Office of the Secretary
Service Date
December 29, 2009

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF MIDVALE TELEPHONE EXCHANGE, INC'S PETITION FOR A DECLARATORY RULING APPROVING THE TRANSFER OF ASSETS AND LIABILITIES TO A WHOLLY OWNED SUBSIDIARY, CREATION OF AN EMPLOYEE STOCK OWNERSHIP PLAN, AND TRANSFER OF MIDVALE'S CERTIFICATE OF PUBLIC CONVENIENCE AND NECESSITY NO. 254.	)	**CASE NO. MID-T-09-03** **ORDER NO. 30969**

On September 22, 2009, Midvale Telephone Exchange (Midvale) filed a Petition for Declaratory Ruling requesting Commission approval of: (1) the transfer of all assets and liabilities of Midvale to its wholly owned subsidiary, Midvale Telephone Company (MTC); (2) the proposed contributions by MTC to an employee stock ownership plan (ESOP); and (3) the acquisition by the ESOP of the authorized and unissued shares of Midvale stock. Midvale also requests that its Certificate of Public Convenience and Necessity (CPCN) No. 254 be transferred to MTC.

On November 10, 2009, the Commission issued Order No. 30943 requesting public comments on Midvale's Petition and Application. Comments were due no later than December 8, 2009. The only comments filed were submitted by the Commission Staff. Midvale did not file reply comments.

THE APPLICATION

Midvale (a Title 61 regulated company) is currently owned by two shareholders, Lane Williams (50%) and the Estate of Shirley Archer (50%). Midvale maintains that, since Shirley Archer's death, it has been exploring options to ensure its continued existence and ongoing operations with the least impact on its customers, services and employees. Mr. Williams and Midvale's Board of Directors believe that the best method to achieve their stated goals is to transfer the ownership of the corporation to its employees through an ESOP. Midvale adopted an ESOP on December 22, 2008. On August 27, 2009, Midvale incorporated Midvale Telephone Company (MTC).

Midvale proposes to transfer to MTC all of Midvale's assets and liabilities (including all operating assets, all debt, all public licenses and the CPCN) in exchange for all of the issued and outstanding shares of MTC stock. After the proposed transfer is complete, the ESOP would acquire a portion of the Midvale stock held by Mr. Williams and the estate of Ms. Archer. Midvale would then redeem the remainder of the shares from the current ownership by delivering to Mr. Williams and the Archer estate a promissory note for the full value of their remaining Midvale shares. Upon a favorable Commission ruling and completion of the transfer, MTC would adopt the ESOP and contribute funds to the ESOP annually as retirement fund contributions for its employees. The Company asserts that the tax advantages of the proposed transactions are substantial.

STAFF COMMENTS

The goal of Midvale's ownership and Board of Directors is to ensure the Company's ongoing operations with the least impact on its customers, services and employees. In this regard, several options were considered, including the sale of stock to Midvale's employees or to a third party, the redemption of stock by Midvale, the transfer of stock to Midvale's employees though the use of an ESOP, or a sale of the assets and liabilities of Midvale to a qualified third party and the discontinuance of service by Midvale. Mr. Williams and the Board of Directors determined that the transfer of Midvale ownership to its employees through an ESOP is the best method to achieve its goals with little or no disruption to its customers and employees.

After reviewing the Company's Petition and Application along with other information provided by the Company, Staff is generally supportive of the Petition for Declaratory Ruling. However, Staff has concerns regarding the ratemaking treatment of the ESOP contributions and other expenses associated with the transfer of ownership. Comments at 2-3.

A. Assets and the CPCN

The proposed transaction contemplates the transfer of all of Midvale's assets and liabilities to MTC in a tax-free "Section 351" capitalization in exchange for all of the issued and outstanding shares of MTC stock. As a result of this transaction, Midvale's existing employees and customers will become the respective employees and customers of MTC. Upon completion of the transactions, Midvale will have no assets other than a 100% ownership interest in MTC and will have no liabilities other than obligations for payments due under the Redemption Notes. *Id.* at 3. Because MTC would own and operate all of the operating assets to provide telecommunication services to Midvale's customers, MTC would need to become the holder of the Certificate of Public Convenience and Necessity (CPCN) and would be "subject to Commission regulation." *Id.* at 4. MTC would also hold all of the debt currently held by Midvale with the Rural Utilities Service and the Rural Telephone Finance Cooperative, but it would have no additional debt obligations as a result of this transaction.

The Company asserts and Staff believes that the current customers of Midvale will not be adversely affected by the proposed transactions. Therefore, Staff recommends that the Commission approve the transfer of all assets and liabilities, along with the CPCN No. 254, from Midvale to MTC.

B. The ESOP

If the Commission issues a favorable declaratory order on the Application, MTC states it will adopt the ESOP plan and trust already adopted by Midvale. MTC would then contribute funds to the ESOP on an annual basis as a retirement fund contribution for its employees. Midvale asserts that there is no specific provision under Idaho Code, Commission rules or other regulations governing telecommunications carriers which require the Commission to approve: (1) the structure of payment under the ESOP; (2) the amount of the contribution; or (3) characterize the contribution as a utility expense. Comments at 3. Therefore, Midvale states its petition for declaratory ruling in this matter is more or less a request that the Commission inform Midvale if the Commission believes it must approve any of the above items or any other items with respect to the creation of the ESOP pursuant to any of the Commission's regulatory powers.

Idaho Code § 61-901 requires that the Commission approve "instruments of security" pertaining to utility assets. Midvale asserts that the operations of the Company will be unchanged and the adoption of the ESOP plan and trust will not impair the Company's assets. No additional debt or equity securities will be issued so Staff agrees that Commission approval under *Idaho Code* § 61-901 is not required. Staff also believes that Midvale is not required to obtain Commission approval to establish and adopt an ESOP plan and trust. *Id.* at 4.

However, Commission approval is required to transfer the Certificate of Public Convenience and Necessity No. 254. The Commission is also vested with the authority to establish rates that are just and reasonable. *Idaho Code* §§ 61-302 and 61-502. In this latter regard, the Commission has the authority to exclude from retail rates any contributions to the

ESOP that it believes to be excessive. Denying recovery of costs in rates would not negate the ESOP plan even though the costs are not paid by customers. *Id.*

MTC intends to contribute approximately $400,000 per year to the ESOP plan and trust. The Company also sponsors a 401(k) plan where employees can receive up to 4% of their compensation in employer-matching contributions. Given that the Company's eligible payroll for 2008 was $1,909,443, the 2008 ESOP contribution of $400,000 represents 21% of eligible compensation. *Id.*; Application at 4. While Staff is aware of the advisability for utility companies to provide retirement benefits to employees, the annual ESOP contribution coupled with the employer matching contributions to the ESOP plan and trust create a level of retirement funding that could be considered excessive beyond the reasonable amount necessary to maintain qualified employees to provide service to its customers. Midvale, however, is not asking to include any ESOP contributions in retail rates at this time. Application at 5.

Midvale has also incurred significant consulting and legal expenses related to the establishment of the ESOP. The expenses have been booked to the Company's operating accounts for financial statement purposes. These accounts are above-the-line accounts that could be included in revenue requirement calculations to determine retail rates. The Company has not requested any rate relief at this time. If these expenses are included during a test year, Staff would likely recommend that these expenses not be recovered in rates paid by customers. Comments at 4. Staff believes that most of these expenses are personal estate planning expenses of the ownership of Midvale and it would be inappropriate to pass these expenses on to customers. Staff agrees with the Company that the tax advantages of the proposed transactions are substantial. In particular, Midvale asserts that use of the ESOP avoids paying federal or state income taxes. Application at 5. The owners will benefit from many of these tax advantages.

COMMISSION FINDINGS

Earlier this year, the Commission found that creation of an employee stock ownership plan (ESOP) by Midvale did not require Commission approval under *Idaho Code* §§ 61-901 *et seq*. Order No. 30765. Having created the ESOP, Midvale now seeks approval: (1) to transfer all of its assets and liabilities to a wholly owned subsidiary, Midvale Telephone Company (MTC); (2) for the ESOP to acquire the authorized and unissued shares of Midvale stock; and (3) to transfer its Certificate of Public Convenience and Necessity No. 254 to the wholly owned subsidiary, MTC. These three subsequent actions do require the Commission's approval.

After reviewing the Application and Staff's comments, we find that it is reasonable and appropriate to approve these subsequent transactions. As noted by the parties, our paramount concern is for the continued operations of the telephone company with the least impact on customers and employees. Upon completion of the transactions, MTC would own and operate all of the transferred assets and provide telecommunications services to Midvale's customers "and be subject to Commission regulations" under Title 61. Application at 4.

Although Staff did not object to the proposed transactions, Staff was concerned with the ratemaking consequences of the transactions. More specifically, Staff expressed concern about the level of annual contributions to the ESOP, and the legal and consulting expenses related to the establishment of the ESOP. However, we note that Midvale (and eventually MTC) are not asking to recover any ESOP contributions in customer rates at this time. Application at 5. Accordingly, the Commission makes no findings at this time and reserves judgment regarding the applicable ratemaking treatment for the annual contributions to the ESOP and the reasonable amounts of consulting and legal expenses related to the establishment of the ESOP. These issues are best addressed in a future rate case.

ORDER

IT IS HEREBY ORDERED that Midvale Telephone Exchange, Inc.'s Petition and Application for a declaratory order is granted as set out above.

IT IS FURTHER ORDERED that Midvale may transfer all of its assets and liabilities to MTC; the previously established ESOP may acquire the authorized and unissued shares of Midvale stock; and MTC may make contributions to the ESOP. The Commission specifically reserves judgment on the contributed amounts to the ESOP until a future proceeding.

IT IS FURTHER ORDERED that Midvale's Certificate of Public Convenience and Necessity No. 254 be transferred to Midvale's wholly owned subsidiary, MTC.

IT IS FURTHER ORDERED that the Commission reserves its authority to make findings regarding the applicable ratemaking treatment for MTC's contributions to the ESOP and the expenses of establishing the ESOP.

IT IS FURTHER ORDERED that given the transfer of the Certificate of Public Convenience and Necessity, MTC work with Staff and resubmit its tariffs and schedules showing the change in the Company's structure within 30 days of this Order.

THIS IS A FINAL ORDER. Any person interested in this Order (or in issues finally decided by this Order) or in interlocutory Orders previously issued in this Case No. MID-T-09-03 may petition for reconsideration within twenty-one (21) days of the service date of this Order with regard to any matter decided in this Order or in interlocutory Orders previously issued in this case. Within seven (7) days after any person has petitioned for reconsideration, any other person may cross-petition for reconsideration. See *Idaho Code* § 61-626.

DONE by Order of the Idaho Public Utilities Commission at Boise, Idaho this 29th day of December 2009.

JIM D. KEMPTON, PRESIDENT

MARSHA H. SMITH, COMMISSIONER

MACK A. REDFORD, COMMISSIONER

ATTEST:

Jean D. Jewell
Commission Secretary

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