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BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION OF MIDVALE TELEPHONE EXCHANGE, INC'S PETITION FOR A DECLARATORY RULING.	**CASE NO. MID-T-09-03** **COMMENTS OF THE COMMISSION STAFF**

The Staff of the Idaho Public Utilities Commission, by and through its Attorney of Record, Donald L. Howell II, Deputy Attorney General, submits the following comments in response to Order No. 30943 issued on November 10, 2009.

BACKGROUND

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 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 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.

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, service and employees. The Company asserts that the tax advantages of the proposed transactions are substantial.

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 the 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 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.

On November 10, 2009, the Commission issued Order No. 30943 requesting public comments on Midvale's Application. Comments are due no later than December 8, 2009.

STAFF ANALYSIS

The goal of Midvale's ownership and Board of Directors is to ensure the Company's existence and 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 have 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, services and employees.

Staff has reviewed the Company's Petition and Application reflecting the proposed transactions along with other information provided by the Company and its representatives and is generally supportive of the Petition for Declaratory Ruling filed by Midvale. Staff has concerns however regarding the ratemaking treatment of the ESOP contributions and other expenses associated with the transfer of ownership.

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. 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 and be subject to Commission regulation. 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.

EMPLOYEE STOCK OWNERSHIP PLAN

If the Commission issues a favorable declaratory ruling on the Application, MTC would 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: (i) the structure of payment under the ESOP; (ii) the amount of the contribution; or (iii) characterize the contribution as a utility expense. 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 authority under *Idaho Code* § 61-901 is not required.

Commission approval is required to transfer the Certificate of Public Convenience and Necessity Certificate No. 254. Staff believes that Midvale is not required to obtain Commission approval to establish and adopt an ESOP plan and trust. However, the Commission is charged with establishing rates that are just and reasonable. In that 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.

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. While Staff is aware of the necessity for utility companies to provide retirement benefits to its 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.

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. 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. The owners will benefit from many of these tax advantages.

RECOMMENDATIONS

Given that the proposed transactions will help ensure the continued existence of the Company without adversely affecting customer service, Staff recommends that the Commission approve the Company's petition for declaratory ruling to:

1. Transfer all assets and liabilities of Midvale to MTC;
2. Establish and adopt the ESOP plan and trust by MTC;
3. Allow the ESOP to acquire the authorized and unissued shares of Midvale stock; and
4. Transfer the Certificate of Public Convenience and Necessity, Certificate No. 254 from Midvale to MTC.

The amount of the annual contributions to the ESOP plan and trust is solely determined by the plan sponsors and trustees and does not require Commission approval. However, the Commission does have the authority to determine the level of retirement contributions to be included in retail rates. Staff recommends that the Commission reserve judgment on the amount of the ESOP contributions to be included in rates until such time that the Company requests recovery of the ESOP contributions in a future rate case.

Respectfully submitted this 8th day of December 2009.

Donald L. Howell, II
Deputy Attorney General

Technical Staff: Donn English
Terri Carlock

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY THAT I HAVE THIS 8TH DAY OF DECEMBER 2009, SERVED THE FOREGOING **COMMENTS OF THE COMMISSION STAFF,** IN CASE NO. MID-T-09-03, BY MAILING A COPY THEREOF, POSTAGE PREPAID, TO THE FOLLOWING:

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SECRETARY