The monetary impact of this finding relative to disbursements for the 12-month period ended December 31, 2015, and for the additional years for the 12-month periods ending December 31, 2012, 2013, 2014, and 2016 is estimated to be an overpayment of $2,244,938 and is summarized by support mechanism by disbursement period as follows:

Support Type	Monetary Effect - 2012	Monetary Effect - 2013	Monetary Effect - 2014	Monetary Effect - 2015	Monetary Effect - 2016	Total Monetary Effect
HCLS	$272,537	$270,586	$394,394	$399,863	$166,992	$1,504,372
ICLS	$107,943	$141,360	$104,279	$92,200	$71,049	$516,831
LSS	$126,968	$96,767	$0	$0	$0	$223,735

Recommendation –
The Beneficiary should implement policies and procedures to ensure it has an adequate system in place for preparing, reviewing, and approving data reported in its HCP filings to ensure compliance with applicable FCC rules.

Beneficiary Response –
As CVTC has stated multiple times since this issue was raised during the audit process, its subject expenses are not substantial rental expenses arising from an alleged (but, in fact, non-existent) sale and lease-back transaction, and are consequently not subject to the provisions of 47 CFR §36.2(c)(2). Rather, the underlying "transaction" is a bona fide arrangement required under Alaska law that consists of (a) the lease of dark fiber facilities by CVTC to its separate interexchange affiliate Copper Valley Long Distance, Inc. (CVLD); and (b) the purchase by CVTC of tariffed interexchange services provided by CVLD to CVTC and unrelated entities over some of the formerly dark fiber to which CVLD has added electronics. The tariffed charges for CVLD's interexchange services were properly treated by CVTC as expenses and were fully compliant with the FCC's affiliate transaction rules.

In *Moultrie Independent Telephone Company*, FCC 01-292, CC Docket No. 96-45, 16 FCC Rcd 18,242 (rel. October 5, 2001), the FCC interpreted 47 CFR §36.2(c)(2) and detailed the regulatory accounting and separations treatment that it mandated for "sale and lease-back" arrangements between incumbent local exchange carriers (ILECs) and their affiliates. There, the ILEC had transferred substantial non-loop related assets (such as motor vehicles, land and buildings, and equipment) to an affiliate, and then leased them back. The ILEC admitted that the purpose of the transaction was to optimize its Universal Service Fund (USF) recovery and to maximize tax benefits. The FCC noted that the ILEC would not have been subject to the 47 CFR §36.2(c)(2) requirements if the transaction had been an arm's length one where the assets were sold to a non-affiliated entity and then leased back (presuming that the ILEC could find a non-affiliated buyer willing to engage in the transaction). *Id.* at 18.

However, when the transaction is a "noncompetitive" sale and lease-back between affiliates, the FCC declared that 47 CFR §36.2(c)(2) is intended to set up safeguards to prevent such transactions from being conducted solely for regulatory manipulation. *Id.*

In the present case, there was neither a "sale" nor a "lease-back" that would render the 47 CFR §36.2(c)(2) procedures and safeguards applicable to the CVTC-CVLD arrangement. First, CVTC leased certain dark fiber facilities to CVLD because CVLD was an Alaska-certificated long distance carrier and CVTC was prohibited by Alaska law to carry traffic between its Valdez and Glennallen exchanges. Second, after CVLD provided the electronics and other functionality necessary to render the dark fiber circuits operational as "lit" fiber and filed tariffs offering various interexchange services over this lit fiber to all interested entities (related and unrelated), CVTC purchased some of the offered interexchange services from CVLD at the tariffed rates. CVTC's arm's length purchase of these tariffed interexchange services cannot reasonably be classified as "rental" or "lease" payments under any conceivable common or technical meaning of those terms.

CVTC is a local exchange carrier (LEC) in Alaska and is not allowed to carry traffic across local exchange boundaries.

Section 42.05.890 of the Alaska Statutes contains the following definitions:

(1) "local exchange carrier" means any carrier certificated to provide local telephone services;
(2) "long distance carrier" or "long distance telephone company" means any carrier certificated to provide long distance telephone services;
(3) "long distance telephone service" or "long distance service" means intrastate, interexchange telephone service.

This statutory scheme limits LECs like CVTC to providing telephone services solely within their state-certificated local exchanges. Traffic between exchanges – that is, interexchange service – must be carried by a state-certificated long distance carrier (IXC). In addition to small IXCs like CVLD, CVTC and other Alaska LECs can obtain interexchange services from large IXCs such as AT&T and GCI, most of which services are provided via satellite facilities.

In Order No. 1 in Docket U-98-176, the Alaska Public Utilities Commission granted CVLD a certificate of public convenience and necessity on March 19, 1999, to furnish intrastate interexchange services within Alaska (copy attached as CVTC Exhibit A). The order contained detailed conditions, including: (a) requiring CVLD and CVTC to operate on a wholly separate basis from each other, including separate staffs, separate services and separate facilities; (b) permitting the provision of services to each other only on an arm's length basis; and (c) ordering CVLD to file its own tariff for its services.

On April 28, 2005, the Regulatory Commission of Alaska approved a Special Contract for the lease of dark fiber by CVTC to CVLD between Valdez and Glennallen, Alaska (copy of approval attached as CVTC Exhibit B). On November 15, 2007, the Regulatory Commission of Alaska approved the extension of this Special Contract beyond its initial two-year term via automatic renewals on a year-by-year basis (copy of approval attached as CVTC Exhibit C). The leased dark fiber facilities now include routes from Edgerton to Chitina, and from Glennallen to Mentasta and on to the Mentasta/Tok exchange boundary, in addition to the main Valdez-to-Glennallen route. The Special Contract (which was required to be amended in June 2005 by the Rural Utilities Service and which remains in effect) was scrutinized by the Regulatory Commission of Alaska and has never been alleged, much less shown, by any regulator or interested party to contain any provisions which would indicate that it is not a *bona fide* arm's length transaction.

CVTC notes that, in approving the Special Contract, the Regulatory Commission of Alaska granted a waiver of certification requirements, to the extent necessary, to allow CVTC to sell "interexchange service" (*i.e.*, the dark fiber extending between local exchange areas) for the sole purpose of the Special Contract even though it did not hold an interexchange certificate. Of course, one of the reasons for the dark fiber lease contract was to enable the carriage of traffic between CVTC's Valdez and Glennallen local exchanges – an interexchange service function which Alaska law prohibits a LEC like CVTC from performing.

CVLD has taken the dark fiber leased from CVTC and added electronic and other facilities necessary to upgrade it to lit fiber and offer various transmission services over it. CVLD offers its services to the public pursuant to its Tariff RCA (formerly APUC) No. 555.

CVTC orders and pays for various voice grade, digital channel and Ethernet private line services from CVLD pursuant to the provisions of Section 6 (sheets 6.1 through 6.69 of CVLD's tariff and their predecessor sections). These are completely arm's length transactions wherein CVTC has no option but to accept CVLD's tariffed services, rates, and regulations, and no control over the assignment of circuits by CVLD or the provisioning of the circuits by CVLD. These transactions constitute a series of clear-cut purchases of tariffed services that entail no negotiation, provide no opportunity for CVTC to request or obtain any favorable treatment from CVLD or to manipulate any regulatory mechanisms, and contain none of the elements or characteristics of a lease or rental transaction.

Unlike the typical sale and lease-back arrangement, the subject dark fiber facilities are not used entirely or predominately to provide services by, for or on behalf of CVTC. Specifically, the leased dark fiber route between Valdez and Glennallen contains four fibers. CVLD not only has improved these fibers by lighting them, but also has dedicated two of the lit fibers exclusively for service to a large, unrelated (non-CVTC) customer and uses the circuits of the remaining two lit fibers to provide a mix of services to CVTC and unrelated entities.

The composition and distribution of CVLD's private line revenues from its leased dark fiber routes (see CVTC Exhibit D) demonstrates further that there is no sale and lease-back arrangement dedicated to serving CVTC.

During the 2014 year under audit, CVLD derived only $455,341 of its $5,069,852 in private line service revenues (8.98%) from CVTC.[1] During the other years mentioned in this Finding #2, the results were similar:

> 2010: only $724,514.05 (30.48%) of $2,376,781.97 in private line service revenues from CVTC
> 2011: only $862,514.88 (24.02%) of $3,590,254.85 in private line service revenues from CVTC
> 2012: only $858,360.08 (19.44%) of $4,414,813.74 in private line service revenues from CVTC
> 2013: only $894,188.21 (19.00%) of $4,706,937.82 in private line service revenues from CVTC

[1] The independent CPA firm, Aldrich CPAs and Advisors LLP (Aldrich) audits the annual financial statements of CVLD. The results of the audits indicate that CVLD is a viable stand-alone business, and that it generates sufficient revenues from its other customers that it is not dependent upon revenues received from CVTC to remain so.

These facts demonstrate that the subject CVTC-CVLD dark fiber transaction is not a sale-lease back transaction that needs to be subjected to the 47 CFR §36.2(c) (2) safeguards. In a typical sale and lease-back arrangement intended to increase USF support, X would have sold dark fiber to affiliate Y, and then leased it back at a rental expense higher than rate-of-return and depreciation expense on X's dark fiber investment. Here: (a) there was no sale of the dark fiber by CVTC to CVLD; (b) CVLD improved the dark fiber by lighting it; (c) CVLD did not lease the dark fiber back to CVTC, but rather used it to provide tariffed services to CVTC and other entities; (d) in fact, CVLD provided the major part of its services over the dark fiber to, and received the major part of its associated private line service revenues from, entities other than CVTC; and (e) CVTC would have no reasonable basis for including in its rate base the dark fiber used by CVLD primarily to provide tariffed services to unrelated entities.

47 CFR §32.27(c) requires that services provided between a carrier and its affiliate pursuant to a tariff, including a tariff filed with a state commission, be recorded in the appropriate accounts at the tariffed rate. Such tariffed rates constitute substantial and persuasive evidence that a transaction is being undertaken at arm's length and at fair market value. Hence, the sale of tariffed services by CVLD to CVTC complied with the FCC affiliate transaction requirements of 47 CFR §32.27.

CVTC notes also that the 47 CFR §36.2(c)(2) safeguards become applicable only if the disputed "lease - back" amounts are "substantial" and are "rents."

NECA Guideline 2.19 – Non Substantial Operating Lease Expense states that the term "substantial" cannot be simply defined and quantified. Rather, "substantial" is dependent on the size and nature of the item and the particular circumstances in which it arises. In the case of CVTC, expenses related to tariffed services purchased from CVLD between 2010-2014 ranged from 4.8% and 5.7% of CVTC's total operating expenses. These relatively small amounts do not appear to be a "substantial" portion of CVTC's total expenses for any of the subject years.

The second condition to be satisfied is that CVTC must be paying "rent" to CVLD. While there is no specific definition of the term "rent" as it relates to this particular situation, prior to a revision in 2000, 47 CFR §32.5999 provided a definition of rents as follows:

(c) Rents. (1) This subsidiary record category shall include amounts paid for the use of **real and personal operating property.** Amounts paid for real property shall be included in Account 6121, Land and Buildings Expense. This category includes payments for operating leases but does not include payments for capital leases.

(2) This subsidiary record category is applicable only to the Plant Specific Operations Expense accounts. Incidental rents, e.g., short-term car rental expense, shall be categorized as Other Expenses (see paragraph (d) of this section) under the account which reflects the function for which the incidental rent was incurred.

CVTC's payments of the tariffed prices for the various voice grade, digital channel and Ethernet private line services it purchased from CVLD are not amounts paid for the use of real or personal property, or for incidental short term rents of cars and similar property. CVTC does not have a special contract or

lease with CVLD specifying rent payments for the tariffed services described, there is no term or fixed period during which CVLD is restricted from changing its services or rates, and CVTC has no control over the assignment or provisioning of circuits or any other property used to provide the services. In other words, CVTC is purchasing tariffed services only from CVLD, and has no rights to the possession or use of any property to which "rent" or "rental payments" or a "lease term" might apply.

In summary, CVTC has properly and consistently accounted for its purchases of tariffed voice grade, digital channel and Ethernet private line services from CVLD in Accounts 6123 (Office equipment expense), 6124 (General purpose computers expense), 6212 (Digital electronic switching expense) and 6232 (Circuit equipment expense) during the 2010-to-2014 data period covered by the audit, and in fact all the way back to 2005. Since then, CVTC's booking of the related expenses associated with the purchase of services has been thoroughly examined without question during multiple National Exchange Carrier Association (NECA) reviews, a Universal Service Administrative Company (USAC) audit and an FCC Office of Inspector General (OIG) audit. At no time, was there an issue raised regarding CVTC's treatment of the related expenses until this audit. Given the thorough vetting of this issue and the significant restrictions outlined in CVLD's application to furnish intrastate interexchange telecommunications service within Alaska, CVTC does not see how this auditor considers a purchase of tariffed services to be a substantial rent and disputes the applicability of the requirements in 47 CFR 36.2(c)(2).

Auditor's Additional Comments –
We have reviewed the Beneficiary's response and the documentation provided as it relates to intrastate rules. While the interexchange facility arrangement between the Beneficiary and its wholly-owned affiliate Copper Valley Long Distance (CVLD) may have been necessary in order to comply with Alaska rules, we don't believe these same rules supersede the rules required by the FCC as it relates to interstate ratemaking and those used in the determination of HCP support. The FCC contemplated jurisdictional ratemaking practices that vary from those of the FCC in Part 32 and provided for those differences in accounts 32.1500 and 32.4370 for assets and liabilities and account 32.7910 for revenues and expenses.

The Beneficiary contends that the arrangement with CVLD was neither a "sale" nor a "lease-back" that would render Part 36.2(c)(2) procedures and safeguards applicable. The Beneficiary also stated in its response that the interexchange facilities purchased from CVLD under its tariff cannot reasonably be classified as rental or lease payments under common or technical meaning of those terms. We recognize that transactions are often labeled with the term lease or rent in the industry when the underlying documents supporting a transaction lend some credence to a service under legal interpretation or Generally Accepted Accounting Principles. Regardless of whether the affiliate charges incurred by the Beneficiary meet the common or technical meaning of rent or lease or whether the arrangement with CVLD qualifies as a sale and lease-back transaction, we don't believe the characterization of the transaction is the fundamental condition for the required application of Part 36.2(c)(2). The application of this Rule is required in this instance because of the mechanics of the Part 36 jurisdictional cost allocation process and the resulting impacts to the Part 36 cost study and HCP support results when large interexchange expenses are included in lieu of the related interexchange plant facilities.

We reference the FCC's explanation for why this treatment was enacted for sale and lease-back arrangements with an affiliate:

> *11. The reason for this specific Part 36 treatment is that, when a substantial amount of investment is involved, the jurisdictional allocation of the lease payment and the combined separations results would be skewed (i.e., the overall interstate allocations may be artificially higher or lower), if the assets were not included in the appropriate separations categories and jurisdictionally allocated based on the rules for the investment-type involved. This occurs because the Part 36 system is premised upon incumbent local exchange carriers owning the majority of their operational assets. Like other utilities, the local exchange telephone industry is, for the most part, characterized as an industry with large, fixed, capital investments that represent a high percentage of total costs. As such, the Part 36 process of jurisdictional cost allocation is predicated on the recognition that incumbent telephone companies will experience large amounts of capital investment cost.*
>
> *12. Under the Commission's Part 36 rules, each of a carrier's basic components of plant, such as Central Office Equipment (COE) or Cable and Wire Facilities (C&WF), is allocated (i.e., separated) between the intrastate and interstate jurisdictions based either on a fixed allocation or results of studies made on the usage of the plant. Once separated, these basic plant costs provide a foundation upon which most other plant, reserve, and expense accounts are allocated between the jurisdictions. If a company were to sell and lease back one of these "foundation blocks" of plant, and were allowed to exclude the sold investment from its cost study, but include the lease payments as an expense, distortions to the separations results would occur. This is because the annual lease payment (which acts as a substitute for the "sold" investment) would be jurisdictionally allocated based on some or all of the remaining basic components of plant, whose usage would not be representative of the plant leased. This would, in turn, alter the separations results between jurisdictions in a manner not anticipated by the Part 36 rules. As an example of this distortion, a carrier might sell large amounts of plant with a low interstate allocation (e.g., 25%) and lease it back. The lease payments and other costs that are allocated based on the Total Plant in Service, total COE, or total C&WF will receive an artificially higher allocation to the interstate jurisdiction, due to the higher interstate allocation of the remaining COE and C&WF interexchange plant costs.*
>
> *13. The distortions caused to the company's separations results by excluding non-loop related investment from its cost study would, as a consequence, also extend to its high-cost loop support. The Subpart F high-cost loop support algorithm uses factors derived from the ratio of loop-related investment to total investment. If an incumbent carrier were to sell large portions of its non-loop related plant to an affiliate, and then lease back those assets and include the lease payment as an expense, the carrier's cost study would be skewed to decrease its assets, and increase its operational expenses, thus resulting in a higher per-loop cost. The higher per loop costs result because of the*

relationship between loop-related investment and total investment. When virtually all of the non-loop related investment is removed from the calculation, the cost allocation factors are significantly altered. Because the categories used to determine high-cost loop support pursuant to Subpart F of part 36 are based upon the categorization rules set forth in other sections of Part 36, it is important for incumbent LECs to ensure that their high-cost loop support submissions to NECA conform with all other sections of Part 36, including section 36.2(c)(2).[2]

We recognize the transaction in Finding #2 may not be characterized as a sale and lease-back of interexchange plant. However, we believe the same principles discussed in the *Moultrie Order* apply to the Beneficiary. The Beneficiary incurred substantial interexchange expenses from its affiliate, and without associated or representative interexchange plant included in its cost studies, the interexchange expenses were improperly assigned to jurisdictions and Part 69 access elements based on the Beneficiary's existing plant categories, which is largely loop or subscriber plant in nature. We believe this results in grossly overstated loop costs recovered from HCLS and ICLS and grossly understates interexchange costs recovered from LSS and CAF.

Further, Part 36.2(c) sets two conditional requirements for its application by referencing 1) affiliate related and 2) substantial [in nature]. In the case of the transaction identified in Finding #2, the interexchange transport expenses are the result of the Beneficiary's affiliate charges. Therefore, the first condition is met. For the second condition, NECA Cost issue 2.19 Separations Treatment of Operating Lease Expenses and Capital Leases provides clarification on the term substantial. The Cost Issue states:

> The term "substantial" cannot be simply defined and quantified. Rather, "substantial" is dependent on the size and nature of the item and the particular circumstances in which it arises. When a lease of property is substantial in nature, the corresponding jurisdictional allocation of the lease payment and associated separations results of the study area would tend to be skewed or distorted if assets were not included in the appropriate separations category and apportioned based on the prescribed investment allocation methodologies.[3]

The Beneficiary argues that the interexchange charges incurred from its affiliate are not substantial in amount and provides the citation from NECA Cost Issue 2.19 Separations Treatment of Operating Lease Expenses and Capital Leases, stating that the term substantial cannot be simply defined and quantified. While Cost Issue 2.19 appears to indicate there is no bright line to define substantial, we note that the Beneficiary's response failed to identify the key element of the FCC's definition of "substantial" as conveyed in the *Moultrie Order* and further emphasized in Cost issue 2.19, which says

[2] *Moultrie Independent Telephone Company et al.*, CC Docket No. 96-45, Order, 16 FCC Rcd 18242, 18247-48, paras. 11-14 (2001) (*"Moultrie Order"*).

[3] 2.19 Separations Treatment of Operating Lease Expenses and Capital Leases, NECA Cost Issue at Section 2: Expenses, Issue number 2.19, page 6 of 9 (2007).

"when a lease of property is substantial in nature, the corresponding jurisdictional allocation of the lease payment and associated separations results of the study area would tend to be skewed or distorted if assets were not included in the appropriate separations category and apportioned based on the prescribed investment allocation methodologies."

We assessed the impact on the Beneficiary's Part 36 cost studies and HCP filings and found the results were significantly skewed by the Beneficiary's practice of including the interexchange expenses in its cost studies in lieu of including the associated interexchange plant in its categorization during the periods under audit (see monetary effects above). Therefore, we believe the substantial condition is met.

Part 36.2(c)(2), as discussed in the *Moultrie Order*, was designed to ensure that costs that could be affected by an affiliate arrangement are evaluated, and if substantial in amount, are subject to restrictions to avoid improper allocation of expenses to separations categories. In the case of expenses associated with property, the expenses should be removed and the related plant should be included in the separations study for category assignment based on separations factors. In the case of Finding #2, the expenses are the circuit charges and the plant is the interexchange fiber owned by the Beneficiary and leased by its affiliate CVLD under a dark fiber IRU.

Based on the information provided by the Beneficiary, the structure of the interexchange transport arrangement identified in Finding #2 may be required by Alaska regulations. However, in performing its interstate cost study used in the determination of HCP support, the interexchange plant associated with the transport arrangement should have been included in the Beneficiary's Part 36 separations study and the associated expenses should have been removed to comply with Part 36.2(c)(2) which would have prevented the over-allocation of costs assigned to loop categories and the under-allocation of costs assigned to interexchange categories. Therefore, our position is unchanged with respect to our finding.

Beneficiary's Response to Auditor's Additional Comments –
Beneficiary Copper Valley Telephone Cooperative, Inc. (CVTC) continues to object to the Auditor's assertions that CVTC was required pursuant to Section 36.2(c)(2) of the FCC Rules: (a) to include in its telephone operations the costs and related expenses of the dark fiber that it was prohibited by Alaska law from using to connect its exchanges and that it instead leased pursuant to Regulatory Commission of Alaska (RCA) approval to its subsidiary Copper Valley Long Distance (CVLD); and (b) to exclude as "rent expenses" the various tariffed charges that it paid CVLD for voice grade, digital channel and Ethernet private line services over portions of the dark fiber that were subsequently lit and otherwise upgraded by CVLD.

There Is No Basis for Preempting Alaska State Law
While Auditor noted that "the interexchange facility arrangement between the Beneficiary and its wholly-owned affiliate *may* have been necessary in order to comply with Alaska rules [emphasis added]," it proceeded to disregard the extent to which the arrangement was mandated by Alaska law, and reviewed, approved and monitored by the Alaska Public Utilities Commission (APUC) and its successor the RCA. As detailed previously, Section 45.05.890 of the Alaska Statutes defines "local

exchange carriers" and "long distance carriers" in a separate and non-overlapping manner, expressly limits local exchange carriers to the provision of services solely within their state-certificated local exchanges, and specifically requires traffic between exchanges to be carried by state-certificated long distance carriers. Whereas CVLD is wholly-owned by CVTC, it was authorized by the APUC in 1999 subject to conditions, *inter alia*, that CVTC and CVLD be wholly separate, including separate employees and cost accounting, and that all transactions between them be on a strict arms' length basis (CVTC Exhibit A). Subsequently, the RCA in May 2005 reviewed and approved the subject dark fiber lease (CVTC Exhibit B), and in May 2007 extended the dark fiber lease and permitted it to be renewed automatically on a year-by-year basis (CVTC Exhibit C). The Auditor seeks to avoid and disregard the state-mandated origin and nature of the dark fiber arrangement by claiming that the very general references in Sections 32.1500, 32.4370 and 32.7910 to the "impact" of "jurisdictional ratemaking practices that vary from those of this Commission" support the Auditor's lack of "belief" that the Alaska rules "supersede" the rules required by the FCC regarding interstate ratemaking and high-cost support. We disagree. First, the cited general rules do not override differing state practices, but rather require the impacts to be recorded net of applicable income tax effects and supported by appropriate subsidiary records. More important, the cited Part 32 rules do not preempt state laws regarding the services permitted to be provided by state-certificated local exchange carriers and long distance carriers, nor state commission actions that require and authorize specific transactions between and among state-certificated local exchange carriers and long distance carriers. The Auditor's interpretation, if adopted, would place CVTC in a clear and unwinnable conflict between state and federal law – between the "rock" of compliance with the Alaska statute and RCA approvals and the "hard place" of forfeiture and repayment of $2,244,938 of its previously received federal high-cost support. Penalizing CVTC in this harsh and substantial manner for its plainly reasonable prior compliance with Alaska statutory and regulatory requirements would effectively constitute a "preemption" of Alaska law. The Auditor provides no support for such pre-emption other than its unsubstantiated "belief" that the vague Sections 32.1500, 32.4370 and 32.7910 of the FCC's Rules override and supersede state law.

There Is No Need to Preempt Alaska Law

CVTC has previously emphasized that the subject dark fiber lease was plainly distinguishable from the sale and lease-back transaction in *Moultrie Independent Telephone Company*, FCC 01-292, released October 5, 2001, because it was in no respect a readily manipulated voluntary transaction by a parent carrier with an affiliate intended for the sole or substantial purpose of maximizing federal high-cost support and/or tax benefits. Rather, the CVTC-CVLD arrangement was mandated by Alaska law and reviewed and approved by the RCA. More important, the FCC made it absolutely clear in *Moultrie* that its predominant concern was the readily manipulated nature of affiliate transactions rather than hypothetical separations calculations. At paragraph 18 of its *Moultrie* decision, the FCC stated expressly that it would have accepted the sale and lease-back transaction, and would have allowed the local exchange carrier to remove the assets from its investment base and include the lease payments as an operational expense, if only the local exchange carrier had made its arrangement at arms' length with a non-affiliate rather than its affiliate. Nothing could be more clear than that the FCC's focus was to address and limit the manipulation of high cost support and tax benefits via voluntary structuring of affiliate transactions. Here, CVTC not only made its lease arrangement at arms' length with the wholly separate CVLD, but did so pursuant to Alaska statutory

requirements and regulatory supervision, and paid the same tariffed charges for CVLD's services as other non-affiliated customers. In sum, CVTC had no intent to enter into the dark fiber arrangement in order to manipulate its federal high-cost support, and had no ability or flexibility to do so under the RCA-monitored and publicly tariffed arrangement. In light of the FCC's explicit recognition that sale and lease-back and similar transactions that are not subject to ready manipulation via affiliate relationships are acceptable and that their accounting will be recognized for interstate ratemaking and federal high-cost support purposes, the Alaska-required CVTC-CVLD dark fiber arrangement should be accepted and there should be no conflict between Alaska law and FCC requirements giving rise to preemption issues.

There Are No Obvious Viable Alternatives to the Subject Dark Fiber Arrangement

CVTC has no clear idea how it could undo its dark fiber arrangement with CVLD or what policies and procedures it might implement to "ensure that it has an adequate system in place for preparing, reviewing, and approving data reported in its [High Cost Program] filings to ensure compliance with applicable FCC rules." As explained previously, CVTC has leased four (4) dark fibers to CVLD between its Valdez and Glenallen exchanges. Subsequently, CVLD has improved the fibers by lighting them, has dedicated two (2) of the fibers to the service of an unrelated large customer, and has been using the other portions of the leased fibers to provide publicly tariffed services to CVTC and unrelated entities. CVTC is at a loss to determine how it could unwind these arrangements without substantial and harmful service interruptions, or how it could have its employees and consultants "certify" to the accuracy of "dark fiber costs" when that dark fiber has been lit and devoted to a variety of regulated and non-regulated uses by CVLD. Furthermore, when Alaska statutes or the RCA require CVTC to do something, it complies or seeks further guidance from the RCA. CVTC does not know what types of policies or procedures it could put in place to ensure that its compliance with Alaska law would not subsequently be deemed to constitute a violation of FCC rules. CVTC notes that the only obvious alternative to its dark fiber arrangement with CVLD would have been to leave its dark fiber in the ground and unimproved, and to purchase the interexchange services necessary to connect its exchanges from unrelated interexchange carriers (IXCs). This alternative would have allowed CVLD to keep the dark fiber costs in its rate base AND include the IXC charges as expenses, thereby maximizing its interstate and intrastate rates and its federal high-cost support. CVTC does not believe that this alternative would have served the public interest, or that the RCA would have permitted it to employ it when the less costly alternative of the subject lease and tariff arrangement with CVLD was available.

Section 36.2(c)(2) of the FCC Rules Is Not Applicable

Section 36.2(c)(2) deals with the case of property rented from affiliates, and states that "the property and related expenses are included with, and the rent expenses are excluded from, the telephone operations of the company making the separation." CVTC has previously addressed this matter in detail. In particular, it reiterates that CVLD's tariffed charges for telecommunications services that were reviewed and allowed to go into effect by the RCA and that are applicable to CVTC and to any and all potential unrelated customers are in no respect equivalent or comparable to readily manipulated rental charges by an affiliate to its parent company. Finally, the Auditor ignored the fact that CVTC had shown that the tariffed services purchased from CVLD between 2010 and 2014 ranged from 4.9% to 5.7% of CVTC's total operating expenses. Without addressing the non-substantial

nature of 5% amounts, the Auditor jumped to the "belief" that this relatively small portion of operating expenses "results in grossly overstated loop costs recovered from HCLS and ICLS." In stark contrast, the FCC has increasingly determined during recent years that 5% deviations from certain requirements are not "substantial." For example, in assessing compliance with Alternative Connect America Cost Model (ACAM) build-out obligations, the FCC has held in Section 54.311(d) of its Rules that a shortfall of up to 5% of the required number of newly served locations will be deemed to constitute compliance.

Auditor's Additional Comments –
We have considered the Beneficary's additional responses and do not believe its additional responses provide any new basis to conclude the Beneficiary complied with Part 36.2(C)(2) as prescribed by the FCC, therefore our position is unchanged with respect to this matter.

Finding	Criteria	Description
#1	47 C.F.R. § 64.901 (a) and (b), (2001)	Carriers required to separate their regulated costs from nonregulated costs shall use the attributable cost method of cost allocation for such purpose. In assigning or allocating costs to regulated and nonregulated activities, carriers shall follow the principles described herein. (2) Costs shall be directly assigned to either regulated or nonregulated activities whenever possible. (3) Costs which cannot be directly assigned to either regulated or nonregulated activities will be described as common costs. Common costs shall be grouped into homogeneous cost categories designed to facilitate the proper allocation of costs between a carrier's regulated and nonregulated activities. Each cost category shall be allocated between regulated and nonregulated activities in accordance with the following hierarchy: (i) Whenever possible, common cost categories are to be allocated based upon direct analysis of the origin of the cost themselves. (ii) When direct analysis is not possible, common cost categories shall be allocated based upon an indirect, cost-causative linkage to another cost category (or group of cost categories) for which a direct assignment or allocation is available. (iii) When neither direct nor indirect measures of cost allocation can be found, the cost category shall be allocated based upon a general allocator computed by using the ratio of all expenses directly assigned or attributed to regulated and nonregulated activities.
#2	47 C.F.R. § 36.2(c)(2) (2006)	Property rented to affiliates, if not substantial in amount, is included as used property of the owning company with the associated revenues and expenses treated consistently: Also such property rented from affiliates is not included with the used property of the company making the separations; the rent paid is included in its expenses. If substantial in amount, the following treatment is applied: (1) In the case of property rented to affiliates, the property and related expenses and rent revenues are excluded from the telephone operations of the owning company, and (2) In the case of property rented from affiliates, the property and related expenses are included with, and the rent expenses are excluded from, the telephone operations of the company making the separation.

The following are the Exhibits referenced in the Beneficiary's response to FINDING No.: HC2016BE030-F02:

CVTC Exhibit A

STATE OF ALASKA

THE ALASKA PUBLIC UTILITIES COMMISSION

Before Commissioners:

Sam Cotten, Chairman
Alyce A. Hanley
Dwight D. Ornquist
Tim Cook
James M. Posey

In the Matter of the Application by COPPER VALLEY LONG DISTANCE, INC., for a Certificate of Public Convenience and Necessity To Operate as a Telecommunications (Intrastate Interexchange) Public Utility Within Alaska	U-98-176 ORDER NO. 1

ORDER APPROVING APPLICATION, SUBJECT TO CONDITIONS; REQUIRING FILINGS; APPROVING INITIAL TARIFF; AND CONDITIONALLY GRANTING WAIVER

BY THE COMMISSION:

Background

On November 20, 1998,[1] Copper Valley Long Distance, Inc. (CVLD), filed an application for a certificate of public convenience and necessity (certificate) for authority to furnish intrastate interexchange telecommunications public utility service within Alaska. CVLD stated that it would provide the proposed telecommunications service by leasing facilities and reselling the telecommunications service of other carriers. Notice of the application was issued to the public on January 6, 1999, with a

[1]The Commission notes that the application was supplemented on December 21, 1998.

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closing date of February 5, 1999, and again on February 17, 1999, with a closing date of March 1, 1999, for the submission of statements in support of, or in opposition to, the application. No comments have been received in response to the notices.

The Commission Staff (Staff) reviewed the filings in this proceeding and on March 1, 1999, submitted its analysis and recommendation (Report) thereon. Staff's Report sets out in detail the history of the proceeding, public notice of the application and responses thereto, and Staff's findings and recommendations regarding disposition of the application. A copy of Staff's Report is attached to this Order as an Appendix.

Among other things, Staff stated that CVLD is fit, willing, and able to resell intrastate interexchange telephone service within Alaska. Staff recommended that CVLD's application be approved with the same conditions that had been applied to other intrastate interexchange carriers (IXCs) with local exchange carrier (LEC) affiliates.

Staff also recommended that the Commission reserve the right to review the above conditions because the Federal Communications Commission (FCC) may ultimately adopt regulations that render those conditions inconsistent with the Telecommunications Act of 1996 (The Act).[2] Further, Staff noted that the Commission may wish to reevaluate the conditions placed on Copper Valley

[2]47 U.S.C. § 151 *et seq.*, as amended by The Act.

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Telephone Cooperative, Inc. (CVTC),[3] and CVLD in this proceeding following the Commission's review of generic regulations governing the IXC market.

Staff recommended that CVLD's tariff Title Sheet and tariff Sheet Nos. 1 through 5.6, filed November 20, 1998, be approved. Staff also recommended that CVLD's request for a waiver of the requirement to provide wholesale services under its tariff be approved subject to the condition that if CVLD constructs or operates interexchange facilities in Alaska, or expands its intrastate service in Alaska, CVLD be required to file a wholesale tariff for the Commission's approval before the new intrastate services are provided or the facilities are placed into service. Staff further recommended that the Commission place CVLD on notice that it may also be required to provide wholesale services in the future if another carrier requests purchase of CVLD's services on a wholesale basis.

Discussion

I. CVLD, IXC Application

Based on its review in the proceeding, the Commission concurs with Staff that CVLD is fit, willing, and able to furnish the proposed intrastate interexchange telecommunications public

[3] CVTC is the LEC affiliate of CVLD.

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utility service.[4] Accordingly, the Commission accepts Staff's recommendation to approve CVLD's application.

The Commission also concurs with Staff that it is appropriate at this time for CVLD's certificate to be subject to the conditions recommended by Staff. Therefore, the approval of CVLD's application is subject to those conditions that are more specifically described in Staff's Report.[5] However, those conditions are the subject of an investigation in Docket U-99-1[6] as to whether they are still appropriate. By Order U-98-144(1)/-U-99-1(1), dated January 5, 1999, the Commission designated CVLD a party to these proceedings.

Additionally, the Commission concurs that CVLD's proposed initial tariff Title Sheet and tariff Sheet Nos. 1 through 5.6 filed November 20, 1998, be approved. Further, the Commission has determined that CVLD's request for a waiver of the requirement to provide wholesale services under its tariff will be approved, with conditions. If CVLD constructs or operates

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[4]The Commission notes that under its regulations at 3 AAC 52.350(b) the competitive provision of intrastate interexchange telephone service in accordance with the provisions of 3 AAC 52.350 – 3 AAC 52.399 is required by the public convenience and necessity.

[5]The Commission notes that those conditions are subject to change as a result of FCC action or the Commission's review of its regulations that govern LECs in the interexchange market in the generic proceeding initiated by Docket U-99-1.

[6]That proceeding is entitled: *In the Matter of the Consideration of Restrictions Placed on Interexchange Carrier Affiliates of Incumbent Local Exchange Carriers.*

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interexchange facilities in Alaska, or expands its intrastate services in Alaska, it will be required to file a wholesale tariff for the Commission's approval before the new intrastate services are provided or the facilities are placed into service.[7]

Staff's Report is adopted by reference and incorporated herein as the Commission's findings of fact and conclusions of law.

II. Consideration of Restrictions on IXCs with LEC Affiliates

By Order U-99-1(1), the Commission opened a docket for the purpose of addressing the restrictions which are placed on IXCs that have LEC affiliates. Based on its review in Docket U-98-144[8] and other recent IXC applications filed by carriers that have incumbent LEC (ILEC) affiliates, the Commission has initiated an investigation regarding the continuing applicability of several conditions currently imposed on the IXC affiliates of ILECs.

ORDER

THE COMMISSION FURTHER ORDERS:

1. As more fully discussed herein, the application filed by Copper Valley Long Distance, Inc., for a certificate of

[7] The Commission may also require CVLD to provide wholesale services under tariff in the future, if another carrier requests purchase of CVLD's services on a wholesale basis.

[8] That proceeding is entitled: *In the Matter of the Application by CORDOVA LONG DISTANCE, INC., for a Certificate of Public Convenience and Necessity To Operate as a Telecommunications (Intrastate Interexchange) Public Utility Within Alaska.*

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public convenience and necessity to operate as a telecommunications (intrastate interexchange) public utility within Alaska is approved, subject to the following conditions:

a. Copper Valley Long Distance, Inc., shall maintain separate books and records for its intrastate interexchange telephone operations;

b. Copper Valley Long Distance, Inc., shall pay intrastate interexchange access charges and file Bulk Bill reports;

c. Copper Valley Long Distance, Inc., shall revise its Cost Allocation Manual with respect to its other affiliated companies and to Copper Valley Long Distance, Inc., to include specific information showing the assignment of costs for Copper Valley Long Distance, Inc., and shall annually file an updated Cost Allocation Manual with the Commission for its review;

d. Copper Valley Telephone Cooperative, Inc., shall quarterly file with the Commission a report certifying that the utility's employees[9] have not provided to Copper Valley Long Distance, Inc., customer proprietary network information or customer information that is protected under 47 U.S.C. § 222;

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[9]This prohibition does not apply to Tim Rennie as the General Manager of CVLD.

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e. the assets of Copper Valley Telephone Cooperative, Inc., may not be used, directly or indirectly, as collateral for financing the operations of Copper Valley Long Distance, Inc.;

f. as more specifically addressed in the body of this Order, Copper Valley Telephone Cooperative, Inc., is prohibited from using its assets, employees,[10] or market position for the benefit of Copper Valley Long Distance, Inc., until such time as effective competition exists in the local exchange market of Copper Valley Telephone Cooperative, Inc., and;

g. Copper Valley Telephone Cooperative, Inc., shall observe strict competitive neutrality in offering its local exchange customers access to long distance services, including:

i. Copper Valley Telephone Cooperative, Inc., and Copper Valley Long Distance, Inc., must be completely separate, with separate employees;[11] and any administrative, financial, legal, accounting, engineering, research, development, or similar services must be provided on a strict arm's-length basis, with strictly segregated cost accounting;

[10] See n. 7.

[11] See n. 7.

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ii. customer service representatives of Copper Valley Telephone Cooperative, Inc., must maintain strict neutrality when presubscribing their customers to long distance carriers;

iii. Copper Valley Long Distance, Inc., and its affiliate may not market local and long distance services as a "bundle;"

iv. access to customer proprietary network information by Copper Valley Long Distance, Inc., must be restricted except to the extent that the information is available to other, unaffiliated, carriers;

v. Copper Valley Telephone Cooperative, Inc., may not share the proprietary information of unaffiliated carriers that is legitimately accessed in the course of business;

vi. Copper Valley Telephone Cooperative, Inc., and Copper Valley Long Distance, Inc., may not jointly own or purchase any transmission or switching facilities in common with one another; and

vii. Copper Valley Telephone Cooperative, Inc., and Copper Valley Long Distance, Inc., may not allow one another to maintain any of the

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facilities of the other unless the same such arrangement is offered to unaffiliated providers.

2. Beginning April 30, 1999, and by April 30 of each year thereafter, Copper Valley Long Distance, Inc., shall file with the Commission its audited or reviewed financial statements for the previous year. If the utility does not plan to have audited or reviewed financial statements prepared for a given year, then it shall file a year-end balance sheet and income statement for that year and audited or reviewed financial statements for the previous year.

3. The tariff Title Sheet and tariff Sheet Nos. 1 through 5.6 filed November 20, 1998, by Copper Valley Long Distance, Inc., are approved, effective the date of this Order.[12]

4. The request by Copper Valley Long Distance, Inc., for a waiver of the requirement to provide wholesale services under its tariff is conditionally approved. If Copper Valley Long Distance, Inc., constructs facilities in Alaska, expands its intrastate services in Alaska, or another carrier requests wholesale services from Copper Valley Long Distance, Inc., the utility shall file a wholesale tariff for the Commission's

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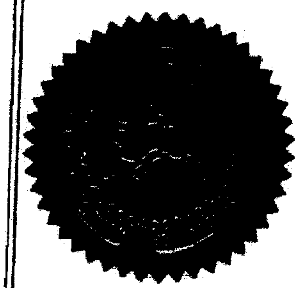
[12] The Commission Staff will forward a validated copy of the approved tariff to the utility under separate cover.

approval before the new intrastate services are provided or the facilities are placed into service.

DATED AND EFFECTIVE at Anchorage, Alaska, this 15th day of March, 1999.

BY DIRECTION OF THE COMMISSION
(Commissioners Sam Cotten, Chairman, and
Dwight D. Ornquist, not participating.)



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M E M O R A N D U M

TO: Commissioners:
Sam Cotten, Chairman
Alyce A. Hanley
Dwight D. Ornquist
Tim Cook
James M. Posey

DATE: March 1, 1999

From: Brad Persson, Utilities Engineering Analyst II

Subject: Docket U-98-176, application by Copper Valley Long Distance, Inc., for a certificate of public convenience and necessity to furnish intrastate interexchange telecommunications services in Alaska.

RECOMMENDATION

1. Staff has reviewed the application of Copper Valley Long Distance, Inc. (CVLD) and believes that it is fit, willing, and able to resell intrastate interexchange telephone carrier (IXC) service in Alaska. Staff recommends that CVLD's application be approved with the following conditions:

   a) CVLD should be required to maintain separate books and records for its IXC operations.

   b) CVLD should be required to pay intrastate interexchange access charges and file Bulk Bill reports.

   c) Copper Valley Telephone Cooperative, Inc.'s (CVTC) Cost Allocation Manual (CAM) including its affiliated companies as well as CVLD, should be updated and filed annually for Commission review.

   d) CVTC should be required to file a quarterly report with the Commission certifying that its employees have not provided customer proprietary network information (CPNI)[1] or customer information to CVLD that is protected under 47 U.S.C. Section 222.

[1] **CPNI means:** (a) information that relates to the quantity, technical configuration, type, destination, and amount of use of a telecommunications service subscribed to by any customer of a telecommunications carrier, and that is made available to the carrier by the customer solely by virtue of the carrier-customer relationship; and (b) information contained in the bills pertaining to telephone exchange service or telephone toll service received by a customer of a carrier; except that such term does not include subscriber list information.

e) CVTC's assets should not be used, directly or indirectly, as collateral for financing of CVLD's operations.

f) CVTC is prohibited from using its assets, employees[2] or market position for the benefit of CVLD until such time as effective competition exists in CVTC's local exchange market.

g) CVTC observe strict competitive neutrality in offering its local customers access to long distance services. For example:

   i. CVTC, and CVLD shall be completely separate, with separate employees -- any administrative, financial, legal, accounting, engineering, research, development or similar services provided on strict arms length basis with strictly segregated cost accounting;

   ii. CVTC, customer services representatives shall maintain strict neutrality when presubscribing CVTC's customers to long distance carriers;

   iii. CVLD and its affiliates shall not be allowed to market their local and long distance services as a "bundle;"

   iv. CVLD's access to CPNI shall be restricted except to the extent it is available to other unaffiliated carriers;

   v. CVLD and CVTC, shall not share unaffiliated carriers' proprietary information which they legitimately access in the course of business; and

   vi. CVTC and CVLD shall not jointly own or purchase any transmission or switching facilities in common with each other.

   vii. CVTC and CVLD shall not allow each other to maintain any of each other's facilities unless the same such arrangements are offered to unaffiliated providers.

2. By April 30 of each year, CVLD should be required to file its audited or reviewed financial statements for the previous year.

3. The Commission should note that with the approval of CVLD's application that to the extent that the Federal Communications Commission (FCC) adopts regulations which render the conditions inconsistent with the Telecommunications Act of 1996, the Commission reserves the right to review the conditions. Furthermore, the Commission may reevaluate conditions placed on CVTC, and CVLD as a result of review of generic regulations governing local exchange companies (LEC) in the IXC market.

4. Staff recommends that CVLD's tariff Title Sheet and tariff Sheet Nos. 1 through 5.6 filed November 20, 1998 be approved.

[2] This prohibition does not apply to CVTC executive staff member Tim Rennie, General Manager.