Cross Telephone Company, L.L.C.

Audit Appeal to FCC

Exhibit 1

USAC Appeal

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January 4, 2019

BY E-MAIL (HCAPPEALS@USAC.ORG)

Universal Service Administrative Co.
High Cost Division
Attn: Letter of Appeal
700 12th Street, NW, Suite 900
Washington, DC 20005

Re: Request for Review of Decision of the Universal Service Administrator High Cost Audit of Cross Telephone Company – SAC No. 431985; Audit Report HC2016BE031

Confidential and Proprietary; Confidential Treatment Requested

To Whom It May Concern:

Cross Telephone Company L.L.C. ("Cross Telephone" or the "Company") (SAC No. 431985), by its attorneys, and in accordance with sections 54.719, 54.720 and 54.721 of the Federal Communications Commission's ("Commission") rules, 47 C.F.R. §§ 54.719-54.721, hereby submits a Request for Review of the Universal Service Administrative Company's ("USAC") Final Audit Report ("Request") issued to the Company on November 6, 2018.

Cross Telephone requests that this letter and the attached Request be treated as confidential pursuant to Section 54.711(b) of the Commission's rules governing information provided to USAC.

Please contact the undersigned at (202) 342-8614 or via e-mail at DSmith@kelleydrye.com, or contact Steven A. Augustino at (202) 342-8612 or by e-mail at SAugustino@kelleydrye.com, if you have any questions regarding the Request.

Respectfully submitted,

Denise N. Smith
Counsel to Cross Telephone Company L.L.C.

Attachment

cc: Jason Cheng, USAC (jason.cheng@usac.org)
Jaia Terry, USAC (Jaia.terry@usac.org)

CONFIDENTIAL AND PROPRIETARY
Confidential Treatment Requested Pursuant to 47 C.F.R. § 54.711(b)

BEFORE THE
UNIVERSAL SERVICE ADMINISTRATIVE COMPANY

In the Matter of	)	
	)	
Cross Telephone Company L.L.C.	)	USAC Audit ID: HC2016BE031
(SAC No. 431985)	)	
	)	
Request for Review of Decision of the Universal Service Administrator	)	

REQUEST FOR REVIEW OF DECISION OF THE UNIVERSAL SERVICE ADMINISTRATOR

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Counsel for Cross Telephone Company L.L.C.

January 4, 2019

SUMMARY

Cross Telephone requests review of Finding No. 1 in the Audit Report issued by USAC's third-party auditor, Moss Adams. In Finding No. 1, the Auditor erroneously concludes that Cross Telephone's expenses for DS1 transport services purchased from its affiliate, MBO Video, L.L.C. ("MBO") should not be included in Cross Telephone's base for High Cost purposes. As a result of the Auditor's erroneous conclusion, the Auditor recommends recovery of over $8 million in USF support received over a period of five years. As shown in this appeal, however, USAC should correct Finding No. 1 because the Auditor's finding is based on an erroneous finding of fact and a misapplication of Part 36 and the Commission's orders.

Cross Telephone obtains DS1 transport services to carry long distance traffic from Warner, Oklahoma to interconnected long distance carrier facilities in Tulsa, Oklahoma. Cross Telephone originally purchased these circuits from Southwestern Bell Telephone ("SWBT") and reported these purchases as expenses under Part 36 of the Commission's rules. The propriety of that treatment is undisputed by the Auditor. In 1998, however, Cross Telephone switched from SWBT to MBO, resulting in a savings of nearly $600 per month in transport costs by 2008. Since 1998, Company consistently has reported these purchases as expenses.

In the audit, the Auditor concludes that these expenses are not purchases of telecommunications services, but instead were a lease of transport facilities, and, as a lease, should have been excluded from Cross Telephone's Universal Service High Cost Program ("HCP") reports and instead reported as interexchange plant and related expenses. During the audit, Cross Telephone provided the Auditor with the Master Services Agreement under which the services were purchased along with other information supporting its classification, including

a memorandum prepared by the Company's regulatory legal counsel Bennet & Bennet PLLC, analyzing Cross Telephone's purchase of DS1 transport services. Despite this evidence, the Auditor found Cross Telephone's DS1 transport service expenses analogous to a sale and lease-back, rather than a purchase of telecommunications services.

In preparation for this appeal, Cross Telephone engaged the services of a respected accounting firm to review Cross Telephone's reporting of the DS1 transport services. After conducting its review, the firm agreed that Cross Telephone has properly reported the DS1 transport circuits as expenses. Therefore, based on this new evidence and the evidence previously provided to the Auditor, Cross Telephone asks USAC to correct the Auditor's error and reverse Finding No. 1.

The Auditor's primary conclusion is that the arrangement between Cross Telephone and MBO was a lease of facilities. However, the Master Services Agreement clearly shows that Cross Telephone is purchasing telecommunications services from MBO, just as it did from SWBT previously. Nothing in the MSA or elsewhere supports the factual conclusion that the purchase is a lease.

The Auditor compounds its factual error by relying on the FCC's decision in *In re Moultrie Independent Telephone Company*, a decision which addressed a sale-and-lease-back arrangement between two affiliates. Neither the *Moultrie* decision nor the rule applied in the case, Rule 36.2(c)(2), are applicable to Cross Telephone's purchase of service from its affiliate, MBO. Moreover, Commission Rule 36.2(c)(2) is *prima facie* inapplicable to the Company as the rule explicitly and exclusively addresses a carrier's rental of property to or from its affiliate and does not address a carrier's purchase of services from an affiliate. Attempting to apply Rule

36.2(c)(2) to Cross Telephone's affiliate service purchase arrangement would require a novel interpretation of the rule's terms, which both contradicts prior Commission definitions of the rule's key terms and is *ultra vires*. The Universal Service Administrative Company ("USAC") is prohibited from interpreting unclear FCC rules and the Auditor, when acting on USAC's behalf, is similarly constrained.

Alternatively, in a prior USAC audit (conducted by a different third-party auditor), the Company previously identified the identical affiliate purchase reporting methodology to USAC and USAC did not express any disagreement with the Company's reporting. Consequently, for the time period at issue here, Cross Telephone reasonably relied on USAC's silence in the prior audit when the Company continued using the same reporting method. USAC's adoption of a new position in this audit -- if permissible at all -- must be applied prospectively only, as any retroactive application would be manifestly unjust. Accordingly, for the above-referenced reasons, Cross Telephone requests USAC reverse Audit Finding No. 1 and not seek to recover any HCP support from the Company related to that Finding.

TABLE OF CONTENTS

BEFORE THE
UNIVERSAL SERVICE ADMINISTRATIVE COMPANY

In the Matter of	)	
Cross Telephone Company L.L.C. (SAC No. 431985)	)	USAC Audit ID: HC2016BE031
Request for Review of Decision of the Universal Service Administrator	)	

REQUEST FOR REVIEW OF DECISION OF THE UNIVERSAL SERVICE ADMINISTRATOR

Cross Telephone Company L.L.C. ("Cross Telephone" or the "Company"), by its attorneys and pursuant to Federal Communications Commission ("FCC" or "Commission") rules 54.719(a) and 54.720(b), 47 C.F.R. §§ 54.719(a), 54.720(b), hereby requests the Universal Service Administrative Company ("USAC") review ("Request for Review") the Final Audit Report ("Audit Report") issued in the above-captioned matter.[1] The Audit Report was issued to the Company on November 6, 2018 and this Request for Review is timely filed within sixty (60) days of its issuance.

[1] Cross Telephone Company L.L.C., Performance Audit on Compliance with the Federal Universal Service Fund High Cost Support Mechanism Rules, USAC Audit ID HC2016BE031 (November 6, 2018) ("Audit Report") (conducted by Moss-Adams LLP (the "Auditor") on behalf of USAC) attached hereto as Attachment A.

Cross Telephone requests review of Audit Report Finding No. 1 which concluded that expenses for the Company's purchase of DS1 transport service from its affiliate, MBO Video LLC ("MBO"), should have been excluded from the Company's High Cost Program ("HCP") reports and that Cross Telephone instead should have reported interexchange plant and related expenses associated with the transport service. After mistakenly equating Cross Telephone's DS1 transport service purchase to an affiliate sale and lease-back transaction, the Auditor attempts to support Finding No. 1 by relying on FCC Rule 36.2(c)(2) and the decision in *Moultrie*,[2] both of which are inapposite. The *Moultrie* decision is based specifically on that carrier's affiliate sale and lease-back transaction and Rule 36.2(c)(2) is *prima facie* inapplicable to Cross Telephone. In addition, new information provided herein, from QSI Consulting ("QSI"), the industry expert that Cross engaged to review and analyze the Company's reporting of the DS1 transport services, shows that Audit Finding No. 1 is erroneous.[3] QSI's analysis shows that Cross Telephone correctly reported its DS1 transport services as expenses and that reliance on *Moultrie* and Rule 36.2(c)(2) requires the Auditor to interpret key terms in ways that contradict the FCC's decision. Any such interpretation by the Auditor of Rule 36.2(c)(2) would be impermissible and *ultra vires*.

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[2] *In re Moultrie Independent Telephone Company; Motion for Stay of Part 69.605(a) of the Commission's Rules and Petition for Declaratory Ruling; Request for Waiver of Part 36 of the Commission's Rules; Federal-State Joint Board on Universal Service*, 16 FCC Rcd 18242 (2001) ("Moultrie").

[3] Cross Telephone engaged the services of QSI Consulting, Inc. ("QSI") to review and provide an expert analysis regarding the Company's purchase of services from MBO and the appropriate regulatory classification of those service revenues. QSI is a respected and well-known company with a long history of expertise and experience in the telecommunications industry. The review was led by Warren Fischer, a certified public account and Chartered Global Management Accountant with more than 20 years of experience in the telecommunications industry. A copy of Mr. Fischer's Declaration, ("Fischer Declaration") is attached hereto as Attachment B in support of Cross Telephone's Request for Review of Decision of the Universal Service Administrator.

Alternatively, Cross reasonably relied on USAC's prior review – during a 2009 audit – and tacit agreement with the Company's reporting of identical DS1 transport services from MBO. If Audit Finding No. 1 is not reversed, the abrupt change in USAC's position regarding the reporting, as reflected in the Audit Finding, must be applied prospectively only to avoid manifest injustice to the Company. For the reasons expressed in this Request, USAC should reverse Audit Finding No. 1 and should not seek to recover any HCP funding associated with this Finding.

I. THE USAC AUDIT REPORT

In 2009, six years prior to the audit at issue here, a different auditor, KPMG reviewed Cross Telephone's High Cost support for 2004 and 2005. KPMG reviewed Cross Telephone's purchase of DS1 transport services from MBO, and found only that the Company had mistakenly undercounted the transport services purchased from MBO resulting in a miscalculation of the transport service expenses paid to MBO.[4] KPMG necessarily had evaluated the purchase of services from MBO in order to make its finding of an undercount of circuits, but KPMG expressed no disagreement with Cross Telephone's classification of the MBO arrangement as a purchase of telecommunications services.

By audit announcement letter dated July 7, 2016, USAC initiated an audit of Cross Telephone's compliance with the FCC's rules and regulations regarding the HCP.[5] The audit,

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[4] *See*, *e.g.*, *Improper Payment Information Act (IPIA) Audit of the High Cost Program of Cross Tel Co*, HC-2009-FL-067, Follow-up Audit to HC-2007-220, USAC Management Response at 1 (Aug. 4, 2010) ("2009 Audit USAC Response") attached hereto as Attachment C. *See also* Draft Cross Summary of Findings, as of June 30, 2010 at 2, attached hereto as Attachment D.

[5] *See* Letter from Wayne M. Scott, USAC (July 7, 2016). *See also* Letter from Jarret Rea, CPA, Moss Adams, LLP to R. David Wright, General Manager, Cross Telephone Company (July 7, 2016).

focused on universal service High Cost support disbursements to Cross Telephone for the year ended December 31, 2015.[6] On July 20, 2018 the Auditor issued its draft findings which included, at USAC's direction, a calculation of the estimated monetary impact of Finding No. 1 on the Company's HCP disbursements for the years ended December 31, 2012, 2013, 2014 and 2016 (in addition to 2015).[7] Cross Telephone submitted written responses to the draft findings and the Company's responses were included in the Final Audit Report e-mailed to Cross Telephone on November 6, 2018. Based on the Auditor's recommendation in Audit Finding No. 1, USAC is seeking to recover $8,251,829 in High Cost Support from Cross.[8] Commission rules permit audited companies to appeal USAC audit findings and, as discussed further herein, Cross Telephone appeals Audit Finding No. 1.

II. USAC IS REQUIRED TO REVIEW AN APPEAL OF AN AUDIT FINDING

Section 54.719(a) of the FCC's rules require any party aggrieved by an action taken by a division of USAC to first seek review of such action with USAC.[9] The Commission's standards for evaluating the merits of an appeal, found in Sections 54.719 through 54.725 of the Commission's rules, remain unchanged and Cross Telephone retains the right to seek Commission review of USAC's decision on appeal.[10]

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[6] *See* Letter from Jarret Rea, CPA, Moss Adams, LLP to R. David Wright, General Manager, Cross Telephone Company, at 2 (July 7, 2016).

[7] Cross Telephone Company, Performance Audit on Compliance with the Federal Universal Service Fund High Cost Support Mechanism Rules, USAC Audit ID HC2016BE031, Draft Report at 1 (July 20, 2018).

[8] Audit Report at 3.

[9] 47 C.F.R. §§ 54.719-54.725. *See* 47 C.F.R. § 54.703 (defining USAC's Board of Directors as the "Administrator" for purposes of appeal).

[10] *See, e.g., In re Modernizing the E-rate Program for Schools and Libraries*, 29 FCC Rcd 8870, 8970-71, ¶¶250-52, 2014 (revising sections 54.719 and 54.720 of the Commission's rules to, among other things, require parties seeking appeal of a USAC decision to first seek review with USAC and confirming the new procedural requirement applies to all USAC decisions.) ("e-Rate Modernization Order").

III. ISSUE: ARE CROSS TELEPHONE'S EXPENSES FOR DS1 TRANSPORT SERVICES PURCHASED FROM AN AFFILIATE PROPERLY REPORTED AS EXPENSES UNDER PART 36 OF THE FCC'S RULES?

A. Statement of Facts

Cross Telephone is a limited liability company formed under the laws of the State of Oklahoma and has a principal place of business located at 704 Third Avenue, Warner, OK 74469. Cross Telephone is a rate-of-return incumbent local exchange carrier ("ILEC") providing local exchange and other telephone services throughout the state of Oklahoma.[11] The Company's customer base includes a mix of business, residential, enterprise and government customers.[12] Cross Telephone receives support from the HCP to aid the Company in making communications service affordable to subscribers in its territory.[13] Cross Telephone provides exchange service to subscribers utilizing a mix of its own facilities and services purchased from other carriers.[14]

During the 2012 – 2016 time period covered by the Audit Finding No. 1, Cross Telephone purchased DS1 transport services, between Warner, Oklahoma and an interexchange carrier POP in Tulsa, Oklahoma.[15] It purchased these transport services from MBO.[16] Cross Telephone did not own the facilities necessary to transport its traffic between Warner and Tulsa

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[11] *See* Declaration of V. David Miller II, Cross Telephone Company L.L.C., ¶3 ("Miller Declaration") attached hereto as Attachment E.

[12] *Id*.

[13] *Miller Declaration*, ¶4.

[14] *Miller Declaration*, ¶3.

[15] *Miller Declaration*, ¶5.

[16] *Miller Declaration*, ¶6.

and, prior to purchasing DS1 transport service from MBO, the Company purchased similar DS1 transport services from other carriers such as Southwestern Bell Telephone (now AT&T).[17] In the late 1990s, MBO constructed a fiber network and used it to offer services to other carriers.[18] Cross Telephone subsequently began purchasing DS1 transport services from MBO and entered into a Master Services Agreement ("MSA") with MBO setting forth the terms and conditions governing the Company's purchase of the transport service.[19] The MSA made clear that Cross Telephone was purchasing services, not leasing facilities, from MBO and that Cross Telephone was not granted title to any of MBO's equipment and facilities in connection with purchase of the DS1 transport service.[20] MBO sold services to other customers and other carriers are receiving services using the same facilities from MBO.[21]

Cross Telephone has consistently reported its DS1 transport service payments to MBO as expenses for HCP support purposes, and information about the Company's reporting methodology was provided to USAC in the course of a 2009 audit reviewing Cross Telephone's HCP reporting in 2004 and 2005.[22] Cross Telephone purchased the same DS1 transport services from MBO in 2012–2016 as it purchased for 2004–2005 and reported the expenses in the same manner during both time periods.[23] The only statement in the 2009 audit findings regarding the DS1 transport services Cross Telephone purchased from MBO was included in a finding which

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[17] *Miller Declaration*, ¶5.

[18] *Miller Declaration*, ¶6.

[19] *Miller Declaration*, ¶7. *See also* MBO Master Service Agreement attached hereto as Attachment F.

[20] *Miller Declaration*, ¶7.

[21] *Miller Declaration*, ¶6.

[22] *Miller Declaration*, ¶9.

[23] *Id*.

also addressed unrelated regulated and non-regulated cost allocations.[24] That statement noted that Cross Telephone had miscounted the transport services purchased from MBO resulting in an understatement of the transport service expenses paid to its affiliate.[25] This conclusion necessarily considered the expenses and how they were reported, but the audit did not challenge Cross Telephone's classification of the services purchased from MBO as expenses for calculating High Cost support. USAC's Management Response to the 2009 Audit Finding No. 1, in turn, included a general statement that carriers must submit accurate financial data and did not express any disagreement with the Company's methodology for reporting expenses for the DS1 transport services purchased from MBO.[26]

B. Audit Finding and Points for Appeal

In Detailed Audit Finding No. 1, the Auditor concluded that Cross Telephone incorrectly included certain affiliate transaction expenses as circuit expenses in the Company's traffic studies and HCP filings.[27] The Audit Report stated that during the period of 2010-2014, Cross Telephone reported $11,512,510 of circuit expenses for DS1 transport service purchased from MBO.[28] Concluding that the DS1 transport service expenses were "substantial" and constituted "rent" expense for Cross Telephone's use of MBO's interexchange plant, the Auditor recommended the DS1 transport service expense be removed and rented interexchange plant

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[24] *See* Draft Cross Summary of Findings as of June 30, 2010 at 2.

[25] *See* Draft Cross Summary of Findings as of June 30, 2010 at 2. *See also* 2009 Audit USAC Response at 1.

[26] *See* Draft Cross Summary of Findings as of June 30, 2010 at 2. *See also* 2009 Audit USAC Response at 1.

[27] Audit Report at 12.

[28] Audit Report at 12.

expenses be included in the Company's HCP filings.[29] Based on the Auditor's recommendation in Audit Finding No. 1, USAC is seeking to recover $8,251,829 in High Cost Support from Cross Telephone.[30]

The Auditor's Finding No. 1 is based on a misguided reliance on Rule 36.2(c)(2) and the Commission's decision in *Moultrie*, both inapplicable to Cross Telephone's affiliate service purchase. First, Cross Telephone only purchased DS1 transport services from its affiliate and did not engage in an affiliate sale and lease-back transaction. Consequently the Commission's decision and rationale in *Moultrie* simply does not apply. Moreover, QSI's review and analysis of Cross Telephone's DS1 transport service agreement with MBO provides new support confirming that the Company's purchase was indeed a purchase of service, not a lease of facilities, and was correctly reported as expenses.[31] Second, Commission Rule 36.2(c)(2), which governs the separations treatment of a carrier's property rented to or from its affiliate[32] is, on its face, inapplicable to Cross Telephone's purchase of DS1 transport service from MBO. QSI's analysis provides additional new information regarding Rule 36.2(c)(2) and shows that any attempt to apply the rule to Cross Telephone's affiliate *service purchase* arrangement would require key rule terms be interpreted contrary to historical and current Commission definitions of those terms. USAC's authority is administrative and it is prohibited from interpreting unclear provisions of Commission rules[33] so any attempt by the Auditor to

[29] Audit Report at 12.

[30] Audit Report at 3.

[31] *See Fischer Declaration passim*.

[32] 47 C.F.R. §36.2(c)(2).

[33] *See, e.g.*, *Changes to the Bd. of Dirs. of the Nat'l Exch. Carrier Ass'n, Inc., Fed.-State Joint Bd. on Universal Serv.*, 13 FCC Rcd 25058, ¶16 (1998) ("*USAC Policy Order*"); Memorandum of Understanding between the

interpret Rule 36.2(c)(2) or the *Moultrie* decision to apply to Cross Telephone's purchase of a service from its affiliate would be *ultra vires*.[34] Alternatively, USAC was aware from its 2009 audit of Cross Telephone's prior purchase of identical DS1 transport services from MBO and reporting of those transport services as expenses. USAC did not express any disagreement with Cross Telephone's reporting methodology during the 2009 audit and the Company therefore reasonably relied on USAC's position when Cross Telephone continued to utilize the reporting methodology which is now at issue in Audit Finding No. 1. If this abrupt change in USAC's position is permitted, it must be applied on a prospective basis only.

C. Application of the *Moultrie* Decision and Commission Rule 36.2(c)(2) to Cross Telephone's Affiliate Transport Service Purchase Requires an Unreasonably Expansive Reading of the Rule and of *Moultrie*

The *Moultrie* decision and the Commission's rationale reflect the Commission's decision regarding a fact-specific, property sale and lease-back affiliate transaction arrangement. Similarly, Commission Rule 36.2(c)(2) addresses the treatment of a carrier's property rental to or from an affiliate. Both *Moultrie* and Rule 36.2(c)(2) address affiliate transactions that differ substantively and significantly from Cross Telephone's affiliate service purchase arrangement.

1. *Cross Telephone's purchase of DS1 transport service from MBO is not a property sale and lease-back affiliate transaction as was at issue in Moultrie.*

Federal Communications Commission and the Universal Service Administrative Company, Section II (2016) ("USAC MOU"). *See also* 47 C.F.R. §54.702. ("The Administrator may not make policy, interpret unclear provisions of the statute or rules, or interpret the intent of Congress. Where the Act or the Commission's rules are unclear, or do not address a particular situation, the Administrator shall seek guidance from the Commission").

[34] *See* 47 C.F.R. §54.702.

Moultrie, a rural, rate-of-return ILEC receiving HCP support, transferred ownership of certain of non-loop assets, including land, buildings, equipment and vehicles, to its affiliate.[35] Moultrie and its affiliate then entered into an arrangement whereby Moultrie leased back the assets, at cost, from its affiliate.[36] Moultrie purposely structured its affiliate transaction to optimize its High Cost support and "maximize tax benefits" "through the transfer of substantial non-loop related assets to an affiliate."[37] Moultrie submitted a cost study to the National Exchange Carrier's Association ("NECA"), for high-cost support purposes, and reported the rental costs for the assets rented from its affiliate but excluded the property assets.[38] NECA returned Moultrie's cost study as non-compliant with the Commission's Part 36 Separations rules.[39] Moultrie sought a Petition for Declaratory Ruling from the Commission regarding the reporting of Moultrie's affiliate sale and lease-back expenses and the *Moultrie* decision reflects the Commission's resolution of Moultrie's Petition.[40]

Cross Telephone is an ILEC that receives HCP support but that is where any similarity between the Company and Moultrie ends. Unlike the facts in *Moultrie*, Cross Telephone's purchase of DS1 transport service from its affiliate is not a sale and lease-back transaction. The FCC's decision in *Moultrie* therefore does not apply to the Cross Telephone affiliate service purchase.

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[35] *Moultrie*, ¶4.

[36] *Moultrie*, ¶4.

[37] *Moultrie*, ¶¶1, 14.

[38] *Moultrie*, ¶¶4-5.

[39] *Moultrie*, ¶¶4-5.

[40] Moultrie Independent Telephone Company, Petition or Declaratory Ruling, at 5, CC Docket No. 96-45 (March 29, 1999) ("Moultrie Petition").

a. Cross Telephone did not engage in a sale and lease-back arrangement with MBO

The Auditor's basis for Finding No. 1 relies heavily on the Commission's discussion in *Moultrie* regarding the potential separations distortion that can occur if a carrier is able to exclude basic plant costs from the carrier's cost study and include additional expenses.[41] However, the Auditor's reliance on *Moultrie* is unfounded as the Commission's rationale in *Moultrie* focused on affiliate property sale and lease-back scenarios[42] which are not present in the Cross Telephone Audit. Unlike in *Moultrie*, Cross Telephone did not enter into a property sale and lease-back transaction with its affiliate.[43] As noted in Section III.A *supra*, Cross Telephone purchases DS1 transport service from MBO to transport traffic between the Company's switch in Warner, Oklahoma and an AT&T meet point in Tulsa, Oklahoma.[44] Prior to obtaining the transport service from MBO, Cross Telephone purchased the service from Southwestern Bell Telephone, an unaffiliated carrier.[45] Cross Telephone does not now own, and has never owned, the facilities necessary to transport its traffic on the Warner-Tulsa route.[46] Consequently, Cross Telephone could not, and did not, sell to MBO the assets used to provide the transport service that Cross Telephone currently purchases from MBO.[47] There was no "sale" of assets to an affiliate and therefore there was no "sale and lease-back" transaction

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[41] Audit Report at 22.

[42] *Moultrie* ¶12 ("If a company were to *sell and lease back* one of these "foundation blocks" of plant") (emphasis added); ¶13 ("If an incumbent were to s*ell large portions of its non-loop related plant to an affiliate, and then lease back those assets*") (emphasis added).

[43] *Miller Declaration*, ¶7.

[44] *Miller Declaration*, ¶5.

[45] *Id*.

[46] *Id*.

[47] *Miller Declaration*, ¶7.

between Cross Telephone and MBO. Consequently, the *Moultrie* decision's rationale regarding the potential separations distortion and impact on high-cost loop support resulting from a sale and lease-back arrangement is not applicable to Cross Telephone's audit.

b. <u>Cross Telephone purchased a service and did not lease facilities from MBO</u>

In contrast to *Moultrie,* and as QSI's review of the Company's DS1 transport service agreement and Commission materials show, Cross Telephone purchased *service*, and *did not lease* any assets, from its affiliate.[48] In seemingly willful indifference to the facts of Cross Telephone's *purchase* of DS1 transport *service* from MBO, the Auditor seeks to require the Company to treat the purchase as a lease of assets. The audit finding is particularly troubling because the Auditor reached a conclusion regarding Cross Telephone's reporting without ever defining the key terms. Specifically, the Auditor states that Cross Telephone had "substantial rent expense"[49] and relies on a NECA discussion applicable to "Operating Lease Expenses and Capital Leases."[50] However, the Audit Report does not define the terms "lease" or "rent" nor does the Auditor attempt to apply any definition of these critical terms to the facts of Cross Telephone's service purchase. However, words matter. Leases and purchases are distinct arrangements and, as discussed below, the key indicia of a lease is the conveyance of a right or interest in an asset.[51]

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[48] *Id*.

[49] Audit Report at 14.

[50] Audit Report at 23.

[51] *See, e.g.*, NECA Cost Issue 2.19 Separations Treatment of Operating Lease Expenses and Capital Leases, ("NECA Cost Issue 2.19"); *In re Connect America Fund*, Report and Order, Further Notice of Proposed Rulemaking, and Order on Reconsideration, FCC 18-176 (Dec. 13, 2018) ("CAM Order"); 26 U.S.C. §7701(e) ("IRC").

NECA, in its Separations Cost Issue, draws a clear distinction between leases and service agreements with conveyance of a right to an asset being the key distinction:

> Leases are defined . . . as '*an agreement conveying the right to use property, plant or equipment* (land and/or depreciable assets) *usually for a stated period of time*. This *definition does not include agreements that are contracts for services that do not transfer the right to use property, plant or equipment from one contracting party to another*.[52]

The Commission just adopted a nearly identical definition of "lease" that similarly focuses on the conveyance of a right to an asset: "[w]e adopt the definition of a lease as contained in the FASB lease accounting standards, which define a lease as a contract, or part of a contract, *that conveys the right to control the use of identified property, plant and equipment* (identified asset) for a period of time in exchange for consideration."[53] Similarly, as discussed in the Memorandum prepared by Bennet & Bennet PLLC, Cross Telephone's regulatory counsel, and that was submitted to the Auditor during the course of the audit, the Internal Revenue Code ("IRC") incorporates principles established by the International Accounting Standards Board and similarly considers the conveyance of a right to an asset as an indicator of an asset lease.[54] Specifically, IRC §7701(e) states that a service contract will be treated as a lease of property if certain factors are present, including "the service recipient is in physical possession of the

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[52] *NECA Cost Issue 2.19* at page 1 of 9, n.1 (emphasis added).

[53] *CAM Order*, ¶156.

[54] *See* Memorandum, prepared by the Law Office of Bennet & Bennet, PLLC ("Bennet Memorandum"), attached hereto as Attachment G. The Bennet Memorandum also was submitted with Cross Telephone's August 14, 2018 response to the draft audit report.

property" or "controls the property" or "has a significant economic or possessory internet in the property".[55]

Cross Telephone explained during the Audit that it purchased DS1 transport services from MBO pursuant to an MSA and, QSI's review and analysis of the MSA provisions, demonstrates that the Company undoubtedly was purchasing a service, not leasing property from MBO.[56] First and foremost, QSI notes that the MSA explicitly denies a conveyance of any rights.[57] This denial of a conveyance of rights is consistent with NECA's statement that service contracts do not transfer rights from one party to another and is inconsistent with the indicia of an asset lease.[58] QSI highlights that at least two provisions of the MSA disclaim any conveyance of rights. MSA Section 8.8 states:

> <u>Title to Equipment</u> This *Agreement shall not, and shall not be deemed to, convey to Customer title of any kind to any MBO owned or leased transmission facilities*, digital encoder/decoders, telephone lines, microwave facilities *or other facilities utilized in connection with the Services*.[59]

Likewise, MSA Section 8.26 states:

> <u>Intellectual Property Rights</u> Unless otherwise specifically agreed in writing by the parties, *each party shall retain all right, title and interest in and to any intellectual property associated with the provision of Services*.[60]

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[55] IRC §7701(e); *See also* Bennet Memorandum at 1-2.

[56] *Fischer Declaration*, ¶17.

[57] *Fischer Declaration*, ¶23.

[58] *See* NECA Cost Issue 2.19. *See also* IRC §7701(e) and *CAM Order*, ¶156.

[59] *Fischer Declaration*, ¶23 (quoting Cross/MBO MSA, §8.8 (emphasis added)).

[60] *Fischer Declaration*, ¶23 (quoting Cross/MBO MSA, §8.26 (emphasis added)).

The foregoing MSA provisions are indicia of a contract for the sale of a service, not for a lease of facilities or equipment.

QSI notes that, in addition, and most obviously, the MSA uses the term "services" repeatedly throughout the document.[61] In particular, "Services" are referenced in "1.1 Services", "3.3 Service Acceptance", "5.7 Charges for Service", "6.1 Suspension of Service", "6.2 Termination of Service", "8.7a Use of Services".[62] Nowhere does the MSA refer to a lease, to the use of "facilities" or to the rental of "property." Moreover, QSI explains that the compensation structure identified in the MSA is indicative of a purchase of telecommunications services.[63] Cross Telephone pays a flat monthly fee per DS1 on a month-to-month basis and the Company's service orders may change based on the Company's particular service demands for each month.[64] In QSI's expert opinion the monthly fluctuation in Cross Telephone's volume of DS1 transport service is more common in service purchases and less common in lease arrangements. [65] QSI's analysis identified fluctuations in Cross Telephone's DS1 transport service circuits, which is consistent with a service purchase rather than a lease.[66] The review of Cross Telephone's DS1 transport service circuits purchased from November 2011 to May 2016 illustrates that the Company's monthly circuit counts varied from 77 to 180 DS1 circuits with only 32 circuits, out of 262 distinct DS1 circuits ordered, being present each month and another

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[61] *Fischer Declaration*, ¶21.

[62] *Id*.

[63] *Fischer Declaration*, ¶22.

[64] *Miller Declaration*, ¶6. *See also Fischer Declaration*, ¶22.

[65] *Fischer Declaration*, ¶¶19, 22.

[66] *Fischer Declaration*, ¶19.

62 DS1s were present in twelve or fewer months.[67] QSI explained that this flexibility in Cross Telephone's monthly DS1 transport circuit purchases stands in stark contrast with lease arrangements which oftentimes require term commitments of at least a year and have monthly payments that typically do not fluctuate based on the customer's demand.[68]

c. <u>Cross Telephone did not purchase DS1 transport services from MBO in an attempt to obtain more HCP Support</u>

In further contrast to *Moultrie*, Cross Telephone's purchase of DS1 transport services from MBO was not designed to manipulate the HCP system to "maximize" the HCP support that the Company received. In fact, QSI's analysis confirmed that Cross Telephone's decision to switch from SWBT to MBO for transport services, created an overall cost savings to the benefit of Cross Telephone and to contributors to the HCP.[69] Because Cross Telephone never owned the facilities necessary to provide the transport it purchased on the Warner-Tulsa route, there was no "gaming" of the HCP such as could result from a carrier selling property to an affiliate and leasing it back from the affiliate. This fact is important because Moultrie's purposeful structuring of its sale and lease-back transaction with its affiliate to "maximize" its HCP support was a key factor in the Commission's decision that Moultrie should have included its property expenses and excluded its rent expenses related to its sale and lease-back affiliate transaction.[70] The Commission noted that the Moultrie arrangement provided a clear example of the purpose of Section 36.2:

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[67] *Id*.

[68] *Fischer Declaration*, ¶22.

[69] *Fischer Declaration*, ¶26.

[70] *Moultrie*, ¶14 (emphasis added).

> Rather, Moultrie appears to have traded with its affiliate the legal ownership of certain assets that it will still use in its operations, for the sole purpose of generating more favorable universal service subsidies. . . . *This case presents us with the exact type of separations or high-cost support manipulation, through the use of sales and lease-backs to and from affiliates, which section 36.2(c)(2)(2) of the Commission's rules seeks to prevent*.[71]

Cross Telephone did not involve the "type of separations or high-cost support manipulation [that Rule 36.2(c)(2)] seeks to prevent" and application of the Rule is not warranted: Cross Telephone never owned the facilities necessary for the transport on the Warner-Tulsa route, never engaged in an affiliate sale and lease-back transaction for the Warner-Tulsa route, and the Company's purchase of DS1 transport service from MBO did not manipulate Cross Telephone's HCP support.

d. <u>Cross Telephone's HCP cost study was never rejected by NECA</u>

Finally, unlike in *Moultrie*, NECA did not disagree with or reject Cross Telephone's support studies.[72] During the time period covered by the audit, Cross Telephone participated in the NECA tariff and submitted annual cost studies to NECA.[73] The Company's cost studies treat its affiliate DS1 transport service purchase expenses as expenses and NECA has never rejected Cross Telephone's cost studies based on that reporting.[74] After the *Moultrie* case and Commission decision, NECA presumably would have been more attuned to reporting of affiliate transactions that could trigger application of Rule 36.2(c)(2). The fact that NECA

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[71] *Moultrie*, ¶14.

[72] *Miller Declaration*, ¶11.

[73] *Id*.

[74] *Id*.

accepted Cross Telephone's cost studies is a strong indicator that the Company's reporting was consistent with applicable Commission rules and that the Auditor's contrary finding was erroneous.

2. *Commission Rule 36.2(c)(2) applies only to affiliate property sale and lease-back transactions and carrier rentals of property to or from an affiliate and does not apply to carrier service purchases from an affiliate.*

As QSI's comprehensive review of Commission Rule 36.2(c)(2), the key Commission rule underlying the *Moultrie* decision, shows, the Rule is *prima facie* inapplicable to Cross Telephone's purchase of DS1 transport services from MBO. Any attempt to interpret the rule more broadly, to encompass the Cross Telephone affiliate service purchase, requires an unreasonably expansive reading of the rule and would be an *ultra vires* interpretation of a Commission rule.

QSI's assessment begins by noting that Commission Rule 36.2(c)(2), on its face, exclusively addresses the reporting of expenses for property rented to or from a carrier's affiliate:

> (c) *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.[75]

[75] 47 C.F.R. §36.2(c)(2) (emphasis added).

The *Moultrie* decision explained that Rule 36.2(c)(2) also applied to affiliate asset sale and lease-back transactions including the transaction at issue in *Moultrie*:

> *with respect to the sale and lease-back transaction*, we direct Moultrie to *include the property and related expenses with, and exclude the related rent expenses from, the carrier's regulated telephone operations as required by section 36.2(c)(2) of the Commission's rules*.[76]

However, neither the rule nor the *Moultrie* decision state, or even suggest, that Rule 36.2(c)(2) applies to a carrier's *purchase of services* from its affiliate. Rather than declaring the rule applicable to *service purchases*, the *Moultrie* decision suggests a more *limited* reading of the parameters of the section 36.2 rules as "governing the treatment of *rented property, related expenses, and lease payments between carriers and their affiliates*" and notes that "*[t]his rule directs* incumbent carriers on the *proper treatment of property rented to or from affiliates* and related costs (i.e., reserves, revenues, expenses lease payments) in the performance of a Part 36 cost study."[77]

Moreover, the *Moultrie* decision is replete with statements that describe the rule's application as limited to property sales and rentals. The Common Carrier Bureau's response to NECA's request for guidance regarding how Moultrie should report its affiliate sale and lease-back expenses stated that the "underlying principle in section 36.2(c)(2) [] governs property rented from affiliates."[78] The Commission further describes the Section 36.2 rules as

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[76] *Moultrie*, ¶1 (emphasis added).

[77] *Moultrie*, ¶10 (emphasis added).

[78] *Moultrie*, ¶5.

"fundamental principles in separations procedures" that "govern[] the treatment to rented property, related expenses, and lease payments between carriers and their affiliates for separations and high-cost loop expense adjustments."[79] In stating that carriers are free to lease, rather than own assets, as long as they report properly, the Commission states "Section 36.2(c)(2) simply instructs carriers on how to treat sale and lease-back arrangements in the performance of the Part 36 cost study."[80]

What is not present in the *Moultrie* decision is any statement or suggestion that Rule 36.2(c)(2) can or should be read broadly to apply to any affiliate transaction other than rented property or an asset sale and lease-back between a carrier and an affiliate. Consequently, the Auditor's efforts to apply Rule 36.2(c)(2) to Cross Telephone's purchase of DS1 transport service from MBO are misplaced.

3. *Applying the Moultrie decision and Rule 36.2(c)(2) to affiliate service purchases requires the Auditor make an unreasonably broad and ultra vires interpretation of the rule.*

The Auditor's proposed application of the *Moultrie* decision and Rule 36.2(c)(2)'s reporting mandate to Cross Telephone requires an expansive and *ultra vires* interpretation of the rule. QSI explains that interpreting Rule 36.2(c)(2) to apply to the purchase of a service requires that the rule's terminology be defined in ways that contradict prior Commission discussions and definitions.

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[79] *Moultrie*, ¶10.

[80] *Moultrie*, ¶15.

a. Interpreting Rule 36.2(c)(2) as applicable to Cross Telephone's purchase of DS1 transport service requires interpretations that conflict with current and historical Commission definitions.

Application of Rule 36.2(c)(2) to Cross Telephone's affiliate service purchase requires substantial interpretation and expansion of the rule. On its face, Rule 36.2(c)(2) does not apply to Cross Telephone's affiliate service purchase unless key terms such as "rent" and "property" can be interpreted to include "purchase" and "service." Despite being an *ultra vires* interpretation of the rule, manipulating these key terms contradicts historical Commission discussion of these terms.

QSI provided a detailed and comprehensive review of the Part 36 reporting, explaining that the Commission's Part 36 jurisdictional separations rules require that a carrier's accounts of telecommunications property, revenues, expenses, *etc*., be classified consistent with the Part 32 Uniform System of Accounts ("USOA") for Telecommunications Companies.[81] QSI noted that the FCC's rules currently do not define the expense subcategory of "rent" but, up until 2000, the terms was defined as expense paid for physical property:

> (3) Rents. (i) This subsidiary record category shall include amounts paid for <u>the use of real and personal operating property</u>. 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. (ii) This subsidiary record category is applicable only to the Plant Specific Operations Expense accounts. Incidental rents, e.g., short-term rental car expense, shall be categorized as Other Expenses (see paragraph (f)(4) of this section) under the account which reflects the function for which the incidental rent was incurred. (<u>emphasis added</u>)[82]

[81] 47 C.F.R. §36.1(f). *See also Fischer Declaration*, ¶32.

[82] *Fischer Declaration*, ¶14 (*citing* former Commission rule 47 C.F.R. §32.5999(f)(3)).

This definition carves out a category of "Other Expenses", which was defined to include costs, including for "*contracted services*" that could not be classified in other record categories.[83] This rule and others were eliminated in a 2000 Commission order streamlining Part 32 reporting.[84] However, QSI highlights that the definitions themselves remain valid as the *2000 Accounting Streamlining Order* noted that companies were expected to continue collecting data covered by the eliminated rules.[85] Based on its experience and review of the rules, QSI concluded that "rent", as used in Rule 36.2(c)(2), refers to payment for the "use of real and personal operating property", *not for the purchase of a service* such as the DS1 transport service that Cross Telephone purchases from MBO.[86] QSI noted that the *2000 Accounting Streamlining Order* further confirms its assessment as "pole attachment rents" was one of the examples of "rent" discussed in that order and pole attachments, which involve the rent of physical space on a pole, are a clear example of the use of personal operating property.[87] In contrast, the DS1 transport service that Cross Telephone purchases from MBO is not "real and personal operating property", rather it is *telecommunications* which provides "transmission, between or among points specified by the user, of information of the user's choosing, without change in the form or content of the information as sent and received."[88]

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[83] *Fischer Declaration*, ¶14 (*citing* former Commission rule 47 C.F.R. §32.5999(f)(4)).

[84] *Fischer Declaration*, ¶15 (*citing In the Matter of Comprehensive Review of the Accounting Requirements and ARMIS Reporting Requirements for Incumbent Local Exchange Carriers: Phase 1*, 15 FCC Rcd 8690 (2000). ("*2000 Accounting Streamlining Order*"). Rule modifications adopted in the *2000 Accounting Streamlining Order* became effective on September 28, 2000 (see Federal Register, Vol. 65, No. 60 dated Tuesday, March 28, 2000)).

[85] *Fischer Declaration*, ¶15.

[86] *Fischer Declaration*, ¶16.

[87] *Id*.

[88] *Fischer Declaration*, ¶16 (*citing* 47 U.S.C. §153).

QSI explains that DS1 transport service utilizes "operating properties" but, the mere fact that a services *relies on* certain operating properties does not mean the service payments are payments for "the use of property."[89] Such an interpretation would lead to the illogical result of the DS1 transport service payments being classified as "rent" for the operating properties such as general purpose computers used for billing for the service or trucks used for repairing service issues.[90] Moreover, based on its review of Cross Telephone's MSA with MBO, QSI notes that the Company's service is not tied to a specific DS1 "property." Instead the DS1 transport service is provided via MBO's high capacity fiber-based system, that is also used to serve other carriers, supporting QSI's assessment that Cross Telephone's DS1 service is not provided via specific strands as would be expected in a "lease" arrangement.[91]

QSI's analysis and research also shows that the FCC recognizes that a service may be provided using property but that "service revenues" can be separate from "rent" revenue. QSI suggests that a prime example of this concept is reflected in Commission rule 32.5200, regarding USOA "Miscellaneous Revenue," excerpted below which specifically references separate equipment and service revenues:

> (a) Rental or subrental to others of *<u>telecommunications plant furnished apart from telecommunications services</u>* rendered by the company (this revenue includes taxes when borne by the lessee). It includes revenue from the rent of such items as space in conduit, pole line space for attachments, and any allowance for return on property used in joint operations and shared facilities agreements.[92]

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[89] *Fischer Declaration*, ¶17.

[90] *Id*.

[91] *Fischer Declaration*, ¶18.

[92] 47 C.F.R. § 32.5200 (emphasis added). *See also Fischer Declaration*, ¶20.

QSI contrasts the prior quote with, USOA which requires service revenues, such as from private line service, to be booked to service-specific accounts:

> Private line revenue. This account shall include *revenue derived from local services that involve dedicated circuits, private switching arrangements, and/or predefined transmission paths*, whether virtual or physical, which provide communications between specific locations (e.g., point-to-point communications).[93]

The FCC Form 499A makes a similar distinction with Line 418 including revenue "from *the sale or lease of transmission facilities*, such as dark fiber or bare transponder capacity, *that are not provided as part of a telecommunications service* or as a UNE."[94] Further exemplifying the separation of "service" revenues from a facilities "rent" revenue, and particularly relevant here, is MBO's reporting of the DS1 service revenue it receives from Cross. MBO reports these services revenues on line 305.1 which reports "[r]evenues from *providing local services* that involve dedicated circuits, private switching arrangements, digital subscriber lines, and/or predefined transmission paths"[95] rather than on line 418 as revenues from the "lease of transmission facilities that are not provided as part of telecommunications service."[96]

QSI's research confirms that the Commission's current and historical definitions of "rent" and "property" as used in Rule 36.2(c)(2) eliminate any doubt regarding the limited scope of that rule and foreclose applying the rule to a carrier's purchase of services from an affiliate. A service is not the same as "real and personal operating property" and the payment for

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[93] 47 C.F.R. § 32.5040 (emphasis added). *See also Fischer Declaration*, ¶20.

[94] 2018 Instructions to the Telecommunications Reporting Worksheet, Form 499-A, p. 33 (emphasis added).

[95] *Miller Declaration*, ¶8. *See also* 2018 Instructions to the Telecommunications Reporting Worksheet, Form 499-A, p. 26.

[96] *Id*.

a service is not the same as "rent" for the "use of real and personal operating property."[97] As QSI's assessment shows, reliance on Rule 36.2(c)(2) to govern Cross' reporting of services purchased from MBO requires the Rule's use of "rent" and "property" to include payment for a service.[98] Such an interpretation would contradict the Commission's definitions of the terms and would result in an *ultra vires* interpretation of the rules.

b. The Auditor's interpretation of Rule 36.2(c)(2) is impermissible and *ultra vires*

The Auditor had no authority to interpret Commission Rule 36.2(c)(2) or the *Moultrie's* discussion of affiliate sale and lease-back transactions as applicable to Cross Telephone's purchase of DS1 transport service from MBO. The FCC authorized USAC to "audit contributors and carriers reporting data to the [USAC] Administrator"[99] but there are specific and firm limits on USAC's authority. USAC's authority is "exclusively administrative"[100] and USAC "may not make policy, interpret unclear provisions of the statute or rules, or interpret the intent of Congress."[101] If USAC encounters rules that are not clear "or do not address a particular situation, USAC <u>must seek</u> Commission guidance" on how to proceed.[102] The requirement that USAC seek Commission guidance is mandatory whenever a policy decision is required or in any situation beyond mere administration of the universal service fund. The Auditor conducted the Cross Telephone audit on behalf of USAC and it would be illogical if

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[97] *Fischer Declaration*, ¶16.

[98] *Fischer Declaration*, ¶42.

[99] 47 C.F.R. §54.707(a).

[100] *See, e.g., Changes to the Board of Directors of the National Exchange Carrier Association, Inc.; Federal-State Joint Board on Universal Service*, 13 FCC Rcd 25058, ¶17 (1998) ("1998 USAC Order").

[101] 47 C.F.R. §54.702(c).

[102] *1998 USAC Order*, ¶17 (emphasis added). *See also* 47 C.F.R. §54.702(c).

the Auditor were permitted to exercise greater authority than what the FCC granted to USAC. Consequently, the Auditor was prohibited from interpreting Commission Rule 36.2(c)(2) to apply to Cross Telephone and should have requested that USAC seek Commission guidance on how to proceed regarding the Cross Telephone audit.

The Cross Telephone audit provides a prime example of a situation where USAC should have sought Commission guidance. As discussed *supra*, Rule 36.2(c)(2), on its face, applies to a carrier's property rental to or from an affiliate and the Moultrie decision in which the Commission applied Rule 36.2(c)(2) involved a specific factual circumstance – Moultrie's sale of property to its affiliate and the lease-back of those properties. Cross Telephone's purchase of DS1 transport service from MBO did not involve property rental from MBO nor did it involve the sale and lease-back of property from MBO. Consequently, the Auditor could not apply either Rule 36.2(c)(2) or the Commission's decision in *Moultrie* to Cross Telephone without interpreting the rule or *Moultrie*. This necessary rule interpretation was the line that the Auditor was prohibited from crossing and triggered the mandatory requirement that USAC seek Commission guidance before proceeding further with respect to this issue in the Cross Telephone audit.

USAC is well aware of this requirement, having sought Commission guidance on a number of issues arising during audits, including the regulatory classification of text messaging service, reporting of prepaid calling card revenues on the FCC Form 499A, High Cost Program income tax reporting for S-Corporations and classification of ATM/Frame Relay revenues, to

name a few.[103] Consequently USAC indirectly exceeded its authority when it permitted the Auditor to include an audit finding that is based on an impermissible and *ultra vires* interpretation of Commission rules and orders.

D. Cross Telephone Reasonably Relied on USAC's Prior Awareness of, and Silence Regarding, Cross' Affiliate Purchase Reporting Methodology

As Cross Telephone explained in Section II.A. *supra*, the Company was the subject of a HCP Audit in 2009 that reviewed the same DS1 transport service purchases from MBO and the same expense reporting methodology as are at issue in Finding No. 1 of the current Audit.[104] Aside from noting a minor calculation error, the 2009 Audit did not identify any objections to Cross' methodology for reporting expenses for the DS1 transport service purchased from MBO.[105] Based on this tacit approval from USAC and KPMG regarding Cross Telephone's expense reporting, the Company reasonably continued utilizing the same reporting methodology when the Company purchased the same DS1 transport services in subsequent years. The proposed reversal in USAC's position regarding Cross Telephone's reporting, as reflected in Audit Finding No. 1, is based on the Auditor's erroneous finding that Cross Telephone's DS1 transport service purchase was analogous to an affiliate sale and lease-back transaction and must be reported consistently with such transactions. This Finding No. 1 should

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[103] *See, e.g.*, Letter to Sharon Gillett, Chief, Wireline Competition Bureau, FCC from Richard Belden, Chief Operating Officer, USAC, (April 22, 2011) (seeking guidance regarding regulatory classification of text messaging); Letter to Julie Veach, Acting Chief, Wireline Competition Bureau, FCC from Richard Belden, USAC (Aug. 18, 2009) (identifying six (6) matters for which USAC previously had sought Commission guidance).

[104] *Miller Declaration*, ¶¶9-10.

[105] *Miller Declaration*, ¶9.

be reversed but, if it is not, the Audit Finding must be applied on a prospective basis only to avoid resulting in a manifest injustice to Cross Telephone.

Applicable judicial and Commission precedent, require that this audit finding's unexpected reversal of USAC's position, on which Cross Telephone reasonably relied for several years, be applied on a prospective basis only. The Court of Appeals for the District of Columbia Circuit ("D.C. Circuit") has long-recognized a distinction between Commission agency actions where prospective rather than retroactive application is appropriate. Where the agency's decision substitutes "new law for old law that was reasonably clear", prospective-only application is appropriate.[106] The Commission similarly has consistently applied rule changes solely on a prospective basis where the changes reflected a "reconsideration of past interpretations and applications of the Act,"[107] or were necessary to ensure providers had "certainty regarding their . . . obligations."[108] The Commission also has considered the following D.C. Circuit, non-exhaustive, list of five factors that can be considered when evaluating whether the retroactive application of a decision is appropriate:

> 1) whether the particular case is one of first impression, (2) whether the new rule represents an abrupt departure from well established practice or merely attempts to fill a void in an unsettled area of law, (3) the extent to which the party against whom the new rule is applied relied on the former rule, (4) the degree of the burden which a retroactive order imposes on a party, and (5) the

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[106] *Verizon Tel. Cos. v. FCC*, 269 F.3d 1098, 1109 (D.C. Cir. 2001).

[107] *See, e.g., In re Restoring Internet Freedom*, FCC 17-166, n.792 (2018) (classification change resulting from the Commission's reconsideration of prior interpretations of the Act applied prospectively only).

[108] *See In re Restoring Internet Freedom*, FCC 17-166, *Id.*, ¶526. *See also, e.g.*, *In re Request for Review by InterCall, Inc. of Decision of Universal Service Administrator*, 23 FCC Rcd 10731, ¶23 (2008) (applying a compliance obligation prospectively only where there previously had been "a lack of clarity regarding the direct contribution obligations" applicable to class of service providers).

> statutory interest in applying a new rule despite the reliance of a party on the old standard.[109]

Evaluating the impact of the Audit finding No. 1 on Cross Telephone under even the most comprehensive of these standards, the D.C. Circuit's five factor test, confirms that prospective-only application is warranted.

First, the proposed application of Rule 36.2(c)(2) to a carrier's purchase of services from an affiliate appears to be a case of first impression. A review of the FCC's decisions suggests that the rule has been addressed only on the context of the *Moultrie* decision.

Second, the Auditor's proposed requirement that Cross Telephone report its DS1 transport service expenses as interexchange plant, pursuant to Rule 36.2(c)(2), rather than as an expense is an unexpected and abrupt departure from USAC's prior position on the Company's reporting methodology. As discussed *supra*, USAC was aware, based on its 2009 audit of Cross Telephone, that the Company reported its DS1 transport services purchased from MBO as expenses.[110] Aside from noting a slight miscalculation in the number of DS1 transport circuits that Cross Telephone purchased from MBO, USAC was silent in that audit regarding Cross Telephone's methodology for reporting the devices.[111] Cross Telephone's DS1 transport services and reporting methodology addressed in the 2009 audit are identical to the services and reporting reviewed in the current audit. Consequently, the Auditor's suggestion that Cross must

[109] *In re Regulation of Prepaid Calling Card Services*, 21 FCC Rcd 7290, ¶42 (2006).

[110] *See* Draft Cross Summary of Findings as of June 30, 2010 at 2. *See also* 2009 Audit USAC Response at 1 *and Miller Declaration,* ¶¶9-10.

[111] *See* Draft Cross Summary of Findings as of June 30, 2010 at 2. *See also* 2009 Audit USAC Response at 1 *and Miller Declaration,* ¶9.

now report its transport services consistent with and pursuant to Rule 36.2(c)(2) is an abrupt departure from USAC's position in the 2009 audit.

Moreover, any retroactive application of Audit Finding No. 1 would be particularly egregious as Rule 36.2(c)(2), on its face and as discussed by the Commission, does not apply to Cross Telephone's purchase of DS1 transport services from its affiliate. Rule 36.2(c)(2) exclusively addresses the reporting of expenses for property rented to or from a carrier's affiliate.[112] As discussed in Section II.C.2, *supra*, the Commission repeatedly has described the rule as being limited to property sales and rentals: "underlying principle in section 36.2(c)(2) [] governs property rented from affiliates"[113]; the Section 36.2 rules as "fundamental principles in separations procedures" that "govern[] the treatment to rented property, related expenses, and lease payments between carriers and their affiliates for separations and high-cost loop expense adjustments"[114] and "Section 36.2(c)(2) simply instructs carriers on how to treat sale and lease-back arrangements in the performance of the Part 36 cost study."[115]

Third, as noted above, Cross Telephone has reasonably relied, for the nearly ten (10) years since the 2009 audit, on USAC's 2009 review and non-objection to the Company's reporting methodology.

Fourth, Cross Telephone will suffer a significant financial hardship as a result of the Finding and it will be a manifest injustice should the Auditor's finding in Finding No. 1 be applied retroactively. The Company would be required to return more than $8.2 million in

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[112] 47 C.F.R. §36.2(c)(2).

[113] *Moultrie*, ¶5.

[114] *Moultrie*, ¶10.

[115] *Moultrie*, ¶15.

support to the High Cost fund, despite having already used those funds to provide modern voice and broadband services to subscribers in the rural and high-cost areas for which the HCP support was intended.[116] Moreover, Cross Telephone would not be able to recover those funds from its current subscriber base.[117]

Fifth, the Company is not aware of any statutory interest that would be advanced by applying Rule 36.2(c)(2) in the manner proposed by the Audit Report. Permitting the Auditor's proposed application of Rule 36.2(c)(2) to remain in place would effect an immediate change to Commission accounting rules that even the FCC is prohibited from making and undermines the statutory interest in protecting carriers that is evidenced in the Communications Act's System of Accounts statutes. By concluding that Cross Telephone must report, both retroactively and prospectively, its DS1 transport service expenses as rent – a direction not required by Commission rules - the Auditor is making a unilateral and unauthorized change to the Commission's Part 32 accounting regime. Section 220(g) of the Act requires that carriers receive advance notice of accounting changes: "Notice of alterations by the Commission in the required manner or form of keeping accounts *shall be given to such persons by the Commission at least six months before the same are to take effect*."[118] The Auditor's direction that Cross Telephone immediately revise its accounting reporting directly contradicts the statutory accounting change notice requirement. The Commission's adherence to both the text and the spirit of the statutory notice requirement and implicit carrier protections exemplifies how such

[116] *Miller Declaration,* ¶4.

[117] *Miller Declaration*, ¶4.

[118] 47 U.S.C. § 220(g) (emphasis added).

rule changes properly are made. A prime example is found in a 1974 Commission Notice of Proposed Rulemaking which considered an accounting change and specifically contemplated providing extra notice to avoid disruptions mid-year:

> 13. The Commission proposes to make any rule amendments adopted as a result of this proceeding *effective not less than six months after the issuance of a final order* with respect to this docket, *as required by section 220(g)* of the Communications Act of 1934, as amended, 47 U.S.C. 220(g) . *As a practical matter and in order to avoid making substantive changes in accounting during the year, it is planned that any rule amendments adopted would be made effective as of January 1 of the first full calendar year beginning not less than six months after the issuance of a final order* in this docket . . . .[119]

The Auditor has no authority to require Cross Telephone to conduct its accounting in a manner not required by the Commission's rules and the Auditor's finding directly undermines the statute's interest in protecting carriers. The Auditor's decision will effect an *ultra vires* accounting rule change and must be withdrawn.

In addition, the Commission stated that Rule 36.2(c)(2) was applied in *Moultrie* to address Moultrie's purposeful attempt to "game" the system and maximize its HCP support. Cross Telephone has not attempted to manipulate its operations, by engaging in a property sale and lease-back transaction with MBO, to obtain additional HCP support. Cross Telephone did not own the facilities necessary to provide the transport it is currently purchasing from MBO and the Company neither sold any assets to MBO nor did it rent any property from MBO for

[119] *In re Amendment of Part 31 (Uniform System of Accounts for Class A and Class B Telephone Companies) so as to Permit depreciable Property to be Placed in Groups Comprised of Units with Expected Equal Life for Depreciation under the Straight-Line Method*, Notice of Proposed Rulemaking, 48 FCC 2d 871, ¶13 (1974).

purposes of MBO providing the DS1 transport service. There is no reason to believe that any statutory objective will be served by requiring Cross Telephone to refund to the HCP nearly $8.2 million, that has already been used for its intended purposes, based on the erroneous interpretation of a rule that, on its face and as described by the Commission, does not apply to the Company.

Applying Audit Finding No. 1 retroactively is unwarranted and requiring Cross Telephone to return its HCP support – support that Cross Telephone already has used to serve rural high-cost communities and that Cross Telephone cannot possibly recover from its service operations – would effect a manifest injustice.

IV. CONCLUSION

For the foregoing reasons, Cross Telephone respectfully requests that USAC reverse the Audit Report finding discussed above.

Respectfully Submitted,

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January 4, 2019

Cross Telephone Company, L.L.C.

Audit Appeal to FCC

Exhibit 1

USAC Appeal, Attachment A

Cross Telephone Company, L.L.C.

ATTACHMENT A

Audit Report

Performance Audit on Compliance with the Federal Universal Service Fund High Cost Support Mechanism Rules

Cross Telephone Company
USAC Audit ID: HC2016BE031
SAC No.: 431985

Disbursements Made During the Year Ended December 31, 2015

MOSS-ADAMS LLP

Certified Public Accountants | Business Consultants

CONTENTS

EXECUTIVE SUMMARY

October 4, 2018

Universal Service Administrative Company
700 12th Street, N.W., Suite 900
Washington, DC 20005

Attention: Ms. Telesha Delmar

This report represents the results of Moss Adams LLP's (we, us, our, and Moss Adams) work conducted to address the performance audit objectives relative to Cross Telephone Company, Study Area Code (SAC) No. 431985, (Cross or Beneficiary) for disbursements of $6,289,399 made from the Universal Service High Cost Program (HCP) (Disbursements) during the year ended December 31, 2015. At your request, we have also calculated the estimated monetary impacts of the issue identified in Finding #1 on HCP disbursements during the years ended December 31, 2012, 2013, 2014, and 2016, based on information provided by the Beneficiary related to that finding.

We conducted our performance audit in accordance with the standards applicable to performance audits contained in generally accepted *Government Auditing Standards*, issued by the Comptroller General of the United States (2011 Revision). Those standards require that we plan and perform the performance audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. The audit included examining, on a test basis, evidence supporting the data used to calculate support, as well as performing other procedures we considered necessary to form conclusions. We believe the evidence we have obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. However, our performance audit does not provide a legal determination of the Beneficiary's compliance with specified requirements.

The objective of this performance audit was to evaluate the Beneficiary's compliance with the regulations and orders governing the federal Universal Service High Cost Support Mechanism, set forth in of 47 C.F.R. Part 54, Subparts C, D, K, and M; Part 36, Subpart F; Part 64, Subpart I; Part 69, Subparts D, E, and F; and Part 32, Subpart B as well as the Federal Communications Commission's (FCC) Orders governing federal Universal Service Support for the HCP relative to the disbursements (collectively, the Rules).

Based on the test work performed, our audit disclosed 8 detailed audit findings (Finding or Findings) discussed in the Audit Results section. For the purpose of this report, a Finding is a condition that shows evidence of noncompliance with the Rules that were in effect during the audit period.

Certain information may have been omitted from this report concerning communications with Universal Service Administrative Company (USAC) management or other officials and/or details about internal operating processes or investigations.

This report is intended solely for the use of USAC, the Beneficiary, and the FCC and should not be used by those who have not agreed to the procedures and taken responsibility for the sufficiency of those procedures for their purposes. This report is not confidential and may be released to a requesting third party.

Moss Adams LLP

Overland Park, Kansas
October 4, 2018

Audit Results

Audit Results	Monetary Effect	Recommended Recovery
Finding #1: 47 C.F.R. § 36.2(c)(2) – Incorrect treatment of substantial rent expense paid to an affiliate: The Beneficiary incorrectly included \$2,906,004 of rent expense paid to an affiliate in its 2013 HCP filings instead of properly removing the rent expense and including the rented plant and associated expenses. Additional work performed also indicates the Beneficiary incorrectly included the affiliate rent expense and did not include the rented plant and related expenses in its HCP filings for the years 2010, 2011, 2012 and 2014. The 2010 HCP filings included \$1,481,215 of affiliate rent expense. The 2011 HCP filings included \$2,461,630 of affiliate rent expense. The 2012 HCP filings included \$1,843,004 of affiliate rent expense. The 2014 HCP filings included \$2,820,657 of affiliate rent expense.	\$8,251,829	\$8,251,829
Finding #2: 47 C.F.R. § 64.901– Lack of nonregulated adjustments for common costs: The Beneficiary has common costs attributable to both regulated and nonregulated activities and failed to remove \$91,901 of nonregulated expenses from its HCP filings.	\$8,587	\$8,587
Finding #3: 47 C.F.R. § 64.901– Incorrect nonregulated adjustments for rate base and expenses: The Beneficiary made nonregulated adjustments for general support expenses, but failed to remove the associated assets and accumulated depreciation. In addition, the nonregulated adjustments were based on 2012 information and should have been based on 2013.	\$15,780	\$15,780

Audit Results	Monetary Effect	Recommended Recovery
Finding #4: 47 C.F.R. § 36.611(h) – Underreported loops: The Beneficiary underreported its total loops by 3 in its 2014-1 HCLS filing.	$2,882	$2,882
Finding #5: 47 C.F.R. § 54. 320(b) – Lack of supporting invoice documentation: The Beneficiary was unable to provide supporting invoice documentation for two of the 65 individual transactions selected from expense accounts.	$1,680	$1,680
Finding #6: 47 C.F.R. § 54.7(a) and 47 C.F.R. § 65.450(a) – Disallowed expenses: The Beneficiary included $18,798 of expenses in its HCP filings that were not related to provisioning, maintaining, or upgrading telecommunications services.	$3,646	$3,646
Finding #7: 47 C.F.R. § 32.6512(b) – Clearing of provisioning expense: The Beneficiary did not clear $59,644 from provisioning expense to plant under construction or plant specific operations expense.	$2,390	$2,390
Finding #8: 47 C.F.R. § 32.12(b) and 47 C.F.R. § 54.320(b) – Payroll allocations: The Beneficiary allocated its 2013 payroll and related benefits based on a 2008 time study and was unable to provide documentation to support the time study was still appropriate for 2013 payroll allocations.	$0	$0
Total Net Monetary Effect	**$8,286,794**	**$8,286,794**

USAC Management Response

USAC management concurs with the audit results and will seek recovery of the High Cost Program support amount noted in the chart below. USAC requests that the Beneficiary provide a detailed description of the policies and procedures implemented to address the findings no later than sixty (60) days after receipt of this audit report. Please submit the requested information to hcaudits@usac.org. The Beneficiary may be subject to further review if the Beneficiary does not provide the requested information to USAC.

	ICLS	LSS	HCL	USAC Recovery Action
Finding #1	$1,595,110	$479,390	$6,177,329	$8,251,829
Finding #2	$2,636	$0	$5,951	$8,587
Finding #3	$10,538	$0	$5,242	$15,780
Finding #4	$0	$0	$2,882	$2,882
Finding #5	$445	$0	$1,235	$1,680
Finding #6	$3,646	$0	$0	$3,646
Finding #7	$10,249	$0	($7,859)	$2,390
Finding #8	$0	$0	$0	$0
Mechanism Total	$1,622,624	$479,390	$6,184,780	**$8,286,794**

As a result of the audit, USAC management will recover $8,286,794 of High Cost Program support from the Beneficiary for SAC 431985.

Background and Program Overview

BACKGROUND

The Beneficiary is a cost-based eligible telecommunications carrier (ETC) that provides telecommunications exchange services, including local access, long distance, and Internet services to residential and business customers residing in areas of northeastern Oklahoma.

PROGRAM OVERVIEW

USAC is an independent not-for-profit corporation that operates under the direction of the Federal Communications Commission (FCC) pursuant to 47 C.F.R. Part 54. The purpose of USAC is to administer the federal Universal Service Fund (USF), which is designed to ensure that all people, regardless of location or income have affordable access to telecommunications and information services. USAC is the neutral administrator of the USF and may not make policy, interpret regulations, or advocate regarding any matter of universal service policy.

The High Cost Program (HCP), a component of the USF, ensures that consumers in all less populated areas of the country have access to and pay rates for telecommunications services that are reasonably comparable to those services provided and rates paid in urban areas. The HCP consists of the following support mechanisms:

- High cost loop support (HCLS): HCLS is available for rural companies operating in service areas where the cost to provide service exceeds 115% of the national average cost per loop. HCLS includes the following:
    - Safety net additive (SNA): SNA support is available for carriers that make significant investment in rural infrastructure in years when HCLS is capped and is intended to provide carriers with additional incentives to invest in their networks.
    - Safety valve support (SVS): SVS is available to rural carriers that acquire high cost exchanges and make substantial post-acquisition investments to enhance network infrastructure.
- High cost model (HCM): HCM support is available to carriers serving wire centers in certain states where the forward looking costs to provide service exceed the national benchmark.
- Local switching support (LSS): LSS was available to rural incumbent local exchange carriers (ILEC) serving 50,000 or fewer lines and is designed to help recover the high fixed switching costs of providing service to fewer customers. LSS was phased out June 30, 2012, and was replaced by the Connect America Fund (CAF) as of July 1, 2012.
- Connect America Fund Intercarrier Compensation support (CAF ICC): CAF ICC support was established in the *2011 Transformation Order* as part of the transitional recovery mechanism adopted to mitigate the effect of reduced intercarrier compensation revenues. CAF ICC is the universal service support available to cover the difference between the amount of recovery a carrier is eligible to receive and the amount it may recover through permitted end user charges. For rate-of-return incumbent LECs, the baseline recovery was established at a fixed amount in 2012 and is reduced by five percent annually. CAF ICC disbursements began July 1, 2012.

- Interstate common line support (ICLS): ICLS is available to ILECs and is designed to help its recipients recover common line revenue requirement while ensuring the subscriber line charge (SLC) remains affordable to customers. The common line revenue requirement is related to facilities that connect end users to the carrier's switching equipment.
- Interstate access support (IAS): IAS is available to price-cap ILECs and competitive carriers, and is designed to offset interstate access charges.

Objective, Scope, and Audit Methodology

OBJECTIVE

The objective of our performance audit was to evaluate the Beneficiary's compliance with 47 C.F.R. Part 54, Subparts C, D, K, and M; Part 36, Subpart F; Part 64, Subpart I; Part 69, Subparts D, E, and F; and Part 32, Subpart B as well as the Federal Communications Commission's Orders governing Federal Universal Service Support for the HCP relative to the disbursements for the 12-month period ended December 31, 2015.

This performance audit did not constitute an audit of financial statements in accordance with *Government Auditing Standards*. We were not engaged to, and do not render an opinion on the Beneficiary's internal control over financial reporting or internal control over compliance. We caution that projecting the results of our evaluation on future periods is subject to the risks that controls may become inadequate because of changes in conditions that affect compliance.

SCOPE

The following chart summarizes the Universal Service High Cost Program support that was included in the scope of this audit:

HCSMP Support	Data Period	Disbursement Period	Disbursements
Connect America Fund (CAF) Intercarrier Compensation (ICC)	7/1/2014-6/30/2015 & 7/1/2015-6/30/2016	12/31/2015	$2,026,674
High Cost Loop Support (HCLS)	12/31/2013	12/31/2015	$2,688,163
Interstate Common Line Support (ICLS)	12/31/2013	12/31/2015	$1,574,562
Total			**$6,289,399**

ADDITIONAL WORK

At USAC's request, we determined that the affiliate circuit rent expense that resulted in finding 1 was also present in the high cost forms filed for the three years prior to and the one year after the 2013 data period. We did not perform any other procedures outlined in the audit methodology section for these additional periods. The following charts summarize the Universal Service High Cost Program support related to the incorrect treatment of substantial rent expense paid to an affiliate for the disbursement period years ended December 31, 2012, 2013, 2014, and 2016:

HCSMP Support	Data Period	Disbursement Period	Disbursements
Connect America Fund (CAF) Intercarrier Compensation (ICC)	7/1/2012-6/30/2013	12/31/2012	$517,344
High Cost Loop Support (HCLS)	12/31/2010	12/31/2012	$2,770,706
Interstate Common Line Support (ICLS)	12/31/2010	12/31/2012	$2,048,760
Local Switching Support (LSS)	12/31/2010	12/31/2012	$53,934
Total			**$5,390,744**

HCSMP Support	Data Period	Disbursement Period	Disbursements
Connect America Fund (CAF) Intercarrier Compensation (ICC)	7/1/2012-6/30/2013 & 7/1/2013-6/30/2014	12/31/2013	$1,243,590
High Cost Loop Support (HCLS)	12/31/2011	12/31/2013	$2,609,316
Interstate Common Line Support (ICLS)	12/31/2011	12/31/2013	$1,930,164
Local Switching Support (LSS)	12/31/2011	12/31/2013	$336,258
Total			**$6,119,328**

HCSMP Support	Data Period	Disbursement Period	Disbursements
Connect America Fund (CAF) Intercarrier Compensation (ICC)	7/1/2013-6/30/2014 & 7/1/2014-6/30/2015	12/31/2014	$1,636,986
High Cost Loop Support (HCLS)	12/31/2012	12/31/2014	$2,353,947
Interstate Common Line Support (ICLS)	12/31/2012	12/31/2014	$2,004,204
Local Switching Support (LSS)	12/31/2012	12/31/2014	$0
Total			**$5,995,137**

HCSMP Support	Data Period	Disbursement Period	Disbursements
Connect America Fund (CAF) Intercarrier Compensation (ICC)	7/1/2015-6/30/2016 & 7/1/2016-6/30/2017	12/31/2016	$1,557,192
High Cost Loop Support (HCLS)	12/31/2014	12/31/2016	$2,624,227
Interstate Common Line Support (ICLS)	12/31/2014	12/31/2016	$1,738,766
Local Switching Support (LSS)	12/31/2014	12/31/2016	$0
Total			**$5,920,185**

AUDIT METHODOLOGY

To accomplish our audit objective, we performed the following procedures:

Reconciliation – We reconciled the December 31, 2013 and 2012, trial balances to the separations and Part 64 study inputs and then to the applicable HCP Forms, obtained explanations for any variances, and evaluated the explanations for reasonableness.

Rate Base and Investment in Network Facilities – We utilized an attribute sampling methodology to select asset samples from central office equipment (COE) and cable and wire facilities (CWF) accounts. Asset selections were made from continuing property record (CPR) detail. We determined that balances for the selected assets were properly supported by underlying documentation such as work order detail, third-party vendor invoices, materials used sheets, and time and payroll documentation for labor and related costs. We agreed the amounts charged to work order detail and verified the proper general ledger coding under Part 32. In addition, we verified the physical existence of selected assets.

Tax Filing Status – We verified the tax filing status for the Beneficiary and obtained and reviewed the tax provision and deferred income tax provision calculations, including supporting documentation, for reasonableness.

Postretirement Benefit Liability Accounting – The Beneficiary does not have any postretirement benefit plans; therefore, no testing was performed.

Expenses – We utilized an attribute sampling methodology to select expense samples from operating expense accounts that impact HCLS, ICLS, and CAF ICC. Payroll selections were made from a listing of employees. We agreed the amounts to supporting documentation such as time sheets, labor distribution reports, and approved pay rates, and verified the costs were coded to the proper Part 32 account. We reviewed benefits and clearings for compliance with Part 32.

We made other disbursement selections from accounts payable transactions and agreed amounts to supporting documentation, reviewing for proper coding under Part 32. We selected a sample of manual journal entries to ensure reclassifications between expense accounts were appropriate and reasonable.

Affiliate Transactions – We performed procedures to assess the reasonableness of affiliate transactions that occurred during the period under audit. These transactions involved the provision of services between the Beneficiary and other entities with common ownership. We noted the Beneficiary holds equity ownership in five entities. These affiliates include Cross Cablevision, LLC (100% ownership), Cross Wireless, LLC (100% ownership), Optictel, LLC (20% ownership), Optictel LD, LLC (16.7% ownership), and Cross-Valliant Cellular Wireless Partnership (50% ownership). The Beneficiary is also affiliated, through common ownership, with MBO Holdings, LLC, which holds equity interests in several nonregulated companies, including MBO Video, LLC.

The Beneficiary purchases services from Cross Cablevision, Cross Wireless, MBO, LLC, Optictel LD, MBO Video, and Cross-Valliant Cellular.

We selected a sample of various types of transactions to determine if the transactions were recorded in accordance with 47 C.F.R. Section 32.27 and categorized in the appropriate Part 32 accounts. The following transactions were selected for testing:

- Cable services – Cross Cablevision provides cable television service to the Beneficiary. Transactions occur at prevailing price.
- Wireless services – Cross Wireless provides wireless telecommunications service to the Beneficiary. Transactions occur at prevailing price.
- Transport services – MBO Video provides transport services to the Beneficiary for the use of plant facilities owned by MBO Video. Transactions occur at rates based on historical tariffed rates from other interexchange carriers.
- Long distance services – Optictel LD provides long distance service to the Beneficiary. Transactions occur at prevailing price.

Revenues and Subscriber Listings **-** We tested revenue general ledger accounts, subscriber bills, and other documentation to verify the accuracy and existence of revenues. We utilized an attribute sampling methodology to select revenue samples from subscriber listings. Our testing of subscriber bills consisted of procedures to ensure the lines were properly classified as residential, single-line business, or multi-line business. In addition, we reconciled the revenues reported to National Exchange Carrier Association (NECA) to the general ledger and billing support. We obtained subscriber listings and billing records to determine the lines or loops reported in the HCP filings agreed to supporting documentation. Our analysis included reviewing the listing for duplicate lines, invalid data, and nonrevenue producing lines.

Part 64 Allocations – We reviewed the Beneficiary's cost apportionment methodology and assessed the reasonableness of the allocation methods and corresponding data inputs used to calculate the factors, recalculated the material factors, and recalculated the material amounts allocated. We also evaluated the reasonableness of the assignment between regulated, nonregulated, and common costs and the apportionment factors as compared to the regulated and nonregulated activities performed by the Beneficiary.

COE and CWF Categorization – We reviewed the methodology for categorizing assets including a comparison to network diagrams. We reconciled the COE and CWF amounts to the cost studies and agreed them to the applicable HCP Forms. In addition, we reviewed power and common allocation and physically inspected a sample of COE assets and tested route distances of CWF for reasonableness.

Revenue Requirement – We recalculated the Beneficiary's revenue requirement using our cost allocation software program and reviewed the calculation of revenue requirement including the applications of Part 64, 36, and 69 for reasonableness. In addition, we traced cost study adjustments that were not recorded in the general ledger to supporting documentation and reviewed them for reasonableness.

Detailed Audit Findings

Our performance audit resulted in the following detailed audit findings and recommendations with respect to the Beneficiary's compliance with the Rules. We also included an estimate of the monetary impact of the findings relative to 47 C.F.R. Part 54, Subparts C, D, K, and M, Part 36, Subpart F; Part 64, Subpart I; Part 69, Subparts D, E, and F; and Part 32, Subpart B, as well as the Federal Communications Commission's (FCC) Orders governing federal Universal Service Support applicable to the disbursements made from the HCP during the year ended December 31, 2015.

FINDING No.: HC2016BE031-F01: 47 C.F.R. § 36.2(c)(2) – INCORRECT TREATMENT OF SUBSTANTIAL RENT EXPENSE PAID TO AN AFFILIATE

Condition –
The Beneficiary incorrectly included amounts in its cost studies and HCP filings for the following years (see table below) in account 6230, circuit expense, for substantial rent expense paid to an affiliate for the use of interexchange plant assets owned by its affiliate. The Beneficiary should have removed the circuit expense and needed to include the rented interexchange plant and related expenses in its HCP filings in accordance with FCC rules.

Year	Circuit Expense
2010	$1,481,215
2011	$2,461,630
2012	$1,843,004
2013	$2,906,004
2014	$2,820,657

Cause –
The processes to prepare, review, and approve the cost studies and HCP filings did not identify the affiliate transaction as substantial rent and the application of the requirements in 47 C.F.R. § 36.2(c)(2).

Effect –
The exception identified above, for the years 2010 – 2014 resulted in a net reduction of plant specific expenses of $7,895,619, an average annual increase in rate base of $1,639,885, an increase in depreciation expense of $3,559,080, and an increase in corporate operations expense of $1,482,591, which impacted HCLS, ICLS, and LSS disbursements. Specifically, the reduction of circuit expenses and the inclusion of non-loop (i.e. interexchange) imputed rate base in the Beneficiary's HCP filings decreased HCLS, ICLS, and LSS support.

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 $8,251,829 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	$715,531	$1,308,650	$1,145,785	$1,332,268	$1,675,095	$6,177,329
ICLS	$171,768	$307,643	$332,772	$300,172	$482,755	$1,595,110
LSS	$155,117	$324,273	$0	$0	$0	$479,390

The monetary effect on LSS disbursements exceeds the amount of disbursements received by the Beneficiary during the audit periods due to the impacts of Finding #1 on actual support true-ups which are received in different periods. For example, the final 2010 LSS true-up is included in 2012 disbursements. We assessed what each true-up should have been in the respective disbursement year, based on the application of Finding #1. The following table shows the timing of final true-ups for each LSS filing and the impacts on each support year based on a comparison of final LSS amounts reported by the Beneficiary to LSS recomputed for the effects of Finding #1:

	LSS Payment Year				
			Audit scope		
Payment Description	2010	2011	2012	2013	
2010 LSS based on forecast	507,672				(1)
2011 LSS based on forecast		248,940			(2)
2012 LSS support (Based on 2011 forecast per 2011 Transformation order) - Amount received January through June			124,470		(3)
2010 LSS forecast true-up			(70,536)		(1)
2011 LSS forecast true-up				224,172	(2)
2012 LSS forecast true-up				112,086	(3)
Total	507,672	248,940	53,934	336,258	
Impact from Finding HC2016BE031-F01:					
Monetary effect on 2012 disbursements from 2010 LSS true-up revised for Part 36.2(c)2 application			(155,117)		
Monetary effect on 2013 disbursements from 2011 LSS true-up revised for Part 36.2(c)2 application				(216,182)	
Monetary effect on 2013 disbursements from 2012 LSS true-up revised for Part 36.2(c)2 application				(108,091)	
Monetary effect on LSS disbursements under audit scope	-	-	(155,117)	(324,273)	

Final 2010 LSS as filed	(1)	437,138
Revised for Part 36.2(c)2 application		282,021
Monetary effect on 2012 disbursement		(155,117)
Final 2011 LSS as filed	(2)	473,112
Revised for Part 36.2(c)2 application		256,930
Monetary effect on 2013 disbursement		(216,182)
Final 2012 LSS (one-half of 2011 - automatically filed)	(3)	236,556
Revised for Part 36.2(c)2 application		128,465
Monetary effect on 2013 disbursement		(108,091)

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 –
We disagree with this finding. The auditor's premise is incorrect with respect to both the facts and the law and has led to an erroneous finding.

The auditor's finding is based on the premise that this transaction involves Cross's "use of interexchange plant assets owned by its affiliate" and, therefore, the "rented interexchange plant" should have been included in its HCP filings.

This is incorrect. The transaction does not involve the "use of interexchange plant assets" owned by an affiliate through a lease arrangement. Rather, Cross purchases transport services provided by the DS1 circuits owned and operated by its affiliate, MBO Video, and has no right to access, use, or integrate MBO Video's facilities through a lease arrangement.

A review of the contracts that govern the transaction confirms that this is a purchase of services rather than the conveyance of a right to use MBO Video's plant assets through a lease. In 1998, when Cross first began ordering DS1 services from MBO Video, the parties entered into a "General Contract for Services," containing, among other terms, a "description of services," a right for Cross to increase or decrease the amount of services it purchases, and MBO Video's warranty on its provision of these services. See Attachment A. These terms are inconsistent with the auditor's premise that Cross uses the plant assets of MBO Video under a lease arrangement.

Contrast the General Contract for Services with the "Equipment Lease" simultaneously entered into by Cross and MBO Video to govern a separate transaction that does involve the conveyance of a right to use assets. See Attachment B. The Equipment Lease establishes the conditions under which the lessee could use the leased facilities. For example, the "equipment may only be used and operated in a careful and proper manner," the lessee's "use must comply with all laws, ordinances, and regulations relating to the possession, use, or maintenance of the equipment," the lessee "shall maintain the equipment in good repair and operating condition," and the lessee "shall not assign or sublet any interest in this Lease or the equipment or permit the equipment to be used by anyone" other than lessee or its employees. (Emphasis added.)

Further, the lessor retains title to the equipment, and the lessee must return possession of the equipment to the lessor at the end of the lease term. These are terms and conditions commonly used in the industry when conveying the right to use assets. Further, these terms and conditions are not present in the General Contract for Services that governs Cross's purchase of DS1 services from MBO Video.

In 2008, the parties updated the terms governing Cross's purchase of DS1 services, entering into MBO's then-current form "MBO Master Service Agreement" ("MSA"). See Attachment C. The MSA replaced the 1998 General Contract for Services. (See Section 8.28 of the MSA). It did not replace the Equipment Lease which continues to govern the leased assets. The terms of the MSA further emphasize that the transaction involves Cross's purchase of services, and not a conveyance of a right to use MBO's assets through a lease arrangement.

For example, Section 1.1, Table A lists the services available to Cross, including Private Line Service. As understood in the telecom industry, private line service is a category that includes DS1 services. (See, for example, the FCC's Business Data Services Report and Order released April 28, 2017, which refers to DS1s as services throughout.)

As another example, Section 8.8 provides that the MSA "shall not, and shall not be deemed to, convey to [Cross] title of any kind to any MBO owned or leased transmission facilities, digital encoders/decoders, telephone lines, microwave facilities or other facilities utilized in connection with the Services." Thus, MBO Video specifically does not convey leasehold title in its facilities to Cross in this transaction.

Further, as set forth in the attached legal memorandum prepared by our outside communications counsel, the FCC's Rules, GAAP, the Internal Revenue Code, and even international accounting standards, all lead to the conclusion that Cross's arrangement with MBO is a purchase of services and not a lease. See Attachment D.

In summary, a review of the appropriate evidence and the law refutes the auditor's incorrect premise. Cross purchases services from MBO Video and does not rent the "use of interexchange plant assets." Accordingly, Cross correctly accounted for this transaction, resulting in a $-0- effect on disbursements.

We request that the auditor reassess Finding HC2016BE031-F01 in light of both the facts and the law and find that there is a $-0- effect on disbursements.

Beneficiary Additional Response –
Cross disagrees with the auditor's response in Audit Finding No. 1. As Cross had explained, and as further confirmed in the supporting memorandum that was submitted with Cross' response, Cross purchased DS1 transport services, not DS1 facilities from its affiliate MBO Video, LLC ("MBO"). Cross' purchase of transport services from MBO is not the same as the sale and lease-back arrangement in the Moultrie case and reliance on that decision is inappropriate. Moreover during a 2009 High Cost program ("HCP") audit, the Universal Service Administrative Company ("USAC") reviewed Cross' reporting of DS1 transport services from MBO, identical to the services reviewed in this audit, and neither the auditor KPMG nor USAC expressed any objection, either explicit or implicit, to Cross' reporting methodology for purposes of receiving HCP support. Since 2009, and in reasonable reliance on USAC's silence, reasonably interpreted as a tacit approval, regarding Cross' reporting method, Cross continued to use the same methodology when reporting expenses for subsequent identical services, including those during the 2010-2014 time period covered by this audit. This audit finding effects a contrary and unanticipated reversal of USAC's position regarding Cross' expense reporting. The audit finding should be rejected and, if it is not, this new affiliate reporting guidance should apply prospectively only as any retroactive application will cause manifest injustice to Cross. Most importantly, in no event should Cross be required to refund any HCP support distributed to Cross during the time period covered by the audit.

Cross' DS1 transport service Master Service Agreement with MBO qualifies as a contract for service, not a lease, under Internal Revenue Service and International Accounting Standards Board Criteria

The memorandum, prepared by the Law Office of Bennet & Bennet, PLLC (the "Bennet Memo") and included with Cross' October 20, 2017 response to Audit Finding No. 1, analyzed Cross' Master Service Agreement ("MSA")[1] with MBO (the "Cross/MBO MSA") under the criteria of the Internal Revenue Code ("IRC") and International Accounting Standards Board ("IASB") criteria for distinguishing a contract for services from a contract for a lease. The Bennet Memo provided a detailed analysis and concluded that Cross/MBO MSA would be deemed a contract for services under the IRC and IASB standards.

The Bennet Memo details the Section 7701 IRC criteria governing when a service contract must be treated as a lease and the Cross/MBO MSA does not meet any of the IRC criteria for classification as a lease agreement.[2] IRC Sec. 7701 considers, among other factors, whether the service recipient "controls the property" or "has a significant or possessor interest in the property." The IRC criteria also consider if the service provider "does not bear any risk of substantially diminished receipts"[3] or "does not use the property concurrently to provide significant services to entities unrelated to the service recipient."[4] The Bennet Memo demonstrated that the Cross/MBO MSA neither permitted Cross physical or other control of MBO's DS1 circuits nor granted Cross a possessory interest in MBO's DS1 circuits.[5] Moreover, the Bennet Memo confirmed that MBO retained both the risk of loss and damages on the DS1 facilities and the right to use its facilities to provide - and actually did provide - services to other customers.[6] Particularly relevant here was the Bennet Memo's discussion of a 2011 Internal Revenue Service (IRS) revenue ruling, in which the IRS considered three hypothetical telecommunications service scenarios involving a carrier providing dedicated circuits to a customer and concluded each involved a sale of service, not a lease.[7] In each hypothetical, the carrier retained control and ownership of the facilities and the right to decide how to route the traffic.[8] Notably, the IRS classified the arrangements as sales of service even where an arrangement included the lease of equipment to the customer.[9] Cross' purchase of DS1 transport services from MBO is not materially different from the scenarios considered by the IRS, and, consequently, it is reasonable to conclude that the IRS would deem Cross' service transaction with

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[1] MBO Master Service Agreement attached hereto Attachment 1.

[2] *Bennet Memo at 1-2,* attached hereto as Attachment 2.

[3] *Bennet Memo at 1-2*.

[4] *Bennet Memo at 2.*

[5] *Bennet Memo at 2.*

[6] *Bennet Memo at 2.*

[7] *Bennet Memo at 2-3.*

[8] *Bennet Memo at 2-3.*

[9] *Bennet Memo at 2-3.*

MBO to involve a sale of a service and not a lease of a facility.

There is little reason to doubt that the Cross/MBO MSA similarly would be considered to be for a sale of services, and not a lease, under the IASB's International Financial Reporting Standard 16 ("IFRS 16"). As explained in the Bennet Memo, IFRS 16 classifies a contract is a lease if it "conveys the right to control the use of an identified asset for a period of time in exchange for consideration."[10] Under IFRS 16, a customer is granted "control" when the customer has the right to direct the asset's intended use and obtains substantially all of the economic benefit of that use.[11] Moreover, for the capacity of an asset to be an "identified asset", the capacity portion must be physically distinct and represent "substantially all the capacity of the asset."[12] The Cross/MBO MSA involves neither an identified asset nor grants Cross control of MBO's DS1 circuits. Moreover, the DS1 capacity provided to Cross is only a portion of a larger network that is also used to serve other customers and therefore is not an identified asset. Consequently, the Cross/MBO MSA would be to a contract for services, and not a lease under IASB criteria.

USAC previously reviewed Cross' purchase of MBO DS1 transport service as well as Cross' HCP reporting of the service expenses and USAC implicitly approved Cross' reporting methodology

In 2009, KPMG, on behalf of USAC, conducted an Improper Payment Information Act performance audit of Cross' participation in the High Cost Program (the "2009 Audit").[13] As part of that audit, KPMG reviewed the DS1 transport services Cross purchased from MBO and related expense reporting to assess Cross' compliance with the HCP support rules.[14] Prior to purchasing DS1 transport service from MBO, Cross had purchased DS1 transport service from Southwestern Bell Telephone ("SWBT") pursuant to SWBT's tariff.[15] Cross subsequently began purchasing DS1 transport service from MBO.[16] The DS1 transport services were not the "use of interexchange plant assets" and, accordingly, Cross reported them as service expenses.[17] After a thorough audit, KPMG's only finding referencing the affiliate DS1 transport service purchase did not identify or suggest that Cross' expense reporting methodology was inappropriate.[18] Rather the finding identified only a minor miscount in the volume of transport services Cross purchased and noted that, absent the error,

[10] *Bennet Memo at 3*.

[11] *Bennet Memo at 3*.

[12] *Bennet Memo at 3*.

[13] *See* Declaration of V. David Miller II in Support of Cross Telephone Company L.L.C., ¶ 6, ("Miller Declaration") attached hereto as Attachment 3.

[14] *Miller Declaration*, ¶ 6.

[15] *Miller Declaration*, ¶ 4.

[16] *Miller Declaration*, ¶ 4.

[17] *Miller Declaration*, ¶ 5.

[18] *Miller Declaration*, ¶ 6.

Cross actually would have been eligible for more HCP support than it had received.[19] USAC's Management Response to KPMG's audit report similarly did not object to Cross' methodology for reporting its DS1 transport service expenses.[20]

The DS1 transport services reviewed in the current audit are identical to those reviewed in the 2009 Audit.[21] During the 2010-2014 time period covered by this audit, Cross continued to purchase its DS1 transport service from MBO.[22] The DS1 transport service expense for 2010-2014 constitutes a similar percentage of Cross' total expenses as did the transport service expense reviewed in the 2009 Audit.[23] Cross reported its DS1 transport service expenses in 2010-2014 using the same methodology that it used during the 2009 Audit.[24] The one significant change from the 2009 Audit is that the DS1 transport services are provided pursuant to a revised MSA that establishes, even more definitively, that Cross is purchasing a service and is not leasing MBO's facilities.[25] Consequently, the current audit's reversal of KPMG's and USAC's tacit approval of Cross' reporting methodology for identical service arrangements reviewed during the 2009 Audit is both confusing and unexpected.

Moreover, the auditor's reference on the Federal Communications Commission's ("Commission") decision in the case of *Moultrie Independent Telephone Company* is inapposite.[26] The *Moultrie* case is distinguishable on its face as it involved an unambiguous sale and lease-back of assets from Moultrie's affiliate.[27] Moultrie transferred its assets, including "motor vehicles, land, and buildings, and equipment" to its affiliate and leased the assets back from its affiliate.[28] In fact, Moultrie acknowledged that it had structured the arrangement with its affiliate in this manner with the express goal of "optimiz[ing] its recovery under the [universal service fund] and to maximize tax benefits."[29] Consequently, it is not surprising that the Commission was able to find fault with Moultrie's transaction and reporting. However, Cross' operations are clearly different from those at issue in *Moultrie*. Most importantly, as detailed *supra*, Cross is purchasing DS1 transport service from MBO. It is not leasing or renting "interexchange plant assets." Cross' service arrangement with MBO

[19] *Miller Declaration*, ¶ 6.

[20] *Miller Declaration*, ¶ 6.

[21] *Miller Declaration*, ¶ 7.

[22] *Miller Declaration*, ¶¶ 4, 7.

[23] *Miller Declaration*, ¶ 7.

[24] *Miller Declaration*, ¶ 8.

[25] *Miller Declaration*, ¶ 5. *See also* Attachment 1.

[26] *Moultrie Independent Telephone Company*, 16 FCC Rcd 18242 (2001) ("Moultrie").

[27] *Moultrie*, ¶ 4.

[28] *Moultrie*, ¶ 4.

[29] *Moultrie*, ¶ 14.

did not involve the sale of assets to an affiliate and the subsequent lease-back of those assets.[30] In fact, as noted *supra*, before it began purchasing transport service from MBO, Cross previously purchased transport service from SWBT.[31] Consequently, Cross' purchase of DS1 transport from MBO did not involve any manipulation of Cross' costs by eliminating its assets and incurring new expenses. Moreover, KPMG and USAC reviewed Cross' services and reporting and have not expressed any objection.[32] For these reasons, Cross' service scenario is distinguishable from *Moultrie* and that decision should not be relied upon in this audit.

Cross reasonably relied on USAC's tacit approval, in the 2009 Audit, of Cross' reporting methodology and any reversal of USAC's position must be applied prospectively only to avoid manifest injustice to Cross

Cross reasonably used the same reporting methodology, that KPMG and USAC had tacitly approved in the 2009 Audit, to report Cross' identical service expenses during 2010-2014. The audit finding's unexpected reversal of USAC's position on Cross' reporting is unfounded and should be rejected. A reversal of USAC's prior tacit approval, on which Cross had reasonably relied, to its detriment, would be manifestly unjust and, if adopted, such change must not be applied retroactively; rather if applied at all, the change must be applied on a prospective basis only. Regardless, under no circumstance should Cross be required to return any previously-disbursed HCP support.

Among other responsibilities, USAC is tasked with assessing a provider's compliance with the Commission's universal service fund rules.[33] Consequently, it is reasonable, and not unexpected, that a provider would rely on a USAC finding, whether explicit or tacit, by USAC's silence, that the provider is compliant with Commission rules. Such reliance is no less reasonable here where, after reviewing the Cross/MBO DS1 transport service arrangements and Cross' related expense reporting in the 2009 Audit, neither KPMG nor USAC identified any noncompliance with the Commission's HCP reporting rules other than a minor capacity miscount.[34] The finding, which noted that, absent that miscount error, Cross would have been eligible for more HCP support, could reasonably be interpreted as an approval of the other aspects of Cross's reporting. Cross, therefore, had no reason to doubt the validity of its affiliate expense reporting framework and reasonably continued to report its DS1 transport service expenses in the same manner as it had done during the 2009 Audit.

Pursuant to applicable judicial and Commission precedent, this audit finding's unexpected reversal of USAC's position, on which Cross reasonably relied for several years, can be applied on a prospective basis only. The Court of Appeals for the District of Columbia Circuit ("D.C. Circuit") has long-recognized a distinction between Commission agency actions where prospective rather than retroactive application is appropriate. Where the agency's decision substitutes "new law for old law

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[30] *Miller Declaration*, ¶ 5.

[31] *See also*, *Miller Declaration*, ¶ 4.

[32] *Miller Declaration*, ¶ 6.

[33] USAC is required to operate within the confines of the Commission's rules and is prohibited from making policy or interpreting unclear statutes or rules. *See* 47 C.F.R. §54.702.

[34] *Miller Declaration*, ¶ 6.

that was reasonably clear", prospective-only application is appropriate.[35] In contrast, a presumption of retroactive applicability may be appropriate where the agency's decision merely reflects "new applications of existing law, clarifications, and additions."[36] The Commission similarly has consistently applied rule changes solely on a prospective basis where the changes reflected a "reconsideration of past interpretations and applications of the Act,"[37] or were necessary to ensure providers had "certainty regarding their . . . obligations."[38] Prospective application of this audit finding is similarly warranted here where the finding essentially reflects a reconsideration of USAC's prior application of the Commission's rules and there is a need to provide Cross with certainty regarding its reporting of affiliate transaction expenses.

Moreover, applying the audit finding on a retroactive basis would result in a manifest injustice to Cross. The D.C. Circuit has explained that manifest injustice results when a party reasonably relies on "reasonably based on settled law" that is contrary to a rule established in a later adjudication.[39] The Commission similarly found prospective application of a rule change appropriate where an interpretation of an existing rule did not "rise to the level of . . . 'new law for old law that was reasonably clear'" but retroactive application would "result in manifest injustice."[40] Here, USAC's tacit approval, in the 2009 Audit, of Cross' reporting methodology reasonably would be considered "settled law" and the proposed reversal in this audit Finding No. 1 is equivalent to a contrary decision in a later adjudication. Cross reasonably relied on USAC's review of Cross' reporting methodology in the 2009 Audit and retroactive application of the new audit change would be manifestly unjust. Specifically, applying the audit's new interpretation retroactively would expose Cross to having to refund in excess of $8M to the HCP. HCP support enables carriers to provide much-needed modern voice and broadband communications networks in rural communities where such buildouts would otherwise be cost-prohibitive.[41] Requiring Cross to return its HCP support – support that Cross already has used to serve rural high-cost communities and that Cross cannot possibly recover from its service operations – would effect a manifest injustice.

For the reasons discussed in this response, Cross requests that Finding No. 1 be rejected and, if it is not, that any application of the Finding be on a prospective basis only.

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[35] *Verizon Tel. Cos. v. FCC*, 269 F.3d 1098, 1109 (D.C. Cir. 2001).

[36] *Id*.

[37] *See e.g., In re Restoring Internet Freedom*, FCC 17-166, n.792 (2018) (classification change resulting from the Commission's reconsideration of prior interpretations of the Act applied prospectively only.)

[38] *See In re Restoring Internet Freedom*, FCC 17-166, *Id*., ¶526. *See also, e.g.*, *In re: Request for Review by InterCall, Inc. of Decision of Universal Service Administrator*, 23 FCC Rcd 10731, ¶23 (2008) (applying a compliance obligation prospectively only where there previously had been "a lack of clarity regarding the direct contribution obligations" applicable to class of service providers.)

[39] *See, e.g., Qwest Services Corp. v. FCC,* 509 F.3d 531 (2007).

[40] *In re: Lifeline and Link Up Reform and Modernization*, 30 FCC Rcd 7818,267, n.536 (2015).

[41] *See, e.g.*, Public Notice, All Universal Service High-Cost Support Recipients are Reminded that Support must be Used for its Intended Purpose, FCC 15-33 (Oct. 19, 2015).

Auditor's Comments –
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 arrangement under legal interpretation or Generally Accepted Accounting Principles. We noted the Beneficiary reported the costs of the facilities purchased in its 2013 financial statement audit report (footnote 11) as lease expense. The Beneficiary also categorized these expenses as rents in its High Cost Loop filings under the rents portion of circuit expense. While we point out that the Beneficiary reported the affiliate transport transactions in its audit report and its High Cost Loop filings as lease expense and rent expense, respectively, we don't believe that 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).[42]

We recognize the transaction in Finding #1 is not necessarily 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, 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 #1, 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

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

> 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.[43]

The affiliate transport expense incurred by the Beneficiary is large in relation to its other operating expenses. Specifically, the expense ranged from $1,481,215 to $2,906,004, which was approximately 13%-23% of operating expenses included in its cost study filings during the periods under audit. In addition, we assessed the impact on the Beneficiary's Part 36 cost studies and HCP filings and found the results were significantly skewed as a result of including the interexchange expenses in its cost studies in lieu of the associated interexchange plant in its categorization (see monetary effects above). Therefore, we believe the second condition is also 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 #1, the expenses are the DS1 circuit charges and the plant is the interexchange fiber owned by the Beneficiary's affiliate. Considering the substantial nature of the affiliate transaction and resulting improper category assignment of the expenses, our position is unchanged with respect to our finding.

Auditor's Additional Comments –
We have considered the Beneficiary's additional responses and do not believe they 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 finding.

FINDING No.: HC2016BE031-F02: 47 C.F.R. § 64.901 – LACK OF NONREGULATED ADJUSTMENTS FOR COMMON COSTS

Condition –
The Beneficiary has common costs attributable to both regulated and nonregulated activities and failed to remove the nonregulated portion of the expenses from its HCP filings. Specifically, expenses related to software maintenance, printing, customer billing supplies, advertising, professional services, and health and dental insurance were incurred for both regulated and nonregulated operations. The application of various indirect cost attribution factors resulted in $91,901 of expenses that should have been excluded from the Beneficiary's HCP filings.

Cause –

[43] 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).

The processes to prepare, review, and approve the 2013 cost study did not identify the proper allocation of expenses to nonregulated accounts.

Effect –
The exception identified above resulted in a reduction of regulated operating expenses of $91,901, which impacted HCLS and ICLS disbursements. The monetary impact of this finding relative to disbursements for the 12-month period ended December 31, 2015, is estimated to be overpayment of $8,587 and is summarized by support mechanism as follows:

Support Type	Monetary Effect
HCLS	$5,951
ICLS	$2,636

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 –
We concur with this finding. The total operating expense is the sum of six different expense allocations, each of which was either deemed immaterial or overlooked. We will update our policies and procedures for preparing, reviewing, and approving data reported in Cross's HCP filings to ensure compliance with applicable FCC rules.

FINDING No.: HC2016BE031-F03: 47 C.F.R. § 64.901– INCORRECT NONREGULATED ADJUSTMENTS FOR RATE BASE AND EXPENSES

Condition –
The Beneficiary properly included nonregulated adjustments for general support expenses and general support depreciation expense, but failed to remove the assets and accumulated depreciation. In addition, the Beneficiary's basis for its nonregulated adjustments were based on book balances from 2012 and should have been based on 2013 balances.

Cause –
The processes to prepare, review, and approve the 2013 cost study did not identify and remove the correct balances.

Effect –
The exception identified above resulted in a decrease in net rate base of $17,784, a decrease in depreciation expense of $5,310, and a decrease in plant specific expenses of $45,551, which impacted HCLS and ICLS disbursements. The monetary impact of this finding relative to disbursements for the 12-month period ended December 31, 2015, is estimated to be an overpayment of $15,780 and is summarized by support mechanism as follows:

Support Type	Monetary Effect
HCLS	$5,242
ICLS	$10,538

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 –
We concur with this finding. This was an apparent oversight. We will update our policies and procedures for preparing, reviewing, and approving data reported in Cross's HCP filings to ensure compliance with applicable FCC rules.

FINDING No.: HC2016BE031-F04: 47 C.F.R. § 36.611(h) – UNDERREPORTED LOOPS

Condition –
The number of total loops reported on the Beneficiary's 2014-1 HCLS filing did not reconcile to the source documentation and were underreported by 3 loops.

Cause –
The process to collect, report, and monitor working loops reported in the 2014-1 HCLS filing did not detect a loop reporting error.

Effect –
The exception identified above resulted in an understatement of total loops, which impacted HCLS disbursements. The monetary impact of this finding relative to disbursements for the 12-month period ended December 31, 2015, is estimated to be overpayment of $2,882 and is summarized by support mechanism as follows:

Support Type	Monetary Effect
HCLS	$2,882

Recommendation –
The Beneficiary should implement policies and procedures to ensure it has an adequate system in place for collecting, reporting, and monitoring data reported in its HCLS filings.

Beneficiary Response –
We concur with this finding. This was an apparent oversight. We will update our policies and procedures for collecting, reporting, and monitoring data reported in Cross's HCLS filings.

FINDING No.: HC2016BE031-F05: 47 C.F.R. § 54.320(b) – LACK OF SUPPORTING INVOICE DOCUMENTATION

Condition –
The Beneficiary was unable to provide supporting invoice documentation for two of the 65 individual transactions selected from expense accounts.

Cause –
The Beneficiary has a policy of maintaining original source documents but in these two instances was unable to locate the invoices and also not able to subsequently obtain them from the vendor.

Effect –
The exception identified above resulted in a decrease in corporate operations expense of $7,696 and a decrease in plant specific expense of $1,829, which impacted HCLS and ICLS disbursements. The monetary impact of this finding relative to disbursements for the 12-month period ended December 31, 2015, is estimated to be overpayment of $1,680 and is summarized by support mechanism as follows:

Support Type	Monetary Effect
HCLS	$1,235
ICLS	$445

Recommendation –
The Beneficiary should implement policies and procedures to ensure it has an adequate system in place for collecting and retaining supporting documentation for expenses reported in its HCP filings.

Beneficiary Response –
We concur with this finding. We were unable to locate the original documentation for these two transactions. We will update our policies and procedures for collecting and retaining supporting documentation reported in Cross's HCP filings.

FINDING No.: HC2016BE031-F06: 47 C.F.R. § 54.7(a) and 47 C.F.R. § 65.450(a) – DISALLOWED EXPENSES

Condition –
The Beneficiary included $18,798 of expenses of related to charitable contributions, membership dues, and community event sponsorships in its HCP fillings that are not considered necessary for the provision, maintenance or upgrade of facilities for which supported is intended.

Cause –
The processes to prepare, review, and approve the 2013 cost study did not identify and adjust for the disallowed expenses.

Effect –
The exception identified above resulted in a decrease in corporate operations and charitable contribution expenses of $18,798, which impacted ICLS disbursements. The monetary impact of this finding relative to disbursements for the 12-month period ended December 31, 2015, is estimated to be overpayment of $3,646 and is summarized by support mechanism as follows:

Support Type	Monetary Effect
ICLS	$3,646

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 –
We concur with this finding. This was an apparent oversight. We will update our policies and procedures for preparing, reviewing, and approving data reported in Cross's HCP filings to ensure compliance with applicable FCC rules.

FINDING No.: HC2016BE031-F07: 47 C.F.R. § 32.6512(b) – CLEARING OF PROVISIONING EXPENSE

Condition –
The Beneficiary did not clear $59,644 from provisioning expense account 6512 to plant under construction or plant specific expense.

Cause –
The Beneficiary was unaware of the FCC rules governing the clearing of provisioning expense.

Effect –
The exception identified above resulted in a decrease of plant nonspecific expenses of $59,644 an increase in plant specific expenses of $18,234, and an increase in rate base of $39,305, which impacted HCLS and ICLS disbursements. The monetary impact of this finding relative to disbursements for the 12-month period ended December 31, 2015, is estimated to be overpayment of $2,390 and is summarized by support mechanism as follows:

Support Type	Monetary Effect
HCLS	($7,859)
ICLS	$10,249

Recommendation –
The Beneficiary should implement policies and procedures to review its process for clearing plant nonspecific expense accounts periodically to ensure they comply with Part 32 regulations.

Beneficiary Response –
We concur with this finding. This was an apparent oversight. We will update our policies and procedures for clearing plant nonspecific expense accounts periodically to ensure they comply with Part 32 regulations.

FINDING No.: HC2016BE031-F08: 47 C.F.R. § 32.12(b) and 47 C.F.R. § 54.320(b) – PAYROLL ALLOCATIONS

Condition –
The Beneficiary allocated its 2013 payroll and related benefits based on a 2008 time study and were unable to provide documentation to support the time study was still appropriate for 2013 payroll allocations.

Cause –
The preparation, review, and approval processes governing the allocation of payroll data did not include procedures to formally document the Beneficiary's evaluation of the relevance of a 2008 time study for its allocations of 2013 labor and benefits.

Effect –
There is no monetary impact of this finding based on our audit procedures. The use of a time study is an acceptable method for allocating labor and benefits. Although the Beneficiary maintained support for the 2008 time study, there has not been a subsequent time study or documentation the time study used was still valid to support the majority of the 2013 payroll allocations. While there is no monetary impact of this finding, the failure to maintain supporting documentation for the allocation to the Beneficiary's accounts increases the probability for errors and/or omissions in future high cost support filings.

Recommendation –
The Beneficiary should implement policies and procedures to formally document its evaluation of historical time studies used for current period labor and benefit allocations and make updates when duties or activities of employees change.

Beneficiary Response –
We concur with this finding. We reviewed the time study and determined that the percentages were still accurate, but we did not properly document this review. We will update our policies and procedures to ensure proper documentation of our review of and updates to historical time studies.

Criteria

Finding	Criteria	Description
#1	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.
#2 & #3	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.

Finding	Criteria	Description
#4	47 C.F.R. § 36.611(h), (2011)	For universal support purposes, working loops are defined as the number of working Exchange Line C&WF loops used jointly for exchange and message telecommunications service, including C&WF subscriber lines associated with pay telephones in C&WF Category 1, but excluding WATS closed end access and TWX service.
#5	47 C.F.R. § 54. 320(b) (2012)	All eligible telecommunications carriers shall retain all records required to demonstrate to auditors that the support received was consistent with the universal service high-cost program rules. This documentation must be maintained for at least ten years from the receipt of funding. All such documents shall be made available upon request to the Commission and any of its Bureaus or Offices, the Administrator, and their respective auditors.
#6	47 C.F.R. § 54.7(a) (2010) 47 C.F.R § 65.450(a) (2011)[44]	A carrier that receives federal universal service support shall use that support only for the provision, maintenance, and upgrading of facilities and services for which the support is intended. Net income shall consist of all revenues derived from the provision of interstate telecommunications services regulated by this Commission less expenses recognized by the Commission as necessary to the provision of these services. The calculation of expenses entering into the determination of net income shall include the interstate portion of plant specific operations (Accounts 6110-6441), plant nonspecific operations (Accounts 6510-6565), customer operations (Accounts 6610-6623), corporate operations (Accounts 6720-6790), other operating income and expense (Account 7100), and operating taxes (Accounts 7200-7250), except to the extent this Commission specifically provides to the contrary.
#7	47 C.F.R. § 32.6512(b) (2011)	(b) Credits shall be made to this account for amounts transferred to construction and/or Plant Specific Operations Expense. These costs are to be cleared by adding to the cost of material and supplies a suitable loading charge.

[44] Public Notice FCC 15-133 reiterates the prohibition of rate of return carriers from including expenses that are not necessary for the provision, maintenance, or upgrading of facilities and services for which support is intended. *See All Universal Service High-Cost Support Recipients are Reminded that Support Must be Used for its Intended Purpose*, WC Docket No. 10-90 *et al.*, Public Notice, 30 FCC Rcd 11821 (2015).

Finding	Criteria	Description
#8	47 C.F.R. § 32.12(b) (2010)	The company's financial records shall be kept with sufficient particularity to show fully the facts pertaining to all entries in these accounts. The detail records shall be filed in such manner as to be readily accessible for examination by representatives of this Commission.
	47 C.F.R. § 54. 320(b) (2012)	All eligible telecommunications carriers shall retain all records required to demonstrate to auditors that the support received was consistent with the universal service high-cost program rules. This documentation must be maintained for at least ten years from the receipt of funding. All such documents shall be made available upon request to the Commission and any of its Bureaus or Offices, the Administrator, and their respective auditors.

The following are the Exhibits referenced in the Beneficiary's response to FINDING No.: HC2016BE031-F01:

Confidential and Proprietary; Confidential Treatment Requested

CONFIDENTIAL AND PROPRIETARY

Confidential Treatment Requested Pursuant to 47 C.F.R. 54.711(b)

Cross Telephone Company

ATTACHMENT 1

Agreement No. ____________

MBO MASTER SERVICE AGREEMENT

This Master Services Agreement ("Agreement") is made this _____ day of ____________________, ________, by and between **MBO Video, L.L.C.** ("MBO or Provider"), with its principal place of business at One Main Street, Earlsboro, Oklahoma 74840, and **Cross Telephone Company, L.L.C.** ("Customer"), with its principal place of business at 704 3rd Avenue, Warner, OK 74469, for the provision of services, subject to this Agreement and as set forth in this Agreement.

Article 1. Agreement of the Parties

1.1 Services. Customer may order from MBO services which may consist of either or both MBO' Services or Third Party Services, (sometimes referred to herein collectively or individually, as the "Service(s)"). "MBOs' Services" shall consist of those Services as indicated in Table A (check as applicable), but does not include any Services which constitute Third Party Services as defined below in Section 1.2. All Services shall be provided upon the terms and conditions that are set forth in this Agreement, including any applicable Customer Service Purchase Order. All Services are subject to availability and approval of Customer's credit by MBO.

Table A:					
Schedule 1	☐	Private Line Service	Schedule 6	☐	Network Timing Services
Schedule 2	☐	Optical Wave Service	Schedule 7	☐	Managed Services
Schedule 3	☐	ATM Service	Schedule 8	☐	Network Interconnection
Schedule 4	☐	Dedicated Internet Service	Schedule 9	☐	Collocation Service
Schedule 5	☐	Video Transport	Schedule 10	☐	Web Hosting Service

1.2 Third Party Services. Upon request by the Customer, MBO may arrange on behalf of Customer for services to be provided by a third party ("Third Party Services"). For instance, Third Party Services may include Local Access Services, third party provided interexchange services, and third party provided international service. Local Access Services shall be arranged pursuant to Article 4 of this Agreement. When Customer requests international service, MBO may arrange for the foreign end of the Service or for a portion of the foreign end of the Service to be provided by a third party carrier licensed in the relevant foreign point. In some cases, MBO may be unable to, and Customer may be required to, arrange the foreign end of such Service with a foreign carrier. Although this Agreement governs the terms of MBO' arrangement of Third Party Service, the service level parameters and related warranties (if any), pricing, surcharges, outage credits, required commitments, termination liability, and other service-specific terms of the Third Party Service shall be those of the provider of the Third Party Services ("Third Party Provider").

Article 2. Effective Date and Term

2.1 Term of Agreement. This Agreement shall become effective on the date first written above ("Effective Date") and shall continue for 180 days from the Effective Date (Term) and shall automatically terminate unless Customer has entered into a "Client Service Purchase Order" as provided for herein or unless the Parties mutually agree to extend the Term in writing.

2.2 Client Service Purchase Order Term. Each Client Service Purchase Order placed under this Agreement shall have its own term, as indicated on such Client Service Purchase Order ("Service Term"). At the end of the Service Term for any Client Service Purchase Order (as defined in Section 3.1.a), such Client Service Purchase Order shall continue on a month-to-month basis ("Extension Period") unless either party gives written notice to the other that the circuit(s) described in such Client Service Purchase Order shall be disconnected, such notice to be delivered at least sixty (60) calendar days before the end of the Service Term, or if during the Extension Period, then upon at least thirty (30) calendar days' written notice. Customer's charges, as set forth in this Agreement, for Services provided by MBO during the Service Term shall continue to apply to Customer's Service throughout any Extension Period, unless modified pursuant to the terms of this Agreement. Unless Customer is in default, any Service being provided at the time of termination of this Agreement shall continue upon the terms and conditions of this Agreement until end of the Service Term or any applicable Extension Period Service as specified in the applicable Client Service Purchase Order or until such Client Service Purchase Order is terminated pursuant to the second sentence of this Section 2.2; provided, however, that Customer may not order any new Service until Customer and MBO have entered into a new agreement or mutually agreed in writing to extend this Agreement.

Article 3. Ordering and Provisioning of Service

3.1 Client Service Purchase Orders

a. All Services shall be requested on MBO' Client Service Purchase Order forms in effect from time to time or on Customer's forms which have been previously accepted in writing by MBO ("Client Service Purchase Order(s)"). Client Service Purchase Orders shall be transmitted and processed in accordance with the terms and conditions of this Agreement as well as any procedures set out in the applicable Customer Service Purchase Order for a specific Service. MBO shall accept any Client Service Purchase Order under this Agreement that complies with the terms and conditions set forth herein, subject to availability and credit approval at the time Customer places such Client Service Purchase Order.

b. A Client Service Purchase Order is deemed accepted (subject to availability) by MBO when MBO' Service Delivery department transmits a copy of the signed Client Service Purchase Order with the TUA Date and Effective Billing Date, as specified in Section 3.2, to Customer indicating that Customer's order is being processed by MBO.

c. When a Client Service Purchase Order is placed, Customer will designate: (i) a requested start date ("Requested Start Date") for the Service; (ii) the desired term of the Service; (iii) the specific city pairs, if applicable; (iv) the bandwidth, if applicable; and (v) any other information necessary to enable MBO to provide the Service. MBO will make reasonable efforts to meet Customer's Requested Start Date. In the event that MBO is unable to meet Customer's Requested Start Date, MBO will notify Customer of the date when MBO believes the Service will be available and Customer's Requested Start Date will be changed to reflect the number of days of delay or advance, as appropriate. Failure of MBO to deliver by Customer's Requested Start Date shall not constitute a default under this Agreement and MBO shall not be liable to pay to Customer any penalties or damages for MBO' failure to meet Customer's Requested Start Date.

d. Any terms or conditions contained in Customer's acknowledgement or Client Service Purchase Order or elsewhere which conflict with, are different from, or are in addition to, the terms and conditions in this Agreement are hereby objected to by MBO and shall not constitute part of this Agreement. No action by MBO (including, without limitation, provision of Services to Customer pursuant to such Client Service Purchase Order) shall be construed as binding or estopping MBO with respect to such term or condition.

3.2 Turn Up Acknowledgement. MBO will issue to Customer notice that Service is available ("Turn Up Acknowledgement" or "TUA"). The TUA will indicate that all the relevant Services ordered through MBO has been tested by MBO and that the MBO' Service meets or exceeds the Technical Specifications set forth in the relevant Customer Service Purchase Order. The TUA will also set forth the date Customer's Service was available for use by Customer and upon which MBO shall commence charging for the Service ("Effective Billing Date").

3.3 Service Acceptance. Customer shall be deemed to have accepted Service and MBO shall begin billing for the Service as of the Effective Billing Date, provided that, if Customer notifies MBO' Service Delivery Department in writing within three (3) business days of the Effective Billing Date that MBO' Service is in material non-compliance with the applicable Technical Specifications and if, upon investigation, such material non-compliance is due solely to MBO fault, then MBO shall correct the non-compliance and make the appropriate adjustment to Customer's billings under this Agreement. The occurrence of any such non-compliance shall not constitute a default under this Agreement and MBO shall not be liable to pay to Customer any penalties or damages resulting from any such non-compliance. Charges for Service begin accruing upon Effective Billing Date, regardless of whether Customer is actually using the Services, or is ready to test and accept the Services.

Article 4. Local Access Services

4.1 Local Access Services. Upon request by the Customer, MBO may obtain "Local Access Service" for Customer, which is defined as the telecommunications facilities or services connecting a Customer-designated termination point to a point of presence ("POP") designated by MBO. The term Local Access Service, as used throughout this Agreement, may include both domestic U.S. and foreign Local Access Service. Customer shall execute a Letter of Agency, in a form provided by MBO, authorizing MBO to interact directly with the Local Access Service provider(s) to obtain the Local Access Service. Customer shall pay all charges including, without limitation, monthly charges, usage charges, installation charges, non-recurring charges, or applicable termination/cancellation charges, of the Local Access Service provider(s).

4.2 MBO' Provisioning, Testing, and Charging for Local Access Services. For Local Access Services ordered by MBO, MBO shall provision and conduct the initial testing of an interconnection between the MBO' Service set forth in the Client Service Purchase Order and the Local Access Service. MBO shall coordinate the installation of the Local Access Service with the MBO' Service. Local Access Service charges shall accrue at the then-current tariff rate (or the standard published rate, if there is no tariff rate) of the Local Access Service provider. If the applicable rate for Local Access Service is changed by the Local Access Service provider, such changes will be passed through to, and be borne by, Customer. In the event MBO' Services are not ready at the same time as the MBO' ordered Local Access Service, MBO will not begin billing Customer for such Local Access Services until the related MBO' Services are turned up.

4.3 Customer Ordered Local Access. Customer may, in conformance with MBO' policies on third parties providing connectivity into a MBO' POP, order its own Local Access Services from a vendor who has established entrance facilities in MBO' POP ("Approved Vendor") In the event Customer desires to order Local Access Services from someone other than an Approved Vendor, Customer must get MBO' prior written permission. In such event, the Local Access Service provider shall directly bill Customer for such Services. MBO may charge Customer for any associated entrance facility or mileage charges if it provides Carrier Facility Assignment ("CFA") to Customer. Customer shall ensure that the Customer-ordered Local Access Services are turned up at the same time as the MBO' Services. If the Customer-ordered Local Access Services are not ready as of the Effective Billing Date, Customer shall nonetheless be obligated to pay for MBO' Services as of the Effective Billing Date.

Article 5. Payment Terms and Charges

5.1 Monthly Billing. MBO provides and charges for Service on a monthly basis in U.S. dollars. Fixed monthly recurring charges are billed one (1) month in advance. Unless MBO requires payment in advance, charges for installation charges and other non-recurring charges shall be billed in MBO' next invoice cycle and are due and payable in accordance with Section 5.2 below.

5.2 Due Date and Invoice. All amounts stated on each monthly invoice are due and payable in U.S. dollars upon receipt and are considered delinquent thirty (30) calendar days from the date of the invoice ("Delinquency Date") Customer agrees to remit payment via Automated Clearinghouse ("ACH") or wire transfer to MBO in care of _________, Account #________ or such other bank or account as MBO may in writing direct Customer to remit payment pursuant to the notice provisions of this Agreement. In the event Customer fails to make full payment of undisputed amounts by the Delinquency Date, Customer shall also pay a late fee in the amount of the lesser of (i) one and one-half percent (1½ %) per month or (ii) the maximum lawful monthly rate under applicable state law, of the unpaid balance which amount shall accrue from the date of the invoice. Customer acknowledges and understands that all charges are computed exclusive of any Additional Charges (as defined in Section 5.8). Such Additional Charges shall be paid by Customer in addition to all other charges provided for herein.

5.3 Adjustments. MBO may make billing adjustments for a period of two (2) years after the Date of an invoice, or two (2) years after the date a Service is rendered, whichever is later.

5.4 Billing Disputes

a. Notwithstanding the foregoing, amounts charged for MBO' Services which are reasonably disputed by Customer (along with late fees attributable to such amounts) shall apply but shall not be due and payable for a period of thirty (30) calendar days following the Delinquency Date, provided Customer: (i) pays all undisputed charges on or before the Delinquency Date, and (ii) presents a written statement of any billing discrepancies to MBO in reasonable detail together with appropriate supporting documentation on or before the Delinquency Date of the invoice in question, and (iii) negotiates in good faith with MBO for the purpose of resolving such dispute within said thirty (30) calendar day period.

b. In the event such dispute is mutually agreed upon and resolved in favor of MBO, Customer agrees to pay MBO the disputed amounts together with any applicable late fees within five (5) business days of the resolution (the "Alternate Delinquency Date"). In the event such dispute is mutually agreed upon and resolved in favor of Customer, Customer will receive a credit for the disputed charges and no late fees shall apply.

c. In the event MBO has responded to Customer's dispute in writing and the parties fail to mutually resolve or settle the dispute within such thirty (30) calendar day period (unless MBO has agreed in writing to extend such period), all disputed amounts together with the late fees shall become due and payable on the thirtieth (30th) day following the Delinquency Date, and this provision shall not be construed to prevent Customer from pursuing any legal remedies.

d MBO shall not be obligated to consider any Customer notice of billing discrepancies which are received by MBO after the Delinquency Date. This right to dispute applies only to MBO' Services provided to Customer and not to any dispute Customer may have with its End User or with respect to Third Party Services. To the extent requested by Customer and to the extent Customer has reasonable grounds for such dispute, MBO' will act on Customer's behalf to dispute any charges for Third Party Services provided that, such dispute shall be subject to the Third Party Provider's rules regarding disputed amounts and not the provisions of this Section 5 4 and provided further, that, Customer shall indemnify MBO against any cost, expenses or charges incurred by MBO as a result of its acting on behalf of Customer to dispute charges for Third Party Services

5.5 Validation of Credit MBO reserves the right to determine the creditworthiness of Customer through available verification procedures or sources and Customer hereby consents to MBO obtaining credit information regarding the Customer, its owners and affiliates. If at any time, Customer presents, in MBO' reasonable discretion, an undue risk of non-payment, or if Customer fails to comply with the payment terms of this Agreement or any Client Service Purchase Order, MBO may require a deposit or other forms of security for payment. In determining whether a Customer presents an undue risk of nonpayment, MBO may consider, but is not limited to, the following factors: (i) the Customer's payment history (if any) with MBO, (ii) the Customer's ability to demonstrate adequate ability to pay for the Service, (iii) credit and related information provided by Customer; (iv) credit and related information lawfully obtained from third parties or publicly available, (v) information relating to Customer's management, owners and affiliates (if any) and (vi) Customer's monthly recurring charges exceeding Customer's established credit limit.

5.6 MBO's Right to Assurance

a. If at any time there is a material adverse change in Customer's creditworthiness or a material adverse change in Customer's financial position, then in addition to any other remedies available to MBO, MBO may elect, in its sole discretion, to demand reasonable assurance of payment from Customer, including among others the posting of a deposit and executing an agreement with MBO regarding the use of any such deposit ("Deposit Agreement"), such Deposit Agreement to be in form and substance acceptable to MBO.

b. A material adverse change in Customer's creditworthiness shall include, but not be limited to: (i) Customer's default of its obligations to MBO under this or any other agreement with MBO; (ii) failure of Customer to make full payment of charges due hereunder on or before the Delinquency Date on two (2) or more occasions during any period of twelve (12) or fewer months; (iii) acquisition of Customer (whether in whole or by majority or controlling interest) by an entity which is insolvent or which is subject to bankruptcy or insolvency proceedings, or which owes past due amounts to MBO or any MBO affiliate, or which is a materially greater credit risk than Customer; or (iv) Customer's being subject to or having filed for bankruptcy or insolvency proceedings or the legal insolvency of Customer.

c. A material adverse change in Customer's financial position shall include, but not be limited to: (i) a decrease in net worth or working capital of five percent (5%) or greater during any calendar quarter; or, (ii) a negative net worth or working capital. If Customer's financial statements are not public information or have not otherwise been made available to MBO, then, upon MBO' request, Customer shall provide its most current audited and unaudited financial statements.

d. If Customer has not provided MBO with (i) its financial statements within ten (10) calendar days of MBO' request therefore or (ii) in the event of a MBO demand for assurance of payment, assurance satisfactory to MBO within ten (10) calendar days of MBO' notice of demand for such assurance, then, in addition to any other remedies available to MBO, MBO shall have the option, in its sole discretion, to exercise one or more of the following remedies: (i) cause the start of any Service described in any previously executed Client Service Purchase Order to be delayed pending receipt of such financial statements or of the satisfactory assurance; or (ii) decline to accept a Client Service Purchase Order or other requests from Customer to provide Service; or (iii) suspend all or any portion of the Service then being provided after giving Customer five (5) calendar days prior written notice. If Customer provides satisfactory assurance during the five (5) calendar day notice period, MBO will not suspend any Service.

5.7 Charges for Services. All charges for Services shall be those in effect as of the date MBO' accepts the Client Service Purchase Order. Customer shall be liable for all charges (recurring and non-recurring) for Services provided by MBO and by Third Party Providers. Additionally, Customer shall incur charges in those circumstances in which extraordinary costs and expenses are generated by Customer and reasonably incurred by MBO beyond those normally associated with the Services, including but not limited to, the following: (a) Customer's request to expedite Service availability to a date earlier than MBO's standard installation interval or a previously customer requested Start Date; (b) Service redesign or other activity occasioned by receipt of inaccurate information from Customer; (c) reinstallation charges following any suspension of the Service for cause by MBO; and (d) Customer's request for use of routes or facilities other than those selected by MBO for provision of the Service.

5.8 Additional Charges

a. If any sales taxes, valued added taxes or other charges or impositions are asserted against MBO after, or as a result of, Customer's use of Services by any local, state, national, international, public or quasi-public governmental entity or foreign government or its political subdivision, including without limitation, any tax or charge levied to support the federal Universal Service Fund contemplated by the Telecommunications Act of 1996, or any state or foreign equivalent ("Additional Charges"), Customer shall be solely responsible for such Additional Charges. Customer agrees to pay any such Additional Charges and hold MBO harmless from any liability or expense associated with such Additional Charges.

b. If Customer has been granted a tax exemption for taxes in a given jurisdiction, then MBO shall not bill Customer for such taxes if Customer provides MBO with written verification of such tax exemption acceptable to MBO and properly issued by the relevant taxing jurisdiction. Service provided hereunder shall also not be subject to contribution to any universal service program if Customer provides MBO with written verification or exemption certificate, acceptable to MBO for the relevant jurisdiction, that the Service will be resold by Customer and that the revenues from such resale shall be subject to the universal service program's contribution requirements. If any jurisdiction, in conjunction with any universal service program, assesses any charges against, or seeks any contributions from, MBO in connection with any of the Service provided hereunder, Customer shall indemnify MBO against any such assessments or contributions.

Article 6. Suspension and Termination

6.1 Suspension Of Service

a. Except for amounts disputed by Customer in accordance with Section 5.4 Billing Disputes, in the event payment in full is not received from Customer on or before the Delinquency Date, MBO shall have the right: (i) upon providing a minimum of ten (10) calendar days written notice (the "Suspension Notice"), to suspend or block, at any time after such Suspension Notice, all or any portion of all the Services then being provided to Customer; and (ii) to immediately place any pending Client Service Purchase Orders on hold, and to decline to accept any new Client Service Purchase Orders or other requests from Customer to provide Service commencing on the day that MBO issues the Suspension Notice to Customer. If MBO receives the entire past due amount within the ten (10) calendar day notice period, then Customer's Service shall not be suspended. MBO may continue such suspension until such time as Customer has paid in full all charges then due, including any reinstallation charges and/or late fees as specified herein. Following such payment, MBO shall reinstate Customer's Services subject to MBO' Right to Assurance as provided above in Section 5.6.

b. Suspension of Services as set forth in this Section shall not affect Customer's obligation to pay for the Services. Notwithstanding anything to the contrary in this Agreement, if Customer has agreed to a Revenue Commitment, any suspension of Service by MBO shall not relieve Customer of its obligations to pay the Revenue Commitment.

6.2 Termination of Service.

a. MBO may, without incurring any liability, cancel any Service prior to its commencement or disconnect such Service, in whole or in part, immediately and without notice if MBO deems that such action is necessary to prevent or to protect against fraud or to otherwise protect its personnel, agents, facilities or Services under any of the following circumstances:
   (i) if Customer refuses to furnish or provides false information to MBO regarding the Customer's identity, address, credit-worthiness, past or current use of Service, or its planned use of Service;
   (ii) if the Customer or End User is using the Service in violation of any applicable law or regulation; or
   (iii) for failure of Customer to comply with Section 8.7a Representations;

b. In addition to its other termination rights hereunder, and with respect to all Services, MBO may immediately disconnect any Services in whole or in part if MBO determines that such Services violate any law, statute, or ordinance, including the Communications Act of 1934 (as amended), or that the imposition of any statute, or promulgation of any rule, regulation, or order of the Federal Communications Commission or other governing body makes MBO' performance under this Agreement commercially impracticable.

6.3 Termination of Agreement.

a. Termination of Agreement For Cause. Except for an event of non-payment by Customer hereunder which is addressed in subsection (b) below, either party may terminate this Agreement if the other is in default of any material obligation contained herein, which default has not been cured within thirty (30) calendar days following the receipt of notice of such default setting forth the specifics of such default. Notwithstanding the foregoing, the failure of any particular Service or Services to comply with the Technical Specifications set forth individually for each Service in the attached Customer Service Purchase Orders shall not be deemed a default by MBO, but may obligate MBO to provide Customer with Outage Credits, if applicable under the relevant Customer Service Purchase Order. Termination of this Agreement for cause does not relieve Customer of any obligations to pay MBO for charges accrued for Service which has been furnished up to the time of termination nor does it relieve the Customer of all applicable cancellation and/or disconnection charges. The remedies available to either Party as set forth in this paragraph shall not be exclusive and either Party shall at all times be entitled to all rights available to it under either law or equity.

b. Termination of Agreement For Non-payment. In the event any amount payable by Customer has not been received in full by MBO on or before the Delinquency Date (except for amounts disputed by Customer in accordance with Section 5.4 Billing Disputes), MBO shall have the right to terminate this Agreement upon ten (10) calendar days' written notice to the Customer. Termination of this Agreement pursuant to this subsection shall not relieve Customer of any obligations to pay MBO for charges accrued for Service which has been furnished up to the time of termination nor does it relieve the Customer of all applicable cancellation and/or disconnection charges. The remedies available to MBO set forth in this paragraph shall not be exclusive and MBO shall at all times be entitled to all rights available to it under either law or equity.

c. Termination Due To Government Action. Notwithstanding the foregoing, and upon written notice consistent with the mandate put forth by the applicable governmental authority or commission, to the other party, either Customer or MBO shall have the right, without incurring an Early Termination Charge or other liability to the other party, to disconnect the affected portion of any Service, if MBO is prohibited by governmental authority from furnishing or Customer is prohibited from using such portion, or if any material rate or term contained herein and relevant to the affected portion of any Service is substantially changed by order of the highest court of competent jurisdiction to adjudicate the matter, the Federal Communications Commission, or other local, state, federal, or foreign government authority.

6.4 Termination Charges

a. Early Termination Charge. If Customer desires to disconnect any Service after installation, Customer may do so by providing written notification to MBO thereof sixty (60) days in advance of the effective date of the disconnection. In the event of such disconnection, Customer shall pay to MBO an "Early Termination Charge" in an amount equal to the monthly recurring charge for such disconnected Service multiplied by the number of months in the relevant Service Term, less the charges for such Service actually paid by Customer through the effective date of the disconnection plus any non-recurring payments not yet paid by Customer together with any termination liability associated with any other Third Party Service.

b. Revenue Commitment Termination Charge. If Customer has made a Revenue Commitment, the rates for Services and associated discounts are based on Customer's agreement to purchase Service for the entire Term of the Agreement. If Customer terminates the Agreement or breaches the Agreement prior to the end of the Term of the Agreement, Customer shall pay to MBO a "Revenue Commitment Termination Charge" in an amount equal to (i) Customer's monthly Revenue Commitment multiplied by the number of months in the Term of this Agreement, less the charges for Applicable Services (as defined in the Revenue Commitment Exhibit if applicable) actually paid by Customer through the effective date of termination and (ii) any non-recurring payments not yet paid together with any termination liability associated with Local Access Service or any other Third Party provided service.

c. Liquidated Damages. Customer agrees that the actual damages in the event of a disconnection pursuant to this Section 6.4 would be difficult or impossible to ascertain, and that the Early Termination Charges and Revenue Commitment Termination Charges, if any, in this Section 6.4 are intended to establish liquidated damages only and are not intended as penalties.

Article 7. Limitation of Liability

IN THE EVENT OF ANY BREACH OF THIS AGREEMENT OR ANY FAILURE OF THE SERVICES, WHATSOEVER, NEITHER MBO NOR ANY MBO' PROVIDER (AS DEFINED IN SECTION 8.4 INDEMNITY) SHALL BE LIABLE FOR ANY DIRECT, INDIRECT, CONSEQUENTIAL, SPECIAL, ACTUAL, INCIDENTAL, PUNITIVE OR ANY OTHER DAMAGES, OR FOR ANY LOST PROFITS OF ANY KIND OR NATURE WHATSOEVER, EVEN IF MBO OR THE MBO' PROVIDER HAS BEEN ADVISED OF THE POSSIBILITY OF SUCH DAMAGE OR LOSS.

Article 8. General

8.1 Exclusive Remedies. Except as otherwise specifically provided for herein, the remedies set forth in this Agreement comprise the exclusive remedies available to either party at law or in equity.

8.2 Warranty and Disclaimer of Warranty. **MBO MAKES NO WARRANTY WITH RESPECT TO THE SERVICE OR ITS PERFORMANCE UNDER THIS AGREEMENT UNLESS EXPRESSLY SET FORTH IN THIS AGREEMENT, INCLUDING ANY CUSTOMER SERVICE PURCHASE ORDER. WITH THE EXCEPTION OF THE EXPRESS WARRANTIES, IF ANY, SET FORTH IN THE CUSTOMER SERVICE PURCHASE ORDER, MBO DISCLAIMS ALL WARRANTIES WHETHER EXPRESS OR IMPLIED INCLUDING WITHOUT LIMITATION THE IMPLIED WARRANTY OF MERCHANTABILITY AND FITNESS FOR A PARTICULAR PURPOSE. NO WARRANTY IS MADE OR PASSED ON WITH RESPECT TO ANY THIRD PARTY SERVICES.**

8.3 Compliance with Law. Customer agrees that its use of the Services shall be in accordance, and comply, with all applicable laws, regulations, and rules and that Customer shall obtain all approvals, consents and authorizations necessary to conduct its business and initiate or conduct any transmissions over any facilities covered by this Agreement. MBO reserves the right, exercisable in its sole discretion, to disconnect or restrict any transmission initiated by Customer, if such actions are reasonably appropriate to assure that MBO is not in violation of any civil or criminal law, regulation or rule.

8.4 Indemnity.

a. Customer and MBO shall defend, indemnify and hold harmless the other against and from any and all claims for damage to tangible property or bodily injury, including claims for wrongful death, to the extent that such claim arises out of the negligence or willful misconduct of the respective indemnifying party, its employees, agents, or contractors in connection with this Agreement or the provision of Services hereunder.

b. Customer will defend, indemnify and hold harmless MBO' Providers and their respective officers, directors, employees, contractors and agents against and from any loss, debt, liability, damage, obligation, claim, demand, judgment or settlement of any nature or kind, known or unknown, liquidated or unliquidated, including without limitation, all reasonable costs and expenses incurred including all reasonable litigation costs and attorneys' fees (collectively, "Damages") arising out of, resulting from or based upon any complaint, claim, action, proceeding or suit of any third party, including any governmental authority, (a "Claim"), including any Claim based on Customer's violation of any law or any rule or regulation to the extent that such Claim arises out of alleged negligence or willful misconduct of Customer, its employees, agents, or contractors. For purpose of this subsection, "MBO' Providers" shall mean MBO and any third party or affiliated provider, operator, or maintenance/repair contractor of facilities employed in connection with the provision of Services.

c. The indemnified party shall promptly notify the indemnifying party in writing of any claims which are subject to the terms of this Section 8.4. The indemnified party shall have the right at its own expense to appoint its own counsel who shall be entitled to participate in any settlement negotiations or litigation regarding any matter for which it is entitled to be indemnified hereunder. The indemnifying party shall not agree to any settlement or consent to any decree, order or judgment without obtaining the consent of the indemnified party which consent shall not be unreasonably withheld.

8.5 Force Majeure. If either party's performance of this Agreement or any obligation (other than the obligation to make payments) hereunder is prevented, restricted or interfered with by causes beyond its reasonable control including, but not limited to, acts of God, fire, explosion, vandalism, cable cut, power outage, storm or other similar occurrence including rain fade or other atmospheric conditions, any law, order, regulation, direction, action or request of any government, or of any department, agency, commission, court, bureau, corporation or other instrumentality of any one or more of said governments, or of any civil or military authority, or by national emergencies, insurrections, riots, wars, acts of terrorism, strikes, lockouts or work

stoppages or other labor difficulties, supplier failures, shortages, breaches or delays, then the party that is unable to perform or meet its obligations due to such causes shall be excused from such performance on a day-to-day basis to the extent of such prevention, restriction or interference. The party that is unable to perform or meet its obligations due to such causes shall use commercially reasonable efforts under the circumstances to avoid and remove such causes of non-performance and shall proceed to perform with reasonable dispatch whenever such causes cease. In the event the force majeure event prevents the use of any circuit provided as part of the MBO' Services and such force majeure event continues for a period of sixty (60) days, then either party may disconnect the affected circuit without incurring liability, except for Customer's liability for any charges of a Third Party Provider.

8.6 Proprietary Information.

a. MBO and Customer understand and agree that the terms and conditions of this Agreement and all documents referenced herein (including invoices to Customer for Services provided hereunder) are confidential as between Customer and MBO. Neither Customer nor MBO shall disclose such information to any third party without the prior written consent of the other, except as provided in Section 8.6(c) below.

b. In addition to the matters covered under clause a. above, when confidential information is furnished in a tangible form by one party to the other, the disclosing party shall mark the information in a manner to indicate that it is considered confidential. When information deemed to be confidential is provided orally, the disclosing party shall, at the time of disclosure, clearly identify the information as being confidential and confirm such designation in writing within ten (10) calendar days thereafter. If the disclosing party fails to identify information as confidential, such disclosing party may correct the omission by later notice consisting of a writing or statement, and the receiving party shall only be liable for unauthorized disclosures of such confidential information made subsequent to said notice. All information identified as confidential pursuant to this clause b. shall not be disclosed by the receiving party to any third party without the written consent of the disclosing party, except as provided in Section 8.6(c) below.

c. The party to whom confidential information is disclosed shall have no obligation to preserve the confidential nature of such information if it: (i) was previously known to such party free of any obligation to keep it confidential; (ii) is or becomes publicly available by other than unauthorized disclosure; (iii) is developed by or on behalf of such party independent of any information furnished under this Agreement; or (iv) is received from a third party whose disclosure does not violate any confidentiality obligation. MBO may disclose confidential information regarding its relationship with Customer to commercial lenders who have specifically agreed to hold such information in confidence. In addition, a party may disclose confidential information provided to it by the other party if such disclosure is made pursuant to the requirement or request of a recognized stock exchange or of a governmental agency or court of competent jurisdiction to the extent such disclosure is required by a valid law, regulation or court order, and provided further, that, prompt notice thereof is given (unless such notice is prohibited by law) to the disclosing party of any such requirement or request.

8.7 Representations.

a. Use of Services

(i) Customer represents that it is a telecommunications carrier under the Communications Act of 1934, as amended or under the laws of the jurisdiction where it operates. The parties do not contemplate, as of the Effective Date, the filing of any tariff as to the Services provided under this Agreement, however, in the event that due to a court or agency ruling, or change in applicable law or regulation, this Agreement becomes subject to a requirement of an FCC tariff, then MBO will file a contract tariff with the FCC incorporating all of the material terms and conditions of this Agreement, including pricing, and the parties agree to abide by that contract tariff. Service may also be subject to tariffs in jurisdictions outside of the United States, and MBO reserves the right to make its provision of Services subject to such tariff terms. Customer represents that it has taken all actions required by the FCC to operate as a telecommunications carrier under the Communications Act of 1934, as amended. Customer may engage in resale of international private lines for the provision of a switched, basic telecommunication service only upon authorization from the FCC under Section 214 of the Communications Act of 1934, as amended, and provided that the private line is used only (i) on a route where Customer exchanges switched traffic with a foreign carrier that the FCC has determined lacks market power; or (ii) on any route for with the FCC has authorized the provision of switched services over international private lines. Service shall not be used for any unlawful purpose

(ii) Customer is responsible for ensuring that it and its customers comply with MBO' Acceptable Use Policy ("AUP") and Customer agrees to be bound by the AUP. The AUP, as it may be amended from time to time, is published at www.mbovideo.net, or such other address at MBO may specify by notice to Customer in accordance with Section 8 9 Notices Any violation of the AUP shall constitute a material breach of this Agreement.

b Customer Facilities Customer has sole responsibility for installation, testing and operation of facilities, services and equipment ("Customer Facilities") other than those specifically provided by MBO as part of the Services as described in a Client Service Purchase Order. In no event will the untimely installation or non-operation of Customer Facilities relieve Customer of its obligation to pay charges for the Services after Customer's acceptance or deemed acceptance.

c. Universal Service Exemption During the Term or Renewal Term of this Agreement, Customer shall provide MBO, on a semiannual basis, a universal service exemption certificate within thirty (30) days of the Customer's filing of the universal service filing made with the appropriate federal agency, evidencing that the Customer is required to contribute to the federal Universal Service Fund. Customer agrees that failure to provide such an exemption authorizes MBO to begin billing Customer prospectively for Universal Service Fund contributions pursuant to the applicable contribution factor (revised quarterly).

8 8 Title to Equipment This Agreement shall not, and shall not be deemed to, convey to Customer title of any kind to any MBO owned or leased transmission facilities, digital encoder/decoders, telephone lines, microwave facilities or other facilities utilized in connection with the Services.

8 9 Notices All legal notices to be sent to a party pursuant to this Agreement shall be in writing and deemed to be effective upon (i) personal delivery, (ii) three (3) business days after mailing certified mail return receipt requested if mailed within the domestic U.S., or (iii) on the day when the notice has been sent by facsimile if sent during business hours and followed by private courier, or express mail priority, next-day delivery. The Full Business Address for purposes of notice under this Section as well as telephone voice and facsimile numbers shall be:

MBO Video, L.L.C.
One Main Street
Earlsboro, Oklahoma 74840
Telephone: (405) 997-5201
Fax: (405) 997-5500
Attention: Contract Administration

With a copy to:
Brad Heckenkemper
Barrow & Grimm, P.C
110 W 7th Street, Suite 900
Tulsa, OK 74119-1044
Telephone: (918) 584-1600
Fax: (918) 585-2444

____
____
____
Telephone:
Fax:
Attention:

For billing issues to:
____
____
____
Telephone:
Fax:

8.10 Written Amendment Any addition, deletion or modification to this Agreement shall not be binding on either party except by written amendment executed by authorized representatives of both parties.

8.11 No Venture. The provision of Services shall not create a partnership or joint venture between the parties. The parties hereto are independent contractors.

8.12 Assignment. Neither Party shall assign or otherwise transfer (including, without limitation, a transfer due to a "Change of Control") its rights or obligations under this Agreement without the prior written consent of the other Party, which shall not be unreasonably withheld. Customer must be current on all payments required by this Agreement before any assignment is approved by MBO. Any such assignment or transfer of Customer's rights or obligations without such consent shall entitle MBO to disconnect the Services provided hereunder at its option upon ten (10) calendar days' prior written notice to Customer and shall constitute a default of a material obligation. A Change in Control shall be deemed to be an assignment, merger, sale of a controlling interest or other transfer of a controlling ownership interest. Any assignment by either Party of any right, obligation, or duty, in whole or in part, or of any interest, without the written consent of the other Party shall be void, except that either Party may assign all of its rights, and delegate its obligations, liabilities and duties under this Agreement, either in whole or in part, to any entity that is, or that was immediately preceding such assignment, a Subsidiary

or Affiliate of that Party without consent, but with prior written notification. The effectiveness of any assignment shall be conditioned upon the assignee's written assumption of the rights, obligations, and duties of the assigning Party

8.13 Choice of Law. This Agreement shall be governed by the laws of the State of Oklahoma, U.S. without regard to choice of law principles. Customer hereby consents to the jurisdiction and venue of the federal and state courts having a situs in Pottawatomie County, Oklahoma, U.S.

8.14 Interpretation. No rule of construction requiring interpretation against the draftsman hereof shall apply in the interpretation of this Agreement.

8.15 Priority of Agreement and Schedules. In the event of any inconsistency between or among a Client Service Purchase Order, this Agreement and MBO's Acceptable Use Policy, the following order of precedence shall prevail (from highest priority to lowest): the Acceptable Use Policy, this Agreement, a Client Service Purchase Order.

8.16 No Third Party Beneficiary. The provisions of this Agreement are for the benefit only of the parties hereto, and no third party may seek to enforce or benefit from these provisions.

8.17 Costs and Attorneys' Fees. If a proceeding is brought for the enforcement of this Agreement or because of any alleged or actual dispute, breach, default or misrepresentation in connection with any of the provisions of this Agreement, the prevailing party shall be entitled to recover reasonable attorneys' fees and other reasonable costs and expenses incurred in such action or proceeding in addition to any other relief to which such party may be entitled.

8.18 Severability. If any term or provision of this Agreement shall, to any extent, be determined to be invalid or unenforceable by a court or body of competent jurisdiction, then (a) both parties shall be relieved of all obligations arising under such provision and this Agreement shall be deemed amended by modifying such provision to the extent necessary to make it valid and enforceable while preserving its intent, and (b) the remainder of this Agreement shall be valid and enforceable.

8.19 No Waiver. The failure of either party to enforce any provision hereof shall not constitute the permanent waiver of such provision.

8.20 Publicity and References. Subject to Section 8.6 Proprietary Information, the parties contemplate and agree that publication of information relating to this Agreement may occur through press releases, articles, interviews, marketing materials, online materials, and/or speeches ("Publicity"). Both parties must approve the content of any such Publicity prior to its publication, which approval shall not be unreasonably withheld. Routine references to the fact that Customer is a customer of MBO and the general nature of services that Customer purchases under this Agreement are not considered Publicity for purposes of this section, and Customer and MBO each authorize the other, during the term of this Agreement, to make such references.

8.21 Headings. Descriptive headings contained in this Agreement are for convenience and not intended as substantive portions of the Agreement. Such headings shall have no affect upon the construction of the Agreement.

8.22 Industry Terms. The parties intend that words having well-known technical or trade meanings shall be accorded such meaning, unless expressly defined otherwise.

8.23 Definitions. For purposes of this Agreement, capitalized words and phrases shall have the respective meanings assigned to them in this Agreement.

8.24 Counterparts. This Agreement may be executed in one or more counterparts, each of which shall be deemed an original and all of which together shall constitute one and the same agreement. Facsimile signatures shall be deemed original signatures.

8.25 General Applicability of Provisions. Unless expressly excluded, all terms of this Agreement are applicable to all sections of this Agreement, notwithstanding the specific reference to such a term in any other particular section.

8.26 Intellectual Property Rights. Unless otherwise specifically agreed in writing by the parties, each party shall retain all right, title and interest in and to any intellectual property associated with the provision of Services. If it should be necessary for a party to practice any patent, copyright, trade secret or other non-trademark intellectual property of the other party to avail itself of the Services, the parties shall negotiate in good faith a license with respect to such intellectual property. Each party acknowledges that the other party's name is proprietary to the other party. This Agreement does not transfer, and confers no right to use, the name, trademarks (including service marks), patents, copyrights, trade secrets, other intellectual property or

CIC of either party, except as expressly provided herein. Neither party shall take any action inconsistent with the intellectual property rights of the other party.

8.27 Survival of Terms. No termination of this Agreement shall affect the rights or obligations of either party: (a) with respect to any payment for services rendered before termination; or (b) pursuant to other provisions of this Agreement that, by their sense and context, are intended to survive termination of this Agreement, including without limitation, indemnification and limitation of liability.

8.28 Merger/Integration. This Agreement consists of all the terms and conditions contained herein and in documents incorporated herein specifically by reference. This Agreement constitutes the complete and exclusive statement of the understanding between the parties and supersedes all proposals and prior agreements (oral or written) between the parties relating to Services provided hereunder.

IN WITNESS WHEREOF, the parties hereto have executed this Master Services Agreement effective as of the day and year first above written The offer expressed in this Agreement is extended to Customer for thirty (30) calendar days from date of MBO' signature, but such offer shall expire immediately following such thirty (30) calendar day period

MBO Video, L.L.C.:	Cross Telephone Company, L.L.C.:
G Bald	V. D. Miller II
Signature of Authorized Representative	Signature of Authorized Representative
Gene Baldwin	V. David Miller II
Printed Name	Printed Name
VP	President
Title	Title
4-12-08	4/10/08
Date of Signature	Date of Signature

Cross Telephone Company

ATTACHMENT 2

Confidential and Proprietary; Confidential Treatment Requested

Law Offices of Bennet & Bennet, PLLC

BENNET & BENNET PLLC

Maryland
6124 MacArthur Boulevard
Bethesda, Maryland 20816
Tel: (202) 371-1500
Fax: (202) 371-1558
www.bennetlaw.com

District of Columbia
5185 MacArthur Boulevard, NW, Suite 729
Washington, DC 20016

Caressa D. Bennet
Michael R. Bennet
Marjorie G. Spivak*
Howard S. Shapiro

*Admitted in DC & PA Only

Daryl A. Zakov▲
Robert A. Silverman
Erin P. Fitzgerald
Frederick W. Giroux#

▲Admitted in DC & WA Only
#Admitted in DC & MA Only

MEMORANDUM

To:	**Jake Baldwin, General Counsel** **Cross Telephone Company**
From:	**Carri Bennet** **Howard Shapiro**
Date:	**October 18, 2017**
Re:	**USAC Audit No. HC2016BE031**

Pursuant to your request, we have reviewed the draft report ("Report) prepared Moss Adams, LLP ("Moss Adams" "Auditor") in response to the above-referenced audit requested by the Universal Service Administration Company ("USAC"). Specifically, we have reviewed the Auditor's Finding #1 related to the treatment of certain expenses incurred by Cross Telephone Company ("Cross") in connection with its purchase of DS1 services from an affiliated company, MBO Video, LLC ("MBO"). For the reasons set forth below, it is our view that the Auditor incorrectly treated the purchase of DS1 transport services as an asset lease arrangement, rather than as the purchase of services and, in doing so, ignored the contractual agreements and arrangements between the parties as well as the guiding principles established by the International Accounting Standards Board ("IASB") and embodied in the Internal Revenue Code ("IRC").

Section 7701(e) of the IRC sets forth specific criteria to determine whether a particular arrangement should be characterized as a service contract or as a lease. That section states:

§ 7701

* * *

(e) **Treatment of certain contracts for providing services, etc.** A contract which purports to be a service contract shall be treated as a lease of property if such contract is properly treated as a lease of property, taking into account all relevant factors including whether or not:

(A) the service recipient is in physical possession of the property,

(B) the service recipient controls the property,

(C) the service recipient has a significant economic or possessory interest in the property,
(D) the service provider does not bear any risk of substantially diminished receipts or substantially increased expenditures if there is nonperformance under the contract,
(E) the service provider does not use the property concurrently to provide significant services to entities unrelated to the service recipient, and
(F) the total contract price does not substantially exceed the rental value of the property for the contract period.

26 U.S.C. §7701(e).

Despite the clarity of these criteria, the Auditor's Report contains absolutely no analysis or even a discussion as to the propriety of ignoring the Master Services Agreement between the parties and treating the provision of DS1 services by MBO to Cross as the lease of an asset rather than as the purchase of services. To the contrary, the Auditor's Report simply assumes, erroneously, that the arrangement between Cross and MBO must be classified as a lease, regardless of how that transaction has been structured by the parties.

Even a cursory review of the Master Services Agreement between Cross and MBO reveals that the arrangement is properly characterized as a services agreement and not a lease. Under the terms of this arrangement, MBO retains total control of the facilities used to provide the DS1 circuits. Indeed the fact that the agreement allows MBO at its discretion to utilize the facilities of third party providers in addition to or in lieu of its own facilities for any part of the communications pathway clearly indicates that Cross has been given neither physical possession of the facilities used to provide the DS1 circuits nor the right to control those facilities. Similarly, Cross retains no economic or possessory interest in the facilities and MBO bears the risk of all losses or damages to the facilities upon the occurrence of any catastrophic incident as well as the risk of substantially diminished receipts or substantially increased expenditures if there is nonperformance under the contract. Finally, the facilities utilized by MBO to provide the DS1 service to Cross are part of an integrated communications platform owned and operated by MBO. This platform supports network redundancy that allows MBO at its sole discretion to re-route traffic in the event of a network failure and thus maintain service level obligations and quality of service standards which MBO is obligated to provide under the Master Services Agreement and associated documents. In his regard it is also significant that MBO's service platform is used not only to provide DS1 services to Cross but also to provide telecommunications services to other unaffiliated carriers as well, further underscoring the arms length nature of the service contract between MBO and Cross in this particular instance.

In 2011, the IRS issued a revenue ruling that specifically applied the leasing criteria contained in Section 7701(e) to distinguish telecommunications service contracts from leases. In Rev. Rul. 2011-24, 2011-41 I.R.B. 485 (copy attached), the IRS considered three hypothetical situations: the first where a telecommunications carrier provided dedicated circuits to a business customer using its own SONET platform; a second where the carrier utilized a

combination of dedicated circuits and the public switched telephone network ("PSTN") to provide services to its business customer; and a third where the telecommunications carrier provided dedicated circuits to its business customer to provide the telecommunications service, but also leased customer premises equipment to the customer. The customer chose the locations to be interconnected under all three agreements while the carrier retained ownership and control of the facilities and the flexibility to determine just how calls would be routed. In the third scenario, the customer retained the authority to remove leased equipment from the premises and use that equipment on other networks or at different locations. In all three cases, the IRS ruled that the service contracts were not leases and that the presence of a separate equipment lease did not convert the service agreement into a lease.

The cases described in the Revenue Ruling are not significantly distinguishable from the service contract arrangement in place between MBO and Cross. The Auditor has provided no evidence or reasoning to support its decision to characterize the Master Services Agreement as a lease. Any such characterization is erroneous and unsupported by law or the facts.

It should be noted that the Auditor's re-characterization of the Master Services Agreement as a lease arrangement is inconsistent with both Generally Accepted Accounting Principles (GAAP) and international accounting standards. The auditor's finding relies on a separations procedure required by Part 36 of FCC rules. *See* 47 C.F.R. Part 36. Part 36 of the FCC's Rules requires classification of accounts for separations purposes to be consistent with the Uniform System of Accounts (USOA). *See* 47 CFR 36.1(f). The Part 32 USOA Rules incorporate GAAP. *See* 47 CFR 32.1 and 32.12. GAAP defines a lease as "an agreement conveying the right to use property, plant, or equipment (land and/or depreciable assets) usually for a stated period of time." ASC 840-10-20.

Further, under international accounting standards, the same treatment applies. In January 2016, the International Accounting Standards Bureau (IASB) issued International Financial Reporting Standard 16 ("IFRS 16") dealing with the proper reporting of leases with a term of 12 months or more. While IFRS 16 takes effect for annual periods beginning on or after January 1, 2019, the standard represents nearly a decade of debate and discussion on, *inter alia*, how to properly distinguish leases from service contract.

Under IFRS 16, a contract is, or contains, a lease if it *conveys the right to control the use* of an *identified asset* for a period of time in exchange for consideration. IFRS 16 states that control is conveyed where the customer has both the right to direct the identified asset's use and to obtain substantially all the economic benefits from that use. Where, as in the case of the Master Services Agreement between MBO and Cross, a supplier has a substantive right of substitution throughout the period of use, a customer does not have a right to use an identified asset. As to the requirement that asset be identified, IFRS 16 states that a capacity portion of an asset may still be considered an identified asset if it is physically distinct (*e.g.*, a floor of a building). However the capacity or other portion of an asset that is not physically distinct (*e.g.* a capacity portion of a fiber optic cable) is not an identified asset unless it represents substantially all the capacity of the asset and the customer obtains substantially all the economic benefits from using the asset. As indicated above, capacity provided by MBO to

Cross is provided as part of a larger system that is used by MBO to service customers other than Cross.

Based on the foregoing and consistent with Section 7.37 of the Government Accounting Office's Government Auditing Standards, Revision 2011, the Auditor must reconsider and amend its Finding #1 so that it is consistent with statutory and case law as well as the standards published by GAAP and the IASB. If the auditor continues to disagree with our legal analysis, the auditor is required to state its basis for its disagreement.

If you have any questions, would like additional information regarding this matter, please contact us.

Internal Revenue bulletin

Bulletin No. 2011-41
October 11, 2011

HIGHLIGHTS OF THIS ISSUE

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Rev. Rul. 2011–22, page 489.

Federal rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate. For purposes of sections 382, 642, 1274, 1288, and other sections of the Code, tables set forth the rates for October 2011.

Rev. Rul. 2011–24, page 485.

Telecommunications services under section 199. This ruling determines in certain situations whether a taxpayer providing telecommunications services is deriving gross receipts from services, leasing or renting property, or some combination thereof for purposes of the domestic production activities deduction under section 199 of the Code.

Notice 2011–74, page 496.

This notice provides for the suspension of certain requirements under section 42 of the Code for low-income housing credit projects in order to provide emergency housing relief needed as a result of the devastation caused by Tropical Storm Irene in Vermont beginning on August 27, 2011.

Notice 2011–79, page 498.

Extension of replacement period for livestock sold on account of drought. This notice explains the circumstances under which the 4-year replacement period under section 1033(e)(2) of the Code is extended for livestock sold on account of drought. The Appendix to this notice contains a list of the counties that experienced exceptional, extreme, or severe drought during the preceding 12-month period ending August 31, 2011. Taxpayers may use this list to determine if an extension is available.

EXEMPT ORGANIZATIONS

Announcement 2011–63, page 503.

The IRS has revoked its determination that Allied Veterans of the World, Inc., & Affiliates of Charlotte, NC; Metropolitan Financial Management Corporation of Roseville, MN; Saint Rest No. 2 Missionary Baptist Church of Chicago, IL; American Homebuyers Foundation, Inc., of Conyers, GA; Bundle of Joy Daycare, Inc., of Long Beach, CA; Columbia Basin Animal Rescue and Protection Agency of Kennewick, WA; Handicap Interests International and World Religions of Saranac Lake, NY; Holographic Ecology, Inc., of Santa Barbara, CA; Mattie's Maternity Homes of Palmdale, CA; Monytek Human Services, Inc., of Pendleton, OR; and Community Day Care Center of Abbeyville, LA, qualify as organizations described in sections 501(c)(3) and 170(c)(2) of the Code.

EMPLOYMENT TAX

Announcement 2011–64, page 503.

This announcement provides notice and details regarding the new Voluntary Classification Settlement Program (VCSP). The VCSP will allow eligible taxpayers to obtain similar relief to that obtained in the current Classification Settlement Program (CSP), which is only available to taxpayers under IRS examination. The VCSP is optional and provides taxpayers with an opportunity to voluntarily reclassify their workers as employees for future tax periods with limited federal employment tax liability for the past nonemployee treatment. To participate, taxpayers must meet certain eligibility requirements, apply to participate in VCSP, and enter into a closing agreement with the IRS.

(Continued on the next page)

Finding Lists begin on page ii.

Department of the Treasury
Internal Revenue Service

ADMINISTRATIVE

T.D. 9545, page 490.

Final regulations under section 6404 of the Code relate to the suspension of interest, penalties, additions to tax, or additional amounts under section 6404(g). Notice 2007–93 obsoleted.

Notice 2011–78, page 497.

This notice provides relief to insurance companies administering certain self-insurance arrangements on behalf of an employer or other entity from any information reporting obligations under section 6050W of the Code. Insurance companies may rely on this notice until the regulations under section 6050W are amended.

The IRS Mission

Provide America's taxpayers top-quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents are compiled semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.
This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

Part II.—Treaties and Tax Legislation.
This part is divided into two subparts as follows: Subpart A, Tax Conventions and Other Related Items, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.
To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

Part IV.—Items of General Interest.
This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

The last Bulletin for each month includes a cumulative index for the matters published during the preceding months. These monthly indexes are cumulated on a semiannual basis, and are published in the last Bulletin of each semiannual period.

For sale by the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 42.—Low-Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2011. See Rev. Rul. 2011-22, page 489.

Section 199.—Income Attributable to Domestic Production Activities

26 CFR 1.199–3: Domestic production gross receipts.
(Also: § 7701.)

Telecommunications services under section 199. This ruling determines in certain situations whether a taxpayer providing telecommunications services is deriving gross receipts from services, leasing or renting property, or some combination thereof for purposes of the domestic production activities deduction under section 199 of the Code.

Rev. Rul. 2011–24

ISSUE

In the situations described below, does a taxpayer that provides telecommunication services derive gross receipts from services to customers, leasing or renting property to customers, or some combination thereof for purposes of the domestic production activities deduction under § 199 of the Internal Revenue Code?

FACTS

Situation 1. Z corporation is in the business of providing telecommunication services, including the transmission of voice, data, and video communications. Z contracts with A, a corporation that is not in the telecommunications industry, to transmit A's telecommunications. A has multiple business locations. The contract requires Z to transmit A's telecommunications at A's desired times, to A's desired destinations, and at a certain speed. If Z cannot transmit A's telecommunications according to the terms of the contract, then the contract requires Z to provide A with a service credit. The contract requires A to make payments to Z for transmitting A's telecommunications.

Z's optical and digital transmission equipment, usually a Synchronous Optical Network (SONET) ring, and the associated Public Switched Telephone Network (PSTN) are used to transmit A's telecommunications. Z's SONET ring is deployed in a ring topology and interconnects multiple business locations designated by A so that telecommunications can be transmitted between A's business locations without being transmitted to Z's PSTN. The SONET ring also connects with Z's central office, switching center, or remote terminal so that telecommunications can be transmitted to and from Z's PSTN.

The PSTN is comprised primarily of fiber optic cable and copper cable that connects switching centers with each other and connects switching centers to remote terminals. The PSTN is owned by Z and is not dedicated to A or to any of Z's other customers. Z's PSTN provides a multitude of different pathways to transmit telecommunications to and from A's business locations. The SONET ring and PSTN assets used to transmit A's telecommunications include: (1) network electronics, such as multiplexers, switches, routers, digital cross connects, optical and digital transmission equipment; (2) fiber optic cable and/or copper cable; (3) network facilities such as a central office; and (4) software.

A owns some telecommunications equipment that connects with the SONET ring to allow transmission of A's telecommunications between A's business locations or to the PSTN, and transmission of others' telecommunications to A from the PSTN. A's telecommunications equipment is located solely on A's side of the demarcation point (point of interconnection) as that term is used in 47 C.F.R. Part 68. A's telecommunications equipment typically includes a router, a channel service unit/data service unit, and diagnostics modem (collectively the "customer premises equipment"). The contract does not require Z to provide any services related to A's customer premises equipment.

Z owns, installs, operates, and maintains the SONET ring and PSTN. Z will replace any SONET ring and PSTN assets when repairs or upgrades are required. The contract requires that A grant Z reasonable access to A's premises for the purpose of installing, inspecting, testing, rearranging, maintaining, repairing, or removing any of the SONET ring assets located on A's premises. Z maintains and repairs the SONET ring and PSTN at no additional charge to A. A is prohibited from installing, inspecting, testing, rearranging, maintaining, repairing, or removing any component of the SONET ring and/or PSTN.

Situation 2. The facts and circumstances are the same as in *Situation 1*, except A does not have multiple business locations and Z's dedicated circuit, instead of a SONET ring, is used to transmit A's telecommunications to the PSTN and others' telecommunications from the PSTN. All telecommunications transmitted to or from A must be transmitted using the PSTN. Z's dedicated circuit, also referred to as the "local loop" or "last mile," is comprised of Z's equipment (copper or fiber optic cable, point of presence equipment, and dedicated or shared equipment).

Z generally does not notify A if Z repairs the dedicated circuit or PSTN. Z may notify A if Z upgrades the dedicated circuit or PSTN. A cannot stop Z from making any necessary repairs or upgrades to the dedicated circuit or PSTN.

Situation 3. The facts are the same as *Situation* 2 except that A does not own the customer premises equipment required to connect with the dedicated circuit to allow transmission of A's telecommunications. As part of the contract for Z to transmit A's telecommunications, Z also provides the customer premises equipment, and provides support services to A in relation to managing the customer premises equipment. The contract provides that it is a lease of the customer premises equipment to A, but does not separately state the lease amount.

Z delivers and installs the customer premises equipment on A's premises. Z, if necessary, helps maintain the customer premises equipment by providing telephone support services to A's designated employees related to diagnosing problems and repairing and replacing the customer

premises equipment. Z can also remotely perform certain maintenance or diagnostic tasks. *A*'s designated employees complete any required repair or replacement. *A* is liable for any repair charges or the replacement cost of the customer premises equipment if it is damaged or lost. *A* can relocate or modify the customer premises equipment, and may attach it to non-*Z* equipment with *Z*'s written authorization, which may not be unreasonably withheld. When the contract terminates, if *A* does not return the customer premises equipment or make it available for removal by *Z*, then *A* is liable to *Z* for the customer premises equipment's then current market value. *A* is liable for costs of any restoration of the customer premises equipment beyond ordinary wear and tear.

LAW AND ANALYSIS

Section 199(a)(1) allows a deduction equal to 9 percent (3 percent in the case of taxable years beginning in 2005 or 2006, and 6 percent in the case of taxable years beginning in 2007, 2008, or 2009) of the lesser of (A) the qualified production activities income (QPAI) of the taxpayer for the taxable year, or (B) taxable income (determined without regard to § 199) for the taxable year (or, in the case of an individual, adjusted gross income).

Sections 199(b)(1) and (b)(2) limit the amount of the deduction allowable under § 199(a) to 50 percent of the W–2 wages of the taxpayer for the taxable year that are allocable to domestic production gross receipts (DPGR).

Section 199(c)(1) defines QPAI for any taxable year as an amount equal to the excess (if any) of (A) the taxpayer's DPGR for such taxable year, over (B) the sum of (i) the cost of goods sold that are allocable to such receipts; and (ii) other expenses, losses, or deductions (other than the deduction under § 199) that are properly allocable to such receipts.

Section 199(c)(4)(A)(i)(I) provides that the term DPGR means the taxpayer's gross receipts that are derived from any lease, rental, license, sale, exchange, or other disposition of qualifying production property that was manufactured, produced, grown, or extracted by the taxpayer in whole or in significant part within the United States.

Section 1.199–3(i)(1) of the Income Tax Regulations provides that applicable Federal income tax principles apply to determine whether a transaction is, in substance, a lease, rental, license, sale, exchange, or other disposition, whether it is a service, or whether it is some combination thereof. Section 1.199–3(i)(4)(i)(A) provides that gross receipts derived from the performance of services generally do not qualify as DPGR.

Section 1.199–3(i)(6)(ii) provides that gross receipts derived from customer and technical support, telephone and other telecommunication services, online services (such as Internet access services, online banking services, providing access to online electronic books, newspapers, and journals), and other similar services do not constitute gross receipts derived from a lease, rental, license, sale, exchange, or other disposition of computer software. *Example 3* of § 1.199–3(i)(6)(v) concludes that gross receipts derived from telephone and related telecommunication services run by computer software produced by the taxpayer are attributable to a service and do not constitute gross receipts derived from a lease, rental, license, sale, exchange, or other disposition of computer software.

Rev. Rul. 68–109, 1968–1 C.B. 10, holds that switchboards or dial switching apparatus installed by the taxpayer, a regulated communications utility, at a customer location and used to furnish communications services to tax-exempt organizations or governmental units were eligible for the investment tax credit because the equipment installed was not owned or leased by the tax-exempt organizations or governmental units. The taxpayer retained all ownership in, and possession and control over, the equipment. The agreement entered into between the taxpayer and the customer was not a sale or lease but a service contract. The services furnished by the taxpayer and the manner in which they must be furnished were described in tariffs (which did not include provisions that authorized the taxpayer to sell or lease any of the property in question) on file with the Federal Communications Commission, and with the pertinent state public utility regulatory agencies.

Rev. Rul. 72–407, 1972–2 C.B. 10, holds that fully serviced vehicles that were furnished on a daily basis to a department of the United States Government were ineligible property for purposes of the investment tax credit because the vehicles were provided under a lease arrangement rather than a service contract. The ruling reasons that the provision of vehicles was more analogous to the facts under Rev. Rul. 71–397, 1971–2 C.B. 63 (in which an owner-manufacturer's machines placed with and for the use of tax-exempt organizations and governmental units were not eligible for the investment tax credit because the manufacturer did not have possession and use of the machines), than to the facts under Rev. Rul. 68–109. The ruling reasons that, because the vehicles were not part of an integrated network and no government regulations prohibited a lease of the vehicles, provision of the vehicles was fundamentally different from the provision of communications services considered in Rev. Rul. 68–109. The vehicles were provided to the governmental unit by the taxpayer; however, the taxpayer did not use them to render services to the governmental unit. Instead, the placement of the vehicles with the governmental unit allowed the governmental unit to provide services to itself.

In addition, case law addresses whether a contract is a lease or a service contract. For example, in *Xerox Corporation v. United States*, 656 F.2d 659 (Ct. Cl. 1981), the court held that machines were eligible for the investment tax credit because the machines were not leased but supplied as an integral part of service. The court, after citing Rev. Rul. 68–109 and other rulings, focused the service-versus-lease analysis on the possessory interest a taxpayer retains in the property and whether the property is part of an integrated operation. The court described four factors to use when analyzing the possessory interest: (1) retention of property ownership by taxpayer (*see* Rev. Rul. 68–109); (2) retention of possession and control of the property by taxpayer (*see* Rev. Rul. 68–109 and Rev. Rul. 71–397); (3) retention of risk of loss by the taxpayer (*see* Rev. Rul. 68–109); and (4) reservation of the right to remove the property, and replace it with comparable property.

In *Smith v. Commissioner*, T.C. Memo. 1989–318, in determining whether the taxpayer was eligible for the investment tax credit, the court listed four factors for distinguishing leases from service contracts: (1) which party has the use and possession or control of the equipment; (2) which

party operates the machine; (3) whether the tax-exempt organization pays for the use of the machine for some duration, or, instead pays based upon the number of procedures executed; and (4) whether the equipment is part of a broader, integrated system of equipment and services.

Applicable Federal income tax principles relevant to determining whether a taxpayer's gross receipts are derived from providing telecommunication services or from a lease or rental of property include the factors described in § 7701(e)(1). Section 7701(e)(1) provides that for purposes of chapter 1, of which § 199 is a part, a contract that purports to be a service contract shall be treated as a lease of property if such contract is properly treated as a lease of property taking into account all relevant factors, including whether or not (A) the service recipient is in physical possession of the property, (B) the service recipient controls the property, (C) the service recipient has a significant economic or possessory interest in the property, (D) the service provider does not bear any risk of substantially diminished receipts or substantially increased expenditures if there is nonperformance under the contract, (E) the service provider does not use the property concurrently to provide significant services to entities unrelated to the service recipient, and (F) the total contract price does not substantially exceed the rental value of the property for the contract period.

Although authorities on Federal income tax principles such as those summarized above demonstrate that Federal income tax principles are generally used to determine a single character for a given transaction, § 1.199–3(i)(1) provides that, solely for purposes of § 199, a single transaction may, depending on applicable Federal income tax principles, have both a services element and a lease element. Accordingly, the application of Federal income tax principles described in § 1.199–3(i)(1) requires an analysis of relevant factors taken from Federal income tax principles, but does not require a determination of a single character. However, analysis of the relevant factors may lead to a determination that the transaction has only a single character element for purposes of § 199.

In *Situation 1*, under the applicable Federal income tax principles described above, *Z* is using its SONET ring and PSTN to provide telecommunication services to *A*, not providing a combination of telecommunication services with a lease or rental of *Z*'s SONET ring or PSTN to *A*. Although a determination for § 199 purposes that a transaction constitutes exclusively the provision of services requires thorough consideration of all relevant facts and circumstances, several significant factors in *Situation 1* support this conclusion.

For instance, *Z* maintains control of the SONET ring and PSTN that are necessary for *Z* to fulfill the conditions of its contract with *A*. To fulfill the contract terms, *Z* must transmit *A*'s telecommunications at *A*'s desired times, to *A*'s desired destinations, and at a certain speed. *A* contracts with *Z* for the quantity and quality of telecommunication services, but does not control how *Z* uses the SONET ring and PSTN to provide the services.

Further, *A* does not have a possessory interest in the SONET ring and PSTN that *Z* uses to complete the transmissions. *Z* must operate the SONET ring and PSTN because, if *A* makes the payments due under the contract to *Z*, *Z* is required to transmit *A*'s telecommunications. *A* does not operate, maintain, repair or upgrade the SONET ring and PSTN. *A* grants *Z* reasonable access to *A*'s premises for the purpose of installing, inspecting, testing, rearranging, maintaining, repairing, or removing any of the SONET ring assets located on *A*'s premises. *Z* operates, maintains, repairs, and upgrades the SONET ring and PSTN at no additional charge to *A*. *A* is prohibited from installing, inspecting, testing, rearranging, maintaining, repairing, or removing any component of the SONET ring or PSTN. *Z* is the party with a possessory interest in the SONET ring and PSTN. *Z* must be able to operate the SONET ring and PSTN because, if *Z* cannot transmit *A*'s telecommunications according to the terms of the contract (*i.e.*, *A*'s desired times, destinations, and speed), then *Z* is required to provide a service credit.

In addition, the SONET ring and PSTN are part of *Z*'s broader integrated operation of transmitting telecommunications. While the SONET ring allows *Z* to transmit *A*'s telecommunications between *A*'s designated business locations without accessing *Z*'s PSTN, the SONET ring also connects with *Z*'s central office, switching center, or remote terminal so that telecommunications can be transmitted to and from *Z*'s PSTN. The PSTN is owned by *Z* and is not dedicated to *A* or to any of *Z*'s other customers. The PSTN provides a multitude of different pathways to transmit telecommunications to and from *A*'s business locations.

In this situation, *A* contracts with *Z* for reliable telecommunication services and *Z* provides those services using its SONET ring and PSTN subject to the contract terms governing the quantity and quality of services that *Z* must provide. Accordingly, *Z*'s gross receipts derived from transmitting *A*'s telecommunications are derived from the performance of services without the lease or rental of *Z*'s SONET ring and PSTN to *A* for purposes of § 199.

In *Situation 2*, under the applicable Federal income tax principles described above, *Z* is using the dedicated circuit and PSTN to provide telecommunication services to *A*, not providing a combination of telecommunication services with a lease or rental of *Z*'s dedicated circuit or PSTN to *A*. Although a determination for § 199 purposes that a transaction constitutes exclusively the provision of services requires thorough consideration of all relevant facts and circumstances, several significant factors in *Situation 2* support this conclusion.

For instance, *A* does not control the dedicated circuit or PSTN as *Z* maintains the same control as *Z* has over the SONET ring and PSTN in *Situation 1*. Further, *A* does not have a possessory interest in the dedicated circuit and PSTN that *Z* uses to complete the transmissions. *Z*, in fact, has broader access to a dedicated circuit than a SONET ring. Also, the dedicated circuit is part of *Z*'s broader integrated operation. The dedicated circuit must connect with *Z*'s PSTN to transmit telecommunications to and from *A*'s business location.

In this situation *A* contracts with *Z* for reliable telecommunication services and *Z* provides those services using its dedicated circuit and PSTN subject to the contract terms governing the quantity and quality of services that *Z* must provide. Accordingly, *Z*'s gross receipts derived from transmitting *A*'s telecommunications are derived from the performance of services without the lease or rental of *Z*'s dedicated circuit or PSTN to *A* for purposes of § 199.

In *Situation 3*, under the applicable Federal income tax principles described above, *Z* is providing a combination of

telecommunication services using its dedicated circuit and PSTN and a lease or rental of *Z*'s customer premises equipment to *A*. Although a determination for § 199 purposes that a transaction constitutes a combination of services and a lease or rental requires thorough consideration of all relevant facts and circumstances, several significant factors in *Situation 3* support this conclusion.

With respect to the dedicated circuit and PSTN, the same analysis applies to *Situation 3* as applied in *Situation 2*. In this situation, *A*'s contract with *Z* also includes the provision of customer premises equipment. The customer premises equipment is necessary to allow *A* to connect with the dedicated circuit so that *Z* can transmit telecommunications to and from *A*'s business location.

A controls the customer premises equipment in generally the same manner as in *Situation 2* where *A* owns the customer premises equipment. However, in this case, *Z* owns, provides necessary telephone support services for, and can perform certain remote maintenance and diagnostic tasks on the customer premises equipment. Nevertheless, *A* has a possessory interest in the customer premises equipment. *Z* must operate the dedicated circuit and PSTN, but just as in *Situation 2*, *A* operates the customer premises equipment. *A* designates employees to perform equipment replacement and repair of the customer premises equipment. *Z* provides telephone assistance, but only if necessary. *A* can relocate or modify the customer premises equipment, and may attach it to non-*Z* equipment with *Z*'s written authorization, which may not be unreasonably withheld. *A* is liable for any repair charges or the replacement cost of the equipment if it is damaged or lost. When the contract terminates, if *A* does not return the customer premises equipment or make it available for removal by *Z*, then *A* is liable to *Z* for the customer premises equipment's then current market value. If *A* does return it and the customer premises equipment has more than ordinary wear and tear, then *A* is liable for those restoration costs. The facts demonstrate in this situation that *A* has a possessory interest in the customer premises equipment.

Because *A* is ultimately the party responsible for ensuring that the customer premises equipment is available to connect with the dedicated circuit to allow *Z* to transmit telecommunications to and from *A*'s business location using *Z*'s dedicated circuit and PSTN, the customer premises equipment should not be considered part of *Z*'s broader integrated network.

In this situation *A* contracts with *Z* for reliable telecommunication services and *Z* provides those services using its dedicated circuit and PSTN subject to the contract terms governing the quantity and quality of services that *Z* must provide, but *A* also contracts for the lease or rental of customer premises equipment. Accordingly, *Z*'s gross receipts derived from transmitting *A*'s telecommunications are derived from a combination of services using its dedicated circuit and PSTN and a lease or rental of the customer premises equipment to *A*.

The terms "lease" and "rent" are used interchangeably throughout the Code, and for purposes of this analysis a distinction is unnecessary. The characterization of a transaction as a combination of services and a lease as opposed to a combination of services and a rental has no effect under § 199.

HOLDINGS

In *Situation 1*, *Z*'s gross receipts are derived from the performance of telecommunication services without the lease or rental of *Z*'s SONET ring and PSTN to *A* for purposes of § 199 and do not constitute DPGR.

In *Situation 2*, *Z*'s gross receipts are derived from the performance of telecommunication services without the lease or rental of *Z*'s dedicated circuit and PSTN to *A* for purposes of § 199 and do not constitute DPGR.

In *Situation 3*, *Z*'s gross receipts are derived from a combination of the performance of telecommunication services using its dedicated circuit and PSTN and a lease or rental of the customer premises equipment described above to *A* for purposes of § 199. *Z*'s gross receipts derived from the performance of services do not constitute DPGR and *Z*'s gross receipts derived from the lease or rental of the customer premises equipment only qualify as DPGR if *Z* meets the other requirements of § 199 with respect to the customer premises equipment.

DRAFTING INFORMATION

The principal author of this revenue ruling is James A. Holmes of the Office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this revenue ruling, contact Mr. Holmes at (202) 622-3040 (not a toll-free call).

Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of October 2011. See Rev. Rul. 2011-22, page 489.

Section 382.—Limitation on Net Operating Loss Carryforwards and Certain Built-In Losses Following Ownership Change

The adjusted applicable federal long-term rate is set forth for the month of October 2011. See Rev. Rul. 2011-22, page 489.

Section 412.—Minimum Funding Standards

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2011. See Rev. Rul. 2011-22, page 489.

Section 467.—Certain Payments for the Use of Property or Services

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2011. See Rev. Rul. 2011-22, page 489.

Section 468.—Special Rules for Mining and Solid Waste Reclamation and Closing Costs

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2011. See Rev. Rul. 2011-22, page 489.

Cross Telephone Company

ATTACHMENT 3

DECLARATION OF RYAN OVERLAND
IN SUPPORT OF CROSS TELEPHONE COMPANY L.L.C.

1. I, V. David Miller II, am President of Cross Telephone Company L.L.C. ("Cross" or the "Company"). I have more than 35 years of experience in the telecommunications industry. I have worked for Cross for in excess of 35 years.

2. I am providing this Declaration in support of Cross' Response to the Draft Audit Report issued in July 2018 ("Audit Report"). The audit, conducted by Moss-Adams LLP (the "Auditor") on behalf of the Universal Service Administrative Company ("USAC"), audited, Cross' compliance with the Federal Communications Commission's ("Commission") rules governing the high cost program ("HCP") support mechanism during calendar years 2010-2014 (the "Audit"). The information in this Declaration is to the best of my knowledge and belief.

BACKGROUND

3. Cross is a limited liability company formed under the laws of the State of Oklahoma and has a principal place of business located at 704 Third Avenue, Warner, OK 74469. The Company is an incumbent local exchange carrier ("ILEC") providing local exchange and other telephone services throughout the state of Oklahoma.

CROSS' SERVICES

4. Cross provides exchange service to subscribers utilizing a mix of its own facilities and services purchased from its affiliates. Cross has purchased DS1 transport services from its affiliate, MBO Video ("MBO"), since the late 1990s, including during calendar years 2010-2014, the time period covered by the Audit. Prior to purchasing DS1 transport service from MBO,

Cross had purchased DS1 transport service from Southwestern Bell Telephone ("SWBT") pursuant to SWBT's tariff.

5. Cross' purchase of DS1 transport service from MBO initially was governed by a General Contract for Services which was replaced, in 2008, by a Master Services Agreement ("MSA"). The MSA provided Cross with DS1 transport service and did not provide Cross with a lease of MBO's DS1 circuits and Cross reported the DS1 transport service as an expense for HCP reporting purposes. Cross' purchase of DS1 transport service from MBO did not involve the sale of Cross' assets to MBO or the subsequent lease-back of those assets.

6. In 2009, KPMG, on behalf of USAC, conducted an Improper Payment Information Act performance audit of Cross' participation in the HCP (the "2009 Audit"). The 2009 Audit reviewed, among other information, Cross' methodology for reporting expenses, associated with DS1 transport service purchased from MBO, for purposes of HCP reporting. Among other information, Cross provided to KPMG and USAC, information regarding Cross' purchase of DS1 transport service from MBO, including copies of the General Contract for Services and MSA, and Cross' methodology for reporting related expenses for purposes of the HCP. In audit materials provided to Cross, neither KPMG nor USAC expressed any objection to Cross' reporting methodology, aside from identifying a minor capacity miscount. The 2009 Audit finding regarding the DS1 transport services noted that, absent the service miscount, Cross would have been eligible to receive more HCP support than Cross had received.

7. The DS1 transport services that Cross purchased from MBO between calendar years 2010 and 2014 were identical to the DS1 transport services that were reviewed during the 2009 Audit. The DS1 transport service expense for calendar years 2010-2014 constituted approximately 13% – 23% of Cross' total expenses. The expenses for the DS1 transport service

that Cross obtained from MBO during the time period covered by the 2009 Audit, constituted a similar percentage of Cross' total expense.

8. Cross has used the same HCP reporting methodology, that was identified to KPMG and USAC during the 2009 Audit, to report expenses for DS1 transport service purchased from MBO during calendar years 2010 to 2014.

I hereby declare under penalty of perjury that the foregoing declaration is true and correct to the best of my knowledge and belief.

Dated this 14 day of August, 2018

V. David Miller II

V. David Miller II
President