

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

An Investigation of the Fiscal and Operational)
Reliability of Cass County Telephone Company)
and New Florence Telephone Company, and) Case No. TO-2005-0237
Related Matters of Illegal Activity.)

**Staff's Response to CassTel and New Florence
Telephone Company's Motion to Quash**

COMES NOW the Staff of the Public Service Commission and, for its suggestions to the Commission regarding Cass County Telephone Company's and New Florence Telephone Company's motion to quash *subpoena*, states:

1. Cass County Telephone Company, LP ("Cass County") and New Florence Telephone Company ("New Florence") have objected to the Commission's *subpoenas* directed to each of them for work papers of their outside auditors—Mize, Houser & Company and Warinner, Gesinger & Associates, LLC. Their grounds for objection are that the work papers are "protected from disclosure under the statutory accountant-client privilege" and that the requests in the *subpoenas* are overbroad and seek irrelevant information.

ACCOUNTANT-CLIENT PRIVILEGE

2. Before turning to the merits of the objections, the Staff emphasizes that it is the utilities that the Commission regulates, Cass County and New Florence, who are claiming the accountant-client privilege in an effort to thwart disclosure of information to the Commission. Further, New Florence filed in this case on February 23, 2005 a motion seeking Commission certification to receive Federal Universal Service Funds based, in part, on it having provided to the Staff on December 23, 2004 an independent, third-party audit. Work papers from that audit are within the scope of the *subpoena* directed to New Florence.

3. Cass County and New Florence rely on Section 326.322.2 RSMo Supp. 2004 for the privilege they assert applies. Section 326.322.2 RSMo Supp. 2004 provides:

A *licensee* shall not be examined by *judicial process or proceedings* without the consent of the licensee's client as to any communication made by the client to the licensee in person or through the media of books of account and financial records, or the licensee's advice, reports or working papers given or made thereon in the course of professional employment, nor shall a secretary, stenographer, clerk or assistant of a licensee, or a public accountant, be examined, without the consent of the client concerned, regarding any fact the knowledge of which he or she has acquired in his or her capacity as a licensee. This privilege shall exist in all cases except when material to the defense of an action against a licensee. (Emphasis added.)

Cass County and New Florence focus on the last sentence of the statute and argue that it means that the privilege applies more broadly than the limitation of the first sentence that the accountant-client privilege applies in examinations by “judicial process or proceedings.”

NO SHOWING PRIVILEGE APPLIES

4. Cass County and New Florence state: “Warinner, Gesinger & Associates, LLC and Mize, Houser & Company are certified public accounting firms hired by the Companies to perform auditing services. As such, the auditors fall squarely within the scope of the language of §326.322.2.” The language of §326.322.2, quoted above, refers to “licensees” not “certified public accounting firms.” “Licensee” is defined in §326.256(10) to be “the holder of a license as defined in this section.” “License” is defined in §326.256(9) to be “a license issued pursuant to section 326.280, or a provisional license issued pursuant to section 326.283; or, in each case, an individual license or permit issued pursuant to corresponding provisions of prior law.” These sections refer to licenses held by *individuals*. “Certified public accounting firm” is defined in §326.256(6) as “a sole proprietorship, a corporation, a partnership or any other form of organization issued a permit pursuant to section 326.289.” It is unclear that Cass County and New Florence meant the definition of certified public accounting firm of §326.256(6); in any

event, their assertion is unsupported in their motion to quash. For this reason alone the assertion of privilege in the motion should be denied.

STANDARD FOR ESTABLISHING SCOPE OF STATUTORY PRIVILEGE

5. Further, in *State ex rel. Southwestern Bell Publications v. Ryan*, 754 S.W.2d 30, 31 (Mo. App. 1988), the Court stated, regarding a predecessor statute to the one at issue here:

No accountant-client privilege existed at common law. In Missouri the privilege was created by the 1967 legislative enactment of section 326.151. A claim of privilege, because it presents an exception to the usual rules of evidence and may constitute an impediment to the discovery of truth, is subject to careful scrutiny. *State ex rel. Chandra v. Sprinkle*, 678 S.W.2d 804, 807 (Mo. banc 1984).

In the foregoing case the Court held that by putting its financial condition in issue, the plaintiff had waived the privilege with regard to discovery. Similarly, in the case *State ex rel. Schott v. Foley*, 741 S.W.2d 111 (Mo. App. 1987), the Court held that the privilege codified in § 326.151 did not bar discovery of a prior accountant's communications when they might be material to the defenses of comparative negligence and assumption raised by a defendant accountant.

6. A fuller explanation of how statutory privileges are to be viewed is found in case, *State ex rel. Health Midwest Development Group, Inc. v. Daugherty*, 965 S.W.2d 841, 843-45 (Mo. Banc 1998). In that case it was claimed that health care peer review committee documents were privileged from discovery under section 537.035.4 RSMo and the Missouri Supreme Court said:

At common law, there is no privilege for documents of peer review committees. *State ex rel. Chandra v. Sprinkle*, 678 S.W.2d 804, 807 (Mo. banc 1984). In order not to be subject to discovery, the disputed documents must fall within a statutory privilege.

* * * *

Such narrower interpretations contradict the general principles that govern privileges. Statutes creating privileges are strictly construed. *State v. Kurtz*, 564 S.W.2d 856, 860 (Mo. banc 1978). Claims of privilege are "impediments to

discovery of truth," "present an exception to the usual rules of evidence," and "are carefully scrutinized." *Chandra*, 678 S.W.2d at 807. Statutes creating privileges "must be strictly construed and accepted 'only to the very limited extent that permitting a refusal to testify or excluding relevant evidence has a public good transcending the normally predominant principle of utilizing all rational means for ascertaining truth.'" *Trammel v. United States*, 445 U.S. 40, 50, 100 S.Ct. 906, 912, 63 L.Ed.2d 186 (1980), quoting *Elkins v. United States*, 364 U.S. 206, 234, 80 S.Ct. 1437, 1454, 4 L.Ed.2d 1688 (1960) (Frankfurter, J., dissenting). In cases with the statutory subject matter, the legislature has determined that relevant evidence should not be excluded. Since privileges are impediments to the truth, and statutes creating them are strictly construed, the peer review privilege in section 537.035 does not apply at all when an entity is sued for actions of its peer review committee that restrict staff privileges. Here, at least the Executive Medical Committee acted to restrict Dr. Vajaranant's privileges. Therefore, subsection 4 does not apply in this case, and the trial court's order does not violate any peer review privilege.

7. Similarly, in a recent case, the Western District Court of Appeals, in reviewing a claim of error in a criminal case for excluding evidence on the basis it was a privileged communication to "clergy" protected by section 491.060(4) RSMo, the Court stated, "Statutes creating 'testimonial privileges are to be strictly construed against the privilege.'" *State v. Gerhart*, 129 S.W.3d 893 (Mo. App. 2004) quoting from *Rodriguez v. Suzuki Motor Corp.*, 996 S.W.2d 47, 61-62 (Mo. banc 1999).

8. "'The primary rule of statutory construction is to ascertain the intent of the legislature from the language used, to give effect to that intent if possible, and to consider the words used in their plain and ordinary meaning.'" *Wolff Shoe Co. v. Director of Revenue*, 762 S.W.2d 29, 31 (Mo. banc 1998). When construing a statute, the Court considers the object the legislature seeks to accomplish and aims to resolve the problems addressed therein. *Gott v. Director of Revenue*, 5 S.W.3d 155, 159 (Mo. banc 1999)." *Nixon v. QuikTrip Corp.* Slip Op. SC 85399 (Mo. Banc March 30, 2004).

PUBLIC POLICY

9. The Legislature has set out in §326.253 RSMo Supp. 2004 the policy of the state and purposes of Chapter 326, which includes §326.322, as follows:

It is the policy of this state and the purpose of this chapter to promote the reliability of information that is used for guidance in financial transactions or for accounting for or assessing the financial status or performance of commercial, noncommercial and governmental enterprises. The protection of the public interest requires that persons professing special competence in accountancy or offering assurance as to the reliability or fairness of presentation of such information shall have demonstrated their qualifications to do so, and that persons who have not demonstrated and maintained such qualifications not be permitted to represent themselves as having such special competence or to offer such assurance; that the conduct of persons licensed as having special competence in accountancy be regulated in all aspects of their professional work; that a public authority competent to prescribe and assess the qualifications and to regulate the conduct of certified public accountants be established; and that the use of titles that have a capacity or tendency to deceive the public as to the status or competence of the persons using such titles be prohibited.

10. While stated in the context of a dispute over the extension of an electric transmission line in 1930, the statements made by and statutes cited by the Missouri Supreme Court sitting *en banc* that follow are still applicable with regard to the Public Service Commission today:

Section 10412, Rev. St. Mo. 1919 [now §386.040] provides that "a public service commission is hereby created and established, which said public service commission shall be vested with and possessed of the powers and duties in this chapter specified, and also all powers necessary or proper to enable it to carry out fully and effectually all the purposes of this chapter." (Italics ours.)

The Public Service Commission Act provides a complete system for the regulation of public utilities by the commission. *State ex inf. v. Gas Co.*, 254 Mo. 515, 534, 163 S. W. 854, 857; *State ex rel. Public Service Commission v. Mo. Southern Ry. Co.*, 279 Mo. 455, 464, 214 S. W. 381, 384. Without lengthening this opinion with a summary of all statutes which vest authority in the Public Service Commission to regulate public utilities and their activities, we refer the reader to sections 10410 to 10434 and sections 10476 to 10494, Rev. St. Mo. 1919.

In the two cases above cited the Public Service Commission Act is reviewed and construed. In *State ex inf. v. Gas Co.* we said: "That act is an elaborate law bottomed on the police power. It evidences a public policy hammered out on the anvil of public discussion. It apparently recognizes certain generally accepted economic principles and conditions, to wit: That a public utility * * * is in its nature a monopoly; that competition is inadequate to represent the public, and, if it exists, it is likely to become an economic waste; [325 Mo. 1224] that state regulation takes the place of and stands for competition; that such regulation, to command respect from patron or utility owner, must be in the name of the overlord, the state, and, to be effective, must possess the power of intelligent visitation and the plenary supervision of every business feature to be finally (however invisible) reflected in rates and quality of service. It recognizes that every expenditure, every dereliction, every share of stock, or bond, or note issued as surely is finally reflected in rates and quality of service to the public, as does the moisture which arises in the atmosphere finally descend in rain upon the just and unjust. Willy nilly."

In *State ex rel. Public Service Commission v. Missouri Southern Ry. Co.*, supra, we said: "The act adds to the powers expressly given to the commission all others necessary to the full and effectual exercise of those powers. [See §386.250(7)] All rates, fares, facilities, service, and equipment, and changes therein, fall within the authority of the commission. Adequate service and facilities are expressly required to be furnished. Questions relative to these things are to be determined by the commission."

Public Service Commission v. Kansas City Power & Light Co., 325 Mo. 1217, 31 S.W.2d 67, 70-71 (banc 1930). In addition, the Legislature has in §386.330.1 specifically authorized the Commission to investigate acts of telecommunications companies subject to its jurisdiction. Further, in §386.450 RSMo the Legislature has empowered the Commission to require of a "corporation," "person" or "public utility" the production of "books, account, papers or records."

11. In reviewing the accountant-client privilege of §326.322 with respect to an inquiry by the Missouri Public Service Commission, the Legislative policy and purpose of Chapter 326 "to promote the reliability of information that is used for guidance in financial transactions or for accounting for or assessing the financial status or performance of commercial, noncommercial and governmental enterprises" must be viewed against the purpose of the Public Service Commission Act to take the place of competition. This substitution for competition

includes commanding respect from utility owners and requires “the power of intelligent visitation and the plenary supervision of every business feature to be finally (however invisible) reflected in rates and quality of service.” Further, effectively substituting for competition includes recognition “that every expenditure, every dereliction, every share of stock, or bond, or note issued as surely is finally reflected in rates and quality of service to the public, as does the moisture which arises in the atmosphere finally descend in rain upon the just and unjust, willy-nilly.”

12. Courts in other jurisdictions that have statutory accountant-client privileges have characterized them as ensuring privacy, or preventing public disclosure, of information passed between the accountant and his client. See e.g. *Ernst & Ernst v. Underwriters National Assurance Company*, 178 Ind. App. 77, 381 N.E.2d 897, 903 (Ind. App. 1978). To the extent that is a purpose of the privilege in Missouri, allowing the Commission to access information passed between the accountant and his client will not automatically make that information public. Section 386.480 RSMo provides:

No information furnished to the commission by a corporation, person or public utility, except such matters as are specifically required to be open to public inspection by the provisions of this chapter, or chapter 610, RSMo, shall be open to public inspection or made public except on order of the commission, or by the commission or a commissioner in the course of a hearing or proceeding. The public counsel shall have full and complete access to public service commission files and records. Any officer or employee of the commission or the public counsel or any employee of the public counsel who, in violation of the provisions of this section, divulges any such information shall be guilty of a misdemeanor.

Further, the Commission issued a protective order on February 25, 2005 that limits disclosure of information filed in this case. On public policy considerations alone the Commission should reject the claim of privilege.

PRIVILEGE UNAVAILABLE IN ADMINISTRATIVE PROCEEDINGS

13. As stated in paragraph 3 above, the privilege applies only where there is *judicial process or proceedings*. That the Courts and Legislature distinguish administrative proceedings and process for judicial proceedings and judicial process should be beyond question. In *Davis v. Board of Education of the City of St. Louis*, 963 S.W.2d 679, 686 App. 1998), the Court recognized the difference between judicial and administrative proceedings when it stated the following regarding actions for malicious prosecution:

This element [commencement of an earlier suit against the plaintiff] can only be satisfied if a malicious prosecution claim can be based on an administrative proceeding. The parties agree that no Missouri court has recognized a claim for malicious prosecution premised on an administrative proceeding. The verdict-directing instruction for malicious prosecution is limited to the instigation of a judicial proceeding.

Further, in cases discussing the Jones-Munger Act, Missouri courts have stated that the Legislature replaced judicial proceedings with administrative proceedings as the method for foreclosing tax liens. See *Stadium West Properties, L.L.C. v. Johnson*, fn. 6, Slip Op. WD 63020 (Mo. App. March 16, 2004).

14. The Legislature, with H.B. 613 in 2003, amended §510.120 to include “administrative proceedings” as matters in which a continuance may be granted when members of the general assembly are representing clients and certain legislative-related events are taking place. The Legislature has made it a crime to tamper with a “judicial proceeding,” §575.260 and it has made it a crime to disturb a “judicial proceeding,” §575.250. The Legislature has recognized “judicial process” in §100.520 stating that in certain circumstances certain property will be “exempt from levy and sale by virtue of an execution, and no execution or other judicial process shall issue against the same” It has also used the terms “process” and “judicial proceedings” in §532.430 regarding *habeas corpus* relief stating “If it appear that the prisoner is

in custody by virtue of process from any court legally constituted, or issued by any officer in the service of judicial proceedings before him,”

15. The seventh edition of Black’s Law Dictionary defines “process” to be “the proceedings in any action or prosecution”; or “a summons or writ, especially to appear or respond in court” and it defines “judicial proceeding” to be “any court proceeding.”

EX REL. ARKANSAS POWER & LIGHT COMPANY

16. Cass County and New Florence cite to a judgment of the Cole County Circuit Court in *Ex rel. Arkansas Power & Light Company v. Public Service Commission*, Case No. CV186-147CC made April 22, 1986 in which the Court, in a *writ of prohibition* case, found the predecessor statute that was the subject of the cases cited in paragraph 5 above—§ 326.151—applied to a discovery request by the Staff made for external auditor work papers and that the Commission could not seek the work papers or a penalty for violation of a Commission order for not producing them. In response, first it should be noted that the statute in question in that case is not the statute offered in this case. Further, the Staff argues that the Court reached a wrong result in that proceeding that regardless, does not establish a principle of law that is binding on the Commission beyond that case since it was not reviewed or sustained by a higher court.

17. In light of all the foregoing, the accountant-client privilege codified in §326.322 is not available to Cass County or New Florence in this administrative proceeding.

18. In making its suggestions regarding the scope of the *subpoenas* the Staff was aware of the time periods where Mize, Houser & Company and Warinner, Gesinger & Associates, LLC provided external auditor services to Cass County and New Florence and intended to obtain audit work papers back as far as for calendar year 1996. If the Commission feels that the *subpoenas* should have an express limitation in time, then that limitation should be

1996, or earlier. As the Commission is aware, it sets rates on a cost basis. Included in that cost is the cost of plant and depreciation of that plant. To the extent that the Staff can comfortably rely on them, external auditor reports will speed the inquiry the Commission has ordered in this case. To assist the Commission in understanding the value to the Staff of the external auditor's work papers, the Staff points out that the second auditor has made restatements to a prior audit of year 2003 for Cass County, but the Staff is unable to decipher from the audit itself the bases for the adjustments. The auditor work papers should disclose that information. Thus, the request is reasonably calculated to lead to the discovery information relevant to the scope of the inquiry the Commission has ordered in this case.

SCOPE OF THIS INVESTIGATION CASE

19. The scope of the Commission's order and recommendations made by the Staff that it is pursuing, as set out in the Staff's suggestions in response to LEC, LLC's motion to quash *subpoenas*, are set out again in the paragraphs following.

20. The Commission stated in the ordering clauses of its Order Establishing Investigation Case that it established this Case No. TO-2005-0237 for the purpose of investigating the "financial and operational status of any certificated company in which Mr. Kenneth Matzdorff has any ownership interest or any operational control or influence resulting from his role as an officer or employee of such company."

21. In the ordering clauses of that same order the Commission directs its Staff to "undertake any discovery, audit, investigation, or other action it deems appropriate to investigate the financial and operational status of any certificated company in which Mr. Kenneth Matzdorff has any ownership interest or any operational control or influence resulting from his role as an

officer or employee of such company,” and to “investigate any matters pertaining to the Universal Service Fund and report any irregularities to the Commission.”

22. In the synopsis section near the beginning of its order the Commission stated, “This order establishes as case within which the Staff of the Public Service Commission is directed to investigate all matters pertaining to the operations of two Missouri telecommunications utilities, Cass County Telephone Company (“Cass County”) and New Florence Telephone Company (“New Florence”)” and “As a result of this order, Staff is directed to investigate the continuing fiscal and operational reliability of telecommunications service for the customers of these companies.”

23. The Commission also made several statements in the body of its order. Commencing on page 4, the Commission stated, “. . . [T]he Staff of the Commission is hereby directed to investigate all matters pertaining to the operations of the companies, including assessment of the continuing fiscal and operational reliability of telecommunications service for the customers of Cass County and New Florence.” On page 5 the Commission stated, “Staff is hereby directed to complete a financial review concerning the receipt and disbursement of Universal Service Funds.” Commencing on page 5 and continuing to page 6, the Commission references section 386.570 RSMo 2000 regarding violations of law and failure to Commission orders and stated, “Staff shall pursue evidence of any circumstances discovered during the course of its investigation.” On page 6 the Commission stated, “Staff shall also review the conduct of the officers and employees of these companies to determine whether either company has suffered a financial loss, or other damage, as a result of illegal acts.” The Commission also stated, on page 7, “The primary concern of the Commission is the ongoing safe and reliable provision of

telecommunications services to the citizens of Missouri. Staff's goal in this investigation should be to ensure the viability of those services."

24. In addition to the statements made by the Commission in its order that established this case, on February 25, 2005, the Staff filed in this Case No. TO-2005-0237 its initial report regarding the impact of the allegations of criminal conduct by Kenneth Matzdorff on Missouri utility consumers. In that initial report the Staff made the following sixteen recommendations:

1. Kenneth M. Matzdorff relinquish all managerial and financial authority for Cass County Telephone Company LP.
2. Rebecca Matzdorff be suspended by the Company from all managerial and financial authority for Cass County Telephone Company LP pending the completion of the Staff's investigation as directed by the Commission in Case No. TO-2005-0237.
3. Controller Debi Long relinquish all authority regarding any receipts and disbursements of Cass County Telephone Company LP funds pending the completion of the Staff's investigation as directed by the Commission in Case No. TO-2005-0237.
4. The Staff explore all options to eliminate the role of LEC LLC regarding the ownership, financing, operation and financial affairs of Cass County Telephone Company LP and New Florence Telephone Company.
5. The Staff initiate an earnings review and audit of New Florence Telephone Company.
6. The Staff initiate an earnings review and audit of Cass County Telephone Company.
7. The Staff initiate management audits of both Cass County Telephone Company and New Florence Telephone Company, to include but not be limited to: 1) quality of service, 2) the operations of the business office, and 3) related party transactions safeguards and controls.
8. The Staff monitor the operation of the Oregon Farmers under its new ownership arrangement and examine the reasonableness of internal controls relative to prior related party transactions.

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

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

11. The Staff depose Kenneth Matzdorff, Rebecca Matzdorff and Controller Debi Long regarding the scope of their non-Missouri regulated telephone company activities, current Cass County operations, relationship and operation of LEC LLC, relationship and operation of Haug Construction, relationship and operation of Local Exchange Carriers, LLC, relationship and operation of the other firms identified in Section 5, 11 and identification of other firms related to Mr. Matzdorff that have not yet been identified.

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

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

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

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

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

While the Commission has not formally adopted these recommendations, it has not rejected them either. The Staff is taking steps to implement its recommendations.

WHEREFORE, for all the foregoing reasons, the Staff recommends that the Commission deny the motion to quash the *subpoenas* to Cass County Telephone Company LP and New Florence Telephone Company.

Respectfully submitted,

DANA K. JOYCE
General Counsel

/s/ Nathan Williams

Nathan Williams
Senior Counsel
Missouri Bar No. 35512

Attorney for the Staff of the
Missouri Public Service Commission
P. O. Box 360
Jefferson City, MO 65102
(573) 751-8702 (Telephone)
(573) 751-9285 (Fax)
nathan.williams@psc.mo.gov

Certificate of Service

I hereby certify that copies of the foregoing have been mailed, hand-delivered, transmitted by facsimile or electronically mailed to all counsel of record this 22nd day of April 2005.

/s/ Nathan Williams