Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Sandwich Isles Communications, Inc.	)	WC Docket No. 09-133
	)	(DA 09-1622)
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Petition for Declaratory Ruling	)	
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COMMENTS OF GVNW CONSULTING, INC.

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EXECUTIVE SUMMARY

Since its inception, NECA pooling was intended to assist the highest cost providers offer services at affordable rates. While no one disputes that there is the need for every pool member to achieve the lowest possible average cost as a participant in the pool, this need must be balanced with an obligation for an individual pool member to satisfy its service commitments and have an adequate opportunity to contest any adverse cost decision related to the carrier's submission of costs to NECA.

As stated in the Petition filed by Sandwich Isles, NECA has chosen to ignore in 2009 what the circumstances were for Sandwich Isles in 2000, the time the "Paniolo lease process" began. In November 2000, the Rural Utilities Service (RUS) approved Sandwich Isles "C" Loan request for funds to construct a statewide transport network to connect the Hawaiian Home Lands (HHL). RUS engineering staff had spent over a year reviewing the proposed network design, assessing the need for a statewide network, and concluded that the investment was necessary. NECA, on the other hand, has never untaken an engineering study but relies on its intuitive conclusion that the network "appears" not to meet the standard of "used and useful."

As noted in SIC's Petition, NECA did not provide adequate notice and opportunity to contest this initial adverse decision, since NECA's most recent comments prior to May 5, 2009 used language couched in terms of "may not," and NECA had been quizzing SIC in earnest since February 2007 and accepting its responses and forecasted costs without objection.

As a result of RUS withdrawing loan funds, SIC was forced to analyze its options to determine the best way to interconnect its widely dispersed service territory, in an environment where upgrading facilities is extraordinarily difficult and costly to complete. The long history of underinvestment by the successive owners of the dominant carrier in the Hawaiian Islands necessitated the Paniolo lease option.

NECA appears to be asserting that telephone plant should be built based on current needs and capacity, or continually leased from others without regard to long range planning considerations, such as cost management and availability of capacity where and when needed to meet Eligible Telecommunications Carrier obligations. This is contrary to a very recent report that the Commission has filed with the United States Congress.

It would appear that NECA is subscribing to the theory that a carrier is able to add to its capacity in very small increments, so that it is able to increase its capacity in an amount equal to, or at least close to the case of one customer at a time. The real world diverges from this type of economic theory. In the instant case of SIC, the carrier gets "one shot" at a major upgrade of this type. Due to its harsh and insular operating environment, SIC is forced to add the needed capacity in a "lumpy" manner as it is not possible or practical to add to its capacity in tiny, measured increments. And facilities must be placed not only where they are currently needed, but where they will be needed to satisfy future service obligations expected over the life of the asset. Thus, it is possible for the uninformed to perceive that this new capacity gives the company more capacity, and infrastructure, than it needs for immediate purposes.

Similarly-situated carriers in states that exhibit high cost tendencies may eventually be faced with the same dilemma that is currently faced by SIC. This concern is evidenced in the filing made by the Alaska Telephone Association (ATA) entered into the record on August 12, 2009. Carriers in Alaska face similar pressures in providing service to isolated and remote customers in the bush regions of Alaska. Without proper direction from the Commission to NECA, carriers such as those represented by the ATA may find themselves in the same unenviable position currently occupied by SIC.

When the regulatory discussion includes a debate over what is used and useful, a companion discussion of what is prudent investment often follows. At present, NECA has not provided a written definition or set of procedures that provides a set of rules for carriers to follow as to what constitutes prudent investment for purposes of traffic sensitive pool settlements. And realistically, a local assessment of need and necessity, or what constitutes prudent investment, is a legitimate management responsibility that should not be relegated to an administrative group in New Jersey.

However, completing the academic discussion the most common definition in industry literature of what constitutes prudent investment is that costs that were reasonable at the time they were incurred, given the circumstances and what was known or knowable at the time, are to be included in rates, which is the reasonable expectation of SIC given a 10-year planning, engineering, and open communication process with NECA.

Critically important revenue streams are requisite to the continued deployment of modern communications infrastructure throughout America. In fact, without “sufficient and predictable” funding, it would be impossible for SIC to fulfill the mandate of the

Telecom Act of 1996, which established the principle in Section 254(b)(3) that "consumers in rural, insular, and high cost areas should have access to telecommunications and information services at rates that are reasonably comparable to rates charged for similar services in urban areas."

INTRODUCTION AND BACKGROUND

GVNW Consulting, Inc. (GVNW) is a management consulting firm that provides a wide variety of consulting services, including regulatory and advocacy support on issues such as universal service, intercarrier compensation reform, and strategic planning for communications carriers in rural America.

The purpose of these comments is to respond to the Public Notice[2] (DA 09-1622) inviting comment on the Petition for Declaratory Ruling filed by Sandwich Isles Communications, Inc. (SIC). GVNW supports both the Petition filed by SIC that certain circuit lease expenses incurred by Sandwich Isles are "used and useful" and that the NECA should be directed by the Commission to accept such costs for inclusion in, and settlement from, the NECA traffic sensitive pool. Further, we believe that it would be appropriate for a statement of direction from the Commission that could prevent future arbitrary actions on the part of NECA that are not based on the record in a proceeding or by FCC rules and regulations.

[2] The Bureau extended the comment filing date to August 31 in an Order dated August 5, 2009 (DA 09-1754).

A DECISION ON THE SIC PETITION MAY HAVE PRECEDENTIAL IMPACT ON FUTURE POOLING ARRANGEMENTS FOR ALL MEMBERS OF THE NECA POOL

The pooling option was developed with high-cost carriers in mind

Since its inception, pooling was intended[3] to assist the highest cost providers offer services at an affordable rate. In NECA's own publication, NECA Guide to Telephone Regulation, the introductory section to Part 69 Access Charges, Revenue Pooling (page 2) states in part:

> *The Commission recognized that it would be difficult, if not impossible, to replace the pre-divestiture "division of revenues" and "settlements" mechanisms with individual access tariffs filed by over 1400 LECs. The Commission was also concerned that wide disparities in common line costs, particularly for LECs providing service in rural areas, could increase pressure for IXCs to deaverage rates, and otherwise harm universal service.*

While no one disputes that there is the need for every pool member to achieve the lowest possible average cost as a participant in the pool, this need must be balanced with an obligation for an individual pool member to have an adequate opportunity to contest any adverse cost decision related to the carrier's submission of costs to NECA regional offices and headquarters.

The ability to participate in interstate, and in some cases intrastate pooling arrangements, provides rural carriers with administrative efficiencies and risk management benefits that are not achievable by an individual carrier. There are four notable benefits of pooling for rural carriers: 1) Pooling reduces risk factors by stabilizing cash flows and helps to offset the effect of unexpected demand reductions or

[3] See MTS and WATS Market Structure, CC Docket No. 78-72, Phase I, Third Report and Order, 93 FCC 2d 241 at paragraph 314-315 (1983)

unanticipated cost increases; 2) The ability to average access rates in rural areas serves to mitigate high access rates that could deter IXCs from serving isolated, high-cost areas; 3) Pooling assists rural carriers with access to reasonably priced capital that is necessary to build and maintain rural infrastructure via adequate recovery of cost, and 4) Pooling reduces the administrative burdens for both the Commission and the rural carriers[4], as the filing of over 1,000 individual tariffs would create administrative complexity. The tangible public policy benefits of uniform rates, terms and conditions remain as valid today as they have been for the last three decades.

The circumstances in this matter were known for a period of years by NECA

SIC was established in 1995 to address the chronic inadequacy of telephone service in rural areas of Hawaii. The sole telecommunications provider in the state at that time was not providing adequate telecommunications service to many rural areas throughout the state, including the rural areas designated as Hawaiian Home Lands (HHL). SIC was specifically formed to effectively address the unique challenges[5] associated with providing affordable and adequate communications services to the virtually unserved HHL. SIC has made significant investments over the past 13 years to deploy critical infrastructure in much of rural Hawaii. Due to circumstances beyond the

[4] CC Docket No. 78-72, FCC 82-579, Final Rules at paragraph 362: "We recognize that we cannot and should not expect a telephone company with eight employees to do everything that Pacific Telephone is expected to do." While Pacific is now again a part of AT&T, the observation remains relevant today.

[5] Costs to construct this critical infrastructure are very high, arguably higher than any other place in the continental United States. The attributes that make Hawaii a very sought after destination, i.e. isolation, rugged beauty, low population density, lack of commercial and industrialization, diverse biology, and balmy sea breezes, contribute to the high costs of serving rural customers. Virtually all materials and supplies necessary for construction of Hawaii's infrastructure arrive by ship or air. As an insular area, Hawaii is not served by other forms of transportation like rail or trucking. Construction of inter-island facilities is expensive, subject to a rigid permit process that includes environmental restrictions geared to protecting marine life, while contending with corrosive conditions found in a tropical marine environment.

control of SIC, the infrastructure has been put in place to accommodate 20,000 HHL home sites, but the timeframe under which these home sites would be occupied has been significantly delayed as a result of factors beyond the control of SIC.

The long history of underinvestment by the successive owners of the dominant carrier in the Hawaiian Islands created the need for SIC to seek an alternative means to meet its transport needs. The record is crystal clear from the SIC Study Area Waiver filing that the outer island infrastructure had been neglected for decades and transport infrastructure was either non-existent or of poor service quality.

NECA has chosen to ignore in 2009 what the circumstances were in 2000, the time this "Paniolo process" began to develop[6]. In November 2000, the Rural Utilities Service (RUS) approved Sandwich Isles "C" Loan request for funds to construct a statewide transport network to connect the Hawaiian Home Lands (HHL). RUS engineering staff had spent over a year reviewing the proposed network design, assessing the need for a statewide network, and concluded that the investment was necessary. NECA, on the other hand, has never untaken an engineering study but relies on its intuitive conclusion that the network "appears" not to meet the standard of "used and useful."

As noted in SIC's Petition, NECA did not provide adequate notice and opportunity to contest this initial adverse decision, since NECA's most recent comments prior to May 5, 2009 used language couched in terms of "may not." SIC has documented

[6] In its own comment filing, SIC clearly delineates the concerns with the other options that were available at the time the decision was made to proceed with Paniolo, including but not limited to: service quality concerns; price quotes at that time, which is the only relevant timeframe, were not attractive; price references in 2009 did not include the terrestrial portion that constitutes 55% of the Paniolo lease; and the international carrier facility as leased by HT is not useful for the relevant SIC routes.

in its Petition that NECA communicated both in 2000 and 2007 that SIC could expect settlements and USF to continue based on its submitted data to NECA.

As a result of RUS withdrawing loan funds, SIC was forced to analyze its options to best determine how to interconnect its widely dispersed service territory, in an environment where upgrading facilities is extraordinarily difficult and costly to complete. A third-party lease arrangement was the best solution available to obtain outside financing for the construction of critical transport infrastructure to connect and serve remote, outer island HHL areas for the foreseeable future.

<u>Other rural and remote carriers will face similar challenges as demonstrated by the facts in the petition at hand in the SIC case</u>

SIC faces higher than average costs in the provision of service to the Hawaiian Homelands, due in part to Hawaii's geographically isolated island structure that creates both distinct challenges and network complexities. Hawaii is the only state in the nation comprised entirely of volcanic islands and cut off from the mainland by thousands of miles of deep ocean waters. Even within the state, Hawaii's six main islands (Kauai, Oahu, Molokai, Lanai, Maui, and Hawaii) are separated by wide and deep ocean channels that reach depths of over 10,000 feet, and span distances of over 100 miles. Hawaii is one of two states, Alaska being the other, for which deep sea submarine fiber and microwave links are essential to provide intrastate and interstate transport.

Other carriers in states that exhibit high cost tendencies may eventually be faced with the same dilemma that is currently faced by SIC. This concern is evidenced in the filing made by the Alaska Telephone Association (ATA) entered into the record on August 12, 2009. Carriers in Alaska face similar pressures in providing service to isolated and remote customers in the bush regions of Alaska. Without the proper direction and clarification from the Commission to NECA, carriers such as those represented by the ATA may find themselves in the same unenviable position currently occupied by SIC. This unenviable position is the one of having the rug pulled out from underneath them at the eleventh hour of a facilities deployment cycle, being thwarted from meeting the goal that the Commission has communicated to Congress discussed in the next section.

NECA'S ACTIONS TO THIS POINT PROVIDE A DISINCENTIVE FOR INFRASTRUCTURE DEPLOYMENT, WHICH IS CONTRARY TO THE VIEW OF THE COMMISSION AS REPORTED TO THE UNITED STATES CONGRESS

NECA appears to be asserting that telephone plant should be built based on current needs and capacity, or continually leased from others without regard to long range planning considerations, such as cost management and availability of capacity where and when needed to meet Eligible Telecommunications Carrier obligations. This is contrary to a very recent report that the Commission has filed with the United States Congress.

On May 22, 2009, the Commission released a report entitled *Bringing Broadband to Rural America – Report on a Rural Broadband Strategy*. As the Commission is aware, the report was authored by the Acting Chairman in the May, 2009 timeframe, Commissioner Michael J. Copps. When reviewed in the context of what is an appropriate level of capacity for carriers to deploy within their telecommunications networks, several passages appear to be relevant to this instant argument with respect to SIC.

For example, at paragraph 82 the issue of Scalability is discussed, and the report states in part:

. . . *As a consequence, we believe that networks deployed in rural areas should not merely be adequate for current bandwidth demands. Instead, they also should be readily* *upgradeable to meet bandwidth demands of the future. An international comparison suggests significant additional capacity may be necessary. . . . Bandwidth-intensive applications could very easily become the norm in the U.S. – even in rural areas. Technologies that cannot be upgraded easily could make Internet applications less than five years from now look like the dial-up downloads of today.*

This is not the only relevant excerpt. There are two references in the footnotes in this same document that are relevant as well: At footnote 173, "…*the next-generation broadband applications require functionalities such as, for example, dramatically faster file transfer speeds for both uploads and downloads, and the ability to transmit streaming video*."

In addition, at footnote 176, Commissioner Copps continues in a similar vein:

"…*The lack of middle-mile infrastructure is one of the greatest obstacles to building sustainable rural broadband networks. Many middle-mile facilities were originally built by telephone and cable companies for ordinary telecommunications or cable television services. Rural communities are often still reliant upon these antiquated copper telephone and cable infrastructures, which lack the capabilities to deliver high-speed, broadband access*."

In the case of SIC, the above footnote reference aptly describes the antiquated facilities of bankrupt carrier Hawaiian Telecom (HT). The struggles of HT[7] have necessitated that SIC develop its own infrastructure. HT has continued a trend in place for decades – that is, the dominant carrier (first GTE, then Verizon, and now Carlyle) has not invested in adequate facilities to serve the outer islands and the rural areas[8] of Hawaii.

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[7] The current distressed financial condition of Hawaiian Telecom is, in part, a reflection of their continued inadequate infrastructure present in the state today. When SIC began to serve the HHL, it was recognized that not only would deployment of modern local distribution facilities be required, but a statewide transport network would be necessary for the delivery of advanced services on HHL.

[8] The lack of rural infrastructure was particularly acute on the Hawaiian Home Lands. GTE failed to build out facilities to the HHL, so prior to SIC's arrival to the HHL, most residents did not enjoy phone service due to the high costs required for the end user customer to fund the build out to their residence.

NECA's arbitrary and capricious determination of "used and useful" is not based on the record

When completed, the SIC terrestrial and undersea transport network leased from Paniolo to SIC will tie together all of the HHL areas on the six major Hawaiian Islands. Utilizing the current technology of digital switching and fiber optic cable to provide voice services, the network will also be capable of providing sufficient bandwidth for evolving data and video broadband communications needs for the foreseeable future. SIC's network is being placed underground to ensure maximum reliability, survivability, and security. Emergency and first responder communications services are intended to remain available barring a direct attack on the network. Each island has a host/remote switching platform for voice services, ensuring continued local calling, even in the event of island isolation.

Utility regulators have long employed[9] or relied on the "used-and-useful" test to determine whether a particular asset belonging to a utility should be included in or excluded from a company's rate base. In the typical ratemaking scenario, if a regulator disallowed an asset as not being used and useful, then the company could not recover, through its rates, the capital that it had invested in that particular asset. In addition, the utility would not be able to earn a return on that investment. The result of such a regulatory disallowance could be summarized as denying the utility a return of, and on,

[9] An oft-cited example in case law is found in *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 308-09 (1989): "To the extent utilities' investments turn out to be bad ones (such as plants that are canceled and so never used and useful to the public), the utilities suffer because the investments have no fair value and so justify no return."

its investment in that particular asset. Stated differently, the rationale for "used-and-useful" is that costs borne by ratepayers[10] should be directly related to benefits derived.

It would appear that NECA is subscribing to the theory that a carrier is able to add to its capacity in very small increments, so that it is able to increase its capacity in an amount equal to, or at least close to the case of one customer at a time. The real world diverges from this type of economic theory. In the instant case of SIC, the carrier gets "one shot" at a major upgrade of this type. Due to its harsh and insular operating environment, SIC is forced to add the needed capacity in a "lumpy" manner[11] as it is not possible or practical to add to its capacity in tiny, measured increments. Thus, it is possible for the uninformed to perceive that this new capacity gives the company more capacity than it needs for immediate purposes. And just as importantly, this presumes the capacity/infrastructure that is needed is physically located where it is needed to provide service. If that were the case in the ocean between and on each of the outer islands, SIC management and the RUS obviously would not have seen the need to complete a statewide transport network to connect the HHL.

In their writings on the topic of lumpy capacity investment[12], Baumol and Sidak offer some commentary that we believe is relevant to the circumstances for Sandwich Isles:

[10] In developing the Part 65 rules, the Commission cited its 1987 Docket No. 191929 with regard to the meaning of "used and useful" by explaining that it requires property that is necessary to the efficient concept of a utility's business in the present period or within a reasonable period of time.
[11] A standard working definition of "lumpy" occurs if the technological attributes of the item means that there is a capacity level of L, such that capital of the type in question is not available with capacity lower than L, or such that lower capacity capital is so costly as to make it unattractive or impractical. A lumpy investment is typically only available to the company on a substantial scale.
[12] Baumol, William J. and Sidak, J. Gregory; *The Pig in the Python: Is Lumpy Capacity Investment Used and Useful?*, 2002. At that time, Baumol was a Professor of Economics, New York University and Senior Research Economist and Professor Emeritus, Princeton University. Sidak was the F.K. Weyerhaeuser Fellow in Law and Economics Emeritus, American Enterprise Institute for Public Policy Research.

> Where an investment is lumpy, one cannot legitimately infer from the existence of excess capacity alone that the investment is not "used and useful." The excess capacity that is characteristic at the time of inauguration of lumpy plant or equipment **is** useful – indeed, it is **in use**. The purpose of that investment may not be to produce output immediately, although that may happen. Rather, the investment is intended to smooth the course of adaption of plant capacity to the expected intertemporal trajectory of demand and, in that process, to keep down cost to the customer. In that role, the excess capacity **is** currently used. When investment is lumpy, such capacity is not only used and useful; it is an inescapable part of the requirements for efficiency in the investment and production process. A regulator's failure to recognize this role of new capacity can ultimately harm the customer. (**emphasis** in original)

<u>NECA's action to remove prudent costs is poor public policy</u>

At the time that the Paniolo lease process was initiated, there were not satisfactory alternatives available to SIC at a reasonable price point. A prudent carrier must analyze both the short term costs as well as the price over the longer term. Price comparisons must also compare similar service attributes. In the case of deep ocean transport, prudent planning[13] requires that the unique challenges of undersea infrastructure are fully recognized. Making small "annual updates" to undersea capacity is not possible or even practical, and certainly not cost effective.

When the regulatory discussion includes a debate over what is used and useful, a companion discussion of what is prudent investment often follows. At present, NECA has not provided a written definition or set of procedures that provides a set of rules for carriers to follow as to what constitutes prudent investment for purposes of traffic sensitive pool settlements. And realistically, a local assessment of need and necessity, or what constitutes prudent investment, is a legitimate management responsibility that should not be relegated to an administrative group in New Jersey. The Hawaii Public

[13] As noted in SIC's Petition in this docket, the incremental cost of the additional capacity in dispute is only a few percentage points of the total lease cost.

Utilitiy Commission, in the course of reviewing each ETC annually in preparation for authorizing continuation of Universal Service Fund support, is presented with 2 years of budgetary construction plans that allow the "local" regulatory body opportunity to challenge investment that may not be deemed prudent.

However, to complete the academic discussion the most common definition in industry literature[14] of what constitutes prudent investment is that costs that were reasonable at the time they were incurred, given the circumstances and what was known or knowable at the time, are to be included in rates. This provides the utility with an opportunity to recover these costs.

NECA's arbitrary actions have a deleterative impact on rural industry lenders

Costly and difficult construction coupled with limited revenues due to Hawaii's small population make it extremely difficult for SIC to find financing for its infrastructure projects. Lenders must be comfortable relying almost exclusively on federal USF and interstate access revenues for the repayment of infrastructure loans extended to SIC. Convincing a lender to rely on a program whose level of support is renewed annually for repayment of a loan that requires twenty to thirty years of payments is challenging at best and usually unsuccessful. Congress recognized the seriousness of this challenge when it separated "insular" areas in the Telecom Act. Without rules that result in "sufficient and predictable" revenue sources for insular areas, the communications infrastructure necessary to ensure a universal level of service to citizens living in insular areas cannot be built.

[14] See for example, *An Economic and Legal Perspective on Electric Utility Transition Costs*, The National Regulatory Research Institute, July 1996, page 50.

THE COMMISSION SHOULD GRANT THE RELIEF REQUESTED BY SIC

We concur with a statement made on page 2 of the August 12 filing entered by the Alaska Telephone Association in this proceeding, where it supports SIC's stance that:

"*decisions by NECA to disallow pool costs should not be made without a full opportunity for the member to demonstrate the justification for the costs or an opportunity to make adjustments. Additionally, there must be timely notice of adverse decisions so that diminished revenue streams do not effect operations to the detriment of customers of a carrier of last resort.*"

A unique set of circumstances drive the need for long-term availability of pooled cost opportunities for SIC. As a starting point, SIC's service obligation results from an Act of the U.S. Congress, i.e. passage of the Hawaiian Homes Commission Act in 1921. SIC plays a key role in the development of HHL, which is a mandate of the Act. New HHL subdivisions will continue to be developed by the State of Hawaii for many years to come in fulfillment of its trust obligations.

Critically important revenue streams are requisite to the continued deployment of modern communications infrastructure throughout America. In fact, without "sufficient and predictable" funding, it would be impossible for SIC to fulfill the mandate of the Telecom Act of 1996, which established the principle in Section 254(b)(3) that "consumers in rural, insular, and high cost areas should have access to telecommunications and information services at rates that are reasonably comparable to rates charged for similar services in urban areas."

Respectfully submitted

Via ECFS on 8/31/09

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