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July 18, 2002

Mr. Dale Hardy Roberts  
Secretary/Chief Administrative Law Judge  
Missouri Public Service Commission  
Post Office Box 360  
Jefferson City, MO 65102

**FILED<sup>3</sup>**

**JUL 18 2002**

**Missouri Public  
Service Commission**

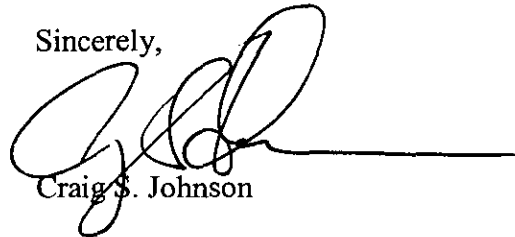
Re: Case No. TM-2002-465

Dear Secretary Roberts:

Enclosed please find an original and eight (8) copies of the Direct Testimony of Gary Godfrey. A copy of this letter and a copy of the enclosed Direct Testimony has been served upon all Attorneys of Record.

Thank you for seeing this filed.

Sincerely,



Craig S. Johnson

CSJ/mo

Enc.

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

**In the Matter of the Joint Application )  
of Northeast Missouri Rural Telephone )  
Company and Modern Telecom- )  
munications Company for Approval )  
to Merge Modern Telecommunications )  
Company and Northeast Missouri )  
Rural Telephone Company. )**

**Case No. TM-2002-465**

**FILED<sup>3</sup>**

**JUL 18 2002**

**DIRECT TESTIMONY**

**Missouri Public  
Service Commission**

**OF**

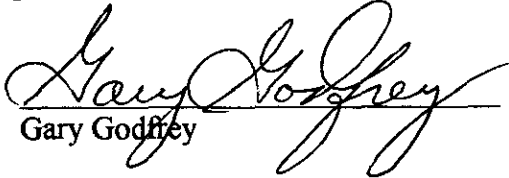
**GARY GODFREY**

Jefferson City, Missouri  
July 18, 2002

**AFFIDAVIT OF GARY GODFREY**

STATE OF MISSOURI     )  
  ) ss.  
COUNTY OF SULLIVAN     )

Gary Godfrey, of lawful age, on my oath states, that I have participated in the preparation of the foregoing testimony in question and answer form, consisting of 15 pages, to be presented in this case; that the answers in the foregoing testimony were given by me; that I have knowledge of the matters set forth in such answers; and that such matters are true to the best of my knowledge and belief.

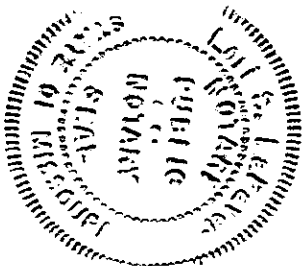
  
Gary Godfrey

Subscribed and sworn to before me this 9TH day of  
July, 2002.

  
Notary Public Lori S. LaFaver

My Commission Expires: 9/26/2004

**Lori S. LaFaver, Notary Public  
Sullivan County, State of Missouri  
My Commission Expires 9/26/2004**



1 **Q. Please state your name, capacity, and business address.**

2 A. My name is Gary Godfrey. I am office manager for both Northeast Missouri  
3 Rural Telephone Company (Northeast) and Modern Telecommunications Company  
4 (Modern). Joint Applicants in this merger proceeding. My business address is P.O. Box  
5 98, 718 South West Street, Green City, MO 63545. .

6 **Q. On whose behalf are you testifying.**

7 A. I am testifying on behalf of the joint applicants Modern and Northeast in support  
8 of their request for authority to merge Modern with and into Northeast, effective January  
9 1, 2003.

10 **Q. What topics will this testimony address?**

11 A. In this testimony I will address the benefits of this proposed merger to the  
12 customers of Modern. I will also address the absence of any detriment of this proposed  
13 merger to other customers of Modern or Northeast. I have arranged my testimony into  
14 the following topics:

- 15 1. Reasons underlying the Merger
- 16 2. Events preceding filing of the Application for Approval
- 17 3. Benefits to present Modern local customers
- 18 4. Lack of detriment to Northeast local customers
- 19 5. Lack of detriment to Northeast and Modern access customers
- 20 6. Other required approvals
- 21 7. Miscellaneous Issues
  - 22 a. earnings reviews
  - 23 b. AT&T and SWBT
  - 24 c. Membership fees

1 **Reasons underlying the Merger**

2 **Q. What are the reasons underlying the request for Approval of this proposed**  
3 **merger?**

4 A. Northeast Missouri Rural Telephone Company is an ILEC which has been  
5 operating in Northern Missouri since the early 1950's. Northeast owns and operates 11  
6 exchanges serving approximately 4,800 customers.

7 In 1996, Northeast acquired three GTE exchanges, Unionville, Memphis, and  
8 Queen City, now serving approximately 4,400 customers. These exchanges were  
9 acquired in order to improve the quality of service in these areas, and eventually to  
10 provide the benefits of a member-owned telephone cooperative to friends, family,  
11 neighbors, and business acquaintances in these areas.

12 For legal and regulatory reasons and due to time constraints, a wholly-owned  
13 subsidiary of the Cooperative, Modern Telecommunications Company, was utilized by  
14 Northeast to acquire these exchanges. Northeast made certain commitments to the  
15 Missouri Public Service Commission with respect to the acquisition. Those  
16 commitments included making significant investment in new plant to improve telephone  
17 service, to not file a rate case for several years, and not to include the acquisition  
18 premium—the amount the purchase price exceeded GTE's depreciated book value—in  
19 Modern's rate base.

20 Those commitments have been met, and the board of directors of Northeast  
21 believe that the time is ripe to finalize the acquisition plan by making Modern customers  
22 member-owners of Northeast alongside existing Northeast member-owners.

23

1 **Events preceding filing of the Application for Approval**

2 **Q. What transpired between that determination and the filing of the Application**  
3 **for authority to merge Modern into Northeast on March 27, 2002?**

4 A. With the assistance of legal and tax consultants, Northeast first reviewed the  
5 regulatory and lender approvals required to effectuate the merger, as well as the legal  
6 merger vehicle and tax considerations. The board of directors of Northeast notified the  
7 Northeast customers of this proposal in advance of its September 8, 2001 Annual  
8 Meeting. The notice stated the reasons for the merger, and announced that the board of  
9 directors desired a "straw" vote from the members regarding their reaction to the  
10 proposed merger. The straw vote was conducted at the 2001 Annual Meeting of  
11 Members with 467 members voting in favor, and 66 voting against the proposed merger.  
12 Based upon this advisory vote, Northeast's board determined to proceed.

13 On October 15, 2001, Northeast met with Staff to preview the merger and to give  
14 Staff an opportunity for input at that time. An Agreement and Plan of Merger was  
15 drafted. The Agreement was executed by Northeast on November 13, 2001, and by  
16 Modern on that same date. This is the Agreement submitted to the Commission with the  
17 Application on March 27, 2002.

18 Northeast/Modern staff also spent a great deal of time with the structural aspects  
19 of rolling the Modern tariffs and rates into Northeast's tariffs and rates. Modern still had  
20 some oddities in local and access rates remnant from the GTE rates. For example two of  
21 the Modern exchanges had a different local rate than the third Modern exchange. That  
22 third Modern exchange had the same residential local rate as all Northeast exchanges  
23 now have, but a different business rate. With respect to exchange access rates, each of

1 the Modern exchanges have different transport rates. Although the composite Modern  
2 access rate structure and level was similar to Northeast's there were individual rate  
3 element differences.

4 It was decided to assure that local customers did not experience local rate  
5 increases. It was also decided to blend the different access rates into a "blended"  
6 structure on a basis that would produce the same amount of access revenues for the  
7 merged entity as would have been achieved by Modern and Northeast separately.  
8 Realizing this could impact different interexchange carriers differently, it was decided to  
9 run this blending proposal by two of the largest interexchange carriers doing business in  
10 the Modern/Northeast service area—AT&T and SWBT. AT&T and SWBT both were  
11 presented the blending proposal in late 2001 or early 2002.

12 Later, on March 14, 2002, Northeast appeared at the Commission's agenda  
13 session and previewed the merger with those Commissioners present. The Application  
14 for Authority to merge was filed thereafter. On June 10, 2002 Northeast filed the  
15 proposed tariffs to include Modern exchanges and the proposed rates in Northeast's  
16 tariffs to effectuate the merger. These were docketed in a separate tariff proceeding.  
17 Those tariffs were proposed to become effective January 1, 2003, the same date the  
18 merger is proposed to become effective. I hope that the issues in this case are resolved in  
19 time to modify the proposed tariffs, if necessary, in time to become effective January 1,  
20 2003.

21 **Benefits to present Modern local customers**

22 **Q. What benefits do Modern and Northeast believe the merger will provide to**  
23 **the present Modern local customers?**

1 A. The main benefit to present local customers of Modern will be the opportunity to  
2 participate in the benefits of a cooperative. Northeast is operated as a member-owned  
3 cooperative. This means Northeast's local customers are its owners. Through patronage  
4 allocation and refund of "profits", the customers of Northeast participate in its "profits".  
5 Although the methodology for cooperatives are different than the methodology applying  
6 to stockholder dividends from investor-owned telephone companies, the concept is the  
7 same. The biggest difference is that cooperative "stockholders" are also the customers  
8 purchasing local service. For investor-owned telephone companies, there is no  
9 requirement that the stockholders be local customers.

10 As cooperative members, Northeast local customers are allocated the "profits" of  
11 Northeast each year as capital credits. These allocated capital credits are eventually  
12 refunded to the members. Currently Northeast is on an approximate 12 year "rotation".  
13 Northeast has refunded \$5,737,673 to members through the 1989 fiscal year. Northeast  
14 has \$13,301,165 allocated but as yet unrefunded capital credits.

15 As cooperative members, Northeast customers also participate in cooperative  
16 governance by choosing the Northeast board of directors, another benefit to local  
17 customers not provided in an investor-owned utility. The members are responsible for  
18 selecting the board of directors, which is responsible for establishing rules and  
19 regulations applicable to all customers as well as retaining operating personnel.

20 **Q. Will there be any additional costs or rate increases to present Modern local**  
21 **customers if the merger is approved?**

22 A. The merger has been structured so these customers will not have to pay the  
23 "membership fee"/single share purchase price otherwise required for membership. With



1 the exception of a \$5.00 charge for late bill payments and one specific combination of  
2 subsequent residential service connection charges, there is no new or increased charge for  
3 these customers. The late payment charge only applies to customers who fail to pay their  
4 bill on time. Northeast's customers are subject to this charge. There will be no local rate  
5 increases for present residential or business customers due to the merger.

6 **Q. Are there any other potential detriments to the Modern customers?**

7 A. The only one that I can think of is that, once they become a member of a  
8 cooperative, their local rates will not be subject to direct regulation by the Commission.  
9 This has not been a problem or issue for Northeast's local customers since this form of  
10 relaxed regulation for cooperatives went into effect. I believe that this theoretical  
11 detriment is more than outweighed by the benefits of profit participation and governance  
12 participation.

13 **Lack of detriment to Northeast local customers**

14 **Q. How has the merger been structured to assure there is no detriment to**  
15 **Northeast's local customers?**

16 A. Northeast local customers will see no local rate changes due to the merger. In  
17 addition, if the merger is approved, capital credit allocations will be structured to assure  
18 the pre-merger Northeast Members receive the benefit of the value of the investment in  
19 Modern carried on Northeast's books prior to the merger.

20 **Lack of detriment to Northeast and Modern access customers**

21 **Q. How has the merger been structured to assure there is no detriment to**  
22 **Northeast and Modern access customers?**

1 A. This is a more difficult consideration. Both Northeast and Modern have several  
2 IXCs originating and/or terminating traffic in the companies' exchanges. Different IXCs  
3 have different mixes of originating and terminating traffic. For example SWBT primarily  
4 only terminates intraLATA traffic. Other IXCs, including AT&T, originate and  
5 terminate both intraLATA and interLATA traffic. Further complicating this matter was  
6 existing access rates. Northeast has a uniform access rate. Modern, however, due to the  
7 rate structure inherited from GTE, has different transport rate elements for different  
8 exchanges.

9 As stated earlier, prior to filing the Application for Merger Approval, I calculated  
10 a single access rate structure for the surviving/merged entity. This structure was  
11 designed to be "revenue neutral" to the merged entity. This information was provided to  
12 both AT&T and SWBT, two of the largest access customers. I think it is fair to say that  
13 both AT&T and SWBT would prefer lower access rates than either Modern or Northeast  
14 currently have tariffed. This was a matter of some contention in Northeast's last rate  
15 proceeding, TR-2001-344. AT&T accepted the revenue neutral proposal and did not  
16 request intervention. SWBT did request intervention. The Commission granted  
17 intervention to both AT&T and SWBT.

18 At this stage it does not appear that there is agreement with respect to the  
19 proposed access rate structure. Although I believe the revenue neutral access structure  
20 does not operate to the detriment of IXCs as a whole, it is possible that individual IXCs  
21 could see some detriment, while other IXC's would see some benefit. A possible  
22 solution to this, which would require a new and different access tariff modification,  
23 would be simply to continue with existing Modern tariffed access rates under Northeast's

1 name and to continue with existing Northeast tariffed access rates as well. This would  
2 assure no IXC sees any rate change as a result of this merger. It would mean different  
3 access rates for different exchanges of “merged” Northeast. I will discuss this further  
4 later in this testimony.

5 **Other required approvals**

6 **Q. What other governmental, regulatory, or lender approvals will be required,**  
7 **besides the Commission’s approval, in order to effectuate the merger?**

8 A. First, we have a request pending with the Internal Revenue Service for a  
9 declaration that the merger would trigger no adverse tax consequences. Second, present  
10 lenders—the Rural Utility Services and the Rural Telephone Finance Cooperative, have  
11 been requested to approve this transaction and any modifications to existing loans or  
12 security documents. Third, upon approval by this Commission, there will be some FCC  
13 notification requirements, NECA notification requirements, and presenting the merged  
14 entities restated articles of incorporation to the Missouri Secretary of State. At this time I  
15 have no reason to believe any of these other approvals will not be forthcoming.

16 **Miscellaneous Issues**

17 **Q. What other issues do you believe are appropriately presented in this direct**  
18 **testimony?**

19 A. Based upon discussions, proceedings, prehearing conferences, and discovery  
20 requests, I believe it appropriate to address matters that are not resolved at this time, and  
21 which may be discussed in later testimony. These matters include the possibility of Staff  
22 conducting earnings reviews of Modern and/or Northeast as part of this proceeding, and  
23 my recommendation for how to handle those. Second, I would like to address potential

1 issues with AT&T and SWBT and my recommendation as to how to treat those issues.  
2 Third, I would like to address an issue associated with not charging existing Modern  
3 customers with the "membership fee" charged to cooperative members at the time they  
4 initiate service.

5 **a. earnings reviews**

6 **Q. What testimony do you want to present with respect to earnings reviews?**

7 A. As I have set forth above, this merger was presented with a local rate structure  
8 assuring that no Modern or Northeast local customer would see any local rate increase as  
9 a result of the merger. In fact some will see decreases. The access structure proposed  
10 was proposed to be revenue neutral for Modern/Northeast. Rates were proposed in this  
11 manner specifically to avoid the possibility revenue or earnings considerations would be  
12 called in to question by the merger. The overriding purpose of the merger is to bring the  
13 benefits of cooperative membership to Modern customers.

14 Staff has submitted data requests indicating it may be reviewing the current status  
15 of Modern's earnings. However I am unsure if Staff has or will also review the current  
16 status of Northeast's earnings.

17 I am concerned that the issues that may arise with respect to earnings reviews will  
18 prevent the merger from being effected by January 1, 2003.

19 **Q. What do you suggest that the Commission and/or the parties do in this**  
20 **regard?**

21 A. First, I suggest that any earnings reviews be conducted separately from this  
22 merger proceeding. Any such review of either Modern and/or Northeast can be  
23 conducted separate and apart from the merger, without any delay resulting to the merger

1 proceeding, or from the merger proceeding. The results can be applied to the merged  
2 entity if the merger is approved. If the merger is not approved, the results can be applied  
3 to Northeast and/or Modern separately.

4 Second, if Staff insists upon conducting its review as part of this merger  
5 proceeding, I believe that Staff should simultaneously review the earnings of both  
6 Modern and Northeast. This will facilitate a fair review of the combined earnings of the  
7 two companies proposed to be merged. This review could be initiated now, and  
8 concluded either before or after the merger without directly impacting the merger itself.  
9 Northeast and Modern would be willing to use the "imputed" local rate concept utilized  
10 for access/local rate design purposes in Northeast's last earnings case, TR-2001-344.

11 **b. AT&T and SWBT**

12 **Q. You mentioned the likely issues that may be raised by AT&T and SWBT**  
13 **earlier in your testimony. Do you have a proposed solution that would be**  
14 **satisfactory?**

15 **A.** Yes I believe I do. Instead of the blended access rate proposal we initially made, I  
16 believe SWBT will make a proposal placing more rate reduction on the terminating  
17 intraLATA carrier common line (CCL) access rate element. This would result in the  
18 most savings for SWBT. I don't believe AT&T will agree to SWBT's proposal. I  
19 believe AT&T is likely to make a proposal different from either SWBT's or the proposal  
20 made by Modern/Northeast.

21 This has the potential to be an issue consuming a great deal of time and resources.  
22 My proposed solution is to simply carry forward Modern's existing rates for its three  
23 exchanges through the merged entity, and also to carry forward Northeast's existing rates

1 for its present exchanges. This will assure all IXCs that they will see absolutely no rate  
2 change as a result of this merger. No IXC could contend it was being adversely effected  
3 by the merger. It would require minor tariff modifications which can easily be done.

4 **Q. Why didn't you propose this initially?**

5 A. It is customary for a LEC to have a single access rate for all exchanges. I have  
6 traditionally viewed Modern's different transport rates for different exchanges as an  
7 aberration. I originally assumed that eliminating this aberration and proposing a uniform  
8 access rate for all exchanges of the merged entity would be the structure to propose. I  
9 may have been somewhat naïve in anticipating SWBT and AT&T would agree to the  
10 blended revenue neutral rate proposal. Now that they have not indicated agreement,  
11 Northeast and Modern are hereby proposing to continue existing access rates without  
12 change. It is my belief this will eliminate the legitimacy of any objection any IXC may  
13 have.

14 This structure is not completely unheard of. Apparently GTE used it before  
15 Modern acquired its three former GTE exchanges. Modern has used this structure for the  
16 past several years. As I understand it CLECs have different access rate caps in different  
17 exchanges depending upon which incumbent's exchange they are in.

18 In future rate proceedings for the merged entity the parties could take up the issue  
19 of whether to continue or eliminate the differing rate structure without impeding this  
20 merger proceeding.

21 **c. Membership fees**

22 **Q. Please set forth the concerns about membership fees?**

1 A. As a cooperative, Northeast requires new customers to pay a "membership fee" of  
2 \$10.00 at the time of initiating service. This fee is refunded to them at the time of  
3 termination of service. Modern, Northeast, and OPC are in agreement that the Modern  
4 customers of December 31, 2002 should not be charged the membership fee due to the  
5 merger. We did not want to have to bill, collect, or consider the consequences of non-  
6 payment of such an attempt. It would also have created an immediate \$10.00 detriment  
7 issue we did not want complicating this proceeding. We have worked out a customer  
8 notice with OPC that would so inform the Modern customers.

9 It was the original plan that, after the merger was implemented, Northeast would  
10 refund its outstanding membership fees. This would assure that Northeast members were  
11 not treated worse than the transferred Modern customers. However, in reviewing  
12 corporate documents, counsel advised that this created a legal problem. Northeast is a  
13 Chapter 351 chartered general business corporation. Its articles and bylaws create the  
14 cooperative operating structure. A consequence is that Northeast's membership  
15 certificates are considered under state law to be corporate stock which cannot be issued  
16 by Northeast for free.

17 To avoid this issue, Modern and Northeast thereafter proposed to Staff and OPC  
18 to have Modern contribute the membership fees for the transferred Modern customers to  
19 Northeast. Thereafter the membership fee requirement would remain intact for new  
20 customers. This would allow us to meet the commitment that Modern customers  
21 transferred to Northeast on the effective date of the merger not be charged a membership  
22 fee. This would also avoid the legal issue We also requested that the amount of this

1 contribution be considered an expense of the merger. We have yet to hear from Staff and

2 OPC in this regard, but are in hopes it can be agreed to.

3 **Q. Does this conclude your direct testimony?**

4 **A. Yes.**