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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	)	
	)	
	)	

COMMENTS
of the
NATIONAL EXCHANGE CARRIER ASSOCIATION, INC. (NECA)

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COMMENTS
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NATIONAL EXCHANGE CARRIER ASSOCIATION, INC. (NECA)[1]

I. INTRODUCTION AND SUMMARY

The Commission has requested comment on Sandwich Isles Communications, Inc's ("Sandwich Isles") petition for a declaratory ruling on a decision made by NECA to exclude certain Sandwich Isles' costs from the NECA traffic sensitive pool.[2] The Commission has held that it is NECA's responsibility to "implement its rule interpretations." NECA members that "disagree with NECA's interpretations of our [FCC] rules are free to present their arguments to the Commission, either in comments on those filings or petitions for declaratory rulings."[3] The

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1 NECA has submitted confidential information that is governed by a confidentiality agreement between Sandwich Isles Communications, Inc. and NECA pursuant to the FCC's protective order issued in this docket. *Sandwich Isles Communications, Inc., Petition for Declaratory Ruling,* WC Docket No. 09-133, DA 09-1880 (Com. Car. Bur., rel. Aug. 26, 2009).

2 Public Notice, *Comments Sought on Petition for Declaratory Ruling of Sandwich Isles Communications, Inc.*, WC Docket No. 09-133, DA 09-1622 (rel. Jul. 27, 2009).

3 *Safeguards to Improve the Administration of the Interstate Access Tariff and Revenue Distribution Process,* CC Docket No. 93-6, *Report and Order and Order to Show Cause,* 10 FCC Rcd. 6243,¶ 40 (1995) ("*Safeguards Order*").

instant Petition for Declaratory Ruling is therefore the correct mechanism for Sandwich Isles to raise its issue with the FCC.

While NECA fully supports the provision of advanced services in rural areas, it could not support Sandwich Isles' decision to lease, in its entirety, a cable transportation network to serve its regulated customer base. This decision was based on the fact that the lease was made at an extraordinarily high cost relative to the number of subscribers, which appears inconsistent with the Commission's longstanding "Used and Useful" standard, especially given the availability of more reasonable alternatives. Therefore, NECA believes that outstanding precedent and policy would lead the Commission not to accede to Sandwich Isles' request that: 1) the Commission rule certain Sandwich Isles' lease costs are "Used and Useful"; 2) NECA be ordered to "accept such costs for inclusion in and settlement from its traffic sensitive pool;" and 3) NECA be ordered to "continue Sandwich Isles' Settlements based on its submitted cost study."[4]

Compliance with FCC rules in administration of its revenue pools is a fundamental FCC mandate, and therefore of paramount importance to NECA.[5] In light of this duty, the FCC has directed NECA to implement its interpretations of FCC rules even if there is some ambiguity to the Commission's rules.[6] The instant matter is one example of NECA implementing its duty to interpret Commission precedent.

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4 *Supra* note 2. *See also*, Sandwich Isles Communications, Inc., Petition for Declaratory Ruling, WC Docket No. 09-133, at 7 (filed June 26, 2009) ("Sandwich Isles Petition").

5 NECA is a non-stock, non-profit association formed in 1983 pursuant to the Commission's Part 69 access charge rules and is responsible for filing interstate access tariffs and administering associated revenue pools on behalf of over 1100 incumbent local exchange carriers ("ILECs") that choose to participate in these arrangements. *See generally* 47 C.F.R. § 69.600, *et seq*.

6 *Supra* note 3.

NECA and Sandwich Isles have been engaged in a number of continuing conversations concerning Sandwich Isles' exclusive lease of a new cable network to serve its subscribers in the Hawaiian Home Lands and Sandwich Isles' desire to report the entire cost of the lease to the NECA pool. Following these extensive discussions and more formal correspondence with Sandwich Isles, and an informal meeting among representatives of NECA, Sandwich Isles and Commission staff, NECA advised Sandwich Isles that the proposed lease costs would not be included in NECA's June 16, 2009 tariff filing.[7]

NECA's analysis concluded that inclusion of the entire new cable lease costs violated the Commission's "Used and Useful" doctrine. That doctrine requires the balancing of three interests: 1) the need to compensate the investor for capital devoted to serving the public; 2) the need to charge the ratepayer for only those investments which benefits him; and 3) a requirement that such benefit be either immediate or coming within a reasonable future period of time. NECA believes that there are substantial questions whether the capacity of the proposed lease is necessary to serve Sandwich Isles' reasonably foreseeable demand for regulated services.

These types of decisions are never made lightly. The instant decision was made only after extensive analysis and research to ensure that NECA acted appropriately. Notwithstanding NECA's decision, NECA recognizes rural telecommunications providers, such as those in Hawaii, face substantial financial and physical considerations compared to other less

[7] NECA's analysis of costs that Sandwich Isles sought to include in pool reporting, together with related revenue and line count data, is attached as Appendix A. NECA officially informed Sandwich Isles of its decision not to include these costs in a Letter from James W. Frame, NECA Vice President of Operations, to Albert S.N. Hee, President of Sandwich Isles Communications, Inc., (May 20, 2009) (Appendix B). NECA has also advised Sandwich Isles that some portion of their new lease cost may be acceptable. In recognition of this fact, the current costs of Sandwich Isles' lease with Hawaiian Telcom were included in NECA's June 16, 2009, tariff filing even though NECA expects that the terms of that lease will have ended once the new cable enters into service.

geographically diverse areas of the country. Based on these considerations, NECA has indicated that Sandwich Isles would need to submit additional data supporting projected demand to determine what portion of the Sandwich Isles' lease costs might fall within the guidelines of the "Used and Useful" doctrine. NECA remains open to the submission of such data, as well as further discussions with Sandwich Isles, consistent with FCC guidance.

II. NECA'S RESPONSIBILITIES

A. General

In 1983, the FCC mandated that NECA serve as an intra-industry, not-for-profit corporation to administer the FCC's interstate access charge system and associated revenue pools.[8] In a revenue pooling environment, if one company claims excessive costs and recovers too much money from the pool, other pool members, and ultimately their ratepayers, fund those excess costs.[9] Therefore, the FCC and NECA have had a keen interest from the beginning in ensuring that the pooling process is administered correctly, fairly and in accordance with FCC rules.

1. FCC Rules Governing NECA Operations

Pursuant to FCC rules and regulations, NECA collects cost, demand, and revenue data from its member companies and files an annual tariff with the FCC, setting out interstate access rates to be charged to interstate access customers. The Commission's rules identify NECA's responsibilities and govern how NECA must interact with its member companies, including

[8] *MTS and WATS Market-Structure*, Third Report & Order, FCC Docket No. 78-72, Phase I, 93 FCC 2d 241, ¶ 339 (1983)("*Access Third Report & Order*").

[9] These rate impacts include Digital Subscriber Line and related NECA pool tariff services which can have an adverse impact on broadband "take" rates in rural areas.

NECA's responsibility to develop and tariff access charge rates for member companies.[10] The FCC rules require member companies performing cost studies, such as Sandwich Isles, to submit cost, demand and access revenue data to NECA,[11], and certify "the data have been examined and reviewed and are complete, accurate, and consistent with the rules of the Federal Communications Commission."[12]

NECA is also required to: calculate monthly pool revenue distributions based on the access revenue, demand, and cost data reported by member companies;[13] reimburse "cost" companies for access expenses to the extent their reported costs exceed their reported revenues;[14] and distribute the pool "residue" or return on investment, in accordance with FCC rules.[15]

The FCC mandates the specific accounts and sub-accounts member companies must use in keeping their books of account for revenues, investments, and expenses pursuant to Parts 32 and 64 of the Rules.[16] FCC accounting rules specify with particularity the types of costs that can be included in accounts, how carriers are required to separate their regulated costs from non regulated costs, and how services and transactions between affiliates and these member

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[10] 47 C.F.R. § 69.601(a).

[11] *Id*., § 69.605(a).

[12] *Id*., § 69.601(c).

[13] *Id*., § 69.605(a).

[14] *Id*., §§ 69.607-.610. The FCC granted a continuing waiver of §§ 69.607-.610 to permit NECA to use a traditional "settlements model" approach to revenue pooling. *See MTS and WATS Market Structure*, CC Docket 78-72, Phase I, Order Granting Waiver, 98 FCC 2d 327 (1984); *extended*, CC 2781 (rel. Feb. 22, 1985), *further extended*, CC 4701 (rel. May 23, 1986)**.**

[15] *Id*., § 69.605(d).

[16] 47 C.F.R. Parts 32 and 64.

companies may be accounted for.[17] FCC rules also require that rate-of-return carriers justify their proposed rates.[18]

These rules are memorialized in a contract NECA has entered into with each of its pool members, which states both parties and the pooling process are subject to all applicable FCC rules and orders.[19] The contract provides for NECA filing a tariff on behalf of its pooling members and further states NECA "shall prepare and furnish to each Exchange Carrier a monthly settlement statement detailing the net amount due to or due from the Exchange Carrier…." [20] The pooling member "shall be responsible for the gathering, accuracy and reporting of all data."[21] The Exchange Carrier also "agrees to make available additional supporting documentation as may be reasonably required by the Association to resolve questions concerning reported data."[22]

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17 47 C.F.R. § 64.901, *et seq. See also, Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities,* Report & Order, CC Docket No. 86-111, 2 FCC Rcd. 1298, (1987)*, aff'd sub nom., Southwestern Bell Corp. v. FCC,* 896 F.2d 1378 (D.C. Cir. 1990).

18 47 C.F.R. § 61.38.

19 Agreement for the Distribution of Interstate Access Revenues, Sandwich Isles Communications, Inc., (Signed by Sandwich Isles on Apr. 10, 1998).

20 *Id.,* § III.B.2.

21 *Id.*, § III.A.1.

22 *Id.* While Sandwich Isles asserts that NECA accepted the first six months of lease payments beginning January 1, 2009 for settlements, Sandwich Isles Petition at 3, in fact, NECA has questioned why Sandwich Isles would report costs for the new lease beginning in January 2009 when the lease documents do not obligate Sandwich Isles to begin making payments until August 2009. Regardless of the outcome of this proceeding, NECA has requested and anticipates Sandwich Isles will revise its preliminary 2009 settlement claims to reflect that the new lease payments do not begin until August 2009.

2. NECA Administration of Tariffs

NECA's tariff setting practices, and its tariffed rates, terms, and conditions, have always been subject to FCC review. Pursuant to Section 204(a)(3) of the Communications Act, tariffs are filed on 15 days' notice (for rate increases) or 7 days' notice (for rate decreases).[23] Interested parties may file petitions to deny a tariff filing, alleging the proposed rates, term, and conditions are unlawful or unjust and unreasonable.[24] Before the tariff goes into effect, the FCC reviews filed rate proposals, supporting documentation, and any opposing petitions. As the FCC explained in a 2004 review, the Commission has a duty to evaluate whether NECA rates are just and reasonable:

> Reliable data are essential to the Commission's ability to conduct tariff review and investigations, ensure just and reasonable rates, and, if necessary, to prescribe rates.[25]

This Order and previous orders demonstrate the FCC carefully evaluates and investigates NECA rates and cost submissions to determine whether they are just and reasonable.

NECA's role as "gatekeeper" is now even more essential to protect other rural LECs and interstate ratepayers. In the past, the FCC used the Section 214 review process to ensure that initial investments for proposed interstate lines were prudent, which, in turn, protected against excess rates for service. The Commission stated that this process was in lieu of its making disallowances of existing investments.[26] However, the Commission has now granted all carriers, including Sandwich Isles, blanket authority to "construct or operate any domestic transmission

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23 47 U.S.C. § 204(a)(3).

24 47 C.F.R. § 1.773.

25 *July 1, 2004 Annual Access Charge Tariff Filings*, WC Docket No. 04-372, 19 FCC Rcd. 23877 at 23886, ¶ 24 (footnotes omitted). (2004).

26 *American Tel. & Tel. Co., Memorandum Opinion, Order & Authorization*, 84 FCC 2d 303, at ¶ 23 (1981).

line as long as it obtains all necessary authorizations from the Commission for use of radio frequencies" and such construction does not have "significant effect on the environment as defined in §1.1307 of this chapter (Chapter 47) without prior compliance with the Commission's environmental rules."[27] Therefore, without the need for prior FCC approval, Sandwich Isles can construct (or, in this case, lease) interstate lines at any cost. However, the elimination of the Section 214 filing requirement does not remove the obligation of the FCC and of NECA to ensure that only those investments that are prudent in amount and actually "Used and Useful" in the provision of interstate services are included in NECA's pools.

B. Sandwich Isles' Leased Cable and Related Transport Costs

In general, as evidenced by the low number of similar proceedings, NECA and its pool members are able to reach agreement on disputed issues through informal data review processes. Occasionally, however, a pool member and NECA simply cannot agree on the resolution of an issue. Such disputes are properly brought to the FCC through petitions for declaratory ruling.[28] Consistent with the obligations described above and its review practices, NECA reviewed the cost information provided by Sandwich Isles and concluded that Sandwich Isles' proposal to include the entire cost of its exclusive lease of a new cable transportation network in its cost reporting to the NECA traffic sensitive pool does not conform to the FCC's "Used and Useful" doctrine. Sandwich Isles disputes this conclusion and NECA agrees that this declaratory ruling petition is the proper vehicle for resolving such disputes.

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[27] 47 C.F.R. § 63.01(a) & (b).

[28] *See, e.g., 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*, 16 FCC Rcd. 18242, (2001)(FCC denied Moultrie claim concerning its accounting treatment for the sale and leaseback arrangement it had with an affiliate).

In this matter, NECA believes it has carefully balanced and complied with its contractual duties to all of its pool members, including Sandwich Isles.[29] Although neither the contract nor FCC rules specify a time frame within which to resolve any disputes concerning cost submissions, NECA strives to provide timely information to carriers in order to give them sufficient opportunity to resolve disputes.

In the instant case, Sandwich Isles provided a preliminary indication to NECA in June 2007, it intended to include new leased cable costs in its NECA cost submissions.[30] The information provided by Sandwich Isles at that time was based on facts never before presented to NECA, and included a proposal to lease cable transmission from a new company, Paniolo, which would reportedly obtain private financing.[31] NECA cautioned Sandwich Isles by e-mail at that

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[29] Sandwich Isles claims that its "due process" rights were violated when NECA did not include its new cable costs in NECA's pooled costs. Sandwich Isles Petition at 5-6. Although this claim is vague, it should be noted that due process only applies to actions of government, not to NECA as a private organization. U.S. Const. Amendment V. *See also*, *Blum v. Yaretsky*, 457 U.S. 991, 1005 (1982); *Martinez v. California*, 444 U.S. 277, 285 (1980). Additionally, NECA's decision should not have been a surprise to Sandwich Isles. As described throughout these comments, NECA had extensive communications with Sandwich Isles regarding this matter, including cautioning Sandwich Isles prior to its signing of the lease that all costs may not be accepted into the pool. Not only did discussions take place between Sandwich Isles and NECA executive management, but Sandwich Isles was provided the opportunity to present its position to the Chairman of the Board and the Chairpersons of the Common Line/Traffic Sensitive Committee of the NECA Board of Directors. Sandwich Isles was also offered the option of making a presentation to the entire NECA Board of Directors if it wished to do so.

[30] E-mail thread between Susan Barrett, NECA Director, Barbara McCarron, NECA Manager and Alan Pedersen, General Manager of Sandwich Isles Communications, Inc., (June 28, 2007) (Appendix C)

[31] NECA is aware that Sandwich Isles had previously sought to build its own undersea cable transport network with Rural Utilities Services ("RUS") funding. *See*, Public Notice, Actions Taken Under Cable Landing License Act, DA No. 04-1604, (June 2, 2004). However, Sandwich Isles informed NECA that RUS withdrew its funding commitment to Sandwich Isles' undersea cable project.

time (prior to Sandwich Isles' signing of its lease with Paniolo on July 19, 2007) that all of the costs related to Sandwich Isles' proposal might not be eligible for inclusion in the NECA pools.[32]

At Sandwich Isles' request, NECA also discussed this matter with a consultant hired by Deutsche Bank, prior to their provision of financing to the Paniolo Cable Company for the new cable. NECA advised the consultant that NECA had not approved the inclusion of the lease costs to the NECA pool.[33] Furthermore, in April, 2008, NECA sent Sandwich Isles a letter, putting the carrier on clear notice that NECA had serious concerns about the amount of the proposed costs and requesting specific details of the proposed cable system in order to evaluate the Sandwich Isles proposal.[34] Sandwich Isles formally responded to that letter in May, 2008.[35] Discussions on the issue continued to take place via correspondence and conversations through July of 2009.[36]

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32 *Supra,* note 30.

33 E-mail thread between Susan Barrett, NECA Director, and Chad Duval, Moss Adams Consultant (July 6, 2007) (Appendix D).

34 Letter from Carol Brennan, NECA Vice President of Industry Relations, to Alan Pedersen, General Manager of Sandwich Isles Communications, Inc. (April 28, 2008) (Appendix E).

35 Letter from Alan Pedersen, General Manager of Sandwich Isles Communications, Inc., to Carol Brennan, NECA Vice President of Industry Relations (May 7, 2008) (Appendix F).

36 *See*, e.g., Letter from Alan Pedersen, General Manager of Sandwich Isles Communications, Inc., to Carol Brennan, NECA Vice President of Industry Relations (March 11, 2009)(Appendix G); Letter from Alan Pedersen, General Manager of Sandwich Isles Communications, Inc., to Carol Brennan, NECA Vice President of Industry Relations (April 22, 2009)(Appendix H); Letter from Carol Brennan, NECA Vice President of Industry Relations, to Alan Pedersen, General Manager of Sandwich Isles Communications, Inc. (May 11, 2009)(Appendix I); Letter from Alan Pedersen, General Manager of Sandwich Isles Communications, Inc., to Carol Brennan, NECA Vice President of Industry Relations (May 15, 2009)(Appendix J); Letter from Carol Brennan, NECA Vice President of Industry Relations, to Alan Pedersen, General Manager of Sandwich Isles Communications, Inc. (July 13, 2009)(Appendix K); Letter from Alan Pedersen, General Manager of Sandwich Isles Communications, Inc., to Carol Brennan, NECA Vice President of Industry Relations (July 20, 2009)(Appendix L); and, *Supra*, notes 7, 34 and 35 (these citations, of course, do not identify all correspondence between NECA and Sandwich Isles).

In addition to NECA's concerns with the costs of the lease relative to the number of served customers, communications between the parties also addressed NECA's concerns regarding whether affiliate transaction(s) might exist as a result of the lease of the new cable[37] and whether all traffic on the leased facilities would serve Sandwich Isles' regulated customers or whether there would also be non regulated use of the leased network.[38] At the beginning of May 2009, NECA advised Sandwich Isles that it might not accept Sandwich Isles' proposed costs in the upcoming tariff filing or for pool reporting, and NECA indicated that it was willing to meet jointly with the FCC staff and Sandwich Isles to discuss this matter.[39] Sandwich Isles responded via letter on May 14, 2009.[40] All of the correspondence resulted in a joint Sandwich Isles and NECA meeting at the FCC with members of the Wireline Competition Bureau's

[37] Sandwich Isles has consistently taken the position that no affiliate transactions exist as a result of this lease. Notwithstanding, NECA has raised concerns on this issue with Sandwich Isles, based on the fact that the Paniolo Cable Company (owner of the leased cable) is now owned in its entirety by Blue Ivory, LLC. Blue Ivory, which is held by the children of Albert S.N. Hee, President of Sandwich Isles, in "three private trusts, the Adrianne 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). In addition, NECA is concerned that the Paniolo cable was constructed by Sandwich Isles' sister company ClearCom. Brandon Roberts, *ClearCom Not So Clear,* Molokai Dispatch, January 24, 2008.) (Additional details concerning the affiliate transaction issue, including the identity of the sole trustee of the Blue Ivory trusts, can be found in Appendices F, G, H and L.)

[38] Sandwich Isles asserted that the cable would only carry regulated traffic and services for the first 5 years of operation. Notwithstanding Sandwich Isles' position, a 2002 Forbes profile on Albert Hee (President of Sandwich Isles) indicates that Sandwich Isles may have plans to allow ClearCom, its sister company and a competitive local exchange carrier (CLEC), to use the Sandwich Isles network. Carleen Hawn, *Dreaming & Scheming Hawaiian Style,* Forbes.com. (http://www.forbes.com/forbes/2002/1028/172.html)

[39] Letters from James W. Frame, NECA Vice President of Operations, to Alan Pedersen, General Manager of Sandwich Isles Communications, Inc. (May 5 and 6, 2009) (Appendices M and N, respectively).

[40] Letter from Albert S.N. Hee, President of Sandwich Isles Communications, Inc., to James W. Frame, NECA Vice President of Operations (May 14, 2009) (Appendix O).

Pricing Policy and Telecommunications Access Policy Divisions on May 18, 2009, to discuss the various issues and concerns related to Sandwich Isles' proposed costs. It was after this meeting with FCC staff that NECA formally notified Sandwich Isles of its decision, by letter dated May 20, 2009, not to include in the upcoming tariff filing or for pool reporting the disputed costs Sandwich Isles had submitted to NECA.[41] These lengthy and thorough discussions demonstrate NECA dealt fairly with the new cable system cost issues and provided Sandwich Isles with substantial and sufficient notice that NECA had serious concerns about the proposal.

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, consistent with FCC rules. In this matter, NECA determined that the submission of Sandwich Isles' entire new cable lease and related transport costs was not compliant with FCC rules and thus NECA took appropriate steps to avoid their inclusion in its calculation of interstate tariffed rates.

III. NECA'S DECISION TO EXCLUDE SANDWICH ISLES' COSTS

NECA's decision to exclude Sandwich Isles' new cable lease costs from the NECA pools and the June 2009 annual tariff filing were made after a thorough analysis of the Commission's "Used and Useful" doctrine and the application thereof to the data NECA received from Sandwich Isles.[42]

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[41] *Supra*, note 7.

[42] NECA did include the current costs of Sandwich Isles' lease of cable from Hawaiian Telcom, in its June, 2009 annual filing. Sandwich Isles has been incurring charges from Hawaiian Telcom to lease cable capacity in order to provide service to Sandwich Isles' customers.

A. "Used and Useful" Doctrine:

The "Used and Useful" doctrine is designed to balance the right of a carrier to be compensated for all of its investment dedicated to the use of providing service to the public with the right of ratepayers to not pay returns on property that cannot be shown to benefit them within a reasonable period of time.[43] There are three prongs to the "Used and Useful" standard: 1) the need to compensate the investor for capital devoted to serving the public; 2) the need to charge the ratepayer for only those investments which benefits him; and 3) and a requirement that such benefit be either immediate or coming within a reasonable future period of time.[44] Thus, imprudent or excess investment, for example, is the "responsibility and coincident burden of the investor, not the ratepayer."[45]

The third prong of the doctrine is included to protect ratepayers from being forced to pay a return on investment which may not be used for a considerable length of time or is not needed

However, NECA expects that this lease of capacity from Hawaiian Telcom will terminate sometime in 2009. NECA has allowed the Sandwich Isles' Hawaiian Telcom lease costs to stay in the tariff filing until it can be determined what amount of payments projected for the Paniolo cable lease reasonably satisfy the "Used and Useful" standards. Again, NECA has also informed Sandwich Isles that it is willing to examine additional data that would support accepting under the "Used and Useful" standard a reasonable portion of its new cable lease costs as Sandwich Isles transitions traffic to its new leased facilities.

43 *American Tel. & and Tel. Co., Phase II Final Decision & Order*, 64 FCC 2d 1 (1977) ("Docket *19129 Phase II*").

44 *Id.*

45 *Id.*, at ¶ 112. *See also*, *Philadelphia Elec. Co. v. Pennsylvania Pub. Util. Comm.*, 433 A.2d 620 (Pa. Cmwlth. 1981) (holding that prudently made investments in operating plant can be lawfully excluded from a utility's rate base when those investments are not "Used and Useful" for the provision of service to the public); *Duquesne Light Co. v. Barasch*, 488 U.S. 299 (1989) (upholding Pennsylvania's scheme of utility regulation against a claim of unauthorized taking of private property simply because it disallowed recovery of capital investments that are not "Used and Useful" in service to the public when the utilities overall return on investment was reasonable).

to serve as a reserve for currently used investment.[46] Accordingly, the Commission concluded that it was duty bound to disallow inclusion of investment from the rate base that is not necessary to insure the utility has a reasonable capability to serve the ratepayers with efficient service on a continuous basis.[47] In other words, ratepayers are not required to pay rates today that recover costs for equipment that will not be used for years to come, if at all.

While the "Used and Useful" standard prohibits the inclusion of the cost of plant in the rate base unless the plant is in operation and is providing direct benefits to subscribers, excess capacity (plant that has been built but is not currently "Used and Useful") is a related concept that must also be considered.[48] The Commission has defined two types of excess capacity.[49] First, where plant is being used but not to its full capacity, the portion of the plant not in use is considered excess capacity. Second, excess capacity can be fully constructed plant not being used at all. The operator may include plant that is considered excess capacity in its rate base only to the extent it intends to place the plant into service within a reasonable amount of time.[50]

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46 *Id.* at ¶113.

47 *Id.* In 1987, the FCC adopted a rule (47 C.F.R. § 32.2002) requiring that property purchased and held for future use be placed into service within two years of its acquisition to be included in the rate base. *See, Amendment of Part 65 of the Commission's Rules to Prescribe Components of the Rate Base and Net Income of Dominant Carriers*, Report & Order, 2 FCC Rcd. 269 (1987), *recon.* 4 FCC Rcd. 1697 (1987), *aff'd*, *Illinois Bell Tel. Co. v. FCC*, 911 F.2d 776 (D.C. Cir. 1990).

48 *Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation.* CS Docket No. 94-28, *Second Report and Order, First Order on Reconsideration, and Further Notice of Proposed Rulemaking*, 11 FCC Rcd. 2220 at ¶ 31 (1996). *See also, Cox Communications San Diego, Inc.; Appeal from a Local Rate Order of the City of Chula Vista, California, Memorandum Opinion & Order*, 13 FCC Rcd. 17653 (1999); *MCI Telecomm. Corp. v. American Tel. & Tel. Co*., *Memorandum Opinion & Order,* 74 FCC 2d 184, at ¶ 24 (1979) ("[C]arriers have an obligation to avoid overexpansion of plant which leads to an excessive rate base.").

49 *Id.* at 36.

50 The Commission also discussed the difference between "excess capacity" and reasonable "spare capacity" in *Federal-State Joint Board on Universal Service; Forward-Looking*

Recent Commission rulings on "Used and Useful" involve cable TV rates. However, the cable-related decisions are themselves based on traditional utility regulation. In the mid 1990's, the FCC addressed rate regulation of the cable TV industry and the FCC's intention to apply the telephone "Used and Useful" standard to cable TV rates.[51] The FCC noted that telephone regulations provide for a limited amount of excess capacity and there is an opportunity annually to adjust the rate base downward if the excess capacity does not become "Used and Useful" within a certain period.[52]

There are also a number of other orders over the years where the FCC disallowed carriers' investments as being excessive or otherwise not "Used and Useful".[53] In the event investments are deemed not "Used and Useful" or deemed to have been imprudently incurred in the provision of interstate services, the Commission has reserved the right to disallow the recovery of any or all such expenditures from interstate ratepayers.[54] Similarly, the FCC has disallowed projected increases in carrier investments in network facilities that exceeded trended

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Mechanism for High Cost Support for Non-Rural LECs, Tenth Report & Order, 14 FCC Rcd. 20156, at ¶186 (1999). There, the FCC noted that "network engineers include a certain amount of spare capacity to accommodate administrative functions, such as testing and repair, and some expected amount of growth," as well as "small increases in demand or [the ability to address] service outages." Id.

51 *Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation and Adoption of a Uniform Accounting System for Provision of Regulated Cable Service*, CS Docket 94-28, *Report and Order and Further Notice of Proposed Rulemaking*, 9 FCC Rcd. 4527 (1994), *recon*., 11 FCC Rcd. 2220 (1996).

52 *Id.*, referring to 47 C.F.R. § 32.2002 (Plant Held for Future Use).

53 *The Western Union Tel. Co., Initial Decision in Phase I of Docket 78-97*, 95 FCC 2d 924 (1982). The hearing examiner concluded that Western Union "modernized its plant to the point where it has padded its rate base with excess capacity DES investment.; *Long-Term Number Portability Tariff Filings, US WEST Communications, Inc.*, CC Docket No, 99-35, *Memorandum Opinion & Order*, 14 FCC Rcd. 11983 (1999); *Annual 1988 Access Tariff Filings, Memorandum Opinion & Order*, 3 FCC Rcd. 1281, at ¶¶ 144-45 (1987).

54 *Contel of Virginia, Inc., doing business as GTE Virginia, Order & Authorization*, 10 FCC Rcd. 12672, at ¶117 (1995).

industry growth rates, when the carriers were unable to differentiate their situations from those experienced by other carriers.[55]

The Commission has also evaluated the issue of plant held for future use, defined as "property purchased [now] taking advantage of cost-saving opportunities…where such acquisition in advance of actual use lowers the ultimate cost of service to the ratepayers", concluding two (2) years, subject to specific waiver, is a reasonable time within which Plant Held for Future Use must be employed in telephone service.[56]

The FCC has also considered the reasonableness of carrier investments by examining the prices paid by carriers for equipment or services used in connection with the provision of interstate services. The leading example is the Commission's scrutiny of Western Electric's prices for equipment sold to AT&T Long Lines Department and the Bell Operating Companies. The FCC concluded the Bell System's purchasing policies required changes to accommodate acquisitions from suppliers other than Western Electric, since that company's prices were often not the lowest. However, the FCC did not make any adjustments to the Bell System's interstate revenue requirements because of its purchases from Western Electric, based on the record of the Commission.[57] The FCC has consistently refused to require carriers to produce or procure

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[55] *Annual 1990 Access Tariff Filings,* MM Docket No. 90-320, *Memorandum Opinion & Order*, 5 FCC Rcd. 4177, at ¶¶ 274-91(Comm. Car. Bur. 1990). Only Lincoln Telephone Company was able to demonstrate that its higher investment projections were tied to a definitive plan to introduce Signaling System 7 (SS7) technology in its single large metro area all at once. Moreover, the facts showed Lincoln's COE Category 3 plant before the SS7 project was undertaken constituted only 25% of the average for all local exchange carriers. *Id.,* at ¶ 290.

[56] *Supra,* note 43, at ¶¶ 155 through 162; 47 C.F.R. § 32.2002.

[57] *Id.,* at ¶¶291 *et seq*. *See also, American Telephone and Telegraph Company, The Bell Telephone Company of Pennsylvania, The Chesapeake and Potomac Telephone Company, The Chesapeake and Potomac Telephone Company of Maryland, The Diamond State Telephone Company, New England Telephone and Telegraph Company, New Jersey Bell*

equipment and services at the lowest possible price. The lowest priced equipment may, for example, have higher maintenance costs or a shorter service life or fail to provide adequate quality service. Notwithstanding this, the FCC has generally examined the totality of the circumstances and accepted or approved carriers' purchase of goods or services that were reasonably priced for the facts of each case.[58] This is a fair standard for both investors and ratepayers.

The FCC also provided guidance in connection with its policy statements related to facilities for international services, which were subject to various levels of competition between wireline voice, wireline data and satellite services, even as far back as the 1970s.[59] After noting its policies would be technology neutral, the FCC stated:

> In applying and implementing these guidelines to specific situations, we will seek to authorize those facilities which will result in the least cost combination of facilities which is consistent

Telephone and Telegraph Company, New York Telephone Company, and The Southern New England Telephone Company, For authority under Section 214 of the Communications Act of 1934, as Amended, to Supplement Existing Facilities by Construction, Acquisition and Operation of a Lightguide Cable between Cities on a Main Route between Cambridge, Massachusetts and Washington District of Columbia, with Extension Lightguide Cables to Various Cities along this Route, Memorandum Opinion, Order & Authorization, 89 FCC 2d 1167 (1982). The FCC stated that, in the context of its review of a Section 214 application: "Ensuring the lowest possible rates is an important goal, but it is not our only one. Indeed, there may be more than one approach to achieving this goal in the long run." *Id.*, at ¶ 29. In that same paragraph, the Commission stated its responsibilities as follows: "But, as has been recognized both by this Commission and the courts, our general mandate and, specifically, our mandate under Section 214, calls for consideration of other factors and a balancing of all relevant factors by this Commission in assessing the public interest." *Id., citing Telegraphers Union v. United States*, 87 F. Supp. 324 (D.C.), *aff'd per curium*, 338 U.S. 864 (1949).

58 *Id.*

59 *See, e.g., Policy to be Followed in Future Licensing of Facilities for Overseas Communications, Further Statement of Policy and Guidelines,* 62 FCC 2d 451 (1976).

> with meeting specified traffic requirements and acceptable service standards.[60]

In another case, the full Commission affirmed the Common Carrier Bureau's disallowance of $73 million of billing expenses claimed by AT&T where those costs exceeded what AT&T would have been required to pay LECs to perform billing and collection services for them and where AT&T was otherwise unable to justify the reasonableness of the extra expenses.[61] The FCC confirmed it was not necessary for there to be "bad faith, exorbitant waste, or other exceptional circumstances" upon the part of the carrier to justify a disallowance, but only that the added level of expenses did not provide sufficient benefits to ratepayers. In other orders, the FCC has disallowed expenses that exceeded industry average expenses or averages for similarly situated carriers.[62]

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[60] *Id.*, at ¶15. The Commission continued to explain its reasoning as follows: "Where no significant differences arise in the resulting levels of service reliability between alternative means of meeting stated service objectives, consideration of service reliability is not a determining factor in the selection of the least cost combination of facilities." *Id*. at n.2.

[61] *AT&T Communications Revisions to Tariff F.C.C. Nos. 1, 2, 11, 13, and 14, Application for Review*, CC Docket No. 87-611, *Memorandum Opinion & Order,* 5 FCC Rcd. 5693 (1990). However, because AT&T interstate earnings were more than $73 million below the earnings ceiling imposed by the FCC, no refunds were required to be made. Nevertheless, the FCC warned AT&T that it would be required to make similar showings in the future or face the possibility of paying refunds to customers in the event that its internal billing expenses continued to be excessive when compared to the cost of competing services from the LECs.

[62] In evaluating LEC access charges, the Commission adopted two tests to identify potential excessive expenses. The first test "compares the projected percentage change in a cost element [for each LEC] with the industry-wide projected percentage change [for the same cost element]." The second test "compares the absolute level of change, relative to the size of the company, with the average absolute change." *Annual 1989 Access Tariff Filings, Memorandum Opinion & Order,* 4 FCC Rcd. 3638, at ¶ 110 (1989). Any carrier's expense for a category that exceeded the average by one standard deviation was flagged. Unless the affected LEC was able to explain satisfactorily the anomaly, the FCC generally reduced the associated expenses to the industry mean. *Id.* at ¶ 112. *See also, Beehive Telephone Company, Inc.*, CC Docket No, 97-237, *Memorandum Opinion & Order,* 13 FCC Rcd. 2736 (1999). In that case, the FCC compared the ratio of Beehive's operating expenses/telephone plant in service (OE/TPIS) to those of similarly sized rural LECs (based on the number of

B. Application to Sandwich Isles

Sandwich Isles is asking the Commission to rule that its entire new cable lease cost satisfies the "Used and Useful" analysis and to direct NECA to accept this as a current cost in the NECA traffic sensitive pool. NECA does not dispute that Sandwich Isles deserves to be compensated at some level in accordance with the first prong of the "Used and Useful" doctrine, the right of the investor to be compensated. However, the issue becomes complicated when the second (benefit to ratepayer) and third prongs (reasonable time) of the "Used and Useful" doctrine are introduced into the equation.

In applying the second prong, NECA has serious concerns about the scale of this project based on the size of Sandwich Isles' customer base for regulated services.[63] Sandwich Isles has asserted it will have 20,000 subscribers over the life of the lease.[64] However, it currently serves substantially less than this number and there are significant questions as to if or when 20,000 Hawaiian Home Land dwellings will actually be built and served by Sandwich Isles.[65] Excessive investment of this type has previously been disallowed by state Utility Commission findings.[66]

access lines) for several years. The comparisons showed that, for 1994 and 1995, Beehive's OE/TPIS ratios were approximately 24% and also somewhat higher than average for similarly sized LECs, but for the tariff filing under investigation, Beehive's OE/TPIS ratio climbed to 59.96%. The FCC, after acknowledging Beehive might be a higher cost carrier, disallowed all operating expenses above an OE/TPIS ratio of 25%.

63 *See*, Appendix A.

64 *Supra*, note 35.

65 The Department of Hawaiian Home Lands has stated their objective is to "Deliver an average of 500 new residential housing opportunities per year in proportion to the number of applicants on the residential waiting list for each island." *See*, Department of Hawaiian Home Lands, General Plan, http://hawaii.gov/dhhl/publications/island-plans/GeneralPlan.pdf/ , (February 16, 2002)(last visited on August 25, 2009). *See also*, Anthony Sommer, *Fiber Optic Firm Taps Federal Gold Mine*, Honolulu Star-Bulletin, June 4, 2002, *available at* http://archives.starbulletin.com/2002/06/04/news/story2.html (last visited on August 25, 2009), "But the 20,000 homes do not yet exist. The number represents the families who are

Under Sandwich Isles' proposal, today's ratepayers would essentially be paying for a level of service that might never be provided during the length of the lease. Even if Sandwich Isles reaches its maximum estimate of 20,000 customers, there is still the strong likelihood the vast majority of its leased capacity would not be necessary to meet the needs of Sandwich Isles' customers for regulated services.[67] This highlights concerns that the inclusion of the entire costs of the cable lease represents excess or imprudent investment. Applicable precedent indicates that the FCC is strict concerning investment in excess capacity, and only allows such investment to be included in the rate base if it will be put into service within a reasonable time or constitutes

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on the Hawaiian Homes waiting list for a new home. At the current rate of DHHL home construction (about 500 new homes per year), the 20,000 dwellings will not be completed for another 40 years." NECA also believes that a substantial number of customers in the Hawaiian Home Lands continue to receive telecommunications services from Hawaiian Telcom.

66 *State ex rel. Utilities Comm'n v. Mebane Home Tel. Co*., 242 S.E.2d 165 (N.C. App. 1978), *aff'd*, 257 S.E.2d 623 (N.C. 1979). The North Carolina Utilities Commission found that a telephone company's investment in plant to serve expected new home construction that had not materialized constituted "excessive investment" that was not recoverable in rates. The State Commission disallowed all investment that was based on demand growth in excess of historical patterns. *See also, In Public Service Comm'n v. Montana-Dakota Utilities Co*., 100 N.W.2d 140 (N.D. 1959), a leading case in which the state supreme court upheld the PSC's disallowance of additional costs to construct a larger capacity natural gas pipeline than was needed to serve existing customers. The court stated, in applicable part: "The anticipated patrons of the company under the present proposal cannot be burdened in order to provide for possible needs of other patrons in other communities sometime in the future." *Id.*, 100 N.W.2d at 150. *Accord, Fern Lake Co. v. Public Service Comm'n*, 357 S.W.2d 701 (Ky. 1962)

67 PacificBusinessNews.com, Sandwich Isles Completes Undersea Cable, http://pacific.bizjournals.com/pacific/stories/2009/06/22/daily63.html (last visited August 24, 2009). This article cites to a Sandwich Isles' statement claiming the new cable "consists of 48 strands of pure glass fiber and that it is the largest in the state, with the bandwidth to carry 2.9 terabits of data per second." NECA believes this cable has the capacity potential to serve the entire 500,000+ combined customer base of Hawaiian Telcom and Sandwich Isles. However, Sandwich Isles currently serves less than 0.4% of the landlines in Hawaii. *See*, Universal Service Administrative Company (USAC), FCC- Quarterly Administrative Filings, 4th Quarter 2009 Appendix HC-05, http://www.usac.org/about/governance/fcc-filings/2009/quarter-4.aspx (last visited on August 25, 2009).

reasonable spare capacity.[68] Sandwich Isles has not adequately demonstrated a reasonable likelihood that it will place all its leased capacity into service for the benefit of Sandwich Isles' subscribers using regulated services within such time.[69] In addition to affecting ratepayers in Hawaii, the inclusion of these costs in the NECA pools would significantly impact both ratepayers and pool members throughout the country.[70] Finally, on the topic of imprudent investment, Sandwich Isles' small number of subscribers raised concerns at NECA over Sandwich Isles' decision to lease the entire cable capacity. These concerns led NECA to investigate whether the leasing of an entire new cable network met the "Used and Useful" and prudent expenditure standards.[71] It appears to NECA that Sandwich Isles had a number of more reasonable alternatives to meet its transport capacity needs to serve its customers on the HHL given there were two and are now three undersea cable systems serving the Hawaiian Islands. It would have been more reasonable and economical to lease only a portion of the cable from the

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[68] *Supra*, note 43.

[69] *Supra*, note 65.

[70] *See*, Appendix A, showing contribution levels that would have to be paid by other pool members to cover Sandwich Isles' proposal, including comparison of pool average and Sandwich Isles broadband costs. *See also*, note 9 referring to potential impacts on broadband "take" rates.

[71] The FCC has directed NECA to "implement the access charge system in accordance with Commission rules . . . . To justify its tariff filings, NECA must believe in good faith that the data in the filings comply with those rules." *See*, *Safeguards Order* at ¶ 40. Because NECA has been given the duty to interpret the Commission's rules on behalf of those companies choosing to participate in the NECA pool, we must be mindful that the "data that each LEC reports to NECA affects not only its own earnings, but also the earnings of other carriers." Reporting the cost(s) of this lease into the pools could have a dramatic effect on the other pool participants. The Commission itself has declared that, "it would be unfair to those participants that implement NECA's rule interpretations to allow more aggressive participants to increase their revenue at the group's expense." An analysis done by NECA shows the proposal submitted by Sandwich Isles for the upcoming annual tariff filing to include its entire lease costs in the traffic sensitive pool posed major concerns relative to the impact on rate levels, as well as to the contribution flow from the pool. *See*, Appendix A.

Paniolo Cable Company (owner of the leased Sandwich Isles' cable).[72] Alternatively, based on NECA's research it appears a lease from either Hawaiian Telcom or Pacific LightNet for needed capacity on their respective cables would have been more reasonable and economical.

The Sandwich Isles Petition also puts forth Sandwich Isles' belief that the Hawaiian Telcom facilities are "obsolete and had serious capacity constraints" and the Pacific LightNet cable had "service quality and reliability" issues.[73] NECA is not in a position to comment on the technical details of Sandwich Isles' concerns since Sandwich Isles has not presented any evidence to support these claims. However, it should be noted that the facilities owned by the alternative providers apparently provide service to the vast majority of customers on the Hawaiian Islands at the present time.[74] In addition, NECA has been assured by both Hawaiian Telcom and Pacific LightNet that their networks have sufficient inter island network capacity to provide high quality transport. Based on NECA comparisons with other pooling companies, this capacity would appear capable of handling traffic at high speed broadband rates for a reasonable projection of increase in the number of Sandwich Isles' customers. Under Commission precedent, Sandwich Isles' lease payments should be reasonable in amount and made in accordance with the FCC's policy expecting carriers to obtain "least cost combination of facilities which is consistent with meeting specified traffic requirements and acceptable service standards."[75] If the capacity available through either Hawaiian Telcom or Pacific LightNet or a combination of the two is more cost effective than leasing the entire Paniolo cable and is

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[72] *Supra*, notes 63 and 67. Sandwich Isles now has an exclusive lease for the largest undersea cable in Hawaii while serving only 0.4 percent of Hawaii customers.

[73] Sandwich Isles Petition at 4,5.

[74] *Supra*, note 67

[75] *Supra*, note 60 at ¶15.

sufficient to provide service to the limited number of Sandwich Isles' subscribers for the foreseeable future, it would seem reasonable to explore those options in greater detail as the cost of the alternate facilities might be more in line with what the Commission would consider "Used and Useful".[76]

IV. CONCLUSION

NECA believes its decision regarding non-inclusion of Sandwich Isles' entire new lease costs into the NECA pool and the June 16, 2009 annual tariff filing based on the "Used and Useful" doctrine was correct. Further, while Sandwich Isles does not have a constitutional right to due process in the manner in which it deals with NECA, NECA has always exhibited a commitment to its members to work through issues on a timely and fair basis. When this informal process failed to resolve the instant matter, the Declaratory Ruling process exists to help resolve disputes.

For all of the reasons demonstrated above, NECA requests that the Commission uphold NECA's decision, based on the "Used and Useful" doctrine, to exclude Sandwich Isles' proposed inclusion of its entire new cable lease costs in the NECA pool. However, should the

[76] It is difficult to determine what portion of the new lease is "Used and Useful". Given the situation, NECA would likely turn to the costs of the alternative facilities to estimate what would be "Used and Useful". However, as noted in these comments, NECA is willing to view new data demonstrating that other amounts should properly be included in the rate base under FCC rules.

Commission determine that either all or a specific portion of Sandwich Isles' new lease costs are "Used and Useful", NECA will promptly comply with the Commission's Order.[77]

Respectfully submitted,

By: /s/ *Gregory J. Vogt*

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August 31, 2009

[77] In the event that the Commission determines that some or all of the Sandwich Isles' lease costs are "Used and Useful", NECA asks the Commission to also provide guidance as to whether affiliate transaction(s) exist per the Commission's rules and to consider whether there should be any allocation of costs to non-regulated use.

APPENDIX A

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.

APPENDIX B

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Certificate of Service

I, Gregory J. Vogt, do hereby certify that I have on this 31st day of August 2009 caused a copy of the foregoing "Comments Of National Exchange Carrier Association" to be served by electronic mail upon the following:

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