

**Before the
Federal Communications Commission
Washington, DC 20554**

In the Matter of)
)
Sandwich Isles Communications, Inc.) WC Docket No. 09-133
Petition for Declaratory Ruling)

PETITION FOR CLARIFICATION AND/OR DECLARATORY RULING

The National Exchange Carrier Association, Inc. (“NECA”) files this petition seeking clarification of the provisions of *Sandwich Isles Communications, Inc.*, 25 FCC Rcd. 13647 (WCB 2010), *pet. for recon. and app. for rev. pending* (“*Declaratory Ruling*” or “*Ruling*”). In administering the terms of the *Ruling*, Sandwich Isles, Inc. (“SIC”) has disputed whether its treatment of “disputed lease expenses,” i.e., as a current accrued liability without completely paying the required periodic obligations, should be included in the NECA pool revenue requirement. To the extent that the Commission believes that the issue is not fairly addressed in the *Ruling*, NECA respectfully requests that the Commission issue a clarification and/or declaration regarding the amount of “disputed lease expenses” that should be recognized in the calculation of the applicable NECA pool revenue requirement.

I. BACKGROUND

SIC operates as an incumbent local exchange carrier for purposes of the FCC’s access charge and universal service rules in certain portions of the State of Hawaii targeted to serving portions of the Hawaiian Home Lands. SIC also provides broadband service to these same

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customers.¹ SIC is a member company of both the NECA common line and traffic sensitive pools.²

Paniolo Cable³ owns an undersea cable system and associated terrestrial transport network (“Paniolo cable system”), constructed by ClearCom, wholly owned by Waimana Enterprises,⁴ connecting SIC’s network facilities on various Hawaiian Islands. SIC became the exclusive lessee of the entire Paniolo Cable system. Because the transmission bandwidth and expenses associated with such facilities appeared to be far in excess of what was “used and useful” to provide regulated service for SIC’s approximately 2500 subscribers, NECA disallowed the majority of these Paniolo cable system expenses from SIC’s revenue requirement.

¹ SIC and/or its affiliates provide other regulated and nonregulated services in the State of Hawaii. SIC is wholly owned by Waimana Enterprises, Inc., whose President is Albert S.N. Hee. Hee has previously been the President of SIC at earlier timeframes during this proceeding, although now the CEO appears to be Janeen-Ann Olds, who at one time was General Counsel of Waimana and who has been trustee for each of the ultimate trust beneficiaries of the company, Blue Ivory Corporation, which indirectly owns Paniolo Cable. See note 3 *infra*.

² The FCC ordered that NECA include SIC as a pool member in *Sandwich Isles Communications, Inc., Petition for Waiver of Section 36.611 of the Commission’s Rules and Request for Clarification*, Order, 13 FCC Rcd. 2407 (Comm. Carr. Bur. 1998); *GTE Hawaiian Telephone Company, Inc., application for Review of a Decision by the Common Carrier Bureau*, Memorandum Opinion and Order, 19 FCC Rcd. 22268 (2004); *Sandwich Isles Communications, Inc., Petition for Waiver of the Definition of “Study Area” Contained in Part 36, Appendix-Glossary and Sections 36.611 and 69.2(hh) of the Commission’s Rules*, Order, 20 FCC Rcd. 8999 (Wir. Comp. Bur. 2004). *app. for. rev. pending*.

³ The Paniolo Cable Company (owner of the leased cable) is indirectly owned in its entirety by Blue Ivory Corporation, which is held by the children of Albert S.N. Hee, in “three private trusts, the Adrienne H.R. Hee Irrevocable Trust, the Breanne E.R. Hee Irrevocable Trust, and the Charlton E.R. Hee Irrevocable Trust. Each trust holds shares of Blue Ivory Hawaii for the benefit of the named beneficiary.” Public Notice, *Actions Taken Under Cable Landing License Act*, DA 09-998 (May 4, 2009). These relationships are more fully disclosed in Comments of NECA, WC Docket No. 09-133 (filed Aug. 31, 2009).

⁴ Brandon Roberts, ClearCom Not So Clear, Molokai Dispatch (Jan. 24, 2008).

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SIC raised this dispute with the FCC in a Petition for Declaratory Ruling, which the Commission, pursuant to delegated authority, eventually denied in part and granted in part in the *Declaratory Ruling*. The Commission found that NECA had acted properly in its handling of the matter, and that only the Commission could grant the relief adopted in the *Ruling*.⁵ The FCC required "NECA to recognize 50 percent of Sandwich Isles' Paniolo cable network lease expenses subject to dispute in its revenue requirement for ratemaking purposes."⁶ NECA has implemented this *Ruling* in accordance with its understanding of the *Ruling's* terms.⁷

NECA strives to administer pool tariffs in a fair and impartial manner consistent with FCC rules. When issues arise NECA attempts to resolve them through amicable negotiations. However, reasonable accommodation of individual pool member requests cannot trump NECA's responsibility to uphold Commission rules and administer the pools fairly for all pool participants.⁸ In accordance with NECA's data review function it routinely evaluates carrier financial and revenue requirement submissions for compliance with FCC rules.

⁵ *Declaratory Ruling* at ¶ 9.

⁶ *Id.* at ¶ 29. The *Declaratory Ruling* specifically provides: "The lease expenses subject to dispute would include the costs for Sandwich Isles to lease the Paniolo cable network each year, including the maintenance and insurance costs Sandwich Isles is responsible for under the terms of the lease agreement, to the extent that they are not attributable to actual usage of the cable." *Id.* at ¶ 9 n.30. The "disputed expenses" also include "certain engineering costs" but exclude "expenses related to the actual usage of the Paniolo cable network for the provision of services covered by the NECA tariff" and "to provide services not encompassed by the NECA tariff, including, among other things non-regulated services and intrastate services." *Id.*

⁷ The Bureau raised questions about the propriety of the Paniolo cable system expenses in another context. *Connect America Fund, Sandwich Isles Communications, Inc. Petition for Waiver of Section 54.302 of the Commission's Rules*, WC Docket No. 10-90, 28 FCC Rcd. 6552, ¶ 19 (Wir. Comp. Bur. 2013).

⁸ *July 1, 2004 Annual Access Charge Tariff Filings*, WC Docket No. 04-372, 19 FCC Rcd. 23877, ¶ 24 (2004).

II. THE CURRENT DISPUTE

In accordance with these routine procedures, NECA has been reviewing a recent SIC cost study and support materials submitted to NECA.⁹ From public documents¹⁰ and a review of submitted cost information, it appears that SIC is ****CONFIDENTIAL******* ****CONFIDENTIAL******* in a manner which could be inconsistent with both the requirements of the *Declaratory Ruling* as well as generally accepted accounting principles (“GAAP”).¹¹ The NECA traffic sensitive pool is currently paying SIC amounts for the Paniolo cable system expenses as if the lease payments were actually made.¹²

However, SIC is only paying a portion of the Lease obligations and it is ****CONFIDENTIAL******* ****CONFIDENTIAL*******. In its review, NECA found SIC ****CONFIDENTIAL******* ****CONFIDENTIAL*******. SIC’s cost study for 2012 indicates that the company had lease payments of \$****CONFIDENTIAL******* for the Paniolo cable system, but its financial statements show

⁹ The Commission has declared that NECA review of cost studies is critical. *Safeguards to Improve the Administration of the Interstate Access Tariff and Revenue Distribution Processes*, CC Docket No. 93-6, Report & Order and Order to Show Cause, 10 FCC Rcd. 6243, ¶ 64 (1995).

¹⁰ SIC is apparently making only some of the Lease payments. *See* note 32, *infra*.

¹¹ This is not the first dispute that has arisen based on the *Ruling*. SIC argued that certain revenues associated with the provision of Paniolo cable system capacity for use in providing unregulated services by a third party should not have been subtracted from SIC’s revenue requirement. The Bureau dismissed a SIC challenge to NECA’s requirement that SIC exclude unregulated revenue from its revenue requirement. *Sandwich Isles Communications Inc., Petition for Declaratory Ruling*, WC Docket No. 09-133, 27 FCC Rcd. 470 (Wir. Comp. Bur. 2012). SIC did not further challenge NECA’s action before the Commission.

¹² The Paniolo cable system provides capacity for multiple services, including DSL services, which are part of NECA’s traffic sensitive pool. As a net taker, SIC receives money from this pool based on its submitted costs. Inclusion of the “disputed lease expenses” impacts certain overhead allocations, and therefore also has some minimal impact on common line revenue requirement.

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SIC ****CONFIDENTIAL*****.¹³ SIC's cost study for 2013 indicates the company had lease payments of \$***CONFIDENTIAL*****.¹⁴ For both years, SIC listed the Lease obligations as a current accrued liability/accounts payable. However, the actual payment of a substantial portion of the Lease has remained unpaid for over two years, with no indication of a date when such actual payment might be made.

NECA requested that SIC provide an explanation of the accounting treatment of these Paniolo cable system expenses.¹⁵ SIC responded on December 31, 2014, attaching a response from its cost consultant.¹⁶ SIC argued in its December 31 response, as well as its January ex parte filed with the Commission,¹⁷ that its treatment of the Paniolo cable system expenses as an accrued liability was in full compliance with the requirements of GAAP accounting, Rural Utility Service ("RUS") rules, and the *Declaratory Ruling*, although SIC does not state how.

¹³ Based on SIC's reported Lease expenses for 2012, SIC's traffic sensitive NECA pool revenue requirement for the lease was approximately \$**CONF**. However, if SIC's data is trued up to reflect its actual Lease payments of \$**CONF*** in line with NECA's interpretation of the *Ruling*, and using switched access amounts frozen at 2011 levels for the second half of the year, SIC's traffic sensitive pool revenue requirement would be approximately \$**CONF***.

¹⁴ As with 2012, SIC's reported Lease expenses for 2013 do not reflect its actual payments towards the Paniolo Lease despite the fact that SIC's traffic sensitive NECA pool revenue requirement explicitly to be used for the lease was approximately \$**CONF****. If the actual Lease payments of only \$**CONF** for 2013 were used, with the switched access amounts frozen at 2011 levels, SIC's traffic sensitive pool revenue requirement would be approximately \$**CONF****.

¹⁵ Letter from Carol Brennan, NECA, to Liko Hee, SIC (Dec. 17, 2014), included as Exhibit 1.

¹⁶ Letter from Janeen-Ann A. Olds, Chief Executive Officer and President of SIC, to Carol Brennan, NECA (Dec. 31, 2014) (attaching Letter from James Rennard, GVNW Consulting, Inc., to Liko Hee, SIC (dated Dec. 29, 2014), included as Exhibit 2 ("SIC Dec. 31 Response").

¹⁷ Letter from Frederick M. Joyce, Counsel for SIC, to Marlene H. Dortch, FCC, WC Docket No. 09-133 (Jan. 14, 2015).

NECA thereafter met with Commission staff and sought guidance as to the proper application of the *Ruling*.¹⁸ NECA files this Petition to formally request such guidance be made by written order.

III. ANALYSIS

From a reading of the *Ruling*, it appears that the intent of the FCC's *Ruling* was to ensure that certain cable lease expenses incurred by SIC be recovered from the NECA pool. This was based on a number of equitable considerations, including the likelihood that SIC customers would benefit from the use of the Paniolo cable system.¹⁹ There is no specific discussion in the *Ruling*, however, of the issue of actually paying, in cash, the "lease expenses subject to dispute."

Additionally, in accordance with NECA's understanding of GAAP requirements, in order for an expense²⁰ to be properly booked as a current accrued liability, the company must intend to pay such liability within the normal business cycle.²¹ If actual payment is not reasonably expected within the normal business cycle, designation as a current liability/account payable is inconsistent with accounting principles. SIC is not paying this accrued liability within the normal business cycle and in fact has not made the full payments in over two years. Therefore,

¹⁸ Letter from Gregory J. Vogt, Counsel for NECA, to Marlene H. Dortch, FCC, WC Docket No. 09-133 (Jan. 29. 2015).

¹⁹ *Declaratory Ruling*, at ¶ 12 n.38 & ¶¶ 17, *et seq.*

²⁰ Expenses represent actual or expected cash out-flows (or the equivalent) that have occurred or will eventuate as a result of the entity's ongoing major or central operations. Financial Accounting Standards Board ("FASB") Concepts Statement No. 6, paragraph 81, *located at* www.fasb.org.

²¹ *See* FASB Master Glossary: "Current liabilities" are obligations whose liquidation is reasonably expected to require the use of existing resources properly classifiable as current assets, or the creation of other current liabilities; "Current assets" is used to designate cash and other assets or resources commonly identified as those that are reasonably expected to be realized in cash or sold or consumed during the normal operating cycle of the business, *located at* www.fasb.org.

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treating the lease obligations as a current expense accrual/accounts payable does not appear to be appropriate.

In the first instance, NECA believes that the FCC intended in the *Ruling* to use the terms “expense” and “cost” interchangeably. “Cost” and “expense” are often considered interchangeable terms.²² The FCC itself has defined “cost” to mean “except as applied to telecommunications plants, franchises, and patent rights, means the amount of money actually paid (or the current money value of any consideration other than money exchanged) for property or services.”²³ Thus, in accordance with the accounting understanding of the term “expense,” the term used in the *Ruling*’s direction to NECA,²⁴ a company must reasonably expect to actually pay value for an item within the normal business cycle in order to be classified as a current expense.²⁵

In computing the actual NECA revenue requirement as required by FCC rules, the traditional formula for rate-of-return companies is to allow recovery for 100 percent of current

²² Expense means “the amount of money that is needed to pay for or buy something” and cost means “the amount of money that is needed to pay for or buy something.” Merriam-Webster Dictionary, www.merriam-webster.com (last viewed on Feb. 3, 2015). In accounting terms, cost may refer to the “total cost” which would allocate a portion of the cost over multiple accounting periods.

²³ 47 C.F.R., Part 32, Glossary.

²⁴ *Supra* text accompanying & note 6.

²⁵ One exception to this general rule is depreciation, which, in concept represents the wear and tear and obsolescence of an asset. Depreciation expense is based on an estimate of the periodic value of such depreciation because it is inherently difficult to value for any particular product while it continues in service. Depreciation is a systematic allocation of cost over several periods. *See, e.g.,* Stickney, Clyde P. and Roman L. Weil. *Financial Accounting: An Introduction to Concepts, Methods, and Uses* at 428 (Thomson, 2003).

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year operating expenses, plus a rate of return on net investment.²⁶ The expense component of the revenue requirement, at least when dealing with lease, maintenance, engineering, and insurance expenses, are expected to be expenses paid within the revenue requirement test year. This framework makes sense, because regulators expect that regulated companies will earn no more than what is reasonably necessary to defray their actual costs. The FCC tests the accuracy of these predictions through periodic rate of return monitoring reports, which reports actual revenue and expense for past years.²⁷

It is routine, of course, for a company to use “accrual” accounting, rather than “cash” accounting. “Accrual” accounting requires a company to book costs when “incurred.” The term incurrence generally means the point in time when a company becomes obligated to pay for a particular item. The concept of “accrual” carries with it the expectation that the expense will actually be paid within the normal business cycle. In general, only current year expenses are includable in NECA revenue requirements for a given cost study. Therefore, even if accrual accounting is used, actual payment must be made within the business cycle (which is generally a year) in order to receive “expense” treatment in a revenue requirement.²⁸

The requirement that expenses represent actually paid items makes sense for regulatory ratemaking. Setting rates has traditionally been based on the need to achieve a balance between

²⁶ *Amendment of Parts 65 and 69 of the Commission's Rules to Reform the Interstate Rate of Return Represcription and Enforcement Processes*, CC Docket No. 92-133, 10 FCC Rcd. 6788, ¶ 7 (1995).

²⁷ 47 C.F.R. § 65.600(d)(1). The Commission has emphasized the need for accuracy of these NECA reporting figures. *See, e.g., July 1, 2004 Annual Access Charge Tariff Filings*, WC Docket No. 04-372, 19 FCC Rcd. 23877 (2004) (“*NECA Rate of Return Investigation*”).

²⁸ Typically, accrued expenses are paid within a month or two of the accrued liability date of incurrence.

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ratepayer and investor interests. Investors need to be afforded a reasonable opportunity to recover a fair return on the value of their expenses and assets. Ratepayers, on the other hand, should only be required to pay for the “used and useful” value of the services they receive.²⁹ Allowing a company to recover an “expense” that is not paid within the current period, and may never be paid, arguably tips that balance in favor of investors which recover costs for expenses that are not actually paid.

There is no clear reference as to whether the “lease expenses subject to dispute” referred to in the item are those actually paid by SIC. There of course was no reason to address this issue because it was fairly assumed that the lease obligations and associated expenses were actually paid expenses because SIC itself claimed that its lease payments were essential to financing the investment and that such “expenditure” was prudent.³⁰ The Commission normally funds specific projects when it makes special allowances for ratemaking purposes, such as in the *Ruling*. The purpose of the *Ruling*’s 50 percent allotment appears to be to reimburse part of the “lease expenses subject to dispute.” Thus, actual payment would seem to be the quid pro quo of the special revenue requirement allowance.

It is true that there is actually a written lease between SIC and Paniolo for the entire capacity of the Paniolo cable system that requires periodic payments to be made by SIC to Paniolo. And Paniolo relies on SIC’s payments in order to pay DeutscheBank, which funded the

²⁹ *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944); *Declaratory Ruling*, ¶¶ 12-13 & n.38.

³⁰ Comments of Sandwich Isles Communications, Inc., WC Docket No. 09-133, at viii (filed Aug. 31, 2009); Reply Comment of Sandwich Isles Communications, Inc., WC Docket No. 09-133, at 7 (filed Sep.10, 2009).

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provide authority for NECA to adjust SIC's pool settlements paid in periods now closed under NECA's 24-month adjustment window in order to give effect to the Commission's ruling.

Respectfully submitted,

By: /s/ Gregory J. Vogt

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February 6, 2015

Exhibit 1

This document contains privileged and confidential information and has therefore been withheld from the public copy of this document pursuant to Federal Communications Commission Protective Order entered in WC Docket No. 09-133.

Exhibit 2

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Exhibit 3

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