DECISION MEMORANDUM

TO:COMMISSIONER HANSEN

COMMISSIONER NELSON

COMMISSIONER SMITH

MYRNA WALTERS

RITA SCOTT

STEPHANIE MILLER

JOE CUSICK

BIRDELLE BROWN

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BEV BARKER

DAVID SCOTT

WORKING FILE

FROM:CHERI C. COPSEY

DATE:JANUARY 7, 1998

RE:APPLICATION OF DIRECT COMMUNICATIONS ROCKLAND, INC. AND DIRECT COMMUNICATIONS LAKESIDE COMMUNICATIONS, INC. FOR AN ORDER AUTHORIZING THE MERGER OF THE APPLICANT COMPANIES.  CASE NO. ROK-T-98-1.

On November 3, 1998, the Commission received an Application from Direct Communications Rockland, Inc. and Direct Communications Lakeside Communications, Inc. for an order authorizing the merger of the applicant companies.  Rockland is a regulated company that provides basic local exchange and other telecommunication services in the Rockland and Arbon exchanges in southeastern Idaho.  Lakeside is a regulated company that provides basic local exchange and other telecommunication services in the Paris exchange in southeastern Idaho.  Lakeside is a wholly-owned subsidiary of Rockland.

Lakeside was created as a Rockland subsidiary to acquire the Paris exchange from U S WEST pursuant to a 1994 asset purchase agreement.  One of the conditions of the agreement required the purchaser to maintain U S WEST’s applicable local exchange rates for a period of three years.  According to the Applicants, the Lakeside subsidiary was created “in order to provide a clean line of demarcation between Rockland and the Paris exchange” to simplify accounting and regulatory issues.  The Applicants claim that this original rationale for operating the Paris telephone property as a separate subsidiary is no longer valid.

APPLICATION

The Applicants claim that the merger is revenue neutral and will not affect either Rockland or Lakeside’s rates and charges.  The two companies now have identical rates for basic local exchange service.  However, there are some remaining rate differences, primarily involving access charges and recurring rates for vertical services.  The Applicants claim that the merger will be advantageous to both companies and to the Commission.  They claim that both will realize cost savings by eliminating duplicate functions and will alleviate regulatory costs associated with investigating and resolving the proper allocation of joint and common costs between the companies.  Moreover, the Applicants claim it will give them better access to capital and the combined companies will be eligible for Rural Utilities Service hardship loans with a five percent (5%) annual interest rate.

The Applicants propose to file a single tariff containing separate schedules to preserve the unique rates in the Lakeside exchange.

STAFF RECOMMENDATION

In evaluating the propriety of the proposed merger, Staff primarily considered whether this merger is in the public’s interest and whether customers will be adversely affected by the merger.  In this case, the Applicants state the merger will not cause rates to change.  They further state that the merger will result in savings to both companies.  Staff stated that merging the companies appears to make reasonable business sense because it should eliminate costs associated with duplicate functions and eliminate costs for personnel time, external auditor time and time answering Commission investigation questions on the proper allocation of joint and common costs between the companies.

In analyzing the public’s interest, Staff considered two issues -- each company’s present access rates and the possible impact on the Idaho Universal Service Fund (USF) of any reductions in access rates in the future.  Staff stated that if the Commission orders a reduction in access rates, the combined companies should adjust the individual access rates to one “merged” access rate and consequently, although the Applicants assert that the merger is revenue neutral, Staff did not have the necessary information to analyze the neutrality.  If financial neutrality is not monitored or verified it could result in a detrimental effect to the USF and the public interest.

Because the Staff and Company Stipulation promoting EAS for Rockland and Lakeside, provided for a period of time when no audits would be conducted Staff found that until a complete test year is available following the merger and the test year has been audited by Staff, the estimated savings derived from this merger are unquantifiable.  Since these savings are not fully quantifiable at this time, Staff supported the merger provided USF funding levels do not increase prior to a Staff re-evaluation to establish a current revenue requirement and any USF funding required.

Staff recommended approval of the Joint Application with the following conditions:

1.That Rockland submit its tariff to the Commission for approval combining the two companies and that the new tariffed rates not be changed from current rates and maintain revenue neutrality, and

2.That Rockland’s current Idaho USF draw be frozen at current levels pending re-evaluation of Rockland’s revenue requirements for the combined company.

Commission Decision

Does the Commission want to approve this Application with conditions recommended by the Staff?

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Cheri C. Copsey

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