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Sharon Gillett
Chief, Wireline Competition Bureau
Federal Communications Commission
445 12th Street, S.W.
Washington, D.C. 20554

Re: Sandwich Isles Communications, Inc.
Petition for Declaratory Ruling
WC Docket No. 09-133

Dear Ms. Gillett:

At our meeting of November 12, 2009 Sandwich Isles committed to providing additional information regarding the factual basis upon which NECA made its decision to disallow Sandwich Isles' 2009 network lease costs. The information and NECA's recent *ex parte* notice[1] and data requests to Sandwich Isles lend strong support to the conclusion that NECA acted arbitrarily and should be directed to include the actual lease costs in Sandwich Isles' pooled revenue requirements. If NECA's arbitrary action is not reversed, Sandwich Isles will suffer irreparable harm which may result in bankruptcy.

From 2000 until May 2009, NECA was aware of the fact that Sandwich Isles' intent was to have access to a separate inter-island network under its control, was aware of the order of magnitude of the costs involved and twice gave assurances that the costs would be included in Sandwich Isles' settlements.[2] NECA was also aware that Sandwich Isles was in the process of upgrading and expanding its terrestrial facilities, and included those costs in Sandwich Isles' settlements, even though those costs were at a level not materially different from the cost level of the terrestrial portion of the Paniolo lease, which represent 55% of the total. In 2008 NECA

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1 Letter from Joe A. Douglas, NECA to Marlene Dortch, FCC, Nov. 25, 2009.

2 Sandwich Isles provided information to NECA that because of the extremely poor and/or non-existent transport available a separate terrestrial and undersea fiber optic network was necessary to bring an adequate level of service to HHL and that RUS supported this decision. NECA, for a period of thirteen years, eight of which involved the engineering, permitting, and construction phase of the Paniolo network, never disputed or developed data to challenge this decision.

included Sandwich Isles forecasted costs for the Paniolo lease in its traffic sensitive pool rate development.

NECA notified Sandwich Isles on May 5, 2009 that it "may" not accept the pooling of Sandwich Isles' Paniolo lease costs. Less than three weeks later and without any opportunity for Sandwich Isles to comment or provide data, on May 20, 2009, NECA informed Sandwich Isles that NECA "would" exclude the undersea cable lease costs from the NECA pools and its June 16, 2009 tariff filing. NECA's conclusion to disallow the cost of the Paniolo lease, based, in part, on its belief that reasonable alternatives were available to Sandwich Isles, is a result of its failure to gather and analyze relevant and material facts and issues in this case.

Arbitrary Action

NECA's letter of May 5, 2009 abruptly swept away its previous concurrence with Sandwich Isles plans for a separate network without fully investigating and evaluating the network requirements to adequately serve the Hawaiian Homelands (HHL). If NECA had a concern as to the cost of the lease in 2007 and its effect on the pool, then it had ample opportunity and a fiduciary duty to Sandwich Isles (as a member of the NECA pool) to clearly state to Sandwich Isles and Paniolo's lender that Sandwich Isles should not rely on the pool for recovery for such costs and the reasoning.

Instead, NECA made only brief passing references to cost level issues and focused on affiliate transactions and other accounting issues. NECA never advised Sandwich Isles, or Paniolo's lender, that Sandwich Isles' current Hawaiian Telcom lease payments would be considered the proper measure of reasonableness of network lease costs. A fair reading of NECA's statements in context shows they were insufficient to reasonably put Sandwich Isles on notice that it would disallow costs of the Paniolo network. Even NECA's reliance on its April 28, 2008 letter as "putting Sandwich Isles on clear notice" and "expressing serious concerns" is misleading when two months later it included Sandwich Isles' forecasts of the Paniolo lease costs in its 2008 annual tariff filing development.

Insufficient Investigation and Review

Although NECA states it performed "extensive analysis and research to ensure that NECA acted appropriately", it appears that the input to its cost/demand analysis consisted at best of looking at present levels of demand and allowing for continuation of historical growth. One can only drive by looking exclusively in the rear view mirrors if the road is perfectly straight. Today, all the evidence, including NECA's own macro studies, indicate demand is quickly approaching the bend in a "hockey stick" pattern. In late October (five months after NECA's decision), NECA formally requested extensive demand data forecasts from Sandwich Isles, but that data is what it should have considered prior to its May 2009 decision.[3] Without analysis of

[3] In a letter dated October 22, 2009, Carol Brennan, NECA VP – Industry Relations, requested Sandwich Isles to project its demand and capacity requirements by wire center, so NECA could better consider what would represent a "Used and Useful" investment. The data Sandwich Isles' expects to submit to NECA will demonstrate that the network is "Used and

demand forecasts and an informed evaluation of the capacity requirements and the probable ability of financially weakened or bankrupt alternative providers to meet them, NECA, in May of 2009, had no adequate basis to conclude that the leased Paniolo transport facilities would not be "used and useful".

NECA's conclusion appears to have relied heavily on comparison with current prices of the other networks not on a proper "used and useful" analysis with respect to issues such as the "lumpy investment" effect of the unique circumstances in Hawaii.[4] Such analysis at a minimum would include informed demand and capacity projections and consider whether the long run interests of Sandwich Isles' customers would be served by abandoning the long standing plan to construct a separate network, which NECA itself had endorsed in 2000.

As the pricing, terms and conditions of what PLNI verbally provided to NECA have not been made a part of the docket record, neither Sandwich Isles nor the Commission can fully evaluate the reasonableness of NECA's ready acceptance of PLNI as a comparable carrier. NECA's evaluation was apparently made without any investigation of its reliability and long term availability. For example, the written quotes from PLNI to Sandwich Isles in 2002 and 2006 were significantly higher than what PLNI gave NECA, and the quote to NECA did not include connection to all the islands and did not include the terrestrial transport that represents 55% of the cost of the Paniolo network.

A recent development that also illustrates the significance of NECA's failure to fully investigate is that Time Warner Telecom is currently in discussions with Sandwich Isles for capacity on the Paniolo network. Time Warner Telecom owns half the fiber count of the undersea cable that PLNI uses to operate in Hawaii today as a CLEC and Alternative Local Transport provider. Despite this access Time Warner Telecom is looking to Sandwich Isles for inter-island transport. Similarly, there is further evidence that NECA incorrectly believed that Sandwich Isles could rely on Hawaiian Telcom for transport. Hawaiian Telcom has recently come to Sandwich Isles to inquire about Sandwich Isles' network capacity.[5]

Sandwich Isles has shown how Hawaiian Telcom's capital structure has not permitted it to devote capital to construction of necessary transport facilities. This fact has now been further

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Useful" and will provide needed bandwidth to HHL and, in the interim, to 7 other carriers, including Hawaiian Telcom and Time Warner Telecom.

[4] In its comments filed August 31, 2009, Hawaiian Telcom presented an affidavit by Daniel Masutomi stating that Hawaiian Telcom transport facilities have sufficient capacity for Sandwich Isles current requirements and a substantial number of additional customers, but did not state what assumptions, if any, it had made with respect to per subscriber growth. . Hawaiian Telcom's comments claimed it currently has 200 Gbps capacity, but provided no information as to its own current demand or future demand forecast. Sandwich Isles filed information indicating that total demand for Hawaii will be significantly above that capacity in the future.

[5] Sandwich Isles has previously noted that that Hawaiian Telcom's 2007 USF waiver petition illustrates the limitations on its financial capability to expand its capacity to deliver broadband services to its own or Sandwich Isles' service areas.

validated by testimony in the Hawaiian Telcom bankruptcy proceeding. In the course of hearings before the bankruptcy court, Hawaiian Telcom sought to establish the value of the carrier through the testimony of J. Nicholas Melton, Managing Director, Lazard Freres & Co., LLC. Mr. Melton's direct testimony comparing Hawaiian Telcom's financial strength with that of comparable ILECs includes the following statements relevant to Hawaiian Telcom's inability to undertake construction of major transport facilities (or any other major investment):

> "Lazard believes EBITDA less Capex is highly relevant in this case given Hawaiian Telcom's significantly lower ability to generate free cash flow as compared to its peers."
>
> "Hawaiian Telcom's EBIDTA margins are the lowest of the group and its network requires a persistently high level of Capex as a percentage of revenue, …. (pp 12-13)[6]

The witness for the secured creditors, Christopher Wilson of Houlihan Lokey Howard and Zukin Capital, Inc. had similar comments with respect to Hawaiian Telcom's severe financial constraints:

> "In order to determine the appropriate multiples to use for the Relevant Metrics to determine the valuation for Hawaiian Telecom, as is standard, we performed a risk assessment analysis to determine how risky the relative financial and operational performance of Hawaiian Telcom as compared to the Comparable Companies. We concluded that Hawaiian Telcom is the worst performing company (in terms of financial and operating metrics) of all Comparable Companies. Specifically, based on our risk assessment analysis, set forth below, *Hawaiian Telcom finished dead last or in the bottom half in every one of 9 relevant quantitative categories…."*[7]

<u>Consistency and Furtherance of National Broadband Plan envisioned by the FCC</u>

The FCC National Broadband Plan Task Force has underscored the critical importance of the Paniolo network. In its September 29, 2009 status report, page 9, the Task Force asserts that broadband enables innovations that will advance solutions to national priorities, including health care, education, energy, public safety, and job creation. The report further states on pages 36-38 that network performance levels (broadband speeds) are substantially driven by how deeply fiber has been driven into the network. Sandwich Isles has invested in rural Hawaii fiber infrastructure, because its goal is to deliver broadband services and their concomitant benefits to residents of the HHL.

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6 Testimony of J.N. Melton, Dkt. #1358, U.S. Bankruptcy Ct., Hawaii, filed November, 3, 2009, pp. 11-12 (<u>emphasis added</u>).

7 Testimony of Christopher Wilson, Dkt. #1358, U.S. Bankruptcy Ct., Hawaii, filed November 3, 2009, p. 30 (<u>emphasis added</u>).

Time is of the essence. Sandwich Isles cannot continue indefinitely without appropriate recovery of its costs of providing service. Sandwich Isles therefore requests the Commission to act promptly and favorably on its Petition with an order that recognizes the need for adequate, modern and reliable inter-island and terrestrial transport if rural Hawaiians are to participate in the telecommunications and information revolution that the National Broadband Plan will foresee.

Sincerely Yours

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