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BY ELECTRONIC FILING

Ms. Marlene Dortch, Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, D.C. 20554

Re: Notice of *Ex Parte* Meeting; CC Docket No. 96-45

Dear Ms. Dortch:

On May 3, 2006, the attached document was sent via e-mail to Jeremy Marcus at the Commission.

Should any questions arise concerning this matter, please communicate directly with the undersigned.

Respectfully submitted,

Randall B. Lowe
Counsel for Cass County Telephone Company, LP

A DESCRIPTION OF EVENTS SURROUNDING CASS COUNTY TELEPHONE COMPANY, THE REMAINING PROBLEM AND A PROPOSED SOLUTION

The purpose of this paper is to summarize and describe the investigative and corrective actions regarding Cass County Telephone ("CassTel") that have taken place since the letter from Mr. Jeffrey Carlisle (who, at the time, was Chief of the Commission's Wireline Competition Bureau) to USAC dated October 15, 2004. The only remaining issues are (i) the suspended 2004 USF payments, (ii) USF for 2005 and 2006, and (iii) the manner by which to recompense NECA and USAC for their overpayments to CassTel. This paper proposes solutions to those issues.

In sum, CassTel's troubles are behind it and CassTel continues to be a rural telephone company as defined by the Act and the Commission but CassTel continues to provide supported services using its own funds. Without immediate relief from the Commission, CassTel may no longer be able to do so.

Summary

In his October 15, 2004 letter, Mr. Carlisle first noted that the Missouri Public Service Commission ("MPSC") declined to certify that CassTel was using its USF funding in accordance with section 254(e) of the Act (47 U.S.C. §254(e)), that the MPSC was conducting an investigation into how the funding was being used, and that the MPSC was awaiting the receipt of a third party audit of CassTel. Mr. Carlisle continued by stating that "[b]ased on the information available" to the Commission at that time, it was "unable to determine if the high-cost and low-income support payments" to CassTel "are being used in accordance with the statute" and the Commission's rules. As a result, Mr. Carlisle directed USAC to suspend "all monthly support payments" to CassTel "[u]ntil this issue is resolved." (In a letter to USAC dated October 22, 2004, Mr. Carlisle reinstated monthly support payments for the Lifeline program.) USAC then followed with a letter to Mr. Kenneth Matzdorff, as "Chairman" of CassTel, a limited partnership. The letter informed Mr. Matzdorff of Mr. Carlisle's letter and that USAC would therefore be withholding any further support payments, beginning with the September, 2004 payment. CassTel then filed a timely appeal before the Commission on January 4, 2005 regarding the remaining 2004 support payments, as well as support payments for 2005. The appeal is still pending.

Since then:

- Mr. Matzdorff has plead guilty to various criminal violations of law, he has relinquished all financial control of CassTel and its General Partner, LEC, LLC ("LEC") and he has been removed from the management of CassTel and LEC.

- An independent, third party manager acceptable to the MPSC was retained by LEC in the first quarter of 2005 to run the operations of CassTel.

- After in-depth investigations by the MPSC and the Kansas Corporation Commission ("KCC"), CassTel has entered into Stipulations and Agreements with the staffs of

those commissions to settle the wrongdoings of Mr. Matzdorff.

- As part of the Stipulation and Agreements with the MPSC and the KCC, the staffs of those commissions recommend that CassTel receive high cost support payments prospectively and that CassTel receive the withheld high cost loop support payments pursuant to a capital expenditure plan to be agreed upon by each commission.[1]

- CassTel has restated its books to correct the wrongdoings of Mr. Matzdorff.

- CassTel has entered into an Asset Purchase Agreement to sell its assets to FairPoint Communications, Inc. ("FairPoint").

- CassTel's books have been audited by a third-party accounting firm.

- After an in-depth investigation by NECA, it has agreed with CassTel's recalculations of what CassTel should have received for high cost support from NECA and USAC from 1996 up to the suspension of that support in September, 2004.

In short, the issues surrounding CassTel, which were the cause of Mr. Carlisle's letter, have now been investigated, quantified, and audited. It was determined that Mr. Matzdorff fraudulently and incorrectly accounted for costs such that CassTel received inflated support payments from NECA and USAC. All of his activity has been corrected and is the subject of settlements.

The Problem

Even though the Commission has suspended support payments beginning in September, 2004 and even though CassTel was not certified to receive those payments for 2005 or 2006, throughout this period CassTel has continued to provide the services that are the object of USF support. It has done so by using available cash. *See* Attachment A. However, without high cost support payments, it will not continue to be able to do so, especially considering the growth demands of its operating areas, which cover approximately 439 square miles served by 6 wire centers.[2] In fact, CassTel has been in a negative cash position since the beginning of 2005 and will continue to be in a negative cash position. At the current rate, CassTel forecasts that it will

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[1]The recommendations of the MPSC and the KCC regarding retroactive high cost support payments only include High Cost Loop Support ("HCLS"). They do not include interstate Local Switching Support ("LSS") or Interstate Common Line Support ("ICLS"), inasmuch as these interstate support mechanisms are within the purview of this Commission.

[2]Cass County, Missouri, for instance, has experienced unprecedented growth. Over the thirty year period from 1970 to 2000, the population of Cass County more than doubled, from 39,500 to over 82,000 people. Between 1990 and 2000, the population increased 29% versus growth for Missouri of about 9.3% over the same period of time. The Kansas City MSA, where Cass County is located, increased 12.2% during that time period, which was 4% higher than the average growth throughout the entire Midwest. Between 2000 and 2004, the population of Cass County grew 11.6% for a total population of 91,593 versus 42,600 in 1970. Another operating county of CassTel, Miami County, Kansas, has grown during the last ten years by over 40%. (Ref.: http://www.casscounty.com under "County Demographics.")

be out of cash by August of this year. Thus, the third-party, independent auditors conclude in their 2005 audit of CassTel that "there is substantial doubt about the ability of [CassTel] to continue as a going concern." CassTel desperately needs to receive high cost support payments, both retroactively and for the remainder of this year. Otherwise, its services, indeed, its existence, are in jeopardy.

The Solution

In light of these circumstances, CassTel proposes the following solution, which, in view of CassTel's current financial state, needs to be implemented as soon as possible:

1. Immediately reinstitute HCLS, ICLS and LSS to enable CassTel to continue to serve its customers, to expand its network to meet the customer and service growth demands of its operating territories and to recover its legitimate costs of service[3];

2. Apply withheld ICLS and LSS amounts for 2004, 2005 and 2006[4] (which, as stated above, have already been incurred by CassTel from available cash to provide interstate services) as an offset to the amounts owed by CassTel to NECA and USAC (and CassTel will use the proceeds from the sale of CassTel to FairPoint to pay NECA and USAC the net amount); and,

3. Upon adoption of a capital expenditure plan pursuant to the Stipulations and Agreements entered into by CassTel and FairPoint with the MPSC and the KCC, release the amount of withheld HCLS in accordance with terms and conditions of those plans.

This solution is balanced and, accordingly, fair to everyone concerned.[5]

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[3]CassTel has not been able to earn its authorized rate of return. The Commission has found that "[b]y judicial standards, each LEC must receive the opportunity to earn a rate of return 'commensurate with returns on investments in other enterprises having corresponding risks' and 'sufficient to assure confidence in the financial integrity of the enterprise, as to maintain its credit and to attract capital.'" *Amendment of Parts 65 and 69 of the Commission's Rules,* Report & Order in CC Docket No. 92-133, 10 FCC Rcd 6788, 6824 (1995), *quoting FPC v. Hope Natural Gas Co.,* 320 U.S. 591, 603 (1944).

[4]Following is a summary of the high cost amounts calculated by NECA that Cass should have been paid since September, 2004:

Support Element	2004*	2005	2006**
HCLS	$978,000	$2,555,000	$125,000
ICLS	228,000	691,000	100,000
LSS	399,000	428,000	26,000
Totals	$1,605,000	$3,674,000	$251,000

* The figures for 2004 are for September through December.

** The figures for 2006 are only for January because the underlying numbers for February and March are not yet available.

[5]If any portion of the solution requires a waiver of the Commission's rules, CassTel is prepared to make such a

Chronology of Events

At the time of Mr. Carlisle's letter, there was considerable uncertainty surrounding CassTel. While Mr. Matzdorff had been arrested and charges of fraud had been made, the extent and scope of the issues were uncertain. The Staffs of the MPSC and the KCC were in the very early stages of their investigations of CassTel and Mr. Matzdorff. Moreover, the formal audit of CassTel's books by a third party auditor for 2003, which is the basis for 2005 High Cost Loop Support payments, had not been completed. Much has happened since that time that has clarified and corrected the situation:

- In January, 2005, Mr. Matzdorff, along with two other individuals, entered guilty pleas before the United States District Court for the Western District of Missouri in Kansas City admitting to charges of mail and wire fraud related to payments made by CassTel to Overland Data Corporation ("ODC"). These pleas identified $8.9 million as the amount over paid by NECA and USAC to CassTel as a result of the fraudulent payments by CassTel to ODC. Consequently, the plea agreements contain forfeitures from the three individuals to the United States in the amount of $8.9 million to reimburse USAC and NECA. (It should be noted that statements, notably by the press, have been made that CassTel was controlled by organized crime. The government made no such allegation in the Western District case. Although the government did make an allegation in a completely unrelated matter in the Eastern District of New York that at least one of the individuals entering a plea with Mr. Matzdorff was connected to organized crime, the allegation was withdrawn by the government.)

- Since January, 2005, Mr. Matzdorff has relinquished all financial control over CassTel and a search was started by LEC, as the General Partner of CassTel, for an independent third party manager to conduct the affairs of CassTel.

- In March, 2005, LEC entered into a contract with GVNW Consulting, Inc. ("GVNW") whereby GVNW was appointed as an independent, third party contractor to manage CassTel. GVNW continues to serve that role today.

- Since the signing of the contract with GVNW, Mr. Matzdorff has not been involved and was removed from the management of any and all interests of LEC, including CassTel and its long distance affiliate, LEC Long Distance, Inc. ("LEC LD"), and he was removed as a manager and President of LEC.

- The third party audit for 2003, that was referred to in Mr. Carlisle's October 15 letter, was completed and transmitted to the MPSC in March, 2005. The third party audit

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showing. The Commission's rules may be waived for good cause shown. 47 C.F.R. §1.3. Specifically, the Commission may exercise its discretion to waive a rule where the particular facts make strict compliance inconsistent with the public interest. *Northeast Cellular Telephone Co. v. FCC*, 897 F.2d 1164, 1166 (D.C. Cir. 1990). In addition, the Commission may take into account considerations of hardship, equity, or more effective implementation of overall policy on an individual basis. *WAIT Radio v. FCC*, 418 F.2d 1153, 1159 (D.C. Cir. 1969), *cert. denied*, 409 U.S. 1027 (1972); *Northeast Cellular*, 897 F.2d at 1166. As an alternative, the Commission may wish instead to treat the matter as part of the annual, support payment true-up employed by NECA.

for 2004 was completed and transmitted to the MPSC in July, 2005.

- In June, 2005, the Staff of the MPSC filed a complaint against CassTel for the actions of Mr. Matzdorff, *i.e.*, making false book entries and lying under oath. The procedural schedule was subsequently suspended in order to allow the parties to settle the case. In December, 2005, the Staff and CassTel filed a Stipulation and Agreement before the MPSC whereby CassTel, without any admission of wrongdoing by the company or its employees, agreed to pay a penalty of $1 million. The Stipulation and Agreement is pending before the MPSC. As part of the Stipulation and Agreement, the Staff recommends to the MPSC that it certify CassTel as eligible to receive high cost support payments.

- Over the summer months of 2005, LEC sought interested buyers of CassTel. CassTel eventually compiled the names of 27 interested parties. These parties were then narrowed to 8 qualified candidates who were further reduced to 6. The 6 remaining companies were asked to send a letter indicating their desire to consider a purchase of CassTel and LEC LD, and to provide certain information about their companies. If, on the basis of that response, they were found to be acceptable, they were sent a non-disclosure agreement. Upon execution of the non-disclosure agreement, they were sent a due diligence package. After allowing them a certain amount of time to review the due diligence material, they were asked to submit a "value" response, *i.e.*, how much they would expect to pay for CassTel and under what conditions. CassTel only received three such responses. CassTel chose FairPoint as the final candidate. LEC then began negotiating with FairPoint for the sale of CassTel's assets and the assets of LEC LD.

- From August, 2005, to March, 2006, the MPSC and the KCC investigated the activities of CassTel on the basis of CassTel's responses to hundreds of data requests, access to its records and on-site visits to review those records. (Among other things, the purpose of those efforts was to verify that the telephone plant on CassTel's books was in fact constructed and in service and that the company was providing quality service to its customers.) Concurrently with these investigations, an outside accounting firm was employed to analyze CassTel's accounting transactions and to develop appropriate correcting entries that were recorded at year end 2005.

- The staff of the MPSC also conducted an investigation to determine whether CassTel was and is over earning. Again, CassTel provided the MPSC staff with answers to numerous, additional, data requests. Based on that investigation, the staff and CassTel have entered into another Stipulation and Agreement in March, 2006, which is also pending before the MPSC. The Stipulation and Agreement requires CassTel to credit subscribers a total of $350,000, as well as to provide them with cash refunds totaling $3.250 million. (CassTel, the staff, and AT&T have also agreed to an addendum to the Stipulation and Agreement whereby CassTel will pay the access customers , *i.e.*, IXCs, an additional $500,000. The parties expect to file it shortly before the MPSC.)

- The KCC's investigation resulted in a Stipulation and Agreement in April, 2006 between the staff of the KCC and CassTel whereby CassTel will pay its Kansas

subscribers credits and cash refunds that are proportionate to the credits and cash refunds paid to Missouri subscribers. (Approximately 5% of CassTel's access lines serve Kansas subscribers.) The Stipulation and Agreement also contains a recommendation by the staff that the KCC certify CassTel as eligible to receive high cost support payments.

- CassTel, LEC LD, and LEC entered into an Asset Purchase Agreement with FairPoint in December, 2005, which is the subject of transfer applications before the MPSC, the KCC and the Commission.

- In addition to the fraudulent payments to ODC by CassTel, which resulted in $8.9 million in overpayments by NECA and USAC, CassTel, on its own initiative, restated its books to correct for the manner by which certain affiliated transactions were recorded. Based on that restatement, CassTel determined that, in addition to the $8.9 million, it was overpaid approximately $5.2 million by NECA and USAC. CassTel, again acting on its own initiative, submitted those calculations to NECA for its review. (CassTel was informed by USAC that NECA would be acting on its behalf.) NECA has thoroughly examined the calculations and determined that they are accurate.

Section 214(e) Compliance

Eligible Telecommunications Carrier

As stated earlier, throughout this period, CassTel has met, and continues to meet, the criteria for an eligible telecommunications carrier ("ETC"). In particular, CassTel has provided and continues to provide the following nine "supported services" that the Act and the Commission's rules have identified as necessary for such certification:

(1) Voice grade access to the public switched network — CassTel provides voice grade access to over 7,900 business and residence customers in its certificated operating areas using modern digital switches and an interoffice feeder and distribution network containing both copper and fiber cable. Much of this network has been built since 1996 when CassTel was formed.

(2) Local usage — CassTel provides unlimited local usage within its local calling areas to all of its local service customers. In addition, CassTel provides MCA (metropolitan calling area) service to all of its customers who desire to subscribe to the service so they can have flat rate, toll-free calling into the Kansas City metropolitan area.

(3) Dual tone multi-frequency ("DTMF") signaling or its functional equivalent — CassTel provides DTMF signaling to all of its customers as part of its local services.

(4) Single-party service or its functional equivalent - CassTel has eliminated all multi-party service and provides single-party service to all of its customers.

(5) Access to emergency services - CassTel provides access to E911 service through the metropolitan Kansas City PSAP. All 911 calls are routed to this PSAP and distributed from the

PSAP to the appropriate authorities.

(6) Access to operator services — CassTel provides access to intraLATA operator services pursuant to a contract with AT&T and to the operator services of the customers' presubscribed interexchange carrier.

(7) Access to interexchange service — CassTel provides both interLATA and intraLATA presubscription to its subscribers, which, in total, currently equals 22 carriers.

(8) Access to directory assistance — CassTel provides access to directory assistance, which it provides under a contract with AT&T Missouri as well as access to directory assistance provided by the interexchange carriers to which it provides access.

(9) Toll limitation for qualifying low-income consumers — CassTel provides toll blocking service to requesting, qualifying, low-income consumers. In addition to these services, CassTel also provides Lifeline and Linkup services to low-income customers as required by the Commission's rules. (At the present time, CassTel has 85 Missouri Lifeline customers and no Kansas Lifeline customers.)

ETC status also requires that CassTel advertise in media of general distribution to disclose the availability of supported services. CassTel has advertised the availability of the services, including the availability of Lifeline and Linkup Services, in media such as the *Democrat-Missourian* and in the *Cass County Shopper*. In addition, disclosure of available services is made in the CassTel telephone directory, on the company's web page and in welcome inserts sent to all new customers. Posters discussing the availability of Lifeline and Linkup Services are in each town hall in CassTel's operating areas and in CassTel's customer service office, as well as in bill messages.

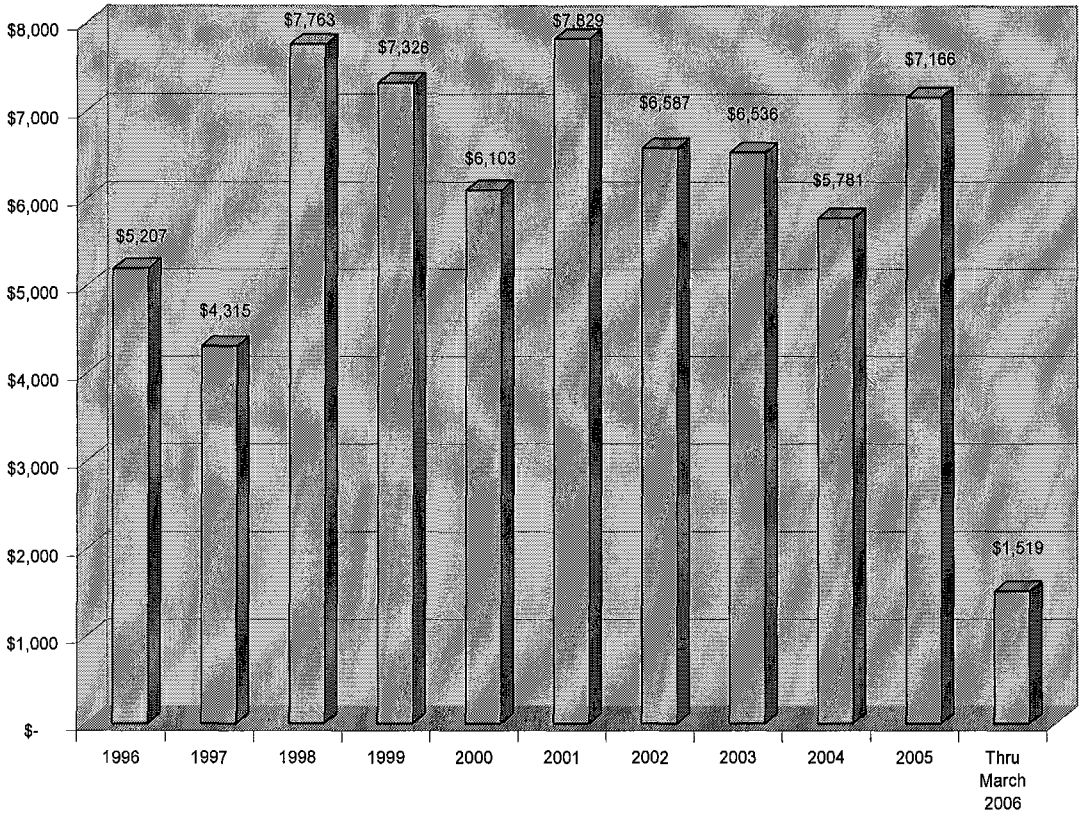
Use of Funds

Section 254(e) dictates that a carrier shall use USF support "only for the provision, maintenance, and upgrading of facilities and services for which the support is intended." As evidence of such intent by CassTel, Mr. Robert Schoonmaker of GVNW has submitted affidavits before the MPSC and the KCC which certify CassTel's commitment to use the funds for their intended purpose. Moreover, and as noted above, the Staff of the MPSC has conducted both a paper and on-site review of CassTel's network. That review has allowed those commissions to determine that the telephone plant on CassTel's books was in fact constructed and in service and that the company was providing quality service to its customers. Similarly, the HCLS that has been requested by CassTel is based on the actual investments and expenses of CassTel. Funds requested for LSS and ICLS are also based on actual investments and expenses of CassTel.

Conclusion

CassTel continues to be a rural telephone company as defined by the Act and the Commission. It has also continued at all times to provide services and expend funds in the manner that make it eligible to receive federal USF. The Commission should have sufficient evidence and take sufficient comfort from the extensive investigations by the Staffs of the MPSC and the KCC, as well as from NECA, to ensure that the issues that caused the Commission to order USAC to withhold high cost support payments to CassTel have been resolved. Consistent

with the Act and coupled with the dire financial straits of CassTel, the Commission should direct USAC and NECA to release all withheld funds in the manner suggested above as the solution, including certification of CassTel as an ETC for 2006 and the payments of USF for 2006. Failure to do so will have detrimental effects on CassTel's customers.

Attachment A

Annual Capital and Operating Expenditures by CassTel to Provide Its Services