

**STATE OF MISSOURI
PUBLIC SERVICE COMMISSION**

At a session of the Public Service
Commission held at its office in
Jefferson City on the 14th day
of June, 2005.

In the Matter of Alma Communications Company,)	
doing business as Alma Telephone Company, for)	
Authority and Approval to Issue a Note, Loan)	
Agreement, Mortgage, Security Agreement, and)	<u>Case No. TU-2005-0358</u>
Financing Statement to Borrow Funds from the)	
Rural Utility Services of the United States of America,)	
for Interim Financing, and for Section 392.280.2,)	
RSMo (HB 360) Accounting Authority Orders.)	

ORDER APPROVING FINANCING APPLICATION

Issue Date: June 14, 2005

Effective Date: June 24, 2005

Procedural History:

On April 8, 2005, Alma Communications Company, doing business as Alma Telephone Company,¹ filed its Application seeking authority to borrow certain funds and to pledge part of its system assets as security for the loan. Alma simultaneously filed its Motion for Protective Order.

Alma states that it is a small, rural incumbent local exchange carrier ("ILEC") with some 350 customers in a single exchange just north of Concordia, Missouri. Alma seeks authority to borrow up to \$5,579,000 from the Rural Utility Services Administration ("RUS") of the United States Department of Agriculture in order to upgrade its network and purchase a new switch. The project, as planned, will take two years. Alma also seeks

¹ Presumably, the reference to Alma of Missouri, Inc., at page 3 of the Application is an error.

approval to borrow funds as interim financing until the proceeds of the loan from RUS become available. Because Alma's last major project was more than 30 years ago, Alma presently has no debt and its capital structure is 100 percent equity. However, if the present application is approved, Alma will be left with an unusually high level of debt.

Also as part of the proposed transaction, Alma seeks certain Accounting Authority Orders ("AAOs") pursuant to Section 392.280.2, RSMo Supp. 2004 (HB 360).

That provision states:

Notwithstanding the provisions of subsection 1 of this section, a telecommunications company may request the commission to authorize minimum depreciation rates in lieu of fixed rates, and to record depreciation expense on the basis of depreciation rates in excess of such minimum rates. The reasonableness of any request for an increase in the tariffed rates for noncompetitive telecommunications service shall be considered on the basis of the minimum authorized depreciation rates, and the depreciation expense attributed to any test period shall be calculated on the basis of the company's minimum depreciation rates regardless of the depreciation expense actually recorded by the telecommunications company. Where minimum depreciation rates have been authorized pursuant to this subsection, the commission may prescribe new minimum depreciation rates in a general rate proceeding and use those new minimum depreciation rates to determine the reasonableness of tariffed rates for telecommunications service in that general rate proceeding. In any proceeding to consider a request for an increase in the tariffed rates for telecommunications service, the telecommunications company shall utilize for the purposes of such proceeding the depreciation reserve levels which have occurred on the basis of the recorded depreciation expenses.

Under this section, Alma seeks authority to book almost \$300,000 in extraordinary retirements and to use certain proposed depreciation rates "which will more appropriately reflect the actual useful life of modern technology, plant, and equipment[.]"

The Commission's Staff filed its Memorandum and Recommendation on May 18. Therein, Staff states that the controlling standard is "not detrimental to the public interest."²

Staff states further:

Staff has reviewed the Application, consulted with Alma, conducted discovery and analyzed the matter. As a result of that process, Staff prepared its Memorandum and Recommendation attached hereto as Appendix A. Staff opines that the transaction is not detrimental to the public interest and recommends approval of the Application subject to the two conditions set out in Appendix A.

Those conditions are:

1. That the Commission reserves the right to consider the ratemaking treatment to be afforded these transactions and the resulting cost of capital in a later proceeding; and
2. That the Company shall not pay dividends to its shareholders, make investments other than those currently contemplated under this Application or incur additional debt until the Company achieves a 3-year average common equity to total capital ratio of at least 38 percent and a 3-year average Debt Service Coverage ratio of at least 1.50 times.

Discussion:

Alma seeks authority to borrow up to \$5,579,000 from the RUS in order to fund capital improvements consisting of a new switch and fiber subscriber lines. Alma is a small, rural incumbent local exchange carrier with some 350 customers in and around the town of Alma, Missouri. Alma last updated its subscriber lines and plant in 1972. Staff states that Alma's current network is "fully used, near fully consumed, and in need of replacement with more modern plant." Alma's Mitel digital switch, purchased in 1992, is no longer supported by the manufacturer and thus cannot be upgraded to meet mandatory regulatory

² *In the Matter of the Application of Le-Ru Telephone Company for Authority to Borrow an Amount not to Exceed \$9,164,700 from the Rural Utilities Service, the Rural Telephone Bank and the Federal Financing Bank and in Connection therewith to Execute an Amending Telephone Loan Contract Amendment, Promissory Notes, and a Restated Mortgage, Security Agreement and Financing Statement*, 9 Mo. P.S.C. 3d 229, 231 (August 15, 2000).

requirements, such as local number portability. Alma intends to install a next generation "softswitch" with IP technology. Alma also plans to replace its existing loops and related plant with fiber in order to provide its subscribers with adequate bandwidth to access future voice, data and video services. With the exception of a few technical specifications, Alma will be 100% fiber to the home upon completion of this project. The new switch and fiber will be installed in 2005 and 2006. Staff states that its Telecommunications Department has no objections to Alma's proposed capital improvements.

Staff states that, in its opinion, the proposed financing is reasonable. The loan approved by the RUS will "bear interest at the Cost-of-Money Interest Rate determined by the Government pursuant to 7 U.S.C. 935(d)(2)(A) of the Act and its implementing regulations, as amended from time to time (7 C.F.R. 1735.31(c)) and the portion of the Telecommunications Loan specified in Schedule 1 hereto will bear interest at the rate of five percent (5.00%) per annum." Although the proposed financing will result in a significant change in Alma's consolidated capital structure, Staff believes that its long-term financial integrity will not be threatened. With the initial draw down of \$1,925,000 in 2005, Alma's Total Debt to Total Capital Ratio will move from 0.00% to 59.86%. With the second draw down of \$2,600,000 in 2006, the ratio will move to 81.28%. By 2009, Staff expects the ratio to be 80.83%. For at least five years, Alma will be highly leveraged. However, the Commission approved a similar financing for Ozark Telephone Company in 1998, which has since reduced its Total Debt to Total Capital Ratio from 80.00% to 48.50%, and raised its equity to 51.5%.

A condition of the loan required by the RUS is a minimum Times Interest Earned Ratio ("TIER") of 1.00 through December 31, 2008, rising thereafter to 1.50. Although the

RUS has calculated that Alma can meet these requirements, and has therefore approved the loan, Staff's calculations predict a TIER for Alma of only 1.31 by the end of 2009 and a TIER of -0.35 in 2006.³ Upon inquiry, Staff learned that RUS's assumptions differed in certain respects from Staff's, yielding different results. One important difference between the calculations made by Staff and RUS is that RUS assumed that Alma would borrow the full amount approved, while Staff assumed that Alma would only borrow \$4,525,000 as indicated in Alma's application. Staff reports that the RUS stated that it would still approve the loan even if Staff's figures were used.

Staff recommends that the Commission authorize the amortization of the extraordinary retirement of the \$122,396 undepreciated value of Alma's present Mitel switch in three equal annual amounts in 2006, 2007 and 2008. Staff notes that Alma has evidently overlooked the Commission's Telephone Authority Order No. 991, dated November 12, 1993, wherein the Commission authorized Alma to use a 5.0% annual depreciation rate after December 31, 1992. Alma's filings in the present case reflect a depreciation rate of 4.5%. The use of the wrong depreciation rate would have contributed significantly to the under-recovery of the Mitel switch. Staff also recommends that the Commission authorize the amortization in three equal, annual amounts in 2006, 2007 and 2008 of the extraordinary retirement of the undepreciated value of Alma's building, \$15,930, and Alma's outside plant that will be replaced, \$146,074.

Alma also seeks, and Staff recommends that the Commission authorize, the use of higher minimum depreciation rates in lieu of fixed rates for 2005 and subsequent years as allowed by Section 392.280.2, RSMo 2002. Any subsequent rate proceeding would use

³ The RUS calculated a TIER of 2.68 for the end of 2009. The RUS also calculated a Debt Service Coverage ratio of 2.02 for the end of 2009, compared to Staff's calculation of 1.79.

depreciation reserve levels based on the recorded depreciation expenses. Alma's proposal would permit a more rapid recovery of capital invested in plant and equipment. Alma suggests that this would better reflect the actual useful life of telephone technology, plant and equipment. Staff notes its position that most of Alma's accounts should have increased depreciation accruals.

Alma did not file any response or reply to Staff's Memorandum and Recommendation and presumably accepts the suggested conditions. Although the Office of the Public Counsel is a party to this case, it did not file a recommendation or a response to Staff's recommendation.

The Commission has reviewed and considered Alma's application and the Recommendation and Memorandum of Staff and concludes that the proposed transaction is not detrimental to the public interest and should be approved. The Commission will require Alma to comply with the conditions recommended by Staff.

IT IS THEREFORE ORDERED:

1. That the Application for Authority and Approval to Issue a Note and Enter into a Loan Agreement, Mortgage, Security Agreement, and Financing Statement to Borrow Funds from the Rural Utility Services of the United States of America, for Interim Financing Approval, and for Section 392.280.2, RSMo (HB 360), Accounting Authority Orders filed by Alma Communications Company, doing business as Alma Telephone Company, on April 8, 2005, is approved.

2. That Alma Communications Company, doing business as Alma Telephone Company, is authorized to obtain such interim financing as may be necessary in order to

complete the project discussed in the application approved in Ordered Paragraph No. 1, above.

3. That Alma Communications Company, doing business as Alma Telephone Company, is authorized to do any and all other things incidental, necessary or appropriate to the performance of any and all acts specifically authorized in this order, including executing all documents necessary for the financing authorized in this proceeding.

4. That the authority granted to Alma Communications Company, doing business as Alma Telephone Company, in this order is subject to the following conditions, with which Alma Communications Company, doing business as Alma Telephone Company, is directed to comply:

A. That the Commission reserves the right to consider the ratemaking treatment to be afforded these transactions and the resulting cost of capital in a later proceeding; and

B. That the Company shall not pay dividends to its shareholders, make investments other than those currently contemplated under this Application or incur additional debt until the Company achieves a 3-year average common equity to total capital ratio of at least 38 percent and a 3-year average Debt Service Coverage ratio of at least 1.50 times.

5. That Alma Communications Company, doing business as Alma Telephone Company, is hereby authorized to amortize certain extraordinary retirements in three equal annual amounts in 2006, 2007 and 2008, as discussed above.

6. That Alma Communications Company, doing business as Alma Telephone Company, is hereby authorized to book depreciation amounts as determined by the rates set out in the column headed "Rates That Will Be Booked" on Attachment F to the Memorandum filed on May 18, 2005, by the Staff of the Missouri Public Service Commission in this case.

7. That the Commission specifically makes no finding as to the prudence of the transactions herein approved and reserves the right to consider the prudence of these transactions in a later proceeding.

8. That this order shall become effective on June 24, 2005.

9. That this case may be closed on June 25, 2005.

BY THE COMMISSION

A handwritten signature in black ink, appearing to read 'Colleen M. Dale', written over a horizontal line.

Colleen M. Dale
Secretary

(S E A L)

Davis, Chm., Gaw, Clayton, and
Appling, CC., concur.
Murray, C., dissents, with separate
dissenting opinion to follow.

Thompson, Deputy Chief Regulatory Law Judge