?

9 MR. WILLIAMS: It's the IR case number, of
10 the three that were mentioned.

11 COMMISSIONER CLAYTON: Is that a yes?

12 MR. WILLIAMS: It was the third -- there
13 are three cases.

14 COMMISSIONER CLAYTON: Okay. Who would be
15 best to ask these questions? I just want to ask how these
16 credits work. Would it be best to ask you or Mr. England
17 or --

18 MR. WILLIAMS: Probably Bob Schallenberg or
19 David Winter.

20 COMMISSIONER CLAYTON: Would you agree with
21 that, Mr. England?

22 MR. ENGLAND: Yes, sir. To the extent I
23 guess we differ in our opinion, which I'd hope we
24 wouldn't, we'd offer some additional comments.

25 COMMISSIONER CLAYTON: Okay. Well, then in

1 that case, whichever Staff witness who would be
2 appropriate to deal with the IR-2006-0374 distribution of
3 credit qualifying customer credits and cash distribution
4 qualifying customers, who would that be?

5 Mr. Williams?

6 MR. WILLIAMS: David Winter.

7 JUDGE WOODRUFF: Please raise your right
8 hand.

9 (Witness sworn.)

10 COMMISSIONER CLAYTON: Judge, just to make
11 sure, since I just walked in, did you-all discuss a
12 particular order of cases, or is everything all thrown
13 together?

14 JUDGE WOODRUFF: Everything's thrown
15 together.

16 COMMISSIONER CLAYTON: Okay. Good. Nice
17 and organized that way.

18 DAVID WINTER testified as follows:

19 QUESTIONS BY COMMISSIONER CLAYTON:

20 Q. Mr. Winter, how have you been a
21 participant, if at all, in Case IR-2006-0374?

22 A. I was one of the lead auditors in this
23 particular proceeding.

24 Q. And this is the earnings investigation in
25 the Cass County Telephone?

1 A. Yes, it is.

2 Q. Are you familiar with the Stipulation &
3 Agreement that's been filed in the case?

4 A. Yes, I am.

5 Q. Did you participate in the negotiations
6 associated with the stipulation?

7 A. Yes, I did.

8 Q. Were you the lead person who authorized
9 Staff to enter into agreement on that stipulation?

10 A. No, I was not.

11 Q. Who would that have been?

12 A. That was Mr. Schallenberg.

13 Q. Schallenberg had the ultimate decision?

14 A. Yes.

15 Q. But you were the --

16 A. One of the.

17 Q. You were, from being on the ground level,
18 you were working on it day to day?

19 A. Yes.

20 Q. Okay. You're familiar with all the terms
21 associated with the Stipulation & Agreement?

22 A. Yes.

23 Q. Did you participate in the negotiation of
24 each of those terms?

25 A. Yes.

1 Q. Okay. There are some definitions in the
2 initial section which make reference to credit qualifying
3 customers and cash distribution qualifying customers. Are
4 you familiar with those terms?

5 A. Yes.

6 Q. Can you tell me the difference between
7 those customers, aside from the dollar amount on the
8 distribution later on, but what is the difference in those
9 definitions?

10 A. The credit qualifying customer would
11 receive a credit on their bill for -- I think we estimated
12 in our suggestions of \$40 per customer. The difference
13 between a cash distribution customer is that, in this
14 particular case, FairPoint, if the Commission approves the
15 Stipulation & Agreement, would actually write a check for
16 cash to these customers.

17 Q. I think it said that was approximately or
18 estimated to be around \$400 per person?

19 A. Yes.

20 Q. Well, my question before we get to the
21 dollar amounts is, are the list of credit -- assumed
22 credit qualifying customers and cash distribution
23 qualifying customers the same people or is there a
24 difference in the list of people? I didn't understand --
25 one -- excuse me -- one makes reference to an effective

1 date, one makes reference to a closing date, and I'm not
2 sure if that's relevant.

3 A. The effective date is the effective date of
4 any Commission order that would be issued in this
5 proceeding. The closing date would be the sale of
6 CassTel to FairPoint, and there would be two separate
7 distributions. The first distribution of 350 would occur
8 upon the second billing cycle after the Commission
9 approval of this particular order. It would show up as a
10 credit on your bill. The other part, the closing date,
11 there would be -- FairPoint would actually write a check
12 to those particular customers that meet these
13 qualifications for the \$400.

14 Q. Are the lists the same, though?

15 A. Essentially they could be the same, yes,
16 there could be differences, but essentially --

17 Q. When would there be a difference? Because
18 the day -- the date they have to be paying a full tariff
19 rate, receiving such service from CassTel on a continuous
20 basis since January 1, 2005. Under what circumstances
21 would the list be different? I guess that's what I'm just
22 not understanding.

23 A. I don't think -- quite frankly, I don't
24 think that the list would be different at all.

25 Q. Okay. So in other words, the same people

1 are going to receive the credit and they're going to
2 receive the cash?

3 A. Yes.

4 Q. Correct?

5 A. Yes.

6 MR. WILLIAMS: Commissioner, if I might?

7 COMMISSIONER CLAYTON: Yes, Mr. Williams?

8 MR. WILLIAMS: That's correct, unless
9 someone quit taking service before the closing date but
10 was a customer on the effective date.

11 COMMISSIONER CLAYTON: Okay. But that
12 would be a small -- supposedly a small number of people
13 over the full scheme.

14 MR. WILLIAMS: Probably.

15 THE WITNESS: Very, very small compared to
16 the 7,900 customers we have.

17 BY COMMISSIONER CLAYTON:

18 Q. So we're talking about people receiving --
19 out of the 7,900 customers, people receiving continuous
20 service and paying the full tariff rate would be eligible
21 for both the credit and the cash?

22 A. Yes.

23 Q. All right.

24 A. In theory, Commissioner, the total credit
25 would be 4 -- the total settlement would be \$440 per

1 customer, \$40 credit and a \$400 check.

2 Q. Okay. The 350,000 -- \$350,000 that would
3 be credited to accounts, that occurs upon the effective
4 date -- when does the credit occur?

5 A. It would occur the second billing cycle
6 after the effective date of the Commission order approving
7 this stipulation.

8 Q. So who would effectively pay? Would that
9 be CassTel?

10 A. That would -- in theory, it would be
11 CassTel, yes.

12 Q. Basically be a reduction in the revenues
13 that go to CassTel?

14 A. Yes.

15 Q. And then the \$400 per person, the
16 \$3.25 million will actually be checks cut by --

17 A. FairPoint Communications.

18 Q. -- the new company to the customer?

19 A. Yes.

20 Q. All right. I believe within this agreement
21 it sets out that there will be money set aside from the
22 closing used to pay that; is that correct?

23 A. Yes. There will be a deduction from the
24 purchase price of the company for 3.-- 3.6 million, I
25 believe now, that will be kept in trust with FairPoint.

1 FairPoint will make the actual distribution of cash.

2 Q. So it will be, to analogize, like going to
3 a closing on a piece of real estate, you have a closing
4 statement, some money will be taken from cash being paid
5 by the purchase, it will be set aside and that money will
6 be used to make these distributions?

7 A. Yes, it will.

8 Q. So effectively CassTel, the current owner,
9 will be paying these credits?

10 A. Yes.

11 Q. Okay. Can you tell me if the \$3.6 million
12 was chosen for a particular reason? Is it tied to a
13 number somewhere else or is it just a number that was
14 picked out of the air associated with the purchase price?

15 A. There -- the purchase price didn't have
16 anything to do with the 3.6 million. The 3.6 became
17 through some extensive negotiations between the Staff and
18 the company. We --

19 Q. The current company?

20 A. The current owners, CassTel. We had
21 negotiated for several weeks, and this is -- in order to
22 resolve, this is what we came up with.

23 Q. But is there a -- is there a connection
24 with a proposed amount of harm or damage that was done to
25 the customers over time that was the reason why you came

1 up with 440 or was there -- I know there were
2 negotiations. I understand that aspect of it. But is
3 there any connection with proposed harm done to these
4 ratepayers?

5 A. This proceeding, the IR case, was done
6 strictly like we would normally do a rate proceeding. It
7 did not take in consideration past harms done by Mr.
8 Matzdorff, his past transactions.

9 Q. So effectively, is the dollar amount
10 effectively a revenue reduction to the company that
11 normally would calculate into a lower rate design?

12 A. It was -- the Staff came up with a very
13 sizeable negative number, and as you -- in the -- so what
14 we did was, basically it's a rate reduction.

15 Q. Okay. So the number is based on -- the
16 number, although it's distributed in a different manner,
17 the number was derived based on a traditional revenue
18 reduction analysis done by Staff?

19 A. Yes.

20 Q. Okay. Based on overearnings?

21 A. Yes.

22 Q. All right. Did you participate in the last
23 rate case? And I don't recall whether it was a complaint,
24 Staff complaint case or it was a rate case filed by
25 CassTel, but the last one that was filed, did you

1 participate in that case?

2 A. Yes, I was the auditor involved.

3 Q. And can you tell me, is there an
4 identifiable line or area within the books of CassTel that
5 would suggest the difference in the Staff analysis from
6 the last case to this case?

7 A. I don't understand your question.

8 Q. Well, as I recall, several years ago there
9 was a rate reduction.

10 A. \$319,000.

11 Q. That was 319,000. And can you identify
12 what has changed in -- is it two years, two and a half
13 years that have passed in the books of CassTel that
14 warrant a \$3.6 million additional reduction?

15 A. There's two -- I'm just going to give you
16 the major items.

17 Q. Sure.

18 A. There are two items, three items.
19 Universal service monies, that has dropped considerably.

20 Q. But that wouldn't trigger a reduction in
21 rates, would it? That would trigger -- theoretically, it
22 would trigger an increase in rates?

23 A. It very well could, but in this particular
24 case we imputed universal service monies that we thought
25 CassTel should have received during our test year.

1 Additionally, the expenses of CassTel did not include any
2 monies from Overland Data Center. It did not include the
3 markups that we had seen -- we saw from LEC, LLC, and it
4 did not include some other things that we found during our
5 investigation. So we believe that we had a clean test
6 year because we pulled all that out of there that would
7 give us enough money or the monies that you see today in
8 this settlement.

9 Q. And do you recall the amount of the
10 Overland Data Center expense from the prior rate case?

11 A. I will give you an estimate because I don't
12 remember.

13 Q. Yeah, an approximation.

14 A. Approximation, there was probably
15 \$1.2 million in the books and records of CassTel Telephone
16 for Overland Data.

17 Q. And do you recall what that service was
18 that Overland Data provided?

19 A. Well, we were told at the particular time
20 that they provided most of their EDP operations for
21 CassTel. As you well know, that was not what was.

22 Q. Is there a replacement service? Is there
23 another company or service provider that has stepped into
24 the shoes of Overland Data to provide EDP services?

25 A. I do not believe so. I believe that

1 they've -- I really can't answer that question
2 authoritatively, but I will say that I don't believe there
3 was a replacement for ODC.

4 Q. Okay. There was another company that I
5 recall that's been included in some of the news reports,
6 and I don't recall whether CassTel had an agreement with
7 them. It was a USF&G or US --

8 A. USP&C.

9 Q. USP&C. Did it have an amount -- was
10 CassTel paying that company any funds in the last rate
11 case?

12 A. We did not find any dollars associated with
13 that company in the last rate case.

14 Q. And certainly they're not included in this
15 one?

16 A. No.

17 Q. You made reference to the LEC, the L-E-C
18 markups?

19 A. Yes.

20 Q. What services were those LEC markups
21 associated with?

22 A. LEC is the holding company that provides
23 the back office systems, in other words, the billing, the
24 personnel, the accounting for CassTel Telephone, and what
25 we found was, is during the -- they would charge CassTel

1 for services. So what it came down to, for every dollar
2 that was charged CassTel, there was a markup. The markup
3 first started at 40 percent. So CassTel was paying
4 \$1.40 for each dollar of service. Then the markup became
5 80 percent. In other words, they were paying 80 cents for
6 every dollar of service, CassTel was. This is the markup
7 that I was referring to a few minutes ago in the previous
8 questions.

9 Q. Do you recall the approximate value of that
10 expense in -- that is different between Staff's last case
11 versus this case?

12 A. I do not have that. But I could probably
13 get it to you, if you wish.

14 Q. Can you give me a ballpark figure, a
15 million dollars more or less?

16 A. I would say off the top of my head that it
17 was probably about a million and a half dollars.

18 Q. Okay. You make reference to a markup
19 changing from -- at one point it changed to 40 percent or
20 was 40 percent and then changed to 80 percent?

21 A. Yes.

22 Q. Is that a fair --

23 A. That's fair.

24 Q. -- recap of what you just said?

25 A. Yes.

1 Q. Was there a number prior to the
2 40 percent? Does Staff have a historical amount that has
3 been associated with LEC services for CassTel?

4 A. From 1996 when CassTel -- the approval of
5 this Commission for CassTel to purchase the exchanges from
6 GTE, the percentage had always been 40 percent.

7 Q. Okay. So from '96 to when was 40 percent
8 the markup?

9 A. I believe they changed the markup in 2002
10 to 80 percent.

11 Q. 2002. Now, it's not uncommon in rate of
12 return regulated companies to have a holding company that
13 provides some central office administrative services, and
14 then -- and then allocate a percentage of the cost for a
15 particular regulated entity to a holding company? Is that
16 uncommon?

17 A. That's not uncommon.

18 Q. All right. Is there a rule of thumb that
19 Staff has in assessing what an appropriate markup would be
20 in any particular industry?

21 A. Each is different in how they allocate
22 costs. Some use -- for instance, in the electric or gas
23 industry they use the Massachusetts method.

24 Q. Assuming -- assuming that some people in
25 the room don't know what the Massachusetts method is -- of

1 course I do.

2 A. It's a method based upon plant, customers
3 and expenses in revenues for a company.

4 Q. That did me no good, but keep going.

5 A. We also have companies, telephone companies
6 that have elaborate cost allocation manuals there, also
7 with software systems that time and materials are
8 specifically allocated towards what company, what job that
9 they are associated with.

10 Q. Okay.

11 A. To follow up, LEC took care of three
12 companies: CassTel, New Florence and another company they
13 own in Texas. So these companies were owned by the same
14 owner we see today.

15 Q. So since there are many different methods,
16 40 percent markup would not necessarily be out of line
17 without looking at additional factors?

18 A. We would consider 40 percent to be out of
19 line, period.

20 Q. You would?

21 A. In this particular case, yes.

22 Q. So then I assume it would even be worse to
23 be at 80 percent markup?

24 A. Absolutely.

25 Q. Now, if it changed to 80 percent in 2002,

1 then in the last rate case that CassTel had before us,
2 that means they would have been subject to an 80 percent
3 markup for administrative services?

4 A. There was portions of that year that had
5 the 80 percent, yes.

6 Q. All right. And Staff agreed to the
7 80 percent markup in that case?

8 A. We did not know about the 80 percent markup
9 in that particular case.

10 Q. Is that because information was withheld
11 from the Staff or was Staff not looking in the right
12 place?

13 A. We looked at those particular costs. We
14 were told that they had a direct allocation method there.
15 We were not told and we specifically asked about the 40 --
16 we didn't know about the markups, but we specifically
17 asked about those, and we were told that -- we were never
18 told about 40 or 80 percent markups.

19 Q. Okay. Does Staff have a way of monitoring
20 such cost allocations and markups in any case outside of
21 this? I mean, moving forward, does Staff have a system
22 that's set up to keep an eye out for inappropriate
23 markups?

24 A. The only time that we would be -- look at
25 these markups probably would be in a rate proceeding. I

1 believe --

2 Q. Like the last complaint case?

3 A. Yes.

4 Q. And this is a complaint case?

5 A. And this is a complaint case. I believe we
6 could probably -- we have in the past -- there's two
7 different things. We have sent all the companies in the
8 state of Missouri I believe two years ago a Data Request
9 requesting how they allocate costs from the holding
10 companies and also whether they develop cost allocation
11 manuals.

12 We're also -- based upon that information,
13 we examine that information, and we're starting -- as part
14 of our USF audits, we're starting to look at how they're
15 allocating costs from the -- if there's a holding company
16 down to the regulated entity.

17 And next, we also looked at -- we had a
18 meeting with industry also looking at the annual report
19 process and how we report those costs from the allocation
20 of costs between the regulated and non-regulated
21 companies.

22 So we're starting to address this. We
23 started two years ago basically when we started seeing
24 CassTel, what was happening there, and we started working
25 with industry, and I believe we're going to be starting

1 about three separate audits within the next month or so.

2 Q. Are there any other lines in the accounting
3 that -- that would be significant numbers that jump out
4 that require a rate reduction? We've assessed Overland
5 Data approximately 1.2 million. This inappropriate
6 markup, which could be a million, a million-five.

7 A. We also found another company called
8 Pegasus. Pegasus was owned by Mr. Matzdorff. He was also
9 billing in the same manner to LEC, which was eventually
10 CassTel, as ODC.

11 Q. Was that EDP services or administrative
12 service, do you recall?

13 A. We've never been able to find out what kind
14 of services it was, if there were services whatsoever.

15 Q. So they were just getting an invoice,
16 paying the invoice to Pegasus?

17 A. Yes. Mr. Matzdorff was handing the
18 invoices to the accounting people and these were being
19 paid.

20 Q. Do you recall the value of how much Pegasus
21 was receiving on an annual basis or what the value would
22 be in a given test year?

23 A. You're testing my memory on that particular
24 case, but I'm guessing it was about a half million
25 dollars.

1 Q. Did Staff look at the Pegasus expenditure
2 in the prior complaint case?

3 A. I found the Pegasus expenditures and I
4 asked about those, and I was given that these were
5 provided services to the company.

6 Q. So the company responded to your inquiry
7 and gave you information that was satisfactory to the
8 normal review that Staff would do?

9 A. Mr. Matzdorff gave me his assurances that
10 these were services that were provided by the company,
11 that they were hired on a temporary basis and that they --
12 and they would be continuing on for the test year.

13 Q. I understand. He gave us a lot of
14 assurances sitting right here in this chair, and a lot of
15 these questions that I'm asking right now, because the day
16 we were asking these questions were actually on the
17 overearnings case from the last case.

18 A. And that's the same, and I gave you some
19 incorrect answers based upon the information we had
20 gotten.

21 Q. Forgive me. Did you testify at that?

22 A. I did that one also.

23 Q. You did that one also. Was
24 Mr. Schallenberg at that one?

25 A. No, he was not.

1 Q. He was not. Just you -- you're taking the
2 heat for that one, aren't you?

3 A. Yes.

4 Q. Okay. Can you think of any other lines
5 that should be highlighted in the difference between the
6 prior rate -- the prior complaint case and the current?

7 A. Now, what we've discussed here is the
8 expense side. Now, what we also did not know at that
9 particular time, we talked about the 40, 80 percent
10 markups. Those markups were also allocated to the capital
11 accounts, in other words, the plant. The plant numbers
12 were also overstated for new construction. And as part of
13 this settlement, I believe in the complaint case we're
14 reducing plant because of those LEC markups within plant.

15 Q. What do you mean there was a markup? Were
16 they basically misleading -- were they misleading you in
17 saying they had spent a certain amount of money on
18 infrastructure or improvements?

19 A. They would -- they would allocate part of
20 overhead to construction, which you'll normally see that,
21 but what we did not know was that the markup, the 40,
22 80 percent markup was also being allocated to plant and
23 service.

24 Q. Through LEC?

25 A. Through LEC, yes.

1 Q. Okay. So it was a LEC markup and there is
2 some -- there is some multiplier that's used in --

3 A. Yes.

4 Q. -- assessing some of the costs to the
5 capital accounts?

6 A. Yes. And that's why we went back -- with
7 the cooperation of CassTel, we went back and completely
8 restated plant in service to pull all that markup,
9 including the Pegasus costs, out of there for restate
10 claims.

11 Q. When did CassTel get all helpful in finding
12 this material for you?

13 A. They've always been very cooperative.

14 Q. Like, we need an invoice for Pegasus and
15 they gave us one, they're very helpful?

16 A. They gave us one. It's been an evolving
17 process.

18 Q. Well, is it safe to say that this
19 information has come to light since CassTel has been out
20 from under Mr. Matzdorff?

21 A. Yes.

22 Q. So the new level of cooperation has been
23 since the other operators have been in place?

24 A. Yes. GV&W has been the manager of CassTel
25 and they've been very cooperative.

1 Q. Have you had any problems with GV&W since
2 they've taken over the reins of CassTel?

3 A. We've always -- we've had some disputes,
4 but for the most part, they've been very cooperative.

5 Q. Good faith disputes or --

6 A. Good faith disputes.

7 Q. -- hiding material, not providing
8 information?

9 A. No. It's been good faith, what you would
10 normally see in a rate proceeding.

11 Q. I understand. Healthy agree to disagree
12 type of banter?

13 A. Yes.

14 Q. Okay. So is there anything else that we
15 need to identify in how this \$3.6 million figure was come
16 up with? I assume Staff started higher?

17 A. No. We did not start higher in that
18 particular case, no. The 3.6, I believe, represents
19 dollars for payments for two years of earnings.

20 Q. Okay. So the 3.6 doesn't come out of one
21 test year, it's --

22 A. It's a negotiated number.

23 Q. Okay. But the number is -- did you say it
24 was two years worth of --

25 A. In theory, it represents a negotiated piece

1 of two years worth of earnings.

2 Q. Okay. Okay. Are you aware of whether
3 Pegasus is still in operation?

4 A. To my knowledge, it is not.

5 Q. And Overland Data is no longer in
6 operation?

7 A. I cannot answer that. I believe -- I think
8 there's still a corporation in the state of Kansas, but I
9 do not know.

10 Q. Are either of those companies providing
11 services to any other Missouri regulated companies that
12 you're aware of?

13 A. Not to my knowledge.

14 Q. Has the 40 percent or 80 percent markup
15 been found in other Missouri regulated companies receiving
16 services from LEC?

17 A. Not -- well, yes, it had been.

18 Q. It has been?

19 A. It has been, yes.

20 Q. I assume there will be some proceeding in
21 the future where we'll address those issues?

22 A. Yes.

23 Q. Okay. In distributing the \$440, the
24 \$40 credit and the \$400 cash payment, did Staff address --
25 I didn't see it in the Staff recommendation, but I may

1 have missed it. Is there any concern about missing
2 customers that were potentially harmed over the past
3 several years that are no longer customers?

4 A. We dealt in this particular case as if it
5 was a normal rate case. We did not go back and look for
6 potential customers, and we had to stop -- we had to
7 establish some deadline. In this particular case it was
8 the beginning of the test year.

9 Q. And in a normal rate case you couldn't do
10 anything to help a customer that paid into an overearnings
11 scenario --

12 A. No.

13 Q. -- that's no longer a customer, so that
14 standard is the same as that it would always apply in an
15 overearnings circumstance?

16 A. Yes.

17 Q. Okay. There's also reference in here about
18 paying a full tariff rate. Who would that exclude? Would
19 that exclude Lifeline and Linkup people?

20 A. I am not sure on that one. I will have to
21 defer that question. I believe it will exclude them, but
22 I'm not --

23 Q. You're not aware --

24 A. I'm not aware.

25 Q. -- who were excluded one way or the other?

1 A. No.

2 Q. Okay. The rate moratorium on the
3 overearnings piece goes to January 1 of 2017; is that
4 correct?

5 A. Yes.

6 Q. Is that a filing date or is that -- is that
7 a date where no change in earnings can occur?

8 A. Be no change in earnings in that particular
9 time. The Staff in that particular case would be free to
10 look at their rates at that particular time.

11 COMMISSIONER CLAYTON: Okay. Just quickly,
12 Mr. Dandino, did Office of Public Counsel participate in
13 the IR --

14 MR. DANDINO: Yes, sir.

15 COMMISSIONER CLAYTON: -- over this case?

16 MR. DANDINO: Yes, sir.

17 COMMISSIONER CLAYTON: And you-all signed
18 on to the Stipulation & Agreement?

19 MR. DANDINO: Yes, sir.

20 COMMISSIONER CLAYTON: OPC is satisfied
21 with the distribution of the funds from the \$3.6 million?

22 MR. DANDINO: Yes. We think it was a
23 practical way of doing it, and under the circumstances,
24 yes.

25 COMMISSIONER CLAYTON: Okay. Thank you.

1 BY COMMISSIONER CLAYTON:

2 Q. Now, Mr. Winter, one part I did not
3 understand. There's a reference in here relating to some
4 accounting treatment of the \$3.6 million?

5 A. Yes.

6 Q. Either through accounting authority or some
7 sort of accounting treatment. Would you explain what that
8 means, and does that mean that FairPoint will be able to
9 have an accounting column where it potentially would be
10 able to seek that money back through rates?

11 I don't understand what the --

12 A. What we're doing is, for accounting
13 treatment stuff, all those dollars hitting the books at
14 one time, are amortizing those dollars over a 24-month
15 period. There's a number of different scenarios in there,
16 but basically a 24-month period those dollars will be
17 amortized. FairPoint will not be able to -- if we do have
18 a rate proceeding, they will not be able to use those in
19 any kind of proceeding whatsoever.

20 Q. Now, are they going to adopt the accounting
21 balances from CassTel?

22 A. It depends on the scenario, but the answer
23 is --

24 Q. By account you mean?

25 A. -- yes. Yes.

1 Q. When you say it depends by scenario, you
2 mean by the different account --

3 A. Yes.

4 Q. -- that may be involved?

5 And that's by account, that's where these
6 funds would go, these --

7 A. Yes.

8 Q. -- refunds?

9 A. If you'll look on the appendix, you'll be
10 able to see where those dollars will be accounted to.

11 Q. Okay.

12 A. So in other words, we can trace them, the
13 companies can trace them and they're fully disclosed.

14 Q. All right. I haven't seen any HC
15 documents, so I guess I'm going to ask you, is the
16 purchase price public or is it private?

17 MR. ENGLAND: I believe that's part of the
18 asset purchase agreement which we've declassified, so it
19 is public.

20 COMMISSIONER CLAYTON: So I can ask, I can
21 verify.

22 BY COMMISSIONER CLAYTON:

23 Q. What is the purchase, Mr. Winter?

24 A. It's \$33 million.

25 Q. And the rate base figure is public, isn't

1 it?

2 A. I believe so. In the --

3 COMMISSIONER CLAYTON: Before you talk,
4 Mr. England, I just want to make sure.

5 MR. ENGLAND: That number should be in the
6 annual report.

7 COMMISSIONER CLAYTON: Okay.

8 THE WITNESS: The number is also in our --
9 on page -- let me get it here.

10 BY COMMISSIONER CLAYTON:

11 Q. It's \$18,322,714?

12 A. Yes.

13 Q. Okay. Just before I repeated it, I wanted
14 to make sure that it was --

15 A. I was trying to find the page number it was
16 on.

17 Q. Okay. So the rate base is 18.3, purchase
18 price is \$33 million, which would suggest an acquisition
19 premium I believe of roughly, what, 14, \$15 million? I
20 was told there would be no math.

21 A. Yes.

22 Q. And is there -- does the Staff
23 recommendation address how that premium will be --

24 A. The premium will not be allowed in rates.
25 FairPoint has already agreed to that. And also the

1 transaction cost to purchase CassTel from FairPoint will
2 also not be in rates.

3 Q. Say that last part again.

4 A. There's two pieces. There's the
5 acquisition premium. FairPoint has agreed not to seek
6 recovery of that in rates.

7 Q. Okay.

8 A. The second piece of these transactions is
9 the transaction cost, your attorneys, your accountants,
10 engineering people. They have also agreed not to seek
11 recovery of those dollars also in rates.

12 Q. Okay. Is the rate base figure, that
13 18.3 million, is that the figure that's being used to
14 establish the appropriate rates in the IR case, if that
15 question makes sense?

16 A. Let me go back. I believe it's very close.
17 Excuse me. That is a total company number, in other
18 words, total CassTel. The number that we used in the rate
19 proceeding is less than this, because we have our
20 separation factors in there.

21 Q. So the interstate --

22 A. Interstate.

23 Q. -- factors are removed?

24 A. Yes.

25 Q. I know I have some questions on universal

1 service, but I'm not sure if you're the appropriate
2 witness for universal service. Are you? I assume someone
3 from teleco would be more --

4 A. I believe Ms. Dietrich is the witness for
5 universal service.

6 Q. Okay. Let me look through this. I may be
7 finished with you here real quick. How was the penalty in
8 the investigation case dealt with in this? Does it come
9 out of the sale price? Is it a separate dollar amount
10 that's held in trust?

11 A. It's a separate check that will be written
12 for \$1 million based upon the day of the closing, yes.

13 Q. So the date of the closing, analogizing
14 with a real estate transaction, more simple transaction,
15 you'd have the purchase price, and I'm sure there would be
16 some secured lenders that would get their cuts of the
17 action, and you'll have 3.6 that will be set aside to deal
18 with the overearnings reduction, and then you'll have --
19 another million dollars will be taken out, payable to the
20 State of Missouri?

21 A. Yes. There will be -- let's go back to
22 your real estate analogy. There will be \$33 million,
23 minus the 3.6 or \$3.1 million. There will be a million
24 dollar fine. There will also -- they have a number of
25 lenders they have to pay off. Then they have to also deal

1 with the federal side of any potential damages they've
2 done.

3 Q. Is there any amount that will come from
4 proceeds that will be refundable to the federal government
5 or USAC or the FCC or --

6 A. All I can say is, there's some negotiations
7 going on at the federal level, and there probably will be
8 some more monies paid.

9 Q. Does the agreement set out whose
10 responsibility those potential other liabilities --

11 A. Those liabilities would be CassTel's
12 responsibility to pay.

13 Q. They will not flow to the new company?

14 A. No.

15 Q. Do you know how many -- how many potential
16 liabilities there are out there, how many federal agencies
17 are --

18 A. In theory, there's -- you have NECA,
19 National Exchange Carriers Association. You have USAC,
20 which is the universal service, and they take their
21 directions from the FCC. There's also sitting out there
22 the Federal Communications -- the FCC's -- they have a
23 division that -- enforcement division.

24 Q. At the FCC?

25 A. And there could also be some potential

1 fines out of the enforcement division.

2 Q. Has Staff made any assumptions on what
3 potential values of those liabilities would be?

4 A. We have seen some of the company documents,
5 but we have not independently calculated how much those
6 liabilities are.

7 Q. So you couldn't give me a ballpark figure
8 on what potential liabilities would be for NECA, for USAC
9 and for the FCC enforcement division? And I also want to
10 ask whether there's any Department of Justice issues with
11 the guilty pleas that are going on?

12 A. Let me first start with the easy one.
13 Nobody knows what the department of the FCC enforcement's
14 going to do.

15 Q. Okay.

16 A. Per the company, and I have discussed this
17 with the company, they owe in total about \$14 million,
18 \$14.1 million to the FCC, NECA, USAC.

19 Q. Those would all be one. I kind of -- the
20 NECA, USAC, FCC, that's one entity and it's 14.1 million?

21 A. Yes. Of that 14.1 million, Mr. Matzdorff
22 and the Martinos have paid 8.9 million.

23 Q. 8.9?

24 A. The difference will have to be paid by
25 CassTel. The difference that you're seeing there is

1 primarily associated with the markups that we discussed
2 earlier in this testimony.

3 Q. Okay. So the difference would be roughly
4 5.2 million, and that would potentially be a liability of
5 CassTel; is that correct?

6 A. Yes.

7 Q. Okay. And that would stay with CassTel, or
8 is there some amount that will continue to be held in
9 trust at the closing?

10 A. That liability will stay with CassTel. It
11 will not be held in trust, as far as I know.

12 Q. So funds will be distributed from the
13 closing to CassTel, and then it will be up to CassTel to
14 pay the 5.2 million?

15 A. That's my understanding. I'm not really
16 privy how that's going on.

17 Q. Okay. Are you aware of any other potential
18 liabilities for CassTel, significant liabilities?

19 A. Not that I'm aware of right now. There
20 could be something sitting out there that I'm not aware
21 of.

22 Q. Are you aware of the amount that lenders
23 will be taking out of the purchase price?

24 A. There is a number, but I don't remember it
25 right now. I believe -- and I'm not sure if that's a

1 confidential number or not, but it's a substantial number.

2 Q. Is that --

3 A. Excuse me. Part of it is in our annual
4 report. They owe CoBank I believe 4 to \$5 million, and
5 then LEC also owes money to CoBank.

6 Q. Okay. So --

7 A. And FairPoint is not assuming those loans,
8 so they will have to pay those loans, too.

9 Q. They'll come out of closing, I assume?

10 A. Yes.

11 Q. I assume that there's securities agreements
12 that would attach to the different assets of CassTel?

13 A. They'll be sitting -- so in theory, in the
14 old days they would be sitting at the table writing
15 checks, this is your check, this is your check, and the
16 checks will make the distribution.

17 Q. In Hannibal we still do that, write checks.

18 A. You do that? Okay.

19 Q. Are you aware -- does Staff have an idea
20 how much cash will actually go to CassTel after lenders
21 are paid at the closing, setting aside 3.6 and the
22 \$1 million?

23 A. I have no idea. I've looked at it, but I
24 just -- I don't know all the liabilities that are sitting
25 out there.

1 Q. You've looked at the financial arrangements
2 what the new company, Fair-- FairPoint?

3 A. FairPoint Communications, yes.

4 Q. You've reviewed the public information, I
5 assume some private information that's available on the
6 new company?

7 A. Yes.

8 Q. You're satisfied with its solvency and with
9 its --

10 A. Mr. Murray looked at that information, and
11 he was satisfied, but he also had some concerns. And
12 that's why we have the requirements in the particular
13 recommendation to the Commission.

14 Q. Will CassTel own anything after this sale?

15 A. CassTel as an entity will be gone. No,
16 they will not.

17 Q. So this will dispose of all the assets of
18 CassTel, and as soon as it winds up its affairs,
19 theoretically it will go away?

20 A. Yes.

21 COMMISSIONER CLAYTON: Okay. Judge, I
22 don't think I have any more questions of this witness, so
23 I'll pass.

24 JUDGE WOODRUFF: Anyone else, any of the
25 other Commissioners have questions for Mr. Winter? We can

1 always bring him back later, too.

2 Then you may step down. We'll call you
3 back later, Mr. Winter.

4 COMMISSIONER CLAYTON: Back to me?

5 JUDGE WOODRUFF: Back to you.

6 COMMISSIONER CLAYTON: My additional
7 questions relate to universal service, so I think
8 Mr. Winter suggested Ms. Dietrich, if she's available, and
9 she's coming forward. While she's getting situated up
10 here, is -- Mr. Voight's participation relates to rate
11 design access and certificate of service authority but not
12 universal service.

13 JUDGE WOODRUFF: Raise your right hand.

14 (Witness sworn.)

15 NATELLE DIETRICH testified as follows:

16 QUESTIONS BY COMMISSIONER CLAYTON:

17 Q. Good morning, Ms. Dietrich.

18 A. Good morning.

19 Q. Quickly I'm going to try to just ask you a
20 few questions relating to Universal Service Fund and USAC
21 and the FCC, and I'm hoping that you're knowledgeable on
22 these issues.

23 A. Okay. I'll try.

24 Q. I'm not sure if that was the confidence I
25 was looking for.

1 A. I will do my best.

2 Q. All right. First of all, the transfer of
3 this -- of this company and the recommendation of Staff
4 and the accompanying stipulations in the other case
5 approve the new company as an eligible telecommunications
6 provider on a prospective basis?

7 A. Recommends that the Commission approve them
8 on a prospective basis, yes.

9 Q. Which would be forward-looking from the
10 closing date?

11 A. Correct. What the Staff recommendation
12 states is that within 60 days of the effective date of a
13 Commission Order, we would come to the Commission with a
14 letter to the FCC, stating that FairPoint is an eligible
15 telecommunications carrier in Missouri and should start
16 receiving USF funding effective with the date of the sale.

17 Q. How does Staff do that when normally
18 Staff's role or the Missouri Commission role is to approve
19 past expenditures? How do you approve them on a
20 prospective basis without assessing past expenditures?

21 A. Well, this would be a new company, new to
22 Missouri, so this would be a new designation. As far as
23 the actual calculations of what they submit to USAC and
24 NECA to determine the amount, that I'm not familiar with.

25 And that would come more into an issue with

1 the October 1st certifications because the information
2 that we look at, as far as basing our recommendation to
3 the Commission for future certifications is based on two
4 years in arrears. To my knowledge, we have not had those
5 conversations with FairPoint as to what they would be
6 submitting.

7 Q. Okay. But so this is -- on the initial
8 designation, it can be done on a prospective basis. It's
9 not based on the past two years like -- like what we would
10 do in an -- an older --

11 A. Correct.

12 Q. -- company in Missouri?

13 A. Correct.

14 Q. All right. And what does the FCC or
15 federal statute require you to look at in making that ETC
16 designation?

17 A. They have to commit to providing the
18 central telecommunications services, voice grade service,
19 access to various things, they committed to doing that or
20 they already do in other states. They also have to commit
21 to providing Lifeline service, which they have done. So
22 those are the types of things that we look at, and they've
23 made those commitments.

24 Q. Those would be the same for this company or
25 any other company?

1 A. Correct.

2 Q. Has the Missouri Staff reviewed FairPoint's
3 participation in the Universal Service Fund in years past
4 at any level?

5 A. No. Huh-uh.

6 Q. Have you called USAC to determine whether
7 they're in good standing with --

8 A. No, we have not.

9 Q. Is that an important part of this analysis?

10 A. I think based on our certification
11 procedures, it's not necessary. The FCC has established
12 this requirement that states, take a look at companies,
13 but they've left it open to the states as to exactly how
14 far to take that. Based on my knowledge of the various
15 states, the Missouri Commission actually takes that
16 further.

17 So I don't know that contacting USAC and
18 saying, are they in good standing with other states, would
19 provide any information when in some other states, all
20 they have to do is --

21 Q. I don't even know if that's appropriate to
22 characterize it as, are they in good standing. I don't
23 know if that's a standard that is in any definition in the
24 regulation.

25 I guess what I was asking is, has the

1 Missouri Staff looked at whether FairPoint's gotten in any
2 Universal Service Fund trouble in the past? Is that
3 something we need to be aware as we move forward?

4 A. We have not specifically looked into that
5 related to FairPoint. However, we have had conversations
6 with the FCC surrounding the issues for these three cases,
7 and the FCC has indicated that this is a first and they
8 don't have any kind of precedent on how to move forward or
9 what to do, and so their indication is that they haven't
10 had any type of fraud to this level with any other
11 companies.

12 Q. But they've had other universal service
13 fraud in the past, haven't they?

14 A. Related to schools and libraries mostly.

15 Q. But not to telecommunications companies?

16 A. Their indications -- most of their
17 fraudulent, if you want to call it that, activities or
18 questionable activities are somebody, you know, stated
19 something in a report that needed to be corrected so they
20 had to go back and correct it or some timing was missed as
21 far as requesting money, but that was the extent of it.

22 Q. So are you telling me that the FCC advises
23 that this is the only time that they're ever really aware
24 of any fraud in the Universal Service Fund?

25 A. To this extent or this -- related to the

1 telecommunications carriers, that's what they're telling
2 us.

3 Q. Do you buy that? How many millions,
4 billions of dollars go through this fund every year?

5 A. Several. I think the last thing I saw was
6 the high cost fund was potentially \$7 billion.

7 Q. Generally, you know, there's never any
8 fraud in government programs.

9 Let me ask you this, and if I ask a highly
10 confidential number, could someone please stop me? What
11 is the value of the annual Universal Service Fund amount
12 that would be receivable or due Cass County in its number
13 of customers if it were approved? Is that a public
14 number?

15 MR. ENGLAND: It is.

16 COMMISSIONER CLAYTON: It is public. Thank
17 you.

18 THE WITNESS: I don't know on a
19 going-forward basis. I know based on --

20 BY COMMISSIONER CLAYTON:

21 Q. Well, just historically, what does
22 universal service mean for a company the size of CassTel
23 on an annual basis?

24 A. There's an estimate for the money that they
25 have not received, which would have been all of 2005, the

1 last quarter of 2004 and to date for 2006, of
2 approximately \$4 million. Approximately 20 months,
3 \$4 million.

4 COMMISSIONER CLAYTON: Instead of trying to
5 figure out how many quarters from outside of one year that
6 would be, Mr. England, do you know what the amount is on
7 an annual basis?

8 MR. ENGLAND: I don't, but I believe either
9 Mr. Schoonmaker or Mr. Trampush could probably answer that
10 question.

11 COMMISSIONER CLAYTON: Okay. Thank you.
12 Maybe we'll get to them.

13 BY COMMISSIONER CLAYTON:

14 Q. So the \$4 million includes all of 2005, a
15 quarter of 2004 and one quarter from 2006?

16 A. Approximately five months. I'm not sure
17 the exact cutoff of that number.

18 Q. You know you break it down less than a
19 quarter, it's getting more difficult for me to figure this
20 number out. Would it be more or less than \$2 million? Be
21 more than 2 million?

22 A. A quarter?

23 Q. For a year.

24 A. For a year? Right, it should be more than
25 2 million for a year.

1 Q. Okay. And how many years is due CassTel or
2 not necessarily how many -- how much is due, but how much
3 universal fund support has CassTel lost in -- due to our
4 lack of certification?

5 A. Approximately \$4 million.

6 Q. That's where that \$4 million comes in?

7 A. Uh-huh.

8 Q. Okay. Now, looking backwards, what happens
9 with that \$4 million? Does FairPoint have the ability to
10 make certain certifications and seek that \$4 million?

11 A. That's one of the issues that we're
12 currently working through with FairPoint. In the
13 stipulation related to the complaint case with Cass
14 County, Staff has agreed to look at the retroactive
15 payments if Cass County submits a capital expenditure plan
16 laying out how that money would be spent, and then they've
17 also committed to quarterly updates saying, you know,
18 we've spent X amount of money and this is what we've done
19 with that money to date. They've committed to that for
20 two years.

21 In the asset purchase agreement, there was
22 some language mentioning that FairPoint would work with
23 Cass to obtain retroactive payments, and so we sent DRs
24 and had conversations with FairPoint, asking them to what
25 extent do you anticipate receiving retroactive payments?

1 Their response in the DRs was that they have no
2 anticipation of requesting retroactive payments, and they
3 don't have an expectation that they would receive
4 retroactive payments.

5 So then in the meantime, in the last couple
6 of days, we have received a draft proposal for retroactive
7 payments that it's my understanding CassTel and FairPoint
8 have been working on, and so we had further conversations
9 with FairPoint saying, hey, according to your DR response
10 you say you have no expectation that you would receive
11 past money, but yet we have this proposal that is -- that
12 the two of you are discussing for retroactive money.

13 And they -- it's my understanding that they
14 were approached by CassTel and said, if we can get this
15 retroactive money, how would you spend it, and that's what
16 this plan is. So that's an issue that we're still working
17 through if --

18 Q. I'm sorry. Slow down.

19 A. Too much?

20 Q. Way too fast for this early in the morning.

21 So the complaint case from the -- that came from the
22 investigation, not the overearnings complaint, I assume
23 that there was -- I thought there was a complaint.

24 A. Right. Right. There's three cases.

25 Q. Mr. Williams referred to it as an

1 investigation, but I think there was a complaint filed in
2 this case, wasn't there?

3 A. There was an earnings investigation case, a
4 complaint case against CassTel, and then the asset
5 transfer case for FairPoint. And in the complaint case
6 against CassTel is where we discussed USF money for
7 CassTel.

8 Q. Okay. In that agreement, there is a
9 reference to past Universal Service Fund payments that
10 would possibly be due for prior years, correct?

11 A. Correct.

12 Q. You said that?

13 A. Correct.

14 Q. And that that amount is roughly \$4 million?

15 A. Correct.

16 Q. Now, in -- when we had the last
17 on-the-record presentation on that case, there was some
18 discussion about Cass County being eligible to receive
19 that money?

20 A. Right.

21 Q. Do you recall that?

22 A. Yes.

23 Q. Now, before us today we have the asset
24 transfer case as well, which would presumably have a
25 closing of sometime within the next, what, 30 or 60 days,

1 right?

2 A. Something like that. Uh-huh.

3 Q. So how did the two agreements, just the way
4 the documents are prepared right now, how do they work
5 together as they relate to this \$4 million? Just the
6 documents, aside from your conversations, your DRs, your
7 phone calls.

8 A. The complaint case, the Stipulation &
9 Agreement anticipates retroactive payment to CassTel
10 providing that they submit a capital expenditure plan and
11 Staff approves the plan.

12 Q. Now, how can they -- how can they submit a
13 capital improvement plan if they don't own anything
14 anymore?

15 A. Well, when this stipulation was negotiated,
16 there wasn't any type of sale at least that had reached
17 the level of being filed at the Commission. So at that
18 point it was strictly CassTel that we were dealing with.

19 Q. So there will need to be supplemental
20 documents filed addressing that issue?

21 A. In our Staff recommendation in the
22 FairPoint case, we only discuss prospective. So assuming
23 that the Commission approves the transfer of assets, then
24 the prospective -- or excuse me -- the retroactive payment
25 should go away because that would no longer apply because

1 CassTel would no longer exist.

2 Q. Well, would there be a way in light of the
3 current circumstances with the property being transferred,
4 resolution of a number of these issues, is there any way
5 that CassTel could comply with the terms of the agreement
6 in seeking the past USF monies?

7 A. I don't think CassTel could actually seek
8 and obtain the money, but I think CassTel could seek the
9 money and then the question would be where does that money
10 go and how does it get transferred or get paid to
11 FairPoint.

12 Q. Do you know what the FCC or USAC, what
13 their interests are with regard to these past dollars?

14 A. The last time we talked to the FCC, they --
15 again, they said, this is a unique situation. We've never
16 dealt with this before. But the process is that if a
17 state commission declines to certify a carrier and then at
18 some point in the future determines that monies should
19 have been paid, then the state commission has to submit a
20 petition for waiver to the FCC, and then the FCC would
21 consider it at that point based on what the state
22 commission stated and just what --

23 Q. So the state would have to seek a waiver?

24 A. Yes.

25 Q. So this Commission will have the ability

1 moving forward -- it sounds like this Commission will have
2 a significant role moving forward on whether or not those
3 past monies will be paid to anyone.

4 A. It should, yes.

5 Q. Now, are you aware whether those monies can
6 be assigned to FairPoint?

7 A. No, I'm not.

8 Q. That's probably a legal question, unless
9 you're a lawyer.

10 A. No, I'm not.

11 Q. Usually people bring that up up here, make
12 us aware of it.

13 Are there any other issues that are
14 outstanding associated with Universal Service Fund? We're
15 dealing with moving forwards, moving backwards. Are there
16 any other issues associated with either ETC designation or
17 USF monies that we need to be aware of?

18 A. I don't think so at this time.

19 Q. In the discussions that are ongoing, do you
20 anticipate Staff filing additional material in one of
21 these cases in how to deal with this issue from the past?

22 A. Either filing something in the case or
23 doing it informally in an agenda, as we do with normal USF
24 certifications.

25 COMMISSIONER CLAYTON: Okay. Judge, I may

1 want to explore this with CassTel or with FairPoint
2 counsel, but I don't think I have any other questions for
3 Ms. Dietrich.

4 JUDGE WOODRUFF: You may step down. We'll
5 call you back if we need you.

6 COMMISSIONER CLAYTON: Should I go ahead?

7 JUDGE WOODRUFF: Yes.

8 COMMISSIONER CLAYTON: Mr. England, can you
9 give me some insight on these Universal Service Fund
10 dollars from, was it the last quarter of 2004, all of '05,
11 and then I guess the closing date in 2006, of how we will
12 address these issues, considering CassTel won't be able to
13 have a capital improvement plan?

14 MR. ENGLAND: I think I'd like Mr. Trampush
15 to handle that because he's been dealing with the FCC and
16 this issue.

17 COMMISSIONER CLAYTON: Is he CassTel or
18 GV&W?

19 MR. ENGLAND: Actually, he's a LEC
20 employee -- I guess not employee. Consultant. And
21 Mr. Mirakian's counsel for that company, so he can bring
22 him up here.

23 COMMISSIONER CLAYTON: Okay. Thank you.

24 MR. MIRAKIAN: Yeah, I think that that
25 would be an appropriate thing to do.

1 (Witness sworn.)

2 JUDGE WOODRUFF: You may be seated. Tell
3 us your name.

4 THE WITNESS: Daniel L. Trampush.

5 JUDGE WOODRUFF: Trampush?

6 THE WITNESS: T-r-a-m-p-u-s-h. I'm
7 employed by Moss Adams.

8 DANIEL L. TRAMPUSH testified as follows:

9 QUESTIONS BY COMMISSIONER CLAYTON:

10 Q. And what is Moss Adams?

11 A. Moss Adams is an accounting and consulting
12 firm.

13 Q. I feel like I should know that, but I don't
14 know that. Where is it based?

15 A. Primarily west coast, headquartered in
16 Seattle, Washington.

17 Q. West coast. And where are you based?

18 A. I'm in Vancouver, Washington, just outside
19 of Portland, Oregon.

20 Q. Vancouver, Washington?

21 A. Yes, sir.

22 Q. We don't get someone from Vancouver,
23 Washington every day.

24 A. I don't get to Jefferson City often either.

25 Q. How's that working out for you?

1 A. It's been a lot of work.

2 Q. Okay. You are a consultant for LEC or
3 CassTel or for FairPoint? Who do you work for?

4 A. My client is Davis Wright Tremain, counsel
5 to LEC.

6 Q. Your --

7 A. But I've been working with LEC and Cass.

8 Q. So who is your counsel again?

9 A. My client is David Wright Tremain. I'm
10 engaged by the law firm of Davis Wright Tremain, who's
11 counsel to LEC. I've been working with LEC.

12 COMMISSIONER CLAYTON: You're with Spencer
13 Fane?

14 MR. MIRAKIAN: I'm with Spencer Fane.
15 Davis Wright Tremain is the DC firm, FCC firm counsel to
16 LEC in this case also.

17 BY COMMISSIONER CLAYTON:

18 Q. So your client is a law firm in DC?

19 A. Yes.

20 Q. It's not LEC?

21 A. It's -- well, they represent LEC.

22 Q. Who's paying your bill?

23 A. I bill Davis Wright Tremain. They in turn
24 bill LEC.

25 Q. Thought we were actually going to meet

1 someone from LEC here. We haven't met anyone from LEC.

2 But you're not affiliated with LEC?

3 A. No.

4 Q. All right. You've been in the hearing room
5 since we've had the discussions regarding universal
6 service?

7 A. Yes, I have.

8 Q. And you're familiar with USAC and the FCC's
9 regulations relating to universal service?

10 A. Yes, I am.

11 Q. And you've had some involvement in this
12 case in, I suppose, either negotiating with the FCC or
13 with someone regarding universal service?

14 A. I've interacted with NECA, USAC and the
15 FCC.

16 Q. Can you describe what your role as a
17 consultant has been so far in this case?

18 A. Really three primary. The first is
19 figuring out what the accounting adjustment should have
20 been for each year with these markups that Mr. Winter
21 referred to, Pegasus, et cetera, so figuring out what the
22 total amounts were by year. Then once those amounts were
23 known, figuring out what the interstate impacts of those
24 adjustments are. In other words, what's the total
25 liability.

1 Q. Intrastate or interstate?

2 A. Interstate.

3 Q. So you're doing the separations analysis?

4 A. All of the impacts on NECA, prior year's
5 universal services, calculating the total liability and --
6 both for the past, and then going forward.

7 Q. Any other areas or is that pretty much it?

8 A. I also worked with the company on the sale
9 to FairPoint, in the areas of due diligence.

10 Q. Okay. Any other -- any other areas?

11 A. Not that I can recall.

12 COMMISSIONER CLAYTON: Are all of these
13 fair game today?

14 MR. MIRAKIAN: I believe so.

15 COMMISSIONER CLAYTON: Good.

16 BY COMMISSIONER CLAYTON:

17 Q. Okay. What is your understanding of
18 whether Universal Service Funds are still available to be
19 paid by the FCC or USAC to someone for the period of late
20 '04 to the present day?

21 A. I think it will take actions of this
22 Commission. In fact, I know it will take actions of this
23 Commission before anything will happen because I was told
24 that directly by the FCC. Do I believe they're entitled
25 to be paid? Yes, I do.

1 Q. And when you say they, who are you
2 referring to?

3 A. Could you repeat how I answered that
4 question?

5 Q. I think you said that, do you think they
6 deserve to be paid?

7 A. Do I believe those amounts should be paid?
8 Yes, I do.

9 Q. All right. Who -- to whom should they be
10 paid?

11 A. What we have proposed, and it's consistent
12 with agreements with Staff, is that the amounts from
13 September 2004 through the date of closing for the high-
14 cost loop support, which totals about \$4.2 million, would
15 flow to FairPoint under a capital plan that they would
16 negotiate with the Staff.

17 There's an additional approximately
18 2 million of interstate common line support and local
19 switching support that has also not been paid, which would
20 be used as an offset to the NECA liability.

21 Q. Used as an offset to the NECA liability?

22 A. Yes.

23 Q. So when you say the NECA liability, what is
24 that?

25 A. Well, the total liability that we've

1 calculated and that we've agreed to with NECA is
2 \$14.1 million, and that's for all -- all elements, NECA
3 and USAC, 14.1.

4 Q. That was a figure that Ms. Dietrich used
5 earlier; is that correct?

6 A. Yes.

7 Q. That about 8.1 or 8.9 has already been paid
8 back?

9 A. Well, the total liability is 14.1 for
10 everything, for all years, '96 through 2003. Looking at
11 2004 forward, the records are clean, but the total
12 liability for all these transgressions is 14.1 million.
13 The defendants in their criminal proceedings have paid in
14 8.9 million. So Cass/LEC is now liable for 5.2 million
15 net of the 8.9. 14.1 minus the 8.9, Cass owes 5.2 for the
16 period '96 through 2003. And we've agreed with NECA on
17 all of these numbers.

18 Q. So the common line support figure of
19 \$2 million would be used as a credit with NECA, or is that
20 a series of cash payments?

21 A. No, there would be no cash. We owe NECA
22 5.2 million. We would take the amounts that Cass was not
23 paid for services they provided and costs they incurred
24 for the interstate common line support, for example, use
25 those amounts as an offset to the liabilities. So instead

1 of owing NECA approximately

2 5.2, we would owe NECA approximately 3 million.

3 Q. Has CassTel assigned the right to receive
4 that \$2 million -- does CassTel have the right to receive
5 it or does LEC have the right to receive it?

6 A. Well, NECA's going to get paid one way or
7 the other. I'm not sure how we would assign -- what would
8 we assign.

9 Q. I'm not sure either.

10 A. Yeah.

11 Q. There is potentially \$4.2 million in --

12 A. Well, that amount is the high-cost loop
13 amount.

14 Q. Right.

15 A. That amount would, subject to an approved
16 plan, capital plan, flow to FairPoint.

17 Q. So that would have to be --

18 A. That's not Cass's money under the
19 agreement.

20 Q. That's FairPoint money?

21 A. That would go to FairPoint, even though
22 Cass accrued the cost.

23 Q. All right. And that's included within the
24 joint application or is it a contract for sale?

25 A. No. There's no mention of that. Contract

1 for sale was done in December. All of this came about
2 after the contract for sale. There's no effect on
3 purchase price either.

4 Q. Right. Well, so that's -- that goes to
5 FairPoint, the \$2 million would simply be a credit with
6 NECA?

7 A. An offset to the liability, yes, sir.

8 Q. And that's for common line support?

9 A. Yes, interstate common line support and
10 local switching.

11 Q. Does it normally just appear as a credit on
12 a -- on a bill or --

13 A. Normally it appears as a revenue item on
14 the NECA settlement statement each month. What we've
15 concluded is that, you know, Cass collected 5.2 million --
16 net of 5.2 million more than they should have, which is
17 owed back to NECA and USAC.

18 Q. So that \$2 million can't go anywhere else?

19 A. No.

20 Q. There is either an attachment that's going
21 to be --

22 A. It shows up. We've proposed to the FCC,
23 and the Staff has all the documentation, that it show --
24 it will be a credit to liability due to NECA.

25 Q. So the common line support really is kind

1 of an internal NECA settlement figure?

2 A. Yes.

3 Q. It's not like you wait for that check to
4 come in?

5 A. No. There is no check. So it will be --
6 Cass will be -- or LEC will be writing a check to NECA and
7 USAC.

8 Q. Okay. You participated in the accounting
9 analysis associated with these markups that were referred
10 to by Mr. Winter?

11 A. Yes, I did.

12 Q. Did you agree in the evaluation that
13 40 percent and 80 percent were high or --

14 A. Yeah. I was the one that told the company
15 how to do it right.

16 Q. Okay.

17 A. Which is basically cost based. There's no
18 markups.

19 Q. Are you familiar with Pegasus that was
20 referenced earlier?

21 A. I know the name Pegasus from looking at the
22 records, yes, sir.

23 Q. Are you aware of what services it
24 supposedly provides?

25 A. I'm not aware of any services that were

1 provided.

2 Q. Okay. And since you work for LEC, have you
3 been doing the same analysis associated with other
4 Missouri regulated companies?

5 A. No. My analysis has been limited to Cass
6 County.

7 Q. So you haven't been involved with
8 New Florence at all?

9 A. No, I have not. Excuse me. I take that
10 back. I have been involved in looking at what the value
11 of New Florence is since Tiger Tel owns a third of it and
12 LEC owns Tiger Tel, but that's the extent.

13 Q. Well, maybe we'll see you again. You'll
14 have another opportunity to come back to Jefferson City.

15 A. I won't comment, sir.

16 COMMISSIONER CLAYTON: I don't think I have
17 any other questions. Thank you.

18 JUDGE WOODRUFF: All right. Thank you.

19 Commissioner Murray, do you have any questions?

20 COMMISSIONER MURRAY: No, I don't. Thank
21 you.

22 JUDGE WOODRUFF: Commissioner Gaw?

23 COMMISSIONER GAW: Have Mr. Schallenberg
24 come up.

25 (Witness sworn.)

1 JUDGE WOODRUFF: You may be seated.

2 ROBERT E. SCHALLENBERG testified as follows:

3 QUESTIONS BY COMMISSIONER GAW:

4 Q. Good morning.

5 A. Good morning.

6 Q. State your name, please.

7 A. Robert E. Schallenberg.

8 Q. And what do you do, Mr. Schallenberg?

9 A. I am the director of utility services
10 division for the Missouri Public Service Commission.

11 Q. How long have you worked for the Public
12 Service Commission, total?

13 A. Approximately 30 years.

14 Q. How long have you had your current
15 position?

16 A. Approximately nine.

17 Q. Generally describe your affiliation and
18 your involvement in the series of cases that we have in
19 front of us.

20 A. The -- my involvement began in '04 when the
21 Commission instructed the Staff to begin an investigation
22 into the extent of criminal activities regarding utilities
23 in the state of Missouri. From that, the Staff produced I
24 believe in January of '05 an initial report identifying
25 the entities that would be possible candidates for further

1 review. That report, I believe, was supplemented in mid
2 '05, and from that spawned the earnings investigation and
3 the complaint that are the matters today.

4 And at the same time, from that, the Staff
5 also began looking at options to change the ownership in
6 any of our utilities that had affiliations or owners that
7 were associated with the indictments that were taking
8 place either in New York and/or in Kansas City, which
9 would involve the third case that is the matter today,
10 which is the ownership change.

11 COMMISSIONER GAW: All right. In effect,
12 all of these cases are in front of us today, if I recall?
13 I think all of them were noticed up, if I'm not mistaken.

14 JUDGE WOODRUFF: That is correct.

15 BY COMMISSIONER GAW:

16 Q. So here's what I would like for you to do
17 for me.

18 A. Sure.

19 Q. First of all, I want to know whether there
20 is already in existence some sort of a schematic or
21 diagram of how the money is flowing as a result of all of
22 these settlements.

23 A. There is not one in existence. As
24 Mr. Winter pointed out, we have in essence taken the sales
25 price and have kept track of the monies that were directly

1 related to our activities, which would be the settlement
2 of the earnings review and the complaint, and we are aware
3 from our audit of an amount that would be a liability that
4 exists to lenders, either at the CassTel level or at the
5 LEC level.

6 And then there's been information today,
7 further information today about their liabilities at the
8 federal level. And I know we've had contact periodically
9 with the Kansas Corporation Commission because CassTel
10 does have some small operation in Kansas. I don't know
11 that we know that amount. So we've had kind of a running
12 draft, but it is not formalized at this time.

13 Q. Well, would it be possible for you to
14 sketch one out for me?

15 A. Yes.

16 Q. I don't know if we've got something in here
17 that you can utilize for that purpose, but it would be
18 helpful for me to see all of this in one place at one time
19 in some sort of a very simple schematic of who's paying
20 who what and where the money's going and how much is left
21 over, and whoever can help facilitate that would be --
22 would be appreciated.

23 A. We could -- at the break, we could create
24 at least an initial draft of that with the lines, and then
25 circulate copies to the Commissioners and to whoever's --

1 Q. Would that take very long? I know that's
2 asking quite a bit.

3 A. I would suspect that it would probably
4 take, given that usually our breaks are 15 minutes, it
5 would probably take within the 15 minutes or maybe an
6 extra 10 from that. If we're going to go into this
7 afternoon, I know it can be done over a lunch hour.

8 Q. Well, I don't know if we're intending -- if
9 it looks like we're going to go that long or not, but in
10 order for me to understand how this all fits together, it
11 would be very helpful for me to see something like that.

12 COMMISSIONER GAW: So, Judge, I don't know
13 when you're planning on taking a break, but --

14 JUDGE WOODRUFF: We can probably go 'til
15 about 11, but if you want to take a break sooner, we can
16 do that, too.

17 COMMISSIONER GAW: I can defer to whoever
18 else wants to ask questions, because before I can get into
19 more my questions, I need to see that.

20 JUDGE WOODRUFF: Chairman Davis, do you
21 want to ask questions now or do you want to take a break
22 first?

23 CHAIRMAN DAVIS: Can I just jump in and ask
24 Mr. Schallenberg a couple questions?

25 JUDGE WOODRUFF: Go right ahead.

1 QUESTIONS BY CHAIRMAN DAVIS:

2 Q. Mr. Schallenberg, in Case No. TC-2005-0357,
3 there was a, I guess an agreement to pay a \$1 million
4 settlement in regard to all these matters. Do you have
5 knowledge of that --

6 A. Yes.

7 Q. -- provision?

8 Can you tell me how that number was arrived
9 at? Was there any formula or was that just an arbitrary
10 amount that the parties negotiated or --

11 A. What I can say is, there were two levels
12 from the Staff's view. There was the amount that we were
13 told or advised is what we could expect that we would
14 receive by litigation through the courts if we litigated
15 the amount what the penalty would be for the -- I believe
16 there were four counts in the complaint.

17 And then there was the amounts that we
18 believed would be a fair settlement, and that amount from
19 the Staff's view was established to be \$1 million, and
20 that's how the
21 \$1 million was derived, from the Staff's view.

22 Q. In light of the apparent acquisition
23 premium being paid for the company, do you have any
24 remorse about that \$1 million amount now?

25 A. No. In terms of what was given to the

1 Staff, the expectation of the amounts that would be
2 resolved from litigation, what the penalty would be, we
3 were advised of an amount substantially lower than that
4 that would be the amount that would go to the school fund.

5 In terms of the settlement now, the second
6 settlement on the earnings review, that number is driven
7 and based by a universal service amount being available to
8 the company, which the current owners did not have, and
9 there was never an expectation in the third case that we
10 would approve a sale to an owner that wouldn't qualify for
11 those types of payments.

12 So in terms of the Staff or my personal
13 view, the value of the enterprise always was going to have
14 in it a number of what the new owner could get from the
15 Universal Service Fund, but until -- unless special
16 arrangement was made, LEC was never going to receive that
17 cash, and we never calculated our earnings review giving
18 LEC the credit for not having that money.

19 CHAIRMAN DAVIS: Okay. I don't think I
20 have any more questions for Mr. Schallenberg at this time.

21 JUDGE WOODRUFF: All right. Let's go ahead
22 and take a break, then. We'll come back at 10:50. Give
23 you 20 minutes.

24 (A BREAK WAS TAKEN.)

25 (EXHIBIT NO. 1 WAS MARKED FOR

1 IDENTIFICATION BY THE REPORTER.)

2 JUDGE WOODRUFF: Welcome back from our
3 break, and we're ready to get started. While we were on
4 the break, Mr. Schallenberg handed out a document showing
5 a purchase price distribution sheet, and I believe it has
6 been marked as Exhibit 1. I believe all the Commissioners
7 have a copy of that. I assume that we'll consider this to
8 be offered into evidence. Does anybody object to
9 receiving that into evidence?

10 (No response.)

11 JUDGE WOODRUFF: It will be received.

12 (EXHIBIT NO. 1 WAS RECEIVED INTO EVIDENCE.)

13 JUDGE WOODRUFF: And, Commissioner Gaw, if
14 you would like to ask your questions.

15 COMMISSIONER GAW: Thank you very much.

16 FURTHER QUESTIONS BY COMMISSIONER GAW:

17 Q. Mr. Schallenberg, would you go down through
18 this exhibit?

19 A. Yes. What I did on the break is I took the
20 \$33 million purchase price and I identified the items or
21 the categories of where that money would be distributed.

22 Q. Yes.

23 A. And when you see the double X, I don't know
24 the number, but I know that will be some money going
25 there.

1 Q. Okay.

2 A. And for example, I know by the agreement
3 there's a \$5 million amount that will have to be held
4 under escrow to see how the cash at the time of closing,
5 where the -- where the business is in terms at the time of
6 transfer. So there's a 5 million escrow that I kept to
7 the side there. And then there will be adjustments for
8 working capital. There will be closing costs.

9 Then at the bottom there were four other
10 categories. There will be the 18-month health coverage
11 COBRA that will be given to the employees. There'll be
12 business wind-down costs, termination pay, and there's an
13 outstanding liability that exists with the FCC enforcement
14 bureau that is not known at this time.

15 Q. Okay.

16 A. Those were the categories that I identified
17 on the break that would have some claim to the amount
18 that's residual. And then you'll see in the middle of the
19 schedule, the ones I did identify, which the aggregate are
20 \$20.3 million --

21 Q. Yes.

22 A. -- which is the first number is the
23 \$1 million which would come from the complaint case that
24 we're discussing today, which would go to the state funds.
25 The 4.1 is the cash and credits related to our settlement

1 for the earnings review.

2 The 5.2 million is the remaining LEC
3 liability to NECA and USAC, which has been reduced by the
4 settlements that have been received from the Martinos and
5 Mr. Matzdorff, but I put an asterisk on that because that
6 number could be 2 million less if there's an agreement
7 reached to use the offset that was discussed earlier this
8 morning, but the 5.2 is the existing liabilities. The KCC
9 settlement will be half a million dollars.

10 Q. Okay.

11 A. And there is outstanding debt on the
12 property that would have to be settled of 9.5. So those
13 are the known distributions as of -- as of today.

14 Q. Okay. Let me ask whether any of the other
15 parties in the room have any information on estimates of
16 the amounts on this exhibit that are not filled?

17 MR. ENGLAND: From CasTel and LEC's
18 perspective, we do not.

19 COMMISSIONER GAW: Are those things that --
20 just have to be determined as the information comes in and
21 as time goes by here toward closing?

22 MR. ENGLAND: That's correct, and some may
23 not be determined until after closing.

24 COMMISSIONER GAW: Okay. But you have no
25 estimates at all or ranges of possibilities in any of

1 those that would be helpful?

2 MR. ENGLAND: Not that we're aware of.

3 COMMISSIONER GAW: Okay.

4 BY COMMISSIONER GAW:

5 Q. Mr. Schallenberg, do you know -- and I'm
6 not asking you what the number is because it could be
7 confidential, but do you know what the -- what the
8 purchase price of this company CassTel was when it was
9 originally purchased by LEC?

10 A. I have -- that was given to me at the
11 break.

12 Q. It was. Is it confidential?

13 MR. ENGLAND: Your Honor, I believe it was
14 back in '96, but we no longer consider that confidential.

15 COMMISSIONER GAW: Thank you, Mr. England.

16 BY COMMISSIONER GAW:

17 Q. Go ahead, Mr. Schallenberg.

18 A. \$18.5 million.

19 Q. 18.5. Okay. And it was in '96?

20 A. Yes. And I think I was told at the break
21 the net book today is a little bit over or probably in
22 excess of 32 million.

23 Q. The net book?

24 A. At today, because there would have been
25 construction expenditures added to the plant since it

1 would have been purchased before, and probably another
2 piece that I didn't explain. I also put at the bottom of
3 this page, I was able to identify that the shareholders of
4 LEC would have had at least an initial investment of
5 \$6.4 million.

6 Q. Okay.

7 A. And they own 99 percent of CassTel.

8 Q. Yes.

9 A. And there was another amount of equity that
10 had to be put into the company, but I don't know that
11 number, so I put that as a kind of a floor. So as you're
12 looking at the distribution and looking at what the
13 investors have in it --

14 Q. Yes.

15 A. -- I know there's an amount somewhere in
16 excess of the \$6.4 million that the shareholders, in
17 essence, invested in LEC and in CassTel.

18 Q. Okay. All right. Now, Mr. Schallenberg,
19 then, is -- in looking at this, at the numbers that you do
20 have access to, and examining that in relation to -- well,
21 let me back up for a moment.

22 Do you know since '96, when LEC became an
23 owner in CassTel, how much money they have -- that LEC has
24 received from CassTel in revenues or in financial benefit?

25 A. No, I don't. I don't have that number. I

1 know the report showed the growth in USF funding by year,
2 and I believe that had grown to be a million dollars per
3 quarter prior to it being suspended.

4 Q. Okay.

5 A. But in terms of what can I recall now,
6 that's the only type of revenue number I can recall now.

7 Q. Yes. What I'm trying to understand here
8 is, in the big picture sense, if I could look at the
9 monies that have flowed to LEC or to affiliates of LEC
10 over the course of the time since it's been an owner of
11 CassTel and then look at the fines that are going to be
12 levied and the revenues that may come in, less whatever
13 else is going to other entities on payoffs and things like
14 that on notes and things, whether or not there was in the
15 end a net benefit to the LEC investors as a result of all
16 of these things that have occurred and up and through the
17 contemplation of approval of the settlements in this case.

18 That's a lot of inf-- I know that covers a
19 lot of territory, but knowing your normal analysis of
20 things in deciding what is and is not an appropriate
21 settlement, I suspect that you have at least thought about
22 some of those things.

23 A. Yes.

24 Q. And I'm interested in, to the extent that
25 you can, having you break that down for me.

1 A. If you look at -- if you look at the owners
2 for -- of CassTel and break those into two groups, and I
3 break those into two groups because some of those owners,
4 in essence, had individual benefits from the transactions
5 that were discussed today, so that besides just what the
6 normal shareholder would have gotten from LEC --

7 Q. Yes.

8 A. -- they participated in some of the
9 payments, and so their gain or the amount of money they
10 realized.

11 Now, what the Staff was never able to
12 determine is some of those individuals appeared to be
13 doing business on behalf of other individuals that the
14 Commission's discovery and our discussions with the
15 Department of Justice and the FBI never revealed to us how
16 much of that money may have flown to -- may have been
17 given to other people who weren't the first or second
18 tier. And in terms of our evaluation, if that was left
19 mostly -- and then there were transactions that took place
20 outside of CassTel.

21 I think Commissioner Clayton asked about
22 USP&C. That activity was not within our examination, but
23 there were monies made, there were transactions all over
24 the United States through the Internet scam or whatever.
25 I think it was called a scam in the indictments. So those

1 people participated in a whole host of monies that came
2 in.

3 Q. Yes.

4 A. I'd say I personally relied on whatever
5 settlements that were made with the Department of Justice
6 and federal prosecutors to be what they felt was fair
7 remuneration because the Staff never had access to the
8 informants and sources and all of that information. If
9 you're limiting your question to CassTel --

10 Q. I am. Generally, CassTel and LEC's
11 interest in CassTel or any affiliates that were doing
12 business with CassTel that were -- and I say affiliates,
13 any entities such as the firm in Kansas that was brought
14 up earlier that would have some relationship with LEC or
15 with CassTel in dealing with CassTel's drawing down of
16 additional revenues from USF. That's what I'm looking at.

17 The other matters dealing with the Internet
18 or the additional surcharge matters on the 900 numbers and
19 other things that were done from the -- I think from the
20 east coast, I'm not wanting necessarily for you to add all
21 of that activity in. I don't know if that's helpful to
22 you. I think that's what you were saying.

23 A. Right. Because I know from Missouri's
24 view, we examined that as well.

25 Q. Yes.

1 A. And Missouri's damages from that other
2 activity were minimal.

3 Q. Okay.

4 A. That Missouri was not a state, because of
5 the actions taken by our dominant ILECs --

6 Q. Yes.

7 A. -- USP&C did not get to bill many
8 Missourians for that. Now, the Internet and the banks, we
9 have no way to know how many people in Missouri may have
10 been taken by that. So we did try to layer that down,
11 now, when you get to just the CassTel piece --

12 Q. Yes.

13 A. -- and we did look at Mr. Matzdorff's
14 property that was made public through his divorce, or
15 first I think it was a separation, and we looked at the
16 material that was filed, and that is for the division of
17 property and assets. So we used that as another
18 barometer.

19 I would say it is -- and I think Chairman
20 Davis asked me the question. I think this is a fair
21 settlement and that those people have suffered losses, and
22 now the shareholders that did not gain from that
23 definitely are suffering a loss in value as to what they
24 would have received absent all these penalties and all
25 these liabilities that exist on their property.

1 Q. And I understand your -- the last part of
2 your statement, that those fines have a negative impact on
3 those. What I want to know is whether there were any
4 benefits that were gained by any of the investors in LEC
5 as a result of their ownership interest in CassTel over
6 the course of time since that ownership interest has
7 existed and contemplating this closing and the revenues
8 from the sales of the purchase of CassTel.

9 A. If I understand, would there have been --
10 would LEC owners have received gains since they invested
11 in LEC through from '96 up to today, the answer would be
12 yes.

13 Q. And for any of those investors, do those
14 gains exceed the losses that will occur because of the
15 fines in this case?

16 A. I would say their gains may exceed -- well,
17 I'll say no, because if you consider the loss of what the
18 enterprise would have been worth and the fines and
19 penalties and the settlements that are being made, I would
20 say the loss will be -- would override the gains they've
21 made historically.

22 Q. And I want to make sure I'm following you.
23 I'm asking you not what their potential profit was
24 compared -- without these funds compared to what it is
25 with them. I'm asking you whether or not from the

1 beginning of this ownership from LEC to the potential
2 termination of that ownership, whether or not all of these
3 transactions that have occurred from beginning to end
4 would result in a net profit to those investors?

5 A. And again, of course, I haven't done, like,
6 actually putting all the numbers together, so I'm just
7 doing it by the general review. And if in your question
8 the loss of the market value, what you owned is not in
9 that -- is not in my answer, I don't know that that would
10 be true.

11 Q. Is it possible to look at that and come up
12 with a number or a range of possible numbers there or is
13 that impossible to reconstruct?

14 A. Well, you could -- we could go back. We
15 know the distributions that have been made since '96. We
16 know how much LEC received in terms of distributions.

17 Q. It would be very troubling to me if I
18 thought that as a result of criminal activity in this --
19 in dealing with CassTel, that investors have benefited,
20 investors in LEC have benefited from that criminal
21 activity. And it is important for me to understand that
22 this settlement ensures that crime don't pay.

23 A. I would say, as some of the parties have
24 been in negotiations with the Staff, I think that was a
25 recurring theme in coming to our settlements.

1 Q. I assumed that was the case.

2 A. So what I could tell you is, there is
3 nothing perceived from the settlements that would be
4 perceived as being, I wouldn't mind trying to do that and
5 getting the same kind of deal.

6 Q. Right.

7 A. So I know the perception is not there, and
8 I know when the Staff was doing this, as I answered the
9 question earlier about the complaint, that number was not
10 a number that was driven by just the dollar amount that we
11 would think we could have gotten. That was driven to the
12 number that we believed, in essence, espoused that theory
13 that we intended to make sure that the Staff was going to
14 put its name on the settlements, that we could represent
15 to you that we believe this puts this matter to rest in a
16 way that no one else will want to be -- will want the
17 CasSTel situation attached to them.

18 I can tell you that that is the case today,
19 because even in discussions in other cases, CasSTel has
20 a meaning in Missouri as Enron does nationally. So there
21 is -- I can -- what I can tell you is there is no -- there
22 is no inkling that anybody believes that the people who
23 were involved in this situation by what they settled with
24 and the settlements before you came out ahead.

25 Q. Okay. And is there -- is there a way that

1 you could give me some numbers, not while you're on the
2 stand, but some numbers that would show me those, the
3 revenue streams to LEC since their ownership interest
4 began in '96, and that against the liabilities that have
5 resulted in the federal and state fines and the -- and
6 whatever other liabilities on paying off notes that might
7 exist?

8 A. I can give you the distributions that went
9 to LEC. I don't know what they paid in taxes.

10 Q. Okay.

11 A. Because see, they -- they have to pay the
12 taxes.

13 Q. Yes. That's an LLC, isn't it?

14 A. Right. So what I'm getting at is the
15 number I would give you would be higher than what they --
16 the actual shareholders would have had, and I know from
17 the earnings review settlement, we never acquired the tax
18 information. So in terms of giving -- I could give you
19 distributions. I know distributions would be a high
20 number, and I can't tell you -- I don't know how to reduce
21 it, because I don't know how much of that number would
22 have been paid to the Internal Revenue Service by that --
23 by the shareholders in order to look at what gains, if
24 any.

25 Now, I know I have been told that the

1 distributions were -- that cash distributions given to
2 these entities was supposed to be a surrogate for their
3 tax liability because they're going to pay based on the
4 income of the enterprise, not on how much cash they get.

5 Q. Yes.

6 A. So I have been told several times, but I've
7 never personally verified, that whatever cash they
8 received was only to match what their tax liability was
9 for their respective ownership of LEC, and if that's the
10 case, then there would be no gain at all in terms of cash
11 received by these owners, other than the ones in the class
12 that I told you about that received monies by transactions
13 by alternative means, which wouldn't be by virtue of their
14 ownership. It was by virtue of them being owners and
15 involved in some of these transactions that were in
16 question.

17 Q. Do you know from the information that
18 you've gathered what the value of LEC is today? Does it
19 have assets and does it have value that would or could be
20 distributed to its investors?

21 A. You mean after -- well, as was pointed out
22 today, they own one-third of Tiger, who owns New Florence.

23 Q. Right.

24 A. And with CassTel being sold, I'm not
25 aware -- Lake Livingston is no longer an asset, which was

1 another piece of LEC. So I'm not aware that they have any
2 other assets.

3 Q. Well, what I was driving at is, you said
4 there might have been cash amounts distributed to LEC
5 investors to take care of tax liabilities?

6 A. Yes.

7 Q. That might infer to me that there were --
8 there were monies that were not distributed and held by
9 LEC.

10 A. Yes.

11 Q. And I guess that's what I'm asking about,
12 in addition to the answer that you gave, is whether or not
13 there's money yet to be distributed or that could be
14 distributed that was held back.

15 A. Well, if you take this exhibit, the cash
16 that actually is within CassTel, that's that -- one of the
17 working capital adjustments.

18 Q. Okay.

19 A. That will actually be left in the accounts
20 and used in the settlement between FairPoint and CassTel.

21 Q. So do you think that the money, if there
22 was money that was paid out, it would have been paid out
23 only the amount for -- if that's what it was for, tax
24 liability would have been paid from CassTel to LEC and
25 then on to the investors and no additional money have been

1 paid from CassTel to LEC to be held by LEC or used for
2 other purposes?

3 A. The cash flows that came from CassTel --

4 Q. Yes.

5 A. -- there would have been, in essence, what
6 it would have given to LEC as a distribution, which LEC
7 would then give to its actual shareholders. CassTel also
8 gave substantial sums of money to LEC to do this
9 management services item that had the markup, and as it
10 was brought up this morning, there was -- the markup was a
11 big portion of it. It also had some salaries in it that
12 we had disputed in there and reviewed, some bonuses, but
13 that was a big cash distribution as well.

14 They did billing and collection was another
15 service that CassTel paid to LEC, and for some reason I
16 think there may have been one other service. But there
17 were cash payments that went from CassTel to LEC for
18 services rendered besides just distributions.

19 Now, we did examine -- and that's where we
20 got into the markup. We did examine to see, once we
21 started getting access to LEC documents, to see if the
22 payments coming from CassTel for a service was
23 approximately equal to the LEC expenditures. And that's
24 where the markup comes up, is the markup is over and above
25 what LEC was paying for the services.

1 Q. What happened to that money, though,
2 after -- if it was paid to LEC, then what became of it
3 after that?

4 A. It would have shown up as a LEC profit.

5 Q. But then was it paid to the investors or
6 was it retained by LEC? That's what I'm looking for.

7 A. It would have increased the tax liability
8 of -- that LEC investors would have had.

9 Q. Yes, but what happened to the money?

10 A. Well, there's -- you know, I can't say that
11 we were able to trace all the funds from LEC, because one
12 of the questions that we tried to examine is -- and we did
13 as much as we could -- is to see if LEC was doing any
14 business on USP&C, Overland Data, and there's that whole
15 chart that, in essence, CassTel money could have been
16 going to -- Garden CitiBank was another one that was in
17 the press. And we know there were accounts with Garden
18 CitiBank, so we tried to check that. I don't know that we
19 found -- I know we didn't find all the ultimate outcomes
20 of those funds. But in terms of answering your
21 question --

22 Q. Yes.

23 A. -- funds were transferred from CassTel not
24 only because of the earnings, they were -- they were paid
25 to LEC for those services.

1 Q. Okay. So you really don't know where the
2 money went after it got into LEC's hands?

3 A. No. I mean, a few isolated examples, I'd
4 say we did, but we never went through and --

5 Q. But generally?

6 A. We never went through and checked all the
7 vendors that LEC gave us to find out.

8 Q. If I'm -- I'm sorry to interrupt you,
9 Mr. Schallenberg. If you make the assumption that LE--
10 that any money that went to LEC benefited the investors,
11 would it be possible for you to come up with some sort of
12 numbers for me on what actually -- what the total benefits
13 generally could have been to investors over the course of
14 its ownership of CassTel?

15 A. I could come up with a number. I know I
16 know the distributions of how much they received in terms
17 of distributions, because the Staff has that.

18 Q. Yes. To LEC or to the investors?

19 A. To the LEC investors.

20 Q. Yes. What I'm looking for, if you
21 just -- if you went ahead and attributed any of the monies
22 that went to LEC to the investors, do you have those -- do
23 you have those numbers?

24 A. Yes. I mean, I know we have the LEC
25 distributions.

1 Q. Okay. I would be interested in that, if
2 it's possible for you to put it together for me. And then
3 let me go to -- I want to -- and I apologize for making
4 you walk through this part, but it would be helpful for me
5 if you would just generally again explain to me how these
6 fines are working and who they're being paid to and the
7 additional amounts that are going to customers, the
8 amounts that are going into the fund for low-income
9 heating assistance, and at some point in time in this
10 dialog, I want you to explain to me the AT&T portion of
11 the settlement.

12 A. Okay.

13 Q. And I'll come back to all those things, if
14 you want, but if you want to pick whichever one you want
15 to do and go with it, that's fine.

16 A. If you take the cash settlement -- excuse
17 me -- the cash credit -- I'll start -- use this one. The
18 \$1 million payment will go into the state school fund. So
19 that's where that money will go.

20 Q. And that is money that's coming out of
21 CassTel?

22 A. Yes. That will be when you get -- when
23 they get out of the 33 million --

24 Q. Yes.

25 A. -- \$1 million of that money will go to the

1 state school fund to settle the complaint case.

2 Q. Okay. Keep going then.

3 A. Then from that, they will have to pay --
4 it's 3.25 million of credit -- of cash checks that are
5 earmarked for the customer list that Commissioner --
6 excuse me -- Commissioner Clayton asked about today.

7 Q. Yes.

8 A. 3.25 million is designated to be given to
9 them for checks, and 500,000 is designated to be given as
10 checks to access carriers. That's what you asked about,
11 that AT&T piece.

12 Q. Right.

13 A. Okay. Now, to the extent that those checks
14 are not cashed --

15 Q. Which checks, the ones on the customer
16 list?

17 A. Or the access carriers.

18 Q. Either one?

19 A. We don't have an expectation that the
20 access carriers won't cash their checks.

21 Q. I didn't think you would, but --

22 A. But if they don't --

23 Q. -- it is in the agreement?

24 A. But if they don't, we have a default is the
25 monies left out of those two total amounts that aren't --

1 that aren't cashed, then they are to go to a local
2 assistance agency or LIHEAP. So that's where the LIHEAP
3 monies -- so there isn't a designated amount that they
4 get, other than we have an expectation of the 3.25 million
5 that some of those checks won't -- they won't find their
6 owners and there's an unrefunded amount, and that will be
7 transferred to help LIHEAP in the Cass County area.

8 Q. I wanted to ask you while you're on that,
9 about the -- first of all, when you say that it goes to
10 the -- to the community action agency, is it intended that
11 the money be utilized for just Cass County individuals,
12 Cass County, Missouri individuals? Is it broader than
13 that? Was there any agreement in that regard?

14 A. The Staff was the one that picked the local
15 assistance agency, and so when we did this, and we do it
16 on other occasions, we try to find the best match of an
17 assistance agency that would match the service territory.

18 Q. Yes.

19 A. There are -- sometimes there are some
20 overlaps or some gaps, but --

21 Q. Do you know what it looks like in this
22 case?

23 A. I don't know.

24 Q. You're just not familiar with the territory
25 of that particular community action agency?

1 A. Mr. Winter is the one that we all --

2 Q. He might know that better?

3 A. He's the one that's always designated in
4 the negotiations to find -- find that -- the entity that
5 we put into it.

6 Q. Okay. Is he still here?

7 A. Yes.

8 COMMISSIONER GAW: Would you come up to
9 this microphone, Mr. Winter, so we can get that?

10 Go ahead.

11 MR. WINTER: What we did was that -- the
12 state of Missouri is divided into a number of different
13 action agencies. So what we did was look at the action
14 agency that was associated with the counties that serve --
15 that Cass County served.

16 COMMISSIONER GAW: Cass County Telephone?

17 MR. WINTER: Cass County Telephone. So
18 what we did was contact that particular agency to make
19 arrangements that if there were excess dollars or excess
20 credits, that those dollars, because Cass County served
21 those particular counties, would be sent to that
22 particular agency for LIHEAP assistance.

23 COMMISSIONER GAW: Okay. Do you know in
24 regard to the LIHEAP assistance whether or not LIHEAP
25 assistance can be utilized for heating needs outside of

1 natural gas customers?

2 MR. WINTER: That's out of my area. I do
3 not know. I believe we had -- I believe it was for
4 natural gas that we had talked to them about, because of
5 the Commission's concern about the high price of natural
6 gas, and that's why we went to LIHEAP.

7 COMMISSIONER GAW: I understand that. But
8 I'm asking because I'm not familiar with whether or not
9 there are -- there are LDCs that cover the more rural
10 areas of Cass County.

11 MR. WINTER: I believe Aquila is probably
12 the service provider for those particular -- that
13 particular area.

14 COMMISSIONER GAW: Okay. Well, if you have
15 a chance to check with someone in Staff and let me know a
16 little bit later, that would be helpful.

17 MR. WINTER: I'll take care of that.

18 COMMISSIONER GAW: Thank you.

19 BY COMMISSIONER GAW:

20 Q. Now, Mr. Schallenberg, now, we were on --
21 the \$3.2 million, again, that goes to who?

22 A. That goes to the access, the customers that
23 have access lines of CassTel.

24 Q. All right. And these customers -- again,
25 there was a designation about whether they were at closing

1 or whether they were at the time of the approval by this
2 Commission. Which is this, do you recall?

3 A. This is going to be -- this amount of money
4 is going to come upon the closing. That's why it's shown
5 at the 33 million.

6 Q. All right.

7 A. When the closing takes place, these monies
8 are actually put in a separate account for this designated
9 purpose.

10 Q. Okay. And that account is being held by
11 who?

12 A. I know it's negotiated in the agreement. I
13 don't remember the specifications as to who. It is
14 separate -- well, FairPoint actually takes over the
15 liability to actually issue the checks, so ...

16 Q. Or the credits as they may be?

17 A. Well, the credits will be issued on the
18 bills, which is separate than the checks. The \$350,000 is
19 a bill credit.

20 Q. Okay.

21 A. That will be issued on the customer's bill
22 when that stipulation is agreed. I think that's within
23 two billing periods. And I think there was a question
24 earlier about who would be excluded from this.

25 Q. Okay. Go ahead.

1 A. And the only -- the only people that will
2 be excluded from this would be people who don't pay for
3 telephone service, which could be -- sometimes there's
4 agreements -- there are some employees of CassTel that are
5 excluded, and if there's any concession service being
6 provided by -- and I don't know that there is -- anybody
7 who was receiving concession services as a matter of
8 employment with the telephone company, that happens
9 sometimes in the telephone industry, they wouldn't be
10 eligible. But every other low income or all the others
11 paying a tariff service, they will receive the credit.

12 Q. Now, what is -- the \$3.25 million, what is
13 it intended to be for? What is the purpose of it?

14 A. When we did the earnings review, we came up
15 with a number that we believe rates should be reduced by.

16 Q. Okay. And that's -- okay. Go ahead.

17 A. And when we did that, at the time the
18 company was also trying to pursue -- and I would say
19 whether you say it was our fault or at our urging or
20 encouragement -- selling the company to get new owners.

21 Q. Right.

22 A. In the negotiations of the earnings review
23 and the change of rates, the matter came up, would be is
24 how difficult it is to get a buyer when they don't know
25 what the rates will be.

1 Q. All right.

2 A. And could we, in essence, agree to a lump
3 sum reduction that would be equivalent to the rate
4 moratorium that we were agreeing to. And what we did then
5 is we looked at the Staff's number as to what we were
6 looking at as an aggregate rate reduction and looked at
7 that, a number that would be equivalent to holding us in
8 abeyance from that day forward for two and a half years.

9 Q. Yes.

10 A. And negotiated a number that was very
11 attractive to the Staff to enter into the agreement that's
12 before you today.

13 Q. Okay. So -- but does this 3.25 million
14 represent then -- I'm just trying to follow you here --
15 represent an amount that would have or does translate into
16 some sort of a rate reduction that Staff believes would
17 have otherwise occurred going forward?

18 A. The number I would use to compare the
19 3.25 -- well, and you have the 3.25 and you've got the
20 350,000.

21 Q. Yes, and if you can talk about them
22 together, fine. If there's a problem in talking about
23 them at the same time, then keep them separate.

24 A. As I mentioned, the sale was an issue, and
25 it was -- it was a desire of the Staff to also make sure

1 that we got a sale completed.

2 Q. Yes.

3 A. So as an agreement, we agreed that, at a
4 minimum, if the Staff was not going to pursue any type of
5 rate reduction --

6 Q. Yes.

7 A. -- we were given the assurance that we
8 would get at least a \$350,000 credit on customers' bills.

9 Q. Okay.

10 A. Just for standing still to allow a sale to
11 develop.

12 Q. And what time frame does that represent in
13 regard to what would have -- might have otherwise occurred
14 if you had been correct and moved forward with a rate
15 reduction? What time frame is that representing in that
16 settlement?

17 A. We were looking at the 350,000 in
18 conjunction with a total overall of -- we were looking at
19 a rate reduction number from the Staff's view -- well, we
20 had a maximum number that our schedule showed.

21 Q. Yes.

22 A. And we were looking at a period of doubling
23 that number for two and a half years.

24 Q. Okay.

25 A. Less than what we expected we would get

1 from the maximum number, and then recognizing that there's
2 a litigation, because we're not going to get that number
3 right away, and that's how we developed what we thought
4 would be the impact to customers of entering into a
5 moratorium.

6 Q. Okay.

7 A. By taking that number and comparing that to
8 the 3.6 --

9 Q. Yes.

10 A. -- we found the 3.6 to be a very attractive
11 number compared to what the amount of rate reductions that
12 were being forgone by waiting -- by accepting a moratorium
13 by two and a half years.

14 Q. All right. So this is an up-front payment
15 in exchange for this moratorium for what -- for what might
16 have otherwise, at least in Staff's view, been a reduction
17 in rates?

18 A. Yes.

19 Q. Okay.

20 A. And so, but because most of this money was
21 not going to be made available unless there was a sale, we
22 carve out of it at least a \$350,000 credit for the Staff
23 at least waiting to allow a sale to develop. In the event
24 that the sale fell apart --

25 Q. Yes.

1 A. -- there would be a \$350,000 credit given
2 regardless, and we could then litigate and start from --
3 you know, if a sale didn't take place. So that's how
4 those two numbers were -- I mean, the 3.6 is, in essence,
5 what the settlement initially was.

6 Q. Yes.

7 A. Which has been increased now to 4.1 with --

8 Q. Because of the access issues?

9 A. Because -- so it's been supplemented and
10 increased since we originally entered into the agreement.
11 But the \$350,000 piece was because it was contingent on
12 the sale.

13 Q. Yes.

14 A. It was, in essence, a piece that, well, we
15 weren't going to put all of the money into a sale that may
16 not take place and then just be delayed, so we agreed to a
17 \$350,000 credit that would go to customers if the sale
18 didn't take place.

19 Q. Okay. Now, have you in your experience
20 seen this particular provision, this type of a provision
21 done before here?

22 A. No. We would have pursued a rate
23 reduction.

24 Q. Yes.

25 A. But on the other hand, we don't do earnings

1 reviews in conjunction with trying to get the owner
2 changed.

3 Q. Normally?

4 A. Well, this is unique.

5 Q. Yes.

6 A. That doesn't mean we may not have another
7 one of these, but --

8 Q. I understand. But in regard to the
9 payments that are being made, the payments are being made
10 to customers as of a certain date relative to closing or
11 this Commission's approval, as the case may be, correct?

12 A. Yes.

13 Q. But the moratorium itself is extending out
14 for two and a half years, correct?

15 A. Yes. It's two years, but there's six
16 months to process it.

17 Q. Okay. So I'm assuming that those -- that
18 potentially there are customers, then, benefiting in that
19 broader window of time that might in a rate reduction case
20 not have benefited because they would have -- if they left
21 the system, if they left CassTel?

22 A. Yes.

23 Q. Or whatever the name is in the new -- with
24 the new company. And there will also be potentially new
25 customers that will not see the benefit because of the

1 rate moratorium and having not been there when the checks
2 were written?

3 A. There is a possi-- there is a possibility
4 that such customers will exist, yes.

5 Q. Okay. And help me -- aside from the
6 350,000, help me with the 3.25 million as to why that --
7 doing the checks in a one-time amount was preferred to a
8 rate reduction for that -- for the customers of CassTel.

9 A. The rate reduction that the Staff, in
10 essence, viewed would have been the likely outcome --

11 Q. Yes.

12 A. -- was less than what the 3.6 generates
13 over that two and a half year period.

14 Q. And when you say generates, what do you
15 mean?

16 A. What I'm saying is, if you would have taken
17 the number the Staff would have had --

18 Q. Yes.

19 A. -- you're going to have a number less than
20 3.6.

21 Q. Okay.

22 A. And then if you take the other factor to it
23 is getting your money up front for customers who don't
24 move.

25 Q. I assume that's what you meant, but I

1 needed you to explain.

2 A. But what I'm saying, but the beginning
3 number was even less in the Staff's view, which is, in
4 essence, a cost for not getting a rate reduction in the
5 first place.

6 Q. Yes.

7 A. And then there is another protection clause
8 in the agreement that the company, the new owner or
9 CassTel can't go to price cap without having a rate case,
10 so that we wouldn't have been caught in a price cap mode
11 where those rates that we did not get reduced were, in
12 essence, the basis for price caps before a full rate
13 proceeding.

14 Q. Yes.

15 A. So we negotiated that safeguard. But the
16 answer to your question is the amount of money that's in
17 this credit and cash check far exceeds in the Staff's mind
18 or in my mind what those customers would have received if
19 we would have pursued a complaint case at this time. And
20 that's what made that option attractive is that the -- you
21 can see the dollar amounts per customer are significant.

22 Q. Yes.

23 A. That was the tradeoff that the Staff agreed
24 to. And at the same time, by agreeing to that, you also
25 put in place the cash flow that a new owner could rely

1 upon to get a purchase price and proceed with the sale
2 case, which was very important to the Staff at the same
3 time we were doing the earnings review.

4 Q. Okay. The price cap issue, moving forward,
5 explain to me how that's going to work in regard to this
6 rate moratorium. If Staff at the end of that period of
7 time believes, after reviewing the books of the company
8 that's now known as CassTel or now -- the territory that's
9 now managed or in CassTel's service territory, how does
10 that -- if they believe, Staff believes that rates should
11 be reduced at the end of that moratorium period, is it
12 clear that price cap is not an option until Staff has an
13 opportunity to go through a rate reduction complaint?

14 A. Unless there's a general rate proceeding,
15 now they can file a rate case, and then go for price caps
16 after a general rate case.

17 Q. After it's completed?

18 A. Right. So you get at least the safeguard
19 that their rates will be established on a cost basis
20 before they can elect to go to price cap. It has happened
21 in the past where there have been some earnings reviews
22 that have been stopped by price cap election. So that in
23 terms of even taking the next piece, where if you just
24 take the money it looks good --

25 Q. Yes.

1 A. -- but in the long run, you may end up
2 having price cap rates that you can pay for for an
3 extended period of time. This provision has that
4 safeguard in it that the company agrees not to elect for
5 price cap until you have a general rate case review either
6 initiated by us or by them, so that if these rates are
7 excessive, you have one opportunity to bring them down to
8 a cost basis or a decision on what the Commission believes
9 is just and reasonable before we would enter into a price
10 cap regime.

11 Q. Okay. Is the number that you were
12 referring to earlier that Staff believed in its position
13 would have been an appropriate amount for a rate
14 reduction, is that something that you can discuss here
15 without compromising Staff's position with the other
16 parties?

17 A. I mean, the company -- we had an
18 earnings -- we had given a run, an earnings review run to
19 the company. I don't know. I mean, there are parties in
20 this room that aren't in those discussions. I mean, you
21 know, I don't have a problem. I mean, the company knew
22 what our numbers were because they saw them and got back
23 to us. So it would be more what the company wants to
24 protect of ours, so I don't know.

25 COMMISSIONER GAW: And I'm -- Mr. England?

1 MR. ENGLAND: I'm not sure I understand the
2 question.

3 COMMISSIONER GAW: I can't imagine. My
4 question was so clear.

5 MR. ENGLAND: No, I'm sorry. Actually, I
6 was saying something to counsel next to me. So I
7 apologize. I just didn't hear it all.

8 COMMISSIONER GAW: No, I don't think my
9 question was that clear actually. That's why I said that.
10 But what I -- what I was asking is whether or not the
11 Staff's position in regard to what it thought rates should
12 be reduced to if there were an earnings complaint filed,
13 and what that number would look like for the two and a
14 half year moratorium that's proposed here. So he's been
15 testifying that in regard to how it compares to the
16 settlement amount, and I was just asking whether or not
17 that number could be disclosed.

18 MR. ENGLAND: Let me -- my initial reaction
19 is, I don't think it ought to be disclosed. I'm also
20 troubled by the whole line of questioning, if you will, or
21 answers. Maybe that's a better way to put it --

22 COMMISSIONER GAW: Oh, okay.

23 MR. ENGLAND: -- because I think it really
24 gets to sort of privileged discussions among parties to a
25 settlement. I recognize this is your Staff and you want

1 to be comfortable with what you're being presented, and I
2 understand that this is their position, not necessarily
3 mine.

4 COMMISSIONER GAW: Yes.

5 MR. ENGLAND: So if they want to disclose
6 their numbers to you, I don't have a problem with it, but
7 at the very least, I would want them to be proprietary
8 figures, because if not privileged, they certainly are
9 confidential as part of the settlement discussions.

10 COMMISSIONER GAW: Okay. And again, I
11 wasn't asking him what you-all had discussed. I was
12 asking what his position was, and I think that's what he's
13 been testifying to.

14 MR. ENGLAND: Okay.

15 COMMISSIONER GAW: So if there are issues
16 there in regard to discussions among the parties, I have
17 not been trying to ask what those discussions were, just
18 simply Staff's justification for this and breakdown how
19 they arrived at this being a settlement that should be
20 approved.

21 MR. ENGLAND: As I said, if Staff has no
22 problem giving those numbers, I certainly don't, but I
23 think they ought to be proprietary.

24 COMMISSIONER GAW: I don't have issues with
25 that one way or the other, whatever Staff's position is on

1 it and the Judge's, any other parties. So we'd have to
2 close to do that.

3 JUDGE WOODRUFF: Yes. If you want to have
4 it spoken in public session, we have to close.

5 COMMISSIONER GAW: Okay.

6 JUDGE WOODRUFF: All right. At this point,
7 then, we'll go into an in-camera session. Anyone who is
8 not authorized to be here please needs to leave.

9 COMMISSIONER GAW: Designation as
10 proprietary is different than HC.

11 JUDGE WOODRUFF: Yes.

12 (REPORTER'S NOTE: At this point, an
13 in-camera session was held, which is contained in
14 Volume 4, pages 239 through 243 of the transcript.)

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1 JUDGE WOODRUFF: We can go back into
2 regular session.

3 BY COMMISSIONER GAW:

4 Q. Okay. Now, in looking, Mr. Schallenberg,
5 at what has occurred in retrospect on the rates that have
6 been charged to CassTel customers, first of all, is it
7 possible for this Commission to retroactively -- in your
8 opinion, retroactively do anything as to rates that have
9 been charged?

10 A. In my experience, unless the rates were
11 adopted interim subject to refund or had some condition on
12 them, I have never seen any successful attempt that has
13 ever gotten rates charged for an historical period prior
14 to determination from the Commission to have new rates or
15 give monies back.

16 Q. And does Staff believe that the rates --
17 looking back, that the rates were higher, lower or about
18 right -- too high, too low or about right? Excuse me.

19 A. I would say in hindsight, if the -- if we
20 would have known, we would have based our settlements in
21 the case before, we would have based it on, one, to a
22 higher amount of USF support than was legitimate, but
23 that's because we had a lot of costs that weren't
24 legitimate.

25 Q. Yes.

1 A. And so that we -- you know, in hindsight,
2 we would have had probably a lower number, but you also
3 have to recognize we also did not honor the moratorium
4 that we negotiated in that agreement as well, and so the
5 change in examination of rates, the Staff was ordered to
6 start this investigation, and we did not satisfy the
7 moratorium requirements that were in that prior agreement.

8 Q. Let me ask it this way: If Staff had had
9 access to all of the information that you now have access
10 to when the last rate reduction case were handled, does --
11 do you have an opinion about where those rates should have
12 been if Staff -- based upon Staff's position in this case
13 analysis of where rates should be going forward?

14 A. We would have had a lower recommendation
15 because we would have had a lower cost basis.

16 Q. And do you know how much additional money
17 ratepayers have paid during that interim period, if
18 Staff's position today were taken by the Commission as
19 being correct?

20 A. I haven't -- I haven't done that
21 calculation, and I haven't seen any -- any aggregate data
22 that would allow me to form an opinion as to the magnitude
23 of that.

24 Q. And in regard to this overall settlement,
25 can you point to me the penalty that CasSTel is paying

1 because of the fact that those consumers up there have
2 been paying rates which, in Staff's position, have been
3 excessive as a result of the failure to disclose or at a
4 minimum the information that you now have? Can you tell
5 me how -- did you tell me what's -- which part of the
6 settlement relates to that?

7 A. Well, I would say -- I think I said it is
8 the Staff's position would have been lower in the prior
9 case. Now, how much of a lower position we would have
10 agreed to a different number, what that number would be --

11 Q. Yes.

12 A. -- that's pure speculation, because when we
13 get into rate reduction cases we understand the value of
14 the rate reduction not being disputed and coming in. So I
15 don't know --

16 Q. And I'm not asking you -- I mean, you've
17 already told me that you haven't calculated those numbers,
18 although I'm sure that if pressed you could come up with a
19 position.

20 What I'm asking you is, what portion of
21 this settlement relates to the misrepresentations that
22 were made by the company in regards to its expenditures
23 that resulted in Staff's recommendation in the last rate
24 case being different than what you believe it should have
25 been if you had had access to all of the information you

1 have today?

2 A. I would say is -- what is being presented
3 and asking the Commission to adopt today?

4 Q. Yes.

5 A. Is, as I pointed out, the amount of the
6 credits and cash refunds in excess of what we would have,
7 you know, what I would say would be a baseline of what we
8 think would be the adjustment.

9 That amount is, in essence, you know,
10 because we're not dealing with an number, that I know the
11 number that I could say these people were overcharged by X
12 and I can tell you today, you add X to the normal rate
13 settlement. But there is a significant amount of in that,
14 now it's 4.1 million, over and above what we believe the
15 rates would be reduced from our earnings review. I think
16 you have gotten reasonable if not more than adequate
17 compensation for that concern in the settlement to that.

18 Q. Well, is any part of this \$1 million
19 penalty attributable to that method --

20 A. No.

21 Q. -- that set of misrepresentations?

22 A. Not -- that amount was -- is going to the
23 school fund.

24 Q. Well, I know where it's going.

25 A. Yeah.

1 Q. I'm asking whether any part of that penalty
2 is due to misrepresentations that occurred to this
3 Commission.

4 A. Oh, yes, because I think perjury was one of
5 our -- I think there's an -- and I don't know exact the
6 term that was in the complaint. We had names that we use.
7 There is one for the -- on the Staff's complaint that
8 perjury took place on the record that was related to that
9 rate settlement. As a matter of fact, there is another
10 provision in the complaint settlement as to -- there was
11 a name given to it, but there's an omission that
12 reasonable -- there's reasonable evidence that something
13 happened that day. And that's one of the items that --

14 Q. And, Mr. Schallenberg, I agree with you
15 that part of this settlement does specifically, I think,
16 reference testimony given to the Commission and on that
17 particular day when we were looking at the approval of
18 that rate reduction. I am sort of focusing on just a
19 little bit of a different take from that, and it may be in
20 here as well, about the misrepresentations that were made
21 to Staff about expenditures that occurred when the audits
22 were being done that would have resulted in -- I think in
23 some different recommendation being made by Staff to this
24 Commission in regards to the rates that were in existence
25 at CassTel at the time.

1 A. And I understand that. I understand that
2 question, and the answer is that was not part of our
3 complaint. The fact that -- and the responsibility would
4 be mine, that the auditors took statements not under oath
5 and relied upon those to make the decisions that we made
6 that was -- that was -- in hindsight wasn't the right
7 thing to do. I can tell you our audits are designed
8 differently today. I can tell you we do not rely on a
9 company official, on a major Data Request today.

10 Q. Yes.

11 A. But that failure was mine, and it wasn't
12 done under -- but it wasn't a complaint because they
13 didn't make statements under oath and we've made
14 adjustments for that.

15 Q. As a result of this case?

16 A. As a result of CassTel.

17 Q. Yes. That's what I mean.

18 A. Yes. I mean --

19 Q. Yes.

20 A. -- as I mentioned earlier, CassTel has
21 changed our approaches, and our audits consider -- the
22 audits done since this event are substantially different
23 than the audits that were done prior to the CassTel issue.
24 And that's not just for telephone. That's all over.

25 Q. Okay. The access portion of the

1 settlement, the \$500,000, can you explain that to me?

2 A. Yes.

3 Q. What that represents?

4 A. There's another pool now, a \$500,000 that
5 will be distributed to the interexchange or the access
6 customers of CassTel in proportionate weight of their
7 business to the total. That's how much share they get of
8 the \$500,000.

9 Q. Well, who are those access carriers just
10 generally? Who are the major ones?

11 A. Well, I know AT&T is one.

12 Q. Yes.

13 A. Bill Voight reviewed the list and the
14 calculation.

15 Q. Okay.

16 A. And so, I mean, he would know of the -- I
17 mean, of the other carriers that are on the list, I'm
18 aware AT&T and Southwestern Bell would have been two of
19 the carriers.

20 Q. Okay. And was this -- was Staff's position
21 on this in regard to the approval of the settlement that
22 there would be in some -- if there would be a rate
23 complaint case, earnings complaint case, it would be some
24 amount of access rate reduction that would occur? Help me
25 to understand why Staff supported this portion of the

1 settlement, if you're the right person to ask.

2 A. I'd be the right person to ask. Staff's
3 support of the settlement is that the settlement that was
4 reached prior to the half million is still intact.

5 Q. Yes.

6 A. So the additional 500,000 being given to
7 the access carriers, access customers of CassTel --

8 Q. Yes.

9 A. -- in no way changes or diminishes the
10 amounts that are going to the customers that were the
11 beneficiaries of the initial draft of the settlement, and
12 all that is coming out of the CassTel's owners' pocket.

13 Q. So in essence, Staff's indifferent about
14 this portion in regard to the 500,000?

15 A. I would say indifferent in that we did
16 not -- we did not take a position that the 500,000 is too
17 high, too low or whatever.

18 Q. Yes.

19 A. And we would not be indifferent to trying
20 to -- being it was an issue that was going to hold up
21 CassTel, we were not indifferent to trying to get the
22 CassTel matters resolved and put behind us.

23 Q. Yes. I understand that.

24 A. We took a very active role in trying to
25 make sure that the matter was defined and processed and

1 had to decide whether -- because depending on the way it
2 was addressed, the agreement may have fallen apart and we
3 may have had to take a different course. So we were
4 interested in getting the settlement done, but we did not
5 take a position regarding the amount.

6 COMMISSIONER GAW: Okay. Maybe I should
7 ask AT&T. If you want, just give me some idea about your
8 support of this figure in the settlement, Mr. Lane, if you
9 can.

10 MR. LANE: Well, I'll say this, that the
11 original stipulation that came out was the first we had
12 learned of the earnings investigation and didn't allocate
13 anything to any interexchange carriers who had paid in our
14 view a third of the rates that were in effect, the
15 revenues generated by the company. We thought it was
16 appropriate that some of the refunds and credits be made
17 available the interexchange carriers who -- that made
18 these access payments. And as a result of the
19 negotiations, that's the figure that was reached.

20 COMMISSIONER GAW: That helps.

21 MR. LANE: Do you want me to repeat it?

22 COMMISSIONER GAW: I heard you, but I don't
23 know if anyone else did, so if you want to repeat it, it
24 might be helpful.

25 MR. LANE: Sure. The original stipulation

1 that came out was the first we learned of the earnings
2 investigation, and the Commission asked for intervention
3 and we chose then to intervene.

4 Our position was that access customers had
5 paid approximately a third of the revenues that CassTel
6 had received, and we thought it was appropriate for
7 interexchange carriers to share in any rate reduction or
8 credits or refunds that were going to be given as a result
9 of it. We intervened on that basis, and the parties came
10 to an agreement on the number that's reflected.

11 COMMISSIONER GAW: Okay. And as I
12 understand it, at least arguably this is -- this is done
13 as a part of an exchange for there not being any earnings
14 complaint possibilities for two and a half years. Is it
15 AT&T's position that this is an appropriate amount in
16 exchange for there not being any rate reduction case in
17 front of this Commission during that time frame?

18 MR. LANE: We agreed to and support the
19 settlement. We support the principle that interexchange
20 carriers should participate in that reduction. I'm not
21 going to tell you I think the amount's adequate, but I'm
22 going to tell you that we support it.

23 COMMISSIONER GAW: Okay. Am I
24 misrepresenting your understanding of what this is for,
25 what that amount represents, as it compares to an earnings

1 complaint case?

2 MR. LANE: I don't think so.

3 COMMISSIONER GAW: I'm just trying to make
4 sure because I'm really just trying to understand how this
5 fits in to this whole picture here. And I know it was a
6 late arrival at the table in regard to this settlement,
7 so --

8 MR. LANE: And a late arrival only in that
9 the Commission opened the case, and I don't have the date
10 in front of me, but called for intervention within a few
11 weeks --

12 COMMISSIONER GAW: Yes.

13 MR. LANE: -- and we intervened within that
14 period of time to represent our interests in it. We made
15 it clear that we were not trying to cause the entire
16 settlement to fall apart and that we understood the
17 Commission's -- or we believed we understood the
18 Commission's concerns in trying to effect the change of
19 ownership that the Commission's otherwise satisfied with
20 the terms of its various stipulations and complaint, but
21 we felt it was appropriate for interexchange carriers to
22 receive something. We received something, and so we
23 agreed to the settlement.

24 COMMISSIONER GAW: Okay. And this, of
25 course, allows all of you to reduce your charges for long

1 distance rates.

2 MR. LANE: It would be like any other
3 expense that we have.

4 COMMISSIONER GAW: Yes, of course.
5 Mr. Dority, do you want to add to that or have anything
6 else to add?

7 MR. DORITY: No, sir.

8 COMMISSIONER GAW: Is anyone else here on
9 this portion of the settlement? I'll ask Public Counsel
10 to give me some feedback on it, if you could.

11 MR. DANDINO: I completely support the
12 settlement. I think it's --

13 COMMISSIONER GAW: Just narrow down on this
14 500,000 for me, if you would.

15 MR. DANDINO: I have no problem one way or
16 the other with the 500,000.

17 COMMISSIONER GAW: Because it didn't impact
18 the other portion that you'd already resolved?

19 MR. DANDINO: That's right.

20 COMMISSIONER GAW: If I recall, at the last
21 on the record we had -- there was some -- I don't recall
22 whether all the parties were in agreement in regard to
23 what, if anything, was being -- well, what all the release
24 provisions in the one agreement covered. Was there any
25 further discussion in that regard since the last time we

1 were here that would shed some light on that? I'm looking
2 at the TC case on page 4.

3 MR. FRANSON: I remember the discussion,
4 Commissioner Gaw, but as far as anything, any other
5 discussion among the parties, no, sir, there has not been
6 that I'm aware of.

7 COMMISSIONER GAW: All right. Mr. England,
8 did you have any more time to think about --I know it's
9 been quite some time since that was discussed.

10 MR. ENGLAND: I did, your Honor, and the
11 release language that was in there and that continues to
12 be in there from the company's perspective is absolutely
13 critical to the settlement of that case. That was drafted
14 after quite a bit of input from various lawyers, not just
15 me.

16 COMMISSIONER GAW: Yes.

17 MR. ENGLAND: And we looked at it and we
18 felt comfortable with it, and in light of the substantial
19 penalty that we're paying, felt it was appropriate to make
20 sure that we were released from any further liability for
21 any acts during the period of time that spans Staff's
22 investigation.

23 COMMISSIONER GAW: Maybe my recollection is
24 incorrect, but I had general recollection that Staff and
25 CassTel might not have been in total agreement on the

1 interpretation of that language. And I could be
2 incorrect.

3 MR. ENGLAND: Without speaking for Staff, I
4 think they think some of the language that we requested be
5 in there is superfluous or unnecessary.

6 COMMISSIONER GAW: Okay.

7 MR. ENGLAND: But -- and that certainly is
8 their opinion. We obviously believe it is significant,
9 and that's why we bargained and asked that it be put in
10 there.

11 COMMISSIONER GAW: Okay. Staff, do you
12 have anything further to add on this portion? It is -- it
13 was an area that made me somewhat uncomfortable before
14 because I wasn't clear about what was intended in the
15 meaning of that language from the comments that were made
16 the last time.

17 MR. FRANSON: Well, Commissioner, I think
18 what we talked about last time was, what does it mean?
19 And Staff's interpretation is that this language closes
20 any complaints that would have been possible about any
21 activities up to what we knew about when we signed the
22 agreement. And that's all it does.

23 It would seem very unlikely that some other
24 party out there could file a private lawsuit under the PSC
25 law and bring that. It would seem that would already be

1 litigated, but that would be a matter that would come up,
2 be very unlikely, but this may be the first line of
3 defense that the company would litigate.

4 And the third-party language was put in
5 there specifically at the request of the company, and
6 Staff went along with that as part of the overall
7 agreement.

8 COMMISSIONER GAW: Can you give me any
9 guidance of what that third-party language might
10 contemplate?

11 MR. FRANSON: Well, I think it would only
12 contemplate the very unlikely event that there's somebody
13 else out there that would have standing and the ability to
14 file a lawsuit, whether it was under these complaints or
15 any other theoretical complaint that could have been
16 brought out there. I think that would be the only
17 possible third party I can envision right now.

18 COMMISSIONER GAW: Do you want to add
19 anything, Mr. England? I know -- I'm not trying to put
20 you totally on the spot here.

21 MR. ENGLAND: I'll give you an example
22 which I think is fairly simple, and that is that we would
23 want to preclude a third party from coming to this
24 Commission and filing the very same complaint that Staff
25 filed.

1 COMMISSIONER GAW: Yes.

2 MR. ENGLAND: Pursuing it. As Mr. Franson
3 correctly notes, to the extent they might or might not
4 have standing, that's another issue, but what we want to
5 do is put an end to this matter.

6 COMMISSIONER GAW: Yes. Did we talk -- I
7 think we did, but I can't recall the answer. Did we talk
8 about what this does in regard to Mr. Matzdorff himself,
9 this release?

10 MR. ENGLAND: He is included within the
11 release.

12 COMMISSIONER GAW: Is anyone else besides
13 Casstel or LEC? I think LEC's included.

14 MR. MIRAKIAN: Yes.

15 MR. ENGLAND: That's correct. Officers,
16 employees of both Casstel and LEC.

17 COMMISSIONER GAW: I see. Successors,
18 assigns, partners, agents, managers, officers and
19 employees. But this does just involve matters before the
20 Public Service Commission?

21 MR. ENGLAND: Under the Public Service
22 Commission law.

23 COMMISSIONER GAW: Under that law. So it
24 potentially could contemplate some other forum, not just
25 the Public Service Commission itself as the forum?

1 MR. ENGLAND: Then I don't think that
2 release might extend to that. If, as Mr. Franson
3 explained, a separate lawsuit were brought under a
4 separate forum --

5 COMMISSIONER GAW: Yes.

6 MR. ENGLAND: -- I'm not sure this release
7 would cover that.

8 COMMISSIONER GAW: Okay.

9 MR. ENGLAND: I guess unless they were
10 trying in that separate forum to enforce the Public
11 Service Commission law or provisions of the Public Service
12 Commission law.

13 COMMISSIONER GAW: Yes. I could see --
14 well, I'll stop there.

15 BY COMMISSIONER GAW:

16 Q. Mr. Schallenberg, do you think you could
17 give me some of those numbers that I asked for earlier in
18 regard to revenues that might have gone to investors,
19 might have gone to their benefit?

20 A. The LEC distributions, in fact, I was
21 thinking when you were just going through that last
22 matter, you asked a question --

23 MR. FRANSON: If I may, Mr. Schallenberg.
24 Commissioner Gaw, I believe it was around January 31st,
25 Staff did -- and this was a highly confidential pleading,

1 so I have to tread lightly here, but part of what we put
2 in there was a request that you made at the last hearing.

3 COMMISSIONER GAW: Is it already in?

4 MR. FRANSON: Yes, it's already in.

5 Mr. England had this readily available. It was filed on
6 January 31, 2006, would readily be available in EFIS, and
7 we could certainly provide it again, if need be.

8 COMMISSIONER GAW: Have you got a copy of
9 it there?

10 MR. FRANSON: I do.

11 COMMISSIONER GAW: Let me see it.

12 Mr. Franson, why don't you hand that to
13 Mr. Schallenberg for me.

14 MR. FRANSON: Certainly.

15 BY COMMISSIONER GAW:

16 Q. I'll avoid getting into the numbers in open
17 session. Mr. Schallenberg, could you take those numbers
18 from that -- from that document which -- what is that
19 again, Mr. Franson?

20 MR. FRANSON: That is a filing we made on
21 January 31 of 2006, at your request, and I believe among
22 other things includes some capital distributions to LEC,
23 and actually Mr. Schallenberg has it. He would be better
24 able to tell you exactly what it is.

25 BY COMMISSIONER GAW:

1 Q. Go ahead Mr. Schallenberg, if you know.

2 A. On Appendix 3.1 --

3 Q. Yes.

4 A. -- that provides you a schedule of the
5 distribution to the entities that own CassTel. LEC owns
6 99 percent.

7 Q. Yes.

8 A. Mr. Fiata and Lexicon own --

9 JUDGE WOODRUFF: Are we getting into
10 anything highly confidential here?

11 MR. ENGLAND: Not the immediate owners of
12 CassTel. When you get into the individual owners of LEC,
13 then I believe that is confidential.

14 THE WITNESS: Right, but that gives you the
15 total 100 percent ownership of CassTel. And what this
16 schedule shows you is that those entities had distribution
17 to their respective owners. Now, there is a document in
18 front of Appendix 3.1 that gives you the breakdown of the
19 names of the owners at LEC that makes up its owners.

20 BY COMMISSIONER GAW:

21 Q. Yes.

22 A. So if you were to look at the numbers on
23 3.1, you would see aggregate paid to those in the LEC
24 column.

25 Q. Okay.

1 A. And that goes from -- that covers the
2 entire period of LEC's ownership up until when the
3 information -- we no longer had information, which is
4 identified on the second page of Appendix 3.2.

5 Q. And do you think that represents all of the
6 benefits that might have gone to LEC?

7 A. That's all of the monies that was paid in
8 the form of distribution to the normal owner of LEC. As I
9 pointed out, some of the owners of LEC participated in
10 some of the activities where they received cash for
11 services that may not have even existed --

12 Q. Yes.

13 A. -- that would be other remuneration.

14 Q. That wouldn't be included there?

15 A. No. And it's hard --

16 Q. Go ahead.

17 A. What I was going to tell you is, if you
18 look at the page in front of that, it is -- you would need
19 to go to the Staff's report that was filed to supplement.
20 You had asked the questions about the releases, and we had
21 mentioned that the Staff's report was one of the bases.
22 And the record in the complaint as I recall has been
23 supplemented with the Staff's report, and the Staff's
24 report contains in the highly confidential portion what it
25 has done to translate what is on this page to identify

1 some of these owners to individual names.

2 Q. Okay. Backing off from individual names,
3 just in regard to this information, is there sufficient
4 information there for you to answer or for me to come up
5 to the answer that I was looking for earlier in regard to
6 whether or not there is -- there's been a net benefit to
7 the LEC investors over the course of their ownership of
8 CassTel?

9 A. This would tell you how much money they
10 have received.

11 Q. Right.

12 A. Now, as I pointed out earlier when you
13 asked me, I don't know how much they had to pay in terms
14 of income taxes.

15 Q. Yes.

16 A. It had been represented to me that these
17 amounts of monies were to be the equivalent of what their
18 tax bills were from the -- their respective shares of the
19 earnings of LEC. So in that case, other than these monies
20 went to the IRS, I have made no independent verification,
21 nor has anybody on the Staff, as to that representation.
22 I can tell you, you know, these monies went to the owners.

23 Q. All right. Well, if you made -- if you
24 made an assumption that those additional sum amounts were
25 distributed for purposes of taxes, and you -- could you

1 with those numbers and comparing what fines -- various
2 fines are being paid and what nets out to LEC after a
3 closing, if it occurs and this Commission approves this
4 matter, could you give me an idea of whether there's a net
5 benefit to the LEC investors with those assumptions?

6 A. If you look at the exhibit that we made up
7 today --

8 Q. Yes.

9 A. -- and you know from that exhibit that
10 \$12.7 million are unaccounted for right now.

11 Q. Yes.

12 A. Left after the proceeds. And as you can
13 see -- and that includes this \$5 million of escrow that
14 you don't know which way that's going to go, whether
15 they're going to get that or not, but they may get that
16 back.

17 Q. Okay.

18 A. If you look at the other items, such as
19 closing costs, business wind down, termination pay, and
20 since I know they are using consultants --

21 Q. Yes.

22 A. -- to do that, and they still have that
23 last liability piece with the FCC enforcement bureau out
24 there.

25 Q. Yes.

1 A. And if you go to the bottom of the page and
2 I know the LEC equity is 6.4.

3 Q. Okay.

4 A. If you have to put it in probabilities,
5 there's probably a significant probability that the owners
6 of LEC, when this is settled and with these amounts that
7 are in this filing were just to pay the income taxes, it
8 is likely that the owners of LEC will have lost their
9 principal by being owners of this enterprise.

10 Q. All right.

11 A. And that's different than what the value of
12 it would have been, what they would have gained, so -- but
13 it is likely that the amount of money they receive will be
14 less than the amount of cash out of pocket they invested
15 in LEC.

16 COMMISSIONER GAW: Okay. Should we have
17 this marked as an exhibit, Judge?

18 JUDGE WOODRUFF: You're talking about this
19 (indicating)?

20 COMMISSIONER GAW: Actually, the other
21 document that he's talking about that was filed.

22 MR. FRANSON: I would encourage we print
23 that out of EFIS. That is Mr. England's copy.

24 COMMISSIONER GAW: Oh, we were using
25 Mr. England's copy. Sorry about that.

1 JUDGE WOODRUFF: It can be marked.

2 COMMISSIONER GAW: Just so we be able to
3 refer to it.

4 JUDGE WOODRUFF: Certainly. Can somebody
5 get a copy of that for us to mark?

6 MR. WILLIAMS: Staff would have no problem
7 with the Commission taking notice of the filing of it.

8 COMMISSIONER GAW: Whatever's easiest to
9 do.

10 JUDGE WOODRUFF: It's already in the record
11 in the TC case, I believe.

12 MR. FRANSON: It's in EFIS, Judge, and
13 that's very different than being in --

14 JUDGE WOODRUFF: It's not in evidence in
15 this proceeding?

16 MR. FRANSON: Correct. But I would ask the
17 Commission at this time to take administrative notice of
18 that filing, and I would offer it into evidence at this
19 point. And I can certainly get copies if we need it, but
20 it is readily available there.

21 JUDGE WOODRUFF: I believe it is HC also,
22 you said?

23 MR. FRANSON: I believe HC, I believe.
24 With the exception of the cover pleading it is HC in its
25 entirety, yes.

1 JUDGE WOODRUFF: We'll go ahead and mark it
2 as 2HC, although I don't have a physical copy to give to
3 the court reporter but someone can obtain that for her,
4 I'm sure.

5 MR. FRANSON: We'll get you one very
6 shortly.

7 JUDGE WOODRUFF: Thank you.

8 MR. WILLIAMS: Judge, you'd be taking
9 notice of it for purposes of all three cases, I assume?

10 JUDGE WOODRUFF: Well, it will be -- assume
11 no one objects, it will be part of the evidence in this
12 case, or in all three cases as part of this proceeding.

13 MR. FRANSON: Your Honor, the copy will be
14 here shortly. It will not, however, include the cover
15 pleading, but it will include the rest of those.

16 JUDGE WOODRUFF: That's fine. And you have
17 offered that into evidence. Does anyone, any of the other
18 parties have any objection to that or do you want to have
19 a chance to see it first?

20 MR. DORITY: We are not a party to the TC
21 case, your Honor, so I don't have standing to object.

22 JUDGE WOODRUFF: At this point, I will
23 admit it into evidence, then.

24 (EXHIBIT NO. 2HC WAS RECEIVED INTO
25 EVIDENCE.)

1 COMMISSIONER GAW: I think, Judge, that's
2 all I have.

3 JUDGE WOODRUFF: All right. Commissioner
4 Appling, do you have anything you'd like to ask?

5 COMMISSIONER APPLING: Judge, I think just
6 one follow-up question, and I would like to ask this
7 question and all three of you can answer, Staff counsel,
8 OPC and Mr. Schallenberg. Is it still your position at
9 this point in time that this Commission approve the
10 Stipulation & Agreement?

11 MR. SCHALLENBERG: It is my opinion you
12 should, yes.

13 COMMISSIONER APPLING: OPC?

14 MR. DANDINO: The Office of Public Counsel
15 hopes the Commission approves the stipulation in both of
16 the cases and approves the recommendation of the Staff in
17 the other case.

18 COMMISSIONER APPLING: Staff?

19 MR. FRANSON: It is Staff's position that
20 you should approve the stipulations in the two cases and
21 approve the Staff recommendation in the sale of assets
22 case.

23 COMMISSIONER APPLING: Thank you.

24 JUDGE WOODRUFF: Commissioner Clayton?

25 COMMISSIONER CLAYTON: The only area of

1 questions that I was -- that I forgot to ask about when I
2 was inquiring earlier related to the intervenors' part of
3 the settlement, the \$500,000. Will it be paid in the same
4 manner out of the -- at the time of the closing, the funds
5 will be set aside and then distributed at that point? Is
6 that how that's contemplated?

7 MR. ENGLAND: That's correct. The only
8 difference, and they are listed by the way in the highly
9 confidential exhibit to the First Amended Stipulation, but
10 the payments are based on sort of relative amounts of
11 payments that have been paid for approximately a 16-month
12 period of time. In other words, the larger -- the access
13 customers who paid more will receive more, relatively
14 speaking, of the \$500,000.

15 COMMISSIONER CLAYTON: But the money gets
16 set aside in the same way at the closing and be
17 distributed?

18 MR. ENGLAND: That's correct.

19 COMMISSIONER CLAYTON: Now, is there an
20 agreement among the parties on how that money will be
21 spent?

22 MR. ENGLAND: I'm not sure I understand
23 your question.

24 COMMISSIONER CLAYTON: There's no agreement
25 that the money be set aside to pay for sending a CPN with

1 a Category 11 record or anything? No?

2 MR. ENGLAND: I'd better stay quiet on
3 that, your Honor.

4 COMMISSIONER CLAYTON: Got you. Thank you.

5 JUDGE WOODRUFF: Anything else that the
6 Commissioners would like to ask?

7 COMMISSIONER GAW: I would like to have
8 Commissioner Clayton's earlier question answered, even if
9 it's after the fact, by Ms. Dietrich, if we could have
10 some comments back in regard to FairPoint and any --
11 directly to the FCC or whoever that would be the
12 appropriate entity to inquire about whether or not there
13 are any issues. So -- in regard to USF. Is that
14 possible? Could there be a direct contact made? My
15 understanding, that question has not directly been asked.

16 JUDGE WOODRUFF: Ms. Dietrich, if you want
17 to come forward?

18 MS. DIETRICH: That's correct. We have not
19 directly asked about FairPoint.

20 COMMISSIONER GAW: But you could do that?

21 MS. DIETRICH: I don't see why not.

22 COMMISSIONER GAW: By this afternoon maybe?

23 MS. DIETRICH: We can try to contact
24 somebody this afternoon.

25 COMMISSIONER GAW: And I assume FairPoint

1 will tell me there are no issues?

2 MR. DORITY: That's what I'm about to tell
3 you. We're not aware of any issues at the FCC regarding
4 USF funds.

5 COMMISSIONER GAW: Yes. But if we could go
6 ahead and close that, unless someone objects. I know
7 that's not normally good evidence, but it would be helpful
8 to have someone just to give us verification since you
9 haven't asked the question directly.

10 MS. DIETRICH: Okay.

11 COMMISSIONER GAW: But that's helpful to
12 have FairPoint give us that representation.

13 MR. DORITY: Yes, sir.

14 BY COMMISSIONER GAW:

15 Q. And was there anything -- Mr. Schallenberg,
16 were you going to get me any additional information in
17 regard to the potential revenues, lost revenues from a
18 change in rates since the last rate case if that change of
19 rates had occurred or not? I can't remember.

20 A. I don't remember. I remember you asking me
21 if I knew --

22 Q. Yes.

23 A. -- what that would be.

24 Q. And you said you didn't know at the moment?

25 A. Right. And I remember we had talked

1 hypothetically or conceptual level that I had answered
2 you that our number would be -- our cost of service would
3 have been less if I had to remove that, but I don't
4 recall. I mean, I would have to create a hypothetical.
5 And then as I told you, I still don't know what the
6 settlement would have been, albeit the Staff would have
7 gone into it. I don't recall that there is a specific
8 calculation or number that could be given to you,
9 Commissioner.

10 Q. Okay.

11 A. I mean, we could do a study and try to come
12 up with one, but it is going to be very speculative as to
13 what that is, and just as a lot of things we do is subject
14 to debate and dispute.

15 Q. I suppose I could -- if I wanted to make
16 some very broad assumptions, I could look at what you've
17 testified to in regard to what it would be going forward
18 in Staff's position and just apply it to the last, what,
19 two years, two and a half years? How long has it been
20 since that case?

21 A. See, you had the on-the-record in '04,
22 early '04 because Mr. Matzdorff was arrested in August,
23 because I know that's when I got involved. The Order in
24 IR-2004-0354 on the prior earnings review --

25 Q. Yes.

1 A. -- was approved, the effective date was
2 May 9th of 2004.

3 Q. Okay.

4 A. So that's the time period that those
5 tariffs would have been in place. And as I remember,
6 there's a moratorium here as well, so you'd have to look
7 at -- that would terminate because you -- I know we didn't
8 honor or we didn't satisfy the moratorium requirement. I
9 don't know how long they were to be rates that were
10 subject to no Staff filing or challenge, so I don't
11 remember.

12 Q. Yes. The Commission itself wasn't bound by
13 any moratorium anyway?

14 A. That's correct. All of our commitments are
15 at the Staff level and they have a clause in it that that
16 can be -- that can be -- the Staff once directed from the
17 Commission to engage in an action will do so even if it's
18 contrary to the agreement in the stip.

19 COMMISSIONER GAW: Okay. Thank you, sir.
20 Thank you, Judge.

21 JUDGE WOODRUFF: Okay.

22 MR. FRANSON: Judge, if I may approach, I
23 have the copies of the exhibit, if I may approach. And
24 how many do you need? I know you need one for the court
25 reporter.

1 JUDGE WOODRUFF: We need one for the court
2 reporter for sure. Do any of the Commissioners want to
3 see it now?

4 COMMISSIONER GAW: Sure.

5 (EXHIBIT NO. 2HC WAS MARKED FOR
6 IDENTIFICATION BY THE REPORTER.)

7 MR. SCHALLENBERG: I have the moratorium in
8 that case was three years or 1,095 days following the
9 effective date of the Order, which I said was May 9th of
10 2004.

11 COMMISSIONER GAW: Okay.

12 MR. SCHALLENBERG: So you can see we would
13 effectuating changes before those.

14 COMMISSIONER GAW: Before that moratorium
15 was --

16 MR. SCHALLENBERG: Would have expired.

17 COMMISSIONER GAW: Yes.

18 MR. SCHALLENBERG: And that's a filing --
19 that's a filing moratorium, so there would be some delay
20 before rates would have been changed.

21 COMMISSIONER GAW: Okay. Thank you.

22 JUDGE WOODRUFF: All right. One other
23 matter to deal with. Commissioner Gaw requested that
24 Natelle Dietrich send some additional information this
25 afternoon. I believe the best way to handle that would be

1 to reserve a number for a post-hearing exhibit for that,
2 so we'll reserve No. 3 for that. And if she can go ahead
3 and file that as a post-hearing exhibit.

4 MR. WILLIAMS: That will be filed in all
5 three cases then.

6 JUDGE WOODRUFF: Yes. Any other matters
7 anyone wants to bring up while we're still on the record?

8 MR. ENGLAND: On some housekeeping, but for
9 purposes of the complaint case, do we need to make the
10 Stipulation & Agreement an exhibit in the earning case?
11 We have the first Stipulation & Agreement -- excuse me --
12 the Stipulation & Agreement, then we have the First
13 Amended Stipulation & Agreement, and in the sale case
14 there would be the Verified Application and exhibits
15 attached thereto, as well as Staff's recommendation.

16 Those seem to be sort of the operative
17 documents that we're all urging you to accept. I'll
18 follow your guidance or judgment on that, whether those
19 need to be made part of the record or not.

20 JUDGE WOODRUFF: Well, they're already part
21 of the record. They have not been referred to
22 specifically in this proceeding, so I don't know that they
23 need filed as exhibits for this proceeding, unless
24 somebody feels otherwise.

25 MR. FRANSON: Your Honor, I don't think

1 they need to be filed otherwise, but I would encourage
2 your Honor -- are you taking administrative notice for --
3 in each case of all of the other cases, the Commission
4 record therein? That probably would cover it.

5 JUDGE WOODRUFF: Yes. We'll do that.
6 Anything else anybody wants to bring up?

7 MR. ENGLAND: One final item. We, like
8 Staff and Public Counsel, would urge the Commission to
9 approve the Stipulations & Agreements in the complaint
10 case and in the earnings investigation case and the Staff
11 recommendation in the sale case.

12 We would also ask that you act as quickly
13 as possible. Missouri seems to be the linchpin right now
14 in a series of commission agency actions that need to be
15 taken before this can close, and we're hopeful that we can
16 get something from the Commission in the very near future
17 approving these agreements so we can then get Kansas's
18 approval and then move on to the FCC. But everyone seems
19 to be waiting for Missouri to act on this.

20 And my understanding is that there is an
21 anticipated or at least closing date of early July. So
22 that hopefully puts some frame of reference on the
23 urgency.

24 MR. MIRAKIAN: And I would add on behalf of
25 LEC actually that the July 3rd date is essentially a

1 drop-dead date in the purchase agreement. So if closing
2 doesn't happen by then, the purchase agreement will become
3 an open issue between FairPoint and the other parties, and
4 it could end up needing to be renegotiated. So the
5 urgency is very real.

6 MR. DORITY: On behalf of FairPoint
7 companies, we would like to echo that sentiment as well.
8 We would urge the Commission to act as quickly as
9 possible.

10 JUDGE WOODRUFF: All right. Thank you.
11 Anything further?

12 (No response.)

13 JUDGE WOODRUFF: With that, then, we are
14 adjourned. Thank you.

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