

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554**

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

REPLY COMMENTS OF SANDWICH ISLES COMMUNICATIONS, INC.

I. INTRODUCTION

Sandwich Isles Communications, Inc. (“SIC”) submits this reply to the Comments of National Exchange Carrier Association (“NECA”)¹, the only entity which has provided a substantive response² to the Commission’s call for comments to refresh the record in this long pending proceeding.³ The core issue on appeal—and which NECA has attempted to raise in ex parte submissions and belatedly in Request for Clarification of the 2010 Order—remains unchanged: whether NECA’s resistance to funding the Paniolo Cable through the tariff pool at the levels the Commission specified in the 2010 Declaratory Order remains open for consideration. However, that issue is now moot. The refinancing proposal SIC has advanced in its Initial Comments—a proposal that NECA has publicly stated, although not on the record in this docket—that it will “consider” is a complete response to the set of issues that NECA has raised.⁴ Given NECA’s record of unwillingness to accept a valid Bureau Order specifying the level of

¹ See Comments of the National Exchange Carrier Association on Refresh Public Notice, WC Docket No. 09-133 (filed April 28, 2016) (hereinafter, NECA Comments (April, 2016))

² Submissions by AT&T and US Telecom are addressed in the Conclusion.

³ See Wireline Competition Bureau Seeks to Refresh Record in WC Docket No. 09-133 and Seeks Comment on AT&T Application for Review, Sandwich Isles Petition for Reconsideration, and NECA Petition for Clarification and/or Declaratory Ruling, Public Notice, DA 16-322 (WCB Mar. 29, 2016) (Sandwich Isles Public Notice).

⁴ See Comments of Sandwich Isles Communications, WC Docket No. 09-133 (filed April 28, 2016) (Hereinafter SIC Comments (April, 2016)).

recovery,⁵ we are constrained to answer the NECA arguments on their own terms. We submit that the position it has taken is wholly without foundation, with respect to both the facts and legal analysis. Indeed, there is but only one point on which we agree with NECA, and that proposition is indisputable: NECA concedes, as SIC has persistently maintained through the nearly decade long duration of this matter, that the “preservation of service to the subscribers of a rural rate- of-return carrier is critical....”⁶ Even in this respect, NECA chooses to ignore the unassailable fact that there was *no* service to significant portions of HHL in 2009 when construction of the Paniolo Cable was authorized by the Commission⁷, and there would be none today, but for the intervention of SIC and the Commission’s determinations which NECA seeks to eviscerate.

If the Commission were to accept, uncritically, NECA’s misstatement of the governing principles and selective examination of central facts, the provision of quality telecommunications services to the HHL would be jeopardized if not completely defeated. We therefore show in these Reply Comments that as a matter of fact and law the Bureau must reject NECA’s collateral attacks on the 2010 Declaratory Ruling on their merit. By approving the lease payment specified under the proposed refinancing plan, the Bureau will provide assurance that the communities and residents of the HHL will continue to receive high quality telecommunications services sufficient to meet their needs and to which they are indisputably entitled.

II. SUMMARY OF POSITION

There is no basis in fact or in principle to support NECA’s claim that SIC is entitled to only \$1.8 million in recovery of the costs incurred under the Paniolo Lease. The claim must be rejected on two independent grounds. First, SIC has shown that the refinancing proposal it has proposed yields an

⁵ See e.g. NECA Petition for Clarification and/or Declaratory Ruling, WC Docket No. 09-133 (filed Feb. 6, 2015) (challenging the Bureau’s initial Declaratory Ruling awarding SIC 50% of its Paniolo Cable lease costs)

⁶ See NECA Comments (April, 2016) at 1.

⁷ See SIC Comments (April, 2016) (noting that “in 1995, after unsuccessful attempts to get GTE to provide single-party service to HHL residents at reasonable cost, the Department of Hawaiian Home Lands (“DHHL”) licensed SIC to serve HHL.”)

annual recovery which is, if anything, slightly lower than the *current* market value of leased lines in Hawaii that would provide service inferior to that SIC is able to offer the HHL through the Paniolo Cable. Second, it is clear that: the incremental cost of the 48 fiber Cable was a tiny fraction of the cost of construction; although the initial demand estimates provided to SIC by the DHHL may have been optimistic, there is no basis for the assumption of zero growth asserted by NECA; and that, most importantly, the number of lines served by an ETC is not now, never has been and cannot ever be the measure of demand in high-cost rural areas because of the very nature of those areas and the purpose of the program itself. Under either result, there is no basis for a conclusion that the Paniolo Cable is a waste of money as NECA claims.

NECA's claim that it has overpaid SIC for recovery of the Paniolo Lease is equally infirm. In fact, total payments SIC has received from NECA are about \$12 million *less than* SIC has paid under the lease. NECA's argument proceeds from a misapprehension of basic accounting principles to an avoidance of facts that it has known for months, to the wholly unsupportable conclusion that SIC has diverted pool revenues to other purposes. The claim must be categorically denied.

To the extent that the Comments of AT&T and US Telecom replicate those of NECA, they are wholly without merit for the same reason. To the extent that these commenters seek to introduce wholly unrelated matter based on—at best—misleading and incomplete coverage in the press, they must be ignored.

III. NECA'S MISSTATEMENT AND MISAPPLICATION OF THE USED AND USEFUL TEST WOULD YIELD RESULTS WHICH ARE IRRATIONAL AND UNLAWFUL

The gravamen of NECA's attack on the 2010 Declaratory Ruling is that the Bureau never should have allowed SIC to recover more than \$1.9 Million of the cost of the Paniolo lease.⁸ NECA does not deny that SIC's annual costs are well in excess of that number, correctly stating that the actual cost is slightly

⁸ See NECA Comments (April, 2016) at ii.

more than \$24 Million in 2016.⁹ The Comments offer a variety of not terribly consistent explanations for NECA's position, under the rubric of the "Used and Useful" standard.¹⁰ We need not burden the Commission with a detailed refutation of each of the points in NECA's Comments because in advancing its theses NECA—unwittingly perhaps but nonetheless—clearly admits that the lease payments under the refinancing plan fully accord with the key precedents invoked by NECA.

NECA invokes a series of cases in which the Commission has considered the "reasonableness of carrier investments by examining the prices paid"¹¹ in the market for the same or comparable equipment or services. NECA cites a case in which the FCC disallowed certain AT&T expenses on grounds that the function could have been performed by the LEC's at a lower price.¹² What these cases essentially stand for is the proposition that an important measure of the reasonableness of an expense is what a comparable investment would cost in the open market. Although the cases invoked by NECA do not directly involve the issue presented here, we certainly do not take issue with the concept that market-alternatives should be considered in assessing the reasonableness of the annual amount that SIC should be permitted to recover for the Paniolo Cable lease. In fact, the application of this principle unambiguously proves our contention that the proposed refinancing plan is plainly just and reasonable, and must be approved.

As we have explained in our Initial Comments, the \$8.1 Million recovery was not arbitrarily reached: "SIC performed a *comparative analysis* using publicly available data"¹³—including the lines for the incumbent LEC—for leased lines from other carriers. We noted that the comparison was imperfect

⁹ See e.g. NECA Comments (April, 2016). at 16.

¹⁰ See generally, *id.*

¹¹ See *id.* 12.

¹² See *id.* at 13.

¹³ See SIC Comments (April, 2016) at 30.

because the leased lines available do not land at the same points and thus the comparison, if anything, understates the amount to which SIC is entitled.¹⁴

This analysis was done in 2013 as part of the negotiations with RUS, but to make sure of its continued value, SIC had the analysis replicated as part of the preparation of SIC's Initial Comments. Both the 2013 and 2016 studies are attached.¹⁵ They show that the \$8.1 million dollar recovery is, if anything, slightly below the market cost for alternatives which are plainly inferior—in terms of quality and reliability of service—to the Paniolo Cable. We respectfully submit that these facts, in and of themselves, compel the Bureau to hold that the NECA position on application of the Used and Useful Standard is without merit.

What remains of NECA's claim that SIC is entitled to only \$1.8 million on an annual lease obligation of \$24 Million is predicated upon a selective and artful examination of the facts, resulting in a misapplication of the economic principles that comprise the used and useful standard:

1) NECA claims that SIC did not need the 48 strand system it built in 2007-2009 to meet demand, and that the Paniolo Cable "lease expenses and capacity are excessive."¹⁶

NECA persists in flatly ignoring the economic reality that the difference in cost between the construction of a 48 and smaller number of fibers is negligible, at most 2% of the total cost.¹⁷ The cost of a submarine cable like this does not turn on the number of fibers, but rather on the labor and construction equipment costs related to laying the cable across sea-beds that are, in places, miles deep; there is a modest increase in cost of splicing, but obviously no splicing is done under the sea. NECA simply ignores these realities. SIC has repeatedly pointed out the

¹⁴ See id. at 6.

¹⁵ See SIC Exhibits 1 and 2 .

¹⁶ NECA Comments (April, 2016) at 17.

¹⁷ See e.g. Wireline Competition Bureau, Sandwich Isles Communications, Inc. Petition for Declaratory Ruling, Declaratory Ruling, 25 FCC Rcd 13647 (DA-10-1880A1) (Sept. 29, 2010)(noting the 2% price-differential between a 12 and 48 fiber cable); see also, Sandwich Isles Communications Petition for Reconsideration, WC Docket No. 09-133 (filed Oct. 29, 2010) (same); see also, SIC Comments (April, 2016) (same).

fact—which is intuitively unassailable—that the incremental cost of the additional fiber in the Paniolo Cable was negligible. NECA has never questioned this fact. To dispel any conceivable doubt, we have attached a Declaration by the Co-President of International Telecom, the company that worked with SIC’s parent and sister companies in the design and construction of the Paniolo Cable. Mr. Graham states that the “incremental cost difference” between the 48 fiber system actually constructed and a 12 fiber system for the entire 480 kilometer project was less than \$1 million, “an extremely small portion of the total cost of the project.”¹⁸ There is simply no merit to the proposition advanced by NECA that the Paniolo Cable never should have been built or the newly-minted thesis—advanced in the NECA Comments for the first time—that a smaller capacity cable would have been materially less expensive. The investment was prudent when it was made, the Commission so held in the 2010 Declaratory Ruling and, therefore the “prudent investment” prong of the Used and Useful doctrine is plainly established.

2) NECA claims that SIC never will need the capacity that the 48 Fiber Paniola Cable provides and therefore the entire cable will never be “useful” under the second prong of the Used and Useful principle.¹⁹

Once again, NECA ignores both economic reality and the facts. NECA bases this claim on the fact that the number of lines within the SIC service area is small. Even in this respect, NECA misstates fact, insisting that the 20,000 households on the waiting list in 2009 when the system was authorized is the maximum number of households that will ever be served. But, despite the economic turmoil of the years since the Paniolo Cable became operational, the number of households on the DHHL waiting list has increased by nearly 45% from 20,000 to 29,000 and,

¹⁸ See Exhibit 3 (Declaration of Mr. Graham)

¹⁹ See e.g. NECA Comments (April, 2016) at 21, note 70.

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as explained in greater detail below, the State of Hawaii has been essentially ordered to invest millions in the HHL building and support programs to satisfy its constitutional obligations.²⁰

It is, of course, hard to know exactly what effect this will have on growth of residences businesses and public buildings such as schools in the HHL areas served by SIC, but there is surely no grounds to conclude that there will be zero growth, as NECA asserts. One clear indication that growth across the HHL will be non-zero in the immediate future is that the DHHL—the Department responsible for administering homesteads across the HHL—is slated to receive a massive influx in funds, by court order. More specifically, in November, 2016 the First Circuit found Hawaii in violation of its constitutional duties by continually failing to provide adequate funding to the DHHL.

The Judge noted that “this failure includes every fiscal year since at least 1992.” Initially, the Judge directed that the DHHL was owed more than \$28 million in general funds for the fiscal year 2015-2016, by Constitutional mandate. She amended her order in March, 2016, clarifying that “the Court is not ordering an appropriation. The Court is ordering that the state must comply with its constitutional duty to make sufficient sums available to the Department of Hawaiian Homelands.” As a result, Governor Ige recently proposed that DHHL’s \$9.61 million in general appropriations for 2016 would be replaced with \$17.1 million. Next year, that number jumps to \$23.5 million. This major capital injection means that DHHL will be able to allow beneficiaries much greater access to the homesteading program already in place with respect to the HHL. The region can therefore expect an influx of residents in the near future, which for SIC means a surge in demand.²¹

²⁰ See SIC Comments (April, 2016) at 21.

²¹ SIC Comments (April, 2016) at 21.

Even accepting the premise that there is a one for one relationship between number of households and number of lines and that number of lines equates to demand for service, there is no factual basis for NECA’s assertion that demand in the HHL is static and that the entire Paniolo Cable is not “useful “supported by the NECA tariff pool.²² The facts as they stand demonstrate that the Paniolo Cable has been used, even by other service providers when their cables have been out of service. It is thus, in the most literal sense of the words, “used and useful.”²³

3) There are fundamental problems with NECA’s attempt to equate demand for service with the number of lines that are or may be served by the Paniolo Cable.

The notion that capacity is useful in direct proportion to the number of lines that the capacity will or is reasonably expected to serve is unprecedented. NECA cites no authority for the proposition; there is no discussion of such a proposition in the literature on the subject.²⁴ There are sound reasons for this, most importantly the fact that if number of lines is used as a proxy for demand, the purposes of the USF High Cost program can never be realized: by definition, high cost service invariably occurs in rural and sparsely-populated areas, which are very difficult to reach and serve. That is exactly the situation which SIC faced when it undertook to serve the HHL²⁵ and the same situation it faces today.

²² See NECA Comments (April, 2016) at 21 (claiming, on no basis, “that there is still the strong likelihood the vast majority of its leased capacity would not be necessary to meet the needs of SIC’ customers for regulated services, even given current expected residential subscriber usage.”) [sic.]

²³ See SIC Comments (April, 2016) at 26.

²⁴ See William J. Baumol and J. Gregory Sidak, *The Pig in the Python: Is Lumpy Capacity Investment Used and Useful?*, 23 ENERGY L.J. 383, 385–86 (2002).

²⁵ See e.g. SIC Comments (April, 2016) (noting that “[t]he Paniolo Cable plainly serves the public interest. It provides essential, redundant and diverse submarine cable capacity for HHL. It thereby exclusively serves the telecom needs of high-cost and otherwise underserved, rural and isolated American communities. This is precisely the demographic the USF was established to serve”; also noting that “the Commission has repeatedly recognized that the unique challenges associated with extending service to the HHL—including deep-sea beds, challenging topography, restless weather patterns, and aging, existing infrastructure—create a profound and transparent need for subsidized support, if the universal service mandate is to be realized in this region.”)

The reliance on number of lines as a measurement of the utility of Paniolo Cable is infirm for other reasons as well. The purpose of the USF program is not merely to bring any level of service to rural high cost areas; it is intended to provide these areas with quality and reliable service employing state of the art technology. As we have pointed out in our Initial Comments, the Paniolo Cable was built to state of the art standards for the telecommunications industry in Hawaii at the time it was constructed; and it was designed, of necessity, to be compatible with the technology employed on the terrestrial legs which were completed or nearing completion when construction of the Paniolo Cable began. Even if it had been possible and economically sensible to downgrade the capacity of the Paniolo Cable, the costs of re-constructing the terrestrial legs would have been substantial.

The rationale underlying NECA's claim that SIC should receive only \$1.8 million for recovery of the costs of the Paniolo cable thus must be rejected on two, independent grounds. Normally the used and useful principle is applied as a part of the regulatory approval process; that is, in fact, what happened here and, if anything, the 2010 Declaratory Order understates the recovery to which SIC is entitled under the traditional standards. In this case, however, NECA keeps insisting that the criteria should be applied retroactively. But even under that approach, it is clear that NECA's claim must be rejected precisely because the \$8.1 million proposal that SIC has advanced is indisputably consistent with current market values, and there is no basis for a claim that money was or is being wasted.

IV. SIC HAS MADE LEASE PAYMENTS IN SUBSTANTIAL EXCESS OF FUNDS RECEIVED

NECA's petition for Clarification raises a different issue. It claims that SIC has been overpaid for its recovery of the Paniolo Lease payments. This claim proceeds from a misapprehension of accounting principles, to a misstatement of the facts concerning SIC's payments under the Paniolo Lease. These factual and analytic errors have led NECA to assert that NECA is "paying SIC amounts [for the Paniolo

Cable] *as if* the lease payments *were actually made*.”²⁶ The implication of this claim is perfectly obvious: without saying so directly, NECA has claimed that SIC is diverting pool funds for some other purpose. The statement is completely untrue. Worse yet, NECA has known, since at least the fall of 2015, that this claim is baseless. This issue was the subject of an exchange between NECA, its outside counsel and SIC from November, 2015 through January, 2016. The truth is that the information provided to NECA at that time showed conclusively that SIC had in fact paid substantially more under the Paniolo lease than it has received from NECA. In response to a specific question propounded by NECA, SIC submitted a summary showing Paniolo lease payments year by year from 2009 to 2015. The fact is, payments made by SIC under the lease exceeded pool revenues received from NECA by over \$12 Million.²⁷ Neither NECA nor its counsel have troubled to respond to these submissions, and the exchange is completely ignored in the NECA Comments submitted on April 28.²⁸ The evidence that SIC submitted to NECA is uncontested and uncontestable. To the extent that the NECA Petition for Clarification was intended to authorize NECA to suspend payments or to claw back payments made to SIC it must be categorically denied as factually unfounded.

In addition, NECA’s reading of GAAP is simply unfounded. The Commission’s rules are predicated on accrual accounting (otherwise the entire cost of the Paniolo Cable would have been recoverable in 2009). Unless and until the terms of the Paniolo Lease are changed or the lease is otherwise discharged, NECA’s obligations are to comply with the Commission Order.

Moreover, SIC has set forth a proposal which will assure that the funds payable from the pool exactly match the payment obligations under the Paniolo Lease. NECA acknowledges that it was aware that SIC was in the process of renegotiating the Lease but claims that this knowledge was insufficient to justify its adherence to the Declaratory Ruling Order, because SIC had not disclosed when actual

²⁶ See NECA Comments (April, 2016) at 1. (Emphasis added).

²⁷ Attached as SIC Exhibit 4 is the chart SIC provided to NECA by letter dated December 7, 2015. Attached as SIC Exhibit 4 is an updated chart comparing payments to SIC from 2009 through 2015 with respect to the Paniolo lease to the actual cash lease payments made by SIC to Paniolo for the same period.

²⁸ See Generally, NECA Comments (April, 2016).

payments of past underpayments will be required. There is nothing in the Commission's accounting rules—which are entirely consistent with the general principles of GAAP—that support this astounding proposition. It is not within NECA's duties to regulate how an ETC like SIC carries out its business affairs with its creditors and vendors. As we have explained, the changes to the Paniolo lease are part of a refinancing arrangement which has been negotiated with both RUS and the private sector lenders. Ongoing obstacles to implementation of that refinancing package are: (1) NECA's reticence to accept the reality that the Paniolo Cable is an indispensable part of the SIC Network; (2) that the entire network including the Paniolo Cable are used and useful in the provision of essential, quality telecommunications services to the HHL and; (3) that there is no valid ground in fact or law for NECA to continue to impede SIC's ability to meet its obligations to its creditors and more importantly to the public it serves.

V. CONCLUSION

For these reasons, as is more fully developed in our Initial Comments, the Bureau should issue an Order that removes the regulatory obstacles to the refinancing proposal SIC has advanced; it should do so by directing NECA to release funding from the pool in such a manner as to generate \$8.1 million of cost recovery per year to SIC with respect to the Paniolo Lease. The Order should require NECA to release funds immediately upon SIC's submission to NECA of evidence that the lease has been amended as specified. Conditioned upon NECA's compliance and adherence to the Order we seek, SIC's Petition can be dismissed as moot, on the understanding that SIC is not prohibited from withdrawing a portion or portions of the Paniolo Cable capacity from its rate base and use that capacity for other unregulated purposes.

The reasons for this outcome are clear and unassailable. The Paniolo Cable fully satisfies the economic and equitable principles that underlie the used and useful evaluation and that result is even more compelling in relation to the refinancing plan that SIC has proposed because the plan will reduce the burden on the NECA pool without impairment of SIC's ability to meet the current and future needs of

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the public in the HHL. NECA's thesis that the Paniolo Cable is not used and useful should be denied as contrary to law and fact; its claim that SIC is over-recovering lease payments should be denied because the claim is utterly false.

To the extent that the Comments submitted by AT&T address the question of determining the proper level and amount of cost recovery to which SIC is entitled, we have answered these claims in our response to NECA's comments and the AT&T Petition for Review should be denied. To the extent that AT&T and US Telecom Association seek, on the basis of newspaper accounts and sheer speculation, to introduce matters unrelated to the determination of the proper level and amount of cost recovery to which SIC is entitled, the pleadings are outside the scope of this docket, and irrelevant to the issue presented. They should be rejected.

For similar reasons the FCC should give no credence to Attachment B to the NECA comments. It is self-evident that, given the geographic and demographic conditions in Hawaii, the Paniolo Cable was expensive to build and that the population that SIC serves is quite small. Those are precisely the reasons that SIC qualifies for support and is entitled to recover its costs from the NECA pool. Nor is it questioned that SIC has delivered quality service to the HHL which the ILECs refused to even undertake. NECA's attempt to fashion a prohibitive set of standards applicable to SIC because it is a net receiver of pool funds is, charitably, irrelevant.

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