

1 STATE OF MISSOURI
2 PUBLIC SERVICE COMMISSION
3
4 IN-CAMERA PROCEEDINGS
5 On-the-Record Presentation
6 July 6, 2006
7 Jefferson City, Missouri
8 Volume 3
9
10 Staff of the Public Service)
Commission of the State of)
11 Missouri)
Complainant,)
12)
13 v.) Case No. TC-2006-0184
New Florence Telephone Company,)
14)
15 Respondent.)
16)
MORRIS L. WOODRUFF, Presiding,
17 SENIOR REGULATORY LAW JUDGE.
STEVE GAW,
18 ROBERT M. CLAYTON,
COMMISSIONERS.
19
20 REPORTED BY:
21 KELLENE K. FEDDERSEN, CSR, RPR, CCR
22 MIDWEST LITIGATION SERVICES
23
24
25

1 I N - C A M E R A P R O C E E D I N G S

2 JUDGE WOODRUFF: It looks like we're ready
3 to go then. We are in-camera.

4 THE WITNESS: Can I have about two minutes
5 to get two of the numbers?

6 JUDGE WOODRUFF: Sure. Go right ahead.

7 THE WITNESS: See if I've got them here.
8 I'm pretty positive I do.

9 DAVID WINTER testified as follows:

10 QUESTIONS BY COMMISSIONER CLAYTON:

11 Q. I'm going to ask for the five -- the dollar
12 amount of the five lines, the five items that you
13 mentioned.

14 A. I can give you three of the five.

15 Q. Go ahead, if you want to take your time to
16 find that, and then --

17 A. Okay.

18 JUDGE WOODRUFF: For your concern, yes, the
19 picture is still there but the sound is gone.

20 THE WITNESS: I do not know if I have the
21 LEC, LLC piece here, but let me give you what I've got.

22 BY COMMISSIONER CLAYTON:

23 Q. Give me what you've got.

24 A. We'll give that a shot. We'll first start
25 off with --

1 Q. Can you start with Matzco?

2 A. Matzco is paid from -- let me back up.

3 These payments started in August of 2001, and Matzco ended
4 in August of 2004. Matzco was paid \$214,000.

5 Q. Over a three-year period?

6 A. Over a three-year period, yes. LEC, LLC
7 Management Services was paid 213,226.

8 Q. 213?

9 A. 213,226.

10 Q. Over how many years?

11 A. Same period of time.

12 Q. Okay.

13 A. South Holt went to -- and this goes to
14 the end of 2004. It was \$238,000. For those three
15 combined --

16 Q. That was for three years?

17 A. That was from 2001 'til December 31st,
18 2004. The total of those payments was 665,226.

19 Q. I'm confused about something.

20 A. Okay.

21 Q. If you look at -- if you divide each of
22 those numbers by three, it comes out to be a little over
23 \$70,000 on an annual basis for each one, correct?

24 A. They changed over time. You know, they
25 started at 6,000. They went to 3,000, I believe, then

1 they went to 10,000. They dropped down. I think they
2 ended at \$3,000, I believe.

3 Q. 3,000. What do you mean 3,000?

4 A. Well, there are monthly fees paid.

5 Q. So you're talking about monthly fees?

6 A. Monthly fees, yes. They didn't write a
7 check for \$72,000.

8 Q. I understand. But if you look at costs
9 over any particular year, if we're talking about a
10 three-year period, consulting or management fees from LEC
11 were 213,000. You divide that by three, that's 70,000 on
12 an annual basis on average?

13 A. Uh-huh.

14 Q. 70,000 for Matzco a year, and a little over
15 70,000 for South Holt. You take that times three, it's
16 210. That's almost the annual revenues -- or revenue
17 requirement of the company, correct?

18 A. Yes. And that was --

19 Q. So where's the cost of service? Where's
20 the -- I mean, that would leave 20,000 in equipment, I
21 guess?

22 A. They have not done very little construction
23 since they bought the company in 1999-2000 time frame.

24 Q. So basically the entire revenue -- I mean,
25 where are the employees being paid?

1 A. There's two employees.

2 Q. So there are two employees. How many
3 customers are we talking about here?

4 A. We are talking 531 customers, I believe.
5 Let me double check that one. 531 customers. We have 332
6 residential and 199 business.

7 COMMISSIONER CLAYTON: We're in-camera,
8 correct?

9 JUDGE WOODRUFF: We are.

10 BY COMMISSIONER CLAYTON:

11 Q. What's the rate base of New Florence --

12 A. I do not have that.

13 Q. -- plant in service?

14 Does anybody know that?

15 A. I do not have that right here.

16 Q. Is that something we can get?

17 A. We can look at the annual report and see
18 what the basic -- what they have.

19 Q. In your review, so you have those -- those
20 are just three out of the five. That's not even including
21 the overhead charges for LEC?

22 A. That's right.

23 Q. Haven't even gotten to that one yet. Then
24 you didn't get to the switch price being over its actual
25 cost, correct?

1 A. That's correct.

2 Q. So, Mr. Winter, if you add the -- if you
3 add the Universal Service Fund support of 369,000, I guess
4 in addition to the annual revenue requirement of 233, the
5 annual revenues of New Florence would be 602,000?

6 A. The annual revenues that we have -- and I
7 probably pulled that from the wrong source. I probably
8 pulled that from the annual report of 2005, which does not
9 have Universal Service in it. Their annual revenues are
10 223,000, Missouri revenues. That does not include --

11 Q. So you add 223 and add it to the 369
12 Universal Service support for your high costs, your local
13 switched access?

14 A. Yes.

15 Q. And then what was the third piece? Isn't
16 there three pieces in Universal Service?

17 A. There's the high cost, local switching --
18 and I get these confused -- long-term support piece.

19 Q. Long-term support.

20 A. The high dollars were coming -- in the 2003
21 number I gave you were coming from the local switching
22 piece, which is -- for our revenue calculations would be
23 on the federal side.

24 Q. Okay. Let me ask you this question: On

25 the LEC management fees that -- that amounted to 213,226,

38

1 if you divide that by three on average, you're looking at
2 70,000 a year. What does Staff believe the appropriate
3 value should have been attributed to the services by LEC
4 Management Consulting?

5 A. Zero.

6 Q. So basically that's 70,000 and just there
7 was no value to that service?

8 A. We believe there's no value.

9 Q. All right. Matzco was 214,000 over three
10 years. You divided that by three, that's 70,000 on an
11 annual basis. What does Staff believe the value of those
12 services provided by Matzco was?

13 A. We never established what the actual
14 services were for, what the actual value of those services
15 were. There was representations that there had been some
16 services done. There were no time sheets kept. There was
17 nothing that would indicate that -- what was actually
18 done. So we -- in our calculation, we cleaned all that
19 out and assigned zero to it for a rate of return.

20 Q. Zero. Okay. And on the South Holt
21 Communications was 238,000. Divided by three, that
22 amounts to 70, maybe 74,000, something like that, a year.
23 What was the value of those consulting services?

24 A. We looked at those. That's the consulting

25 services over time. We weren't sure exactly what the

39

1 nature of those were. We assigned a zero value to those
2 from our rate calculation. That nature has -- the nature
3 of that has changed. Mr. Williams is now the president
4 and is in charge of New Florence Telephone.

5 Q. Okay. Do you know what the average
6 distribution to Tiger Telephone was, what its dividend
7 was? I assume this is a Subchapter S corporation or an
8 LLC that would kick up a dividend?

9 A. I do not have that information here. We do
10 have that information of how much was paid. It was
11 represented to us that the payments were primarily for two
12 things: No. 1, to pay the taxes and, No. 2, the note to
13 buy New Florence Telephone was held at the Tiger Telephone
14 level. So New Florence, in essence, had zero debt and was
15 paying Tiger Telephone to pay for the debt to I believe
16 Cobank.

17 Q. But it doesn't appear that -- was there any
18 cash dividend being paid on to the owners of the company?

19 A. Not to my knowledge.

20 Q. I mean, so there wasn't a profit in
21 addition to each of the fees that were being --

22 A. From our reviewing, it's not to my
23 knowledge that they were paying excess dividends or

24 dividends other than the two areas that I mentioned.

25 Q. So if you take just the three items that

40

1 you've mentioned, 210, \$215,000 a year in overages, where
2 has that -- what costs have increased by 210,000 to cause
3 the rates not to be reduced?

4 A. Remember we talked about the case, maybe
5 their last rate case, which I cannot tell you. It was
6 probably in the '60s, so nothing has really -- I mean,
7 those rates you have 5.75 touch-tone for residential, and
8 they're a very low cost to the service provider. And when
9 we went back there and looked at it, we just -- even if we
10 take those costs out, they were still -- they were still
11 -- there wasn't hardly any overearnings at all in this
12 particular case.

13 Q. When was the last assessment by Staff or
14 how does Staff look at whether or not a rate of return
15 company should be audited or determination made to whether
16 they are overearning? is there a regular schedule? Does
17 something have to tip you off, like a federal indictment
18 or something?

19 A. Things have changed over the years. A
20 number of years ago, we took -- we developed a model and
21 went through every annual report to give us an indicator
22 of where they were at on rate of return regulation. We've
23 done that until probably this last year or two, when we

24 were pretty well consumed with these two telephone
25 companies.

41

1 But traditionally what happens, we go
2 through there, we look at the annual report, we put the
3 numbers in to give us an indicator of where they're at in
4 their earnings. We also had a Data Request outstanding
5 that we insert also, some -- there are separation factors
6 to determine where they're at, and from that we determine
7 whether we should review those company rates at that time.

8 COMMISSIONER CLAYTON: I don't think I have
9 any other questions at this time. Thank you, Judge.

10 JUDGE WOODRUFF: Commissioner Gaw?

11 COMMISSIONER GAW: Let me stay in-camera
12 for a moment, Judge.

13 JUDGE WOODRUFF: All right.

14 COMMISSIONER GAW: For a little while
15 anyway.

16 QUESTIONS BY COMMISSIONER GAW:

17 Q. Did you -- I'm not sure if I got this. Did
18 you get all of the numbers on the monies being paid out?

19 A. We can provide it to you. We still have
20 the LEC additive charges to provide, and we also have the
21 switch costs that were in the inflated switch cost.

22 Q. Okay. And how long will it take you to get

23 that?

24 A. I have the inflated switch cost right here,
25 and it wouldn't take me very long to find the LEC additive

42

1 cost.

2 Q. Go ahead. Having any luck, Mr. Winter?

3 A. I can give you the switch provider. I can
4 provide the additive after this hearing.

5 Q. I was just wondering. I don't want to -- I
6 don't want to wait too long.

7 A. No, I do not have that. I thought I did.

8 Q. Have you become Mr. Summer? I mean --

9 A. Excuse me?

10 Q. Have winter turn to summer.

11 A. Well, my roommate in college was named
12 Summer.

13 Q. We have another one here, too. Not the
14 same one we have here, though?

15 A. No.

16 Q. Okay. So what have you got that you have?

17 A. In 2001, New Florence put in a new switch.
18 What was charged on the books and records was \$584,000.
19 The actual cost per a cashier's check that was paid to
20 Siemens Network Carriers, which was the company that they
21 purchased the switch from, it was 183,753, was the cost of
22 the switch.

23 Q. Okay. Now we know that that amount does
24 not -- is not reflected in any adjustment in the actual
25 rates because there was no rate case?

43

1 A. There was no rate case.

2 Q. So I guess I'll ask you -- I think I know
3 the answer. What did that impact?

4 A. What it impacted was it allowed the company
5 or some of the shareholders to be able to write off two of
6 the loans that it had with the company and also made a
7 cash distribution to LEC, LLC.

8 Q. So there's money that went to LEC?

9 A. There was money that went to LEC, and then
10 allowed two of the shareholders to write off the balance
11 of the loans that they had with the company.

12 Q. And what about how that might have
13 impacted -- what year was that?

14 A. That was in 2001.

15 Q. Were they receiving USF funding at that
16 point?

17 A. No. They -- well, excuse me. LEC, New
18 Florence, when they were purchased by Tiger in 1999, was
19 an average schedule company. They changed over August 1st
20 or July 31st of 2001 to a cost company.

21 Q. Yes.

22 A. And when they went to a cost company, they
23 started receiving Universal Service monies, and the cost
24 of that switch, pieces of that switch went to Universal
25 Service or NECA reimbursements. One or the other, they

44

1 were getting reimbursed for.

2 Q. So did New Florence receive benefit from
3 the USF as a result of putting in inaccurate information
4 as to the costs of that switch?

5 A. I can be more precise with you. The Staff
6 went back and recalculated what we believe NECA -- no, we
7 didn't do that piece. Yes, they did. They received from
8 NECA and/or Cass County and/or USF, they received benefits
9 for the -- for the inflated cost of that switch.

10 Q. Do you know how much?

11 A. No, I do not. We do have it quantitized in
12 our report about the LEC additive management fees, but we
13 do not have the switch piece in there.

14 Q. Okay. Is that something you could provide?

15 A. Okay.

16 Q. You can provide that?

17 A. I believe so. I'll have to check it out.

18 Q. Do you know whether or not the fact that
19 that additional benefit was derived from the USF as a
20 result of that of your allegation that there was a
21 misrepresentation, has that been turned over to anyone

22 else besides the Public Service Commission, that
23 information?

24 A. Not to my knowledge. Those journal entries
25 have been -- were found by the new external auditor of New

45

1 Florence, and to my knowledge that has not been given to
2 anybody else with the exception of the Public Service
3 Commission.

4 Q. And the information in regard to findings
5 that there may have been inflated -- let me ask you this.
6 In regard to the other four areas where there were
7 payments that the Public Service Commission Staff believed
8 were inflated, did the company submit anything in regard
9 to additional reimbursement from the USF that would have
10 been based on in any way those inflated costs?

11 A. You'll receive -- if you don't receive
12 reimbursement based upon the USF, you will get it from
13 NECA. So either NECA reimbursement or USF reimbursement,
14 they received a portion of those dollars back.

15 Q. And has that information been turned over
16 to anyone else other than the information given to the
17 Public Service Commission?

18 A. My understanding is that NECA is looking at
19 the matter, but that's just my understanding. I do not
20 have -- I've never talked to anybody with NECA about it.

21 Q. Has anyone, to your knowledge, with the
22 Public Service Commission Staff discussed this issue with
23 any other governmental authorities?

24 A. Not to my knowledge.

25 COMMISSIONER GAW: And, Judge, anything

46

1 here that I'm asking that is not -- that is not
2 confidential, I would ask that it be made public after
3 we're finished here, because I'm bouncing around. Some of
4 this information I would assume ought to be available to
5 the public.

6 JUDGE WOODRUFF: At the moment, we are in
7 in-camera. Do we want to go out of in-camera at this
8 point?

9 COMMISSIONER GAW: Well, I have a few more
10 questions regarding some numbers. I'll try to stick to
11 that, but I do want that other part of the record
12 clarified.

13 JUDGE WOODRUFF: Well, you'll have to --
14 I'm not sure how we can do that.

15 COMMISSIONER GAW: I'm going to say I want
16 you to review it, and if you want me to do it myself and
17 put the proposal in front of you, I'll do that. Anything
18 that the public has a right to know out of this, I want to
19 make public.

20 JUDGE WOODRUFF: Certainly, but we'll need

21 to provide the parties a chance to talk about that.

22 COMMISSIONER GAW: You do whatever you
23 think you need to do about that. I'll be fine with it.

24 JUDGE WOODRUFF: Okay.

25 BY COMMISSIONER GAW:

47

1 Q. Does the issue in regard to these costs
2 apply only after the year that they went to cost based on
3 USF?

4 A. That's when the costs start showing up in
5 August of 2001.

6 Q. Were there -- were there -- were these five
7 areas that you have been talking about, the payments to
8 Matzco, the incorrect value on the cost of the new switch,
9 were those -- were any of those things occurring prior to
10 that date?

11 A. Let me make a clarification. The LEC
12 overhead costs started when they bought the company in
13 1999.

14 Q. Okay.

15 A. The other costs, the other four that we've
16 talked about started at essentially the same time in
17 August, July/August of 2001.

18 Q. And that was the year they went to cost-
19 based USF?

20 A. Yes. That's when they went from an average
21 schedule company to a cost company, which is based upon a
22 company's embedded cost.

23 Q. And prior to that time, these other amounts
24 were not being paid?

25 A. That is correct, with the exception of the

48

1 LEC, what we talked about, the 40/80 percent.

2 COMMISSIONER GAW: Thank you for clarifying
3 again. Let's go out of camera. I'll let somebody else
4 decide if I'm getting into territory.

5 JUDGE WOODRUFF: All right.

6 WHEREUPON, the in-camera portion of David
7 Winter's testimony was concluded.

8

9

10

11

12

13

14

15

16

17

18

19

20

21

22

23

24

25