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

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

DECLARATORY RULING

Adopted: September 29, 2010 **Released: September 29, 2010**

By the Chief, Wireline Competition Bureau:

I. INTRODUCTION

1. In this order, we consider whether certain cable lease costs incurred by Sandwich Isles Communications, Inc. (Sandwich Isles) may be recovered through the National Exchange Carrier Association (NECA)[1] pooling process, which is an averaging mechanism to smooth out rates for small carriers over a larger base of costs and revenues.[2] Balancing the unique facts and circumstances at issue here, we determine that some—but not all—of those lease costs are properly recoverable consistent with Commission rules and precedent.

II. BACKGROUND

2. Sandwich Isles provides telephone service to a study area consisting of most of the Hawaiian Home Lands (HHL).[3] Sandwich Isles began operations in 1997, and was licensed by the Department of Hawaiian Homelands to construct and operate a modern telecommunications network serving the HHL.[4] Sandwich Isles functions as an incumbent local exchange carrier (incumbent LEC) for access charge and universal service purposes[5] and has approximately 2,000 access lines.[6]

3. On February 3, 1998, the Common Carrier Bureau (Bureau) granted Sandwich Isles a waiver of section 36.611 of the Commission's rules to the extent necessary to permit it to receive high-cost loop

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[1] NECA is an intra-industry, not-for-profit corporation charged by the FCC with administering the FCC's interstate access charge system and associated revenue pools. *See* NECA Comments at 4. *See also* NECA Comments, at 4-8 (describing NECA's duties pursuant to FCC rules and regulations).

[2] Petition for Declaratory Ruling of Sandwich Isles Communications, Inc., WC Docket No. 09-133, at 1 (filed June 26, 2009) (Petition).

[3] The HHL, created by Congress in 1921 for the benefit of native Hawaiians, consists of a total of 203,000 acres in seventy non-contiguous areas. Ninety-eight percent of this area, which is spread out over the six major islands of Hawaii, is rural. *See* Sandwich Isles Comments at 1-2. Sandwich Isles is licensed by the Department of Hawaiian Home Lands (DHHL) and is subject to regulation by the Hawaii Public Utilities Commission (HPUC). *See* Petition at 2.

[4] Sandwich Isles Comments at 2.

[5] *See* Petition at 1.

[6] *See* Letter from Donna Epps, Vice President, Federal Regulatory, Verizon, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 09-133 at 2 (filed Aug. 26, 2010) (Verizon Aug. 26, 2010 *Ex Parte* Letter).

support for a period of time based on projected costs.[7] In addition, the Bureau waived the incumbent LEC requirements of Part 36 and 69 of the Commission's rules to permit Sandwich Isles to receive high-cost support based on its costs and to become a member of NECA.[8] The Bureau recognized Sandwich Isles' service territory in Hawaii as a study area.[9]

4. In March 1998, GTE Hawaiian Telephone Company Inc. (GTE) filed an Application for Review of the Bureau's decision.[10] On October 29, 2004, the Commission granted GTE's petition, requiring Sandwich Isles to "seek and obtain a study area waiver in order to be treated as an incumbent LEC for purposes of receiving universal service support."[11] Sandwich Isles timely filed its study area waiver petition, which the Bureau[12] granted for those areas of the HHL that it found were unserved by GTE in 1997.[13] Additionally, the Bureau noted that Sandwich Isles planned to use funding from the Rural Utilities Service (RUS) to finance new construction that included additional switching facilities, DSL equipment, local outside distribution facilities, and completion of a terrestrial underground fiber network.[14] However, RUS rescinded its approval of loan funds, and Sandwich Isles sought alternative financing.[15]

5. In mid 2007, Sandwich Isles indicated to NECA that it was considering a finance lease arrangement with another entity, Paniolo, LLC, which would obtain financing to build an inter-island network that would be leased to Sandwich Isles.[16] Additionally, Sandwich Isles advised NECA at this

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[7] *See Sandwich Isles Communications, Inc., Petition for Waiver of Section 36.611 of the Commission's Rules and Request for Clarification*, AAD 97-82, Order, 13 FCC Rcd 2407, 2411, para. 11 (Com. Car. Bur. 1998).

[8] *See id.* at 2413, para. 15.

[9] *See id.*

[10] *See* GTE Hawaiian Telephone Company, Inc. Application for Review of an Order Granting in Part a Petition for Waiver by Sandwich Isles Communications, Inc., AAD 97-82, at 1 (filed Mar. 5, 1998) (Application for Review).

[11] *GTE Hawaiian Telephone Company, Inc., Application for Review of a Decision by the Common Carrier Bureau, Petition for Waiver of Section 36.611 of the Commission's Rules and Request for Clarification*, AAD 97-82, Memorandum Opinion and Order, 19 FCC Rcd 22268, para. 1 (2004).

[12] The Common Carrier Bureau became the Wireline Competition Bureau in 2002 as part of organizational changes at the Commission. *See generally Establishment of the Media Bureau, the Wireline Competition Bureau and the Consumer and Governmental Affairs Bureau*, Order, 17 FCC Rcd 4672 (2002). The term "Bureau" in this order refers to the Common Carrier Bureau prior to the reorganization, and to the Wireline Competition Bureau after the reorganization.

[13] *See Sandwich Isles Communications, Inc., Petition for Waiver of the Definition of "Study Area" Contained in Part 36, Appendix-Glossary and Sections 36.611 and 69.2(hh) of the Commission's Rules*, CC Docket No. 96-45, Order, 20 FCC Rcd 8999, 8999-9000, para. 1 (Wir. Comp. Bur. 2005) (*Study Area Waiver Order*). On June 15, 2005, Hawaiian Telcom filed an application for review of the Bureau's order, which remains pending. Hawaiian Telcom Communications, Inc. Application for Review, CC Docket No. 96-45 (filed June 15, 2005).

[14] *See id.* at 9004, para. 11.

[15] *See* Petition at 2; *see also* Sandwich Isles Comments at 10-11.

[16] *See* Sandwich Isles Comments at 6; *see also* NECA Comments at 9. The Paniolo cable network "is approximately a 358 mile undersea and overland fiber optic cable system linking the islands of Kauai, Oahu, Molokai, Maui and Hawaii in the State of Hawaii. The Paniolo network consists of four (4) Undersea Components and six (6) Overland Components, including but not limited to beach landings, terminal buildings and central office electronics." Sandwich Isles Comments at 17.

time of its intention to include the new cable lease costs in its NECA cost submissions.[17] NECA and Sandwich Isles subsequently discussed a number of factors bearing on the extent to which the lease payments could be included in NECA's cost study.[18] Sandwich Isles ultimately entered the lease agreement, and its base lease costs currently are $15 million annually.[19]

6. In early 2008, Sandwich Isles submitted its cost forecast for the 2008 NECA tariff and included six months of the Paniolo cable lease cost.[20] In April 2008, NECA sent a letter to Sandwich Isles expressing "serious concerns about the amount of the proposed costs and requesting specific details of the proposed cable system."[21] On May 5, 2009, NECA notified Sandwich Isles that the costs for the undersea cable transaction "do not appear to meet the standards of the 'used and useful' doctrine"[22] and that NECA might not accept Sandwich Isles' proposed costs in the upcoming tariff filing or for pool reporting.[23]

7. On May 18, 2009, NECA, Sandwich Isles and members of the Bureau's Pricing Policy Division and Telecommunications Access Policy Division met to discuss issues related to the proposed costs.[24] At the meeting, Sandwich Isles asserted that the costs were reasonable under the circumstances and that the costs allocated to the NECA pool would be offset by increasing transport revenue over the next few years.[25]

8. On May 20, 2009, NECA formally notified Sandwich Isles by letter of its decision not to include the disputed costs in the upcoming tariff filing or for NECA pool reporting.[26] In response, on June 26, 2009, Sandwich Isles filed a petition requesting that the Commission issue a declaratory ruling

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[17] *See* NECA Comments at 9.

[18] *See* Sandwich Isles Comments at 6. NECA states that, at Sandwich Isles' request, it also spoke with a consultant hired by Deutsche Bank, which was financing the construction, and advised the consultant that it had not approved the inclusion of the lease costs in the NECA pool. *See* NECA Comments at 10.

[19] *See, e.g.*, Letter from Megan Strand, counsel for Sandwich Isles, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 09-133 at 3 (filed June 4, 2010) (Sandwich Isles White Paper). These base lease costs increase over time, *see id.* at 12, and Sandwich Isles also is responsible under the lease for maintenance and insurance costs. Sandwich Isles Comments at 17; Letter from Dana Frix, counsel for Sandwich Isles, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 09-133 at 1 (filed Aug. 27, 2010) (Sandwich Isles Aug. 27, 2010 *Ex Parte* Letter) (discussing engineering, operating, and maintenance costs associated with the Paniolo cable network).

[20] *See* Sandwich Isles Comments at 7; *see also* NECA Comments at 10.

[21] NECA Comments at 10.

[22] Sandwich Isles Comments at 7-8.

[23] *See* NECA Comments at 11.

[24] *See id.* at 11-12.

[25] *See* Petition at 3.

[26] *See* NECA Comments at 12. According to Sandwich Isles, NECA "accepted the first six months of the lease payment and provided settlements to Sandwich Isles for the period beginning January 1, 2009." Petition at 3. NECA explains that "[it] 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. " NECA further explains, however, that it expected that this lease of capacity would terminate sometime in 2009, and that NECA has allowed the Hawaiian Telcom lease costs to stay in the tariff filing until it can finally be determined what amount of payments for the Paniolo cable lease reasonably satisfy the "used and useful" standard. NECA Comments at n.42 (emphasis added).

that certain circuit lease expenses incurred by Sandwich Isles for the inter-island submarine cable system are "used and useful."[27] The petition further requested that the Commission direct NECA to accept all of the lease costs for inclusion in, and settlement from, its traffic-sensitive pool.[28] On July 27, 2009, the Bureau issued a pubic notice seeking comment on the petition.[29]

III. DISCUSSION

9. As discussed below, we do not find 100 percent of Sandwich Isles' lease expenses per se "used and useful" and appropriate for inclusion in the NECA pool. Nor do we find NECA's determination not to include the lease costs in its pool unreasonable as a matter of that entity performing its role in the pooling process. In determining what percentage of the lease expenses should be included in the NECA pool, we note that the Commission has flexibility itself to consider a variety of equitable factors beyond current actual usage in evaluating the costs that are "used and useful" and appropriate for inclusion in the revenue requirement. Based on that analysis and relevant Commission precedent, as applied to the unusual facts here, we find that 50 percent of Sandwich Isles' lease expenses subject to dispute should be included in the revenue requirement for recovery in the NECA pool.[30] In addition to applying this decision going forward, NECA's contract with its members allows for a 24-month period in which members may correct their filings and which also allows for a mid-course correction, enabling the implementation of this decision for the 2009 and 2010 tariff periods.

A. The Commission Did Not Previously Approve Inclusion of the Entire Lease Costs

10. As a threshold matter, we reject Sandwich Isles' contention that the Commission already has held that 100 percent of its lease costs should be included in the NECA pool.[31] The Bureau- and Division-level orders cited by Sandwich Isles in this regard do not support its claims. For example,

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[27] *See* Petition at 1.

[28] *See id.*

[29] *See Comments Sought on Petition for Declaratory Ruling of Sandwich Isles Communications, Inc.*, WC Docket No. 09-133, Public Notice, 24 FCC Rcd 9386 (Wir. Comp. Bur. 2009) (*Public Notice*). Comments were filed by Sandwich Isles, NECA, the Alaska Telephone Association, GVNW Consulting, Inc., Hawaiian Telcom, Inc. and Verizon. Reply comments were filed by Sandwich Isles, NECA, AT&T Inc. and Hawaiian Telcom, Inc. The Bureau also granted a request from Sandwich Isles and NECA for the adoption of a Protective Order in this proceeding. *Sandwich Isles Communications, Inc. Petition for Declaratory Ruling*, WC Docket No. 09-133, Protective Order, 24 FCC Rcd 11004, 11004, para. 2 (Wir. Comp. Bur. 2009).

[30] The lease expenses subject to dispute would include the costs for Sandwich Isles to lease the Paniolo cable network each year, including the maintenance and insurance costs Sandwich Isles is responsible for under the terms of the lease agreement, to the extent that they are not attributable to actual usage of the cable. *See* Sandwich Isles Comments at 17. We also include certain engineering costs associated with the Paniolo cable network. Sandwich Isles Aug. 27, 2010 *Ex Parte* Letter at 1 (discussing the engineering costs). For example, we exclude from the lease expenses subject to dispute here those expenses related to the actual usage of the Paniolo cable network for the provision of services covered by the NECA tariff, 100 percent of which already would be included in Sandwich Isles' revenue requirement even absent this order. *See infra* para. 18 (noting the $1.9 million included in the pool). Likewise, in the future, the lease expenses subject to dispute would exclude those expenses associated with actual usage of the cable to provide services not encompassed by the NECA tariff, including, among other things, non-regulated services and intrastate services. . *See, e.g.*, Sandwich Isles Comment at 21.

[31] *See* White Paper of Sandwich Isles Communications, Inc. in Support of Inclusion of its Undersea able Costs in the NECA Pool, WC Docket No. 09-133 (filed June 3, 2010) (Sandwich Isles White Paper) at 20-25.

although the Division granted a waiver to allow Sandwich Isles to participate in the NECA pool,[32] it did not find that it is in the public interest to include all of the cable leasing costs in the NECA revenue requirement; at best, this decision is an initial determination that Sandwich Isles, as a small, new carrier providing service to a previously unserved area, would benefit from participation in the NECA pool as a general matter. Further, Sandwich Isles' claim that the Bureau found that building the cable was in the public interest, and by extension, that the attendant costs are prudently incurred and "used and useful," is incorrect.[33] The public interest analysis in that context was focused more generally on whether the public interest would be served by extending service to that area and its people.[34] Thus, contrary to Sandwich Isles' contention, the Bureau did not approve the eventual costs of Sandwich Isles' network for inclusion in the NECA pool.[35] In sum, Sandwich Isles' arguments misconstrue the Commission's actions with regard to those waiver decisions; the analyses for deciding study area waivers and requests to join the NECA pool do not traditionally, and did not in this case, include a determination of what costs should ultimately be allowed in Sandwich Isles' revenue requirement.

B. Used and Useful Analysis

11. Because the Commission has not previously decided the appropriate amount of Sandwich Isles' lease costs to be included in the revenue requirement under the "used and useful" analysis or otherwise, we now consider the application of the "used and useful" test to the facts and circumstances here, consistent with Commission precedent.

1. Used and Useful Precedent

12. The "used and useful" standard provides the foundation of Commission decisions evaluating whether particular investments can be included in a carrier's revenue requirement. Property is considered "used and useful" for regulatory ratemaking if it is "necessary to the efficient conduct of a utility's business, presently or within a reasonable future period."[36] There are several elements of the Commission's analysis whether property is "used and useful." First, the Commission considers the need

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[32] *Sandwich Isles Communications, Inc., Petition for Waiver of Section 36.611 of the Commission's Rules and Request for Clarification,* 13 FCC Rcd 2407, 2412, para. 13 (Acctg. Aud. Div. 1998) ("because [Sandwich Isles] plans to make large capital investments to initiate service, its company-specific rates would likely be extremely high . . . [and therefore] it is in the public interest to permit [Sandwich Isles] and its potential customers to benefit from both the cost savings and lower rates available through NECA participation").

[33] *See* Sandwich Isles White Paper at 25.

[34] "The public interest is served . . . because of the significant investment *to provide service in areas and to customers that did not previously have service.*" *Study Area Waiver Order*, 20 FCC Rcd at 9007, para. 19 (emphasis added). Indeed, in addressing a concern raised by a commenter about the study area waiver and its contention that there were other providers that would be able to maximize the use of high cost support to provide service to these areas, the Bureau stated "[w]e find that the fact that GTE (later Verizon) may have had authority to serve the Hawaiian home land does not demonstrate that it is not in the public interest to grant a study area waiver to [Sandwich Isles] . . . the record is clear that GTE was not offering service throughout much of [that area]." *Id.* at 9008, para. 21.

[35] Sandwich Isles' contention that the Commission repudiated any notion that the submarine cable costs were unreasonably high is equally unsupportable. Sandwich Isles White Paper at 23-24. The specific language cited for this claim appears in the first paragraph of the *Study Area Waiver Order*, and merely summarizes the Bureau's action in that order; *i.e.,* the Bureau was only deciding whether to grant a study area change. *Study Area Waiver Order*, 20 FCC Rcd at 8999-9000, para. 1.

[36] *American Tel. and Tel. Co.*, Phase II Final Decision and Order, 64 FCC 2d 1, at 38, para. 111 (1977) (*AT&T Phase II Order*).

to compensate the utility's owners for the use of their property in providing public service.[37] Second is the equitable principle that ratepayers should not be forced to pay a return except on investments that can be shown to benefit them.[38] Finally, the Commission considers whether a carrier's investment was prudent,[39] and whether the benefit from the investment will be realized in a reasonable period of time.[40] Although the Commission has identified general principles regarding what constitutes "used and useful" investment to be included in a carrier's revenue requirement, it has recognized "that these guidelines are general and subject to modification, addition or deletion. The particular facts of each case must be ascertained in order to determine what part of a utility's investment is used and useful."[41]

13. As a threshold matter, plant currently used for the provision of regulated services generally is recognized to be "used and useful." In adopting rules to govern cable rate regulation in 1996, for example, the Commission adopted a "used and useful standard together with the prudent investment standard" that was "the same as that which the Commission has applied to telephone companies."[42] In that order, the Commission "clarif[ied] that used and useful plant is plant that is actually used to send signals to customers. Plant which is not currently used and useful, however, is excess capacity."[43]

14. On occasion in the past, the Commission has treated investments beyond plant currently used for the provision of regulated services as "used and useful" based on equitable considerations. The Commission has stated that "[t]he question of what property falls within the definition of used and useful has no rigid, economic answer and depends upon the balance of equities in each situation."[44] For

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[37] *See id.*

[38] "Equally central to the used and useful concept, however, is the equitable principle that the ratepayers may not fairly be forced to pay a return except on investment which can be shown directly to benefit them. Thus, imprudent or excess investment, for example, is the responsibility and coincident burden of the investor, not the ratepayer." *Id.* at 38, para. 112. The benefit, however, does not have to be immediate and can include, for example, a portion of equipment that is serving as a reserve for future use. *See, e.g., Investigation of Special Access Tariffs of Local Exchange Carriers*, FCC 86-52, 1986 WL 291617, para. 41 (1985) (*Phase I Special Access Tariffs Investigation Order*), *remanded on other grounds, MCI Telecom. Corp. v. FCC*, 842 F.2d 1296 (D.C. Cir. 1988).

[39] *See, e.g., 1990 AT&T Tariff Revisions Order*, 5 FCC Rcd at 5695, at para. 17 (citations omitted).

[40] *AT&T Phase II Order,* 64 FCC 2d at 38, para. 113 ("The phrase 'presently or within a reasonable future period' in the denotation of 'used and useful' 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 to serve as a reserve for currently used investment.").

[41] *AT&T Phase II Order*, 64 FCC 2d at 39, para. 114.

[42] *Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation; Adoption of a Uniform Accounting System for Provision of Regulated Cable Service, Second Report and Order, First Order on Reconsideration, and Further Notice of Proposed Rulemaking*, 11 FCC Rcd 2220, 2235-36, para. 33 (1996).

[43] *Id.* at 2236-37, para. 36. In that context, the Commission allowed inclusion of costs only for fully constructed plant that will be used to provide regulated service within 12 months, although it does not appear to have so limited the inclusion of costs related to other services. *See, e.g., 1977 AT&T Rate Order,* 64 FCC 2d at 38, para 113 (stating that the question of what length of time constitutes "the near future" for purposes of determining whether investment is "used and useful" "has no strict, economically sound answer," and "is thus subject to Commission judgment and discretion, and depends upon the particular circumstances of each case").

[44] *Phase I Special Access Tariffs Investigation Order* at para. 37, *See also Establishing Just and Reasonable Rates for Local Exchange Carriers, Notice of Proposed Rulemaking,* 22 FCC Rcd 17989, 17997 n.47 (2007) (noting that (continued....)

example, in one such case, the Commission determined that a portion of the cost of polyethylene shielded video (PSV) cable that was not then being used to provide video services, and indeed had never been used, was nevertheless partially eligible for inclusion in the rate base. In balancing the equities between the interests of carriers and ratepayers,[45] the Commission found that "video service customers have benefitted to some degree from [the] decision to include PSV cable in composite sheaths," and that this benefit justified limiting the disallowance to 50 percent of the investment in question.[46]

15. In another case, the Commission approved the inclusion of the cost of Comsat satellites that failed to achieve orbit or malfunctioned in space. Specifically, the Commission found "under the peculiar circumstances of this case, where Comsat's mission was the commercial exploitation of this new satellite technology that the costs of satellites that failed to achieve proper orbit and satellites that malfunctioned in orbit can be properly included in the rate base."[47] It further found that the cost of Comsat's spare satellites could be included in the rate base because they provided customers with greater assurance of continuity of service in the event of a malfunction of on-line equipment.[48]

16. The Commission has also allowed costs to be included in the revenue requirement to address inequities or avoid complications and burdens. Explaining that the cost of materials and supplies held for long-term construction projects are usually excluded from the rate base, the Commission in a rulemaking proceeding made an exception to allow such costs to be included, in part based on the relatively small (less than a tenth of a percent) impact to the rate base.[49] Thus, this Commission may, in its reasonable discretion, fashion an appropriate resolution that is tailored to the specific circumstances before it.[50]

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under the "used and useful" and prudent investment standards, "the Commission examines whether the expense promotes customer benefits, or is primarily for the benefit of the carrier").

[45] *Phase I Special Access Tariffs Investigation Order* at para. 36.

[46] *Id.* at para. 41. The Commission also found that the disallowance should be limited because a certain amount of the excess cable not physically in use was actually serving as a reserve. *Id.*

[47] *Communications Satellite Corporation, Investigation Into Charges, Practices, Classifications, Rates, and Regulations,* 56 FCC2d 1101 at para. 93 (1975) (*Comsat*). *See also Phase I Special Access Tariffs Investigation Order* at para. 41 n.67 (characterizing the *Comsat* decision as allowing recovery of certain investments on the "basis of Comsat's pioneering mission in commercial exploitation of satellite technology").

[48] *Id.* at para. 94; *see also id.* at para. 347 (explaining that it included in the rate base "failed satellites and launches in addition to property 'used and useful' in providing service . . . in furtherance of recognized regulatory principles").

[49] *Amendment of Part 65 of the Commission's Rules to Prescribe Components of the Rate Base and Net Income of Dominant Carriers, Order on Recon,* 4 FCC Rcd 1697, 1701-02, paras. 42-47 (1989) (also noting that this resolution was consistent with the goal of simplifying the rate base and "produce[d] a result that is equitable to both investors and ratepayers.").

[50] *See, e.g,. American Telephone and Telegraph Co., et al., 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 Cambride, Mass. and Washington, DC, with extension lightguide cables to arious cities along this route,* File No. W-P-C-3071, Memorandum Opinion, Order and Authorization, 84 FCC 2d 303, para. 32 (1981) (*AT&T LightGuide Cable 214 Order*) (acknowledging that rate matters "involve a great deal of judgment," and concluding that expenditures were "justifiable in the long run and will serve the public convenience and necessity"). Moreover, courts typically defer to the Commission's discretion on rate-related determinations. *See, e.g., Illinois Bell Tel. Co. v. FCC,* 911 F.2d 776, 780 (D.C. Cir. 1990), *rem. on other grounds, Amendment of Part 65 of the Commission's Rules of [sic] Prescribe Components of the Rate Base and Net Income of Dominant Carriers,* 7 FCC Rcd 296 (1991) ("In reviewing the Commission's rules for inclusion of an item in the
(continued....)

2. Application to the Particular Circumstances Here

17. Although the record reveals that only a very small portion of the capacity leased on the cable currently is in use by Sandwich Isles to provide regulated services, relying on additional equitable considerations, we find that 50 percent of the Paniolo cable network lease expenses subject to dispute[51] should be included in the revenue requirement. We make this finding based on balancing the current lack of use of the cable and a lack of substantial record evidence concerning future demand, against a number of countervailing factors, including the unique geographic conditions in Hawaii, the special role that Sandwich Isles plays in providing telecommunications services to rural areas of Hawaii, and the ability to include some spare capacity in the revenue requirement.

18. As a baseline, we note that "NECA has proposed paying [Sandwich Isles] $1.9 million a year, approximating the amount that [Sandwich Isles] was previously paying . . . to lease voice grade capacity" on another undersea cable.[52] Based on the record here, we interpret that amount as reflecting a reasonable application of the threshold "used and useful" considerations, which we ordinarily expect to be sufficient to resolve revenue requirement questions. As discussed above, however, the Commission has discretion to weigh additional equitable considerations as part of its "used and useful" analysis. We evaluate such equitable considerations below. Of particular importance, we observe the unique telecommunications infrastructure needs arising both from the geographical characteristics of Hawaii, and the special role of Sandwich Isles in particular.[53] These and other equitable considerations here, taken as a whole, justify also including in the revenue requirement a percentage of the remaining cable lease costs at issue.

19. *Unique Geographic Challenges in Hawaii.* Providers in Hawaii, such as Sandwich Isles, rely on submarine cable transmission to connect the various islands that they serve. As Sandwich Isles observes, improved route diversity historically has been viewed as a factor supporting the deployment of submarine cable,[54] and is an equitable consideration that we find particularly important in an area like Hawaii, given, for example, the depth of the ocean and associated difficulty of repairs.[55] Although there

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rate base, in a context in which we have no basis for thinking that the end result will be unjust, we inquire only into whether the agency's rules are arbitrary or unreasonable.").

[51] *See supra*, note 30.

[52] Sandwich Isles White Paper at 2, 14.

[53] We note that, in prior proceedings, Sandwich Isles has claimed that it has exclusive authority to provide service in at least portions of the Hawaiian home lands. *See, e.g., Study Area Waiver Order*, 20 FCC Rcd at 9008, para. 20. The *Study Area Waiver Order* did not expressly endorse that view in that context, and our identification in this order of a special role served by Sandwich Isles does not do so, either. However, as we note later in this order, we find that Sandwich Isles serves a unique role in its provision of service to Hawaiian home lands. *See infra*, para 20.

[54] Sandwich Isles White Paper at 29 (citing *American Telephone and Telegraph Company CICI, Inc. d/b/a IDB International; et al.*, File No. I-T-C-91-135, Memorandum Opinion, Order and Authorization, 7 FCC Rcd 445 (1992) (*TAT-10 Section 214 Order*). *See also, e.g., Phase I Special Access Tariffs Investigation Order*, para. 41 (as an equitable consideration in its "used and useful" analysis, considering the fact that particular cable was, to some extent, serving as a reserve). Sandwich Isles states that, absent its lease of the entire capacity of the cable, the Paniolo cable would not have been built. Sandwich Isles Reply at 6-7. This claim is not meaningfully disputed in the record.

[55] Sandwich Isles White Paper at 12-13. *See also* Sandwich Isles Comments at 3, 20 & Exh. 3 (describing the characteristics of Hawaii that make construction and repair of a submarine cable challenging); *id.* at 16 (observing that, in 2003, a Wavecom (then PLNI) cable was cut, and "PLNI was unable to repair the cable for 16 months.").

were two submarine cables already serving the Hawaiian Islands,[56] "[t]he Paniolo cable lands in different places than do the other two cables of HTI and Wavecom (formerly PLNI)" and thus enhances route diversity.[57] Indeed, the record reveals that Sandwich Isles recently performed precisely this function using its cable capacity on an emergency basis to restore Oceanic Time Warner's cable and Internet service, which had been affected by a service interruption on the Wavecom cable.[58]

20. *The Special Role of Sandwich Isles.* Sandwich Isles serves a unique role in its provision of service to Hawaiian home lands. Sandwich Isles was established in response to a 1994 Hawaiian law passed to improve telecommunication service in rural areas of Hawaii.[59] Sandwich Isles was designed primarily to serve Hawaiian home land areas scattered throughout Hawaii.[60] The record reveals that Sandwich Isles' creation responded to concerns about the adequacy of communications services provided in these areas, with the expectation that Sandwich Isles would offer improved service.[61] As the Department of Hawaiian Home Lands (DHHL) reports, "[Sandwich Isles'] telecommunications infrastructure and delivery of modern broadband communications" brings a number of benefits to these communities, and facilitates DHHL's efforts to award leases and develop the Hawaiian home lands.[62] Moreover, the submarine cable includes technological advances over the pre-existing cables.[63] Given Sandwich Isles' special role pursuant to federal and state law, we thus weigh these advancements in the available technology and services among our equitable considerations.[64]

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[56] Hawaiian Telcom notes that Southern Cross also operates an undersea cable, although, unlike the other cables, it does not appear to connect all of the Hawaiian islands. *See* Letter from Suzanne Yelen, counsel for Hawaiian Telcom, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 09-133 at 1-2 (filed Aug. 11, 2010) (describing the Southern Cross cable as "provid[ing] substantial service between Oahu, the Big Island, Australia, and the United States").

[57] Sandwich Isles White Paper at 29.

[58] *See generally* Letter from Dana Frix, counsel for Sandwich Isles, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 09-133 (filed July 30, 2010) (Sandwich Isles July 30, 2010 *Ex Parte* Letter). *See also* Letter from Dana Frix, counsel for Sandwich Isles, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 09-133, at 14 (filed Aug. 2, 2010) (Sandwich Isles Aug. 2, 2010 *Ex Parte* Letter).

[59] Sandwich Isles White Paper at 8.

[60] Sandwich Isles White Paper at 8; Sandwich Isles Comments at 2.

[61] *See, e.g.*, Sandwich Isles Comments at 5.

[62] Letter from Kaulana H.R. Park, Chairman, Hawaiian Homes Commission, Department of Hawaiian Home Lands, to Chairman Julius Genachowski, *et al.*, FCC, WC Docket No. 09-133, at 2 (filed Sept. 15, 2009). *See also* Sandwich Isles Comments at 20-21 & n.43.

[63] Sandwich Isles White Paper at 12 ("The HTI cable was constructed with dispersion-shifted fiber, ... More modern cables use single mode fiber and the division into wavelengths is accomplished by the electronics on the ends of the cable. Modern electronics do not work well with dispersion-shifted fiber . . . . The PLNI cable uses somewhat more modern technology than the HTI cable, but nevertheless the PLNI cable is 13 years old and only 2.5 gigabits.").

[64] Sandwich Isles cites certain submarine cable precedent for the importance in weighing advances in technology. *See* Sandwich Isles White Paper at 30 (citing *TAT-10 Section 214 Order*, 7 FCC Rcd at 447, para. 20). As the Commission has found, however, "[a]lthough technological innovation[s] . . . are factors in considering the need for new cable facilities, these factors, standing alone, rarely are of decisional significance." *AT&T, MCI Int'l, et al.*, File No. SCL-91-001, Cable Landing License, 7 FCC Rcd 130, 132, para. 17 (1992) (*TAT-10 Cable Landing License Order*). And although Sandwich Isles argues for consideration of the role in advancing technology, it (continued....)

21. *Inclusion of Spare Capacity.* Once the decision was made to deploy the cable, we find that it was logical here to include some spare capacity in the cable, given the relatively small increase in cost to include the additional capacity[65] as compared to deploying an entirely new cable in the future. Particularly given the significant costs of deploying facilities in an environment like the Hawaiian Islands, some spare capacity can be included in the Sandwich Isles' revenue requirement.[66] We note that NECA argues that "there are substantial questions whether the capacity of the proposed lease is necessary to serve Sandwich Isles' reasonably foreseeable demand for regulated services,"[67] and that inclusion of those costs in the revenue requirement would violate the "used and useful" principle that ratepayers are charged only for investments that benefit them.[68] As NECA recognizes, however, some recovery for spare capacity can be reasonable.[69] We agree, and as part of our equitable balancing, we consider the reasonableness of including spare capacity once the decision was made to deploy the cable. Unduly limiting cost recovery solely to the percentage of cable capacity actually used by Sandwich Isles in the provision of regulated services today might deter other carriers from deploying spare capacity in the future, even when otherwise reasonable to do so.

22. *Anticipated Demand.* Although we do not find it necessarily fatal to Sandwich Isles' position that a large percentage of the cable is not being used today,[70] we are concerned that Sandwich Isles is

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recognizes "that does not mean that NECA should reimburse carriers for every conceivable investment in new technology, but it does mean that advancing technology is a legitimate factor to be weighed among all the facts and circumstances." Sandwich Isles Comments at 20. In this regard, we note that the weight we place on these considerations here derives primarily from the special role served by Sandwich Isles in Hawaii.

[65] Sandwich Isles states that the cost difference between a 12-fiber system and a 48-fiber system is approximately 2%. Sandwich Isles Reply at 5.

[66] *See supra* note 55 and accompanying text. Although we consider the inclusion of spare capacity in the submarine cable among the equitable considerations discussed above, some recovery for the cost of spare capacity can occur even when considering current use. *See, e.g., AT&T Phase II Order*, 64 FCC 2d at 38, para. 113 ("The phrase 'presently or within a reasonable future period' in the denotation of 'used and useful' 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 to serve as a reserve for currently used investment.").

[67] NECA Comments at 3. We also note that with respect to how much of the Paniolo cable network is being used for regulated vs. nonregulated services (and also interstate vs. interstate services), Sandwich Isles has the obligation and responsibility to account for those differences in compliance with the Commission's rules and to accurately report the results of its accounting to NECA.

[68] NECA Comments at 13, 20-21.

[69] NECA Comments at 14. *See also, e.g.*, Alaska Telephone Association (ATA) Comments at 2 ("It would be poor planning and irresponsible to construct facilities with no anticipation for increased demand over the life of the infrastructure."); GVNW Comments at 15-16 ("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.") (footnote omitted).

[70] We note disagreement in the record regarding whether all of the cable investment was "prudently incurred." *Compare* NECA Comments at 20 (arguing that "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," which "highlights concerns that the inclusion of the entire costs of the cable lease represents excess or imprudent investment."); Letter from Matthew Robert Sutherland, General Attorney, AT&T, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 09-133, at 2 (filed Aug. 20, 2010) (AT&T Aug. 20, 2010 *Ex Parte* Letter) (asserting that the record fully supports "[t]hat the entirety of Sandwich Isles' fiber network lease is not 'used and useful' or a 'prudent investment') *with* Sandwich Isles White Paper at 25-33 (arguing that prior Commission decisions regarding (continued....)

unable to quantify any meaningful projected demand for the near-term future. As NECA observes, the "used and useful" analysis requires that regulated ratepayers realize the benefit from the investment be realized in a reasonable time.[71] The Commission has flexibility in considering what constitutes a "reasonable time," but here we lack meaningful projected demand data both in general, and for particular types of services.[72] Although Sandwich Isles states that it ultimately anticipates 20,000 new residents of the Hawaiian home lands,[73] it is not clear how quickly those residents are likely to arrive, particularly given past trends.[74] Moreover, a projection of anticipated *customers* does not, in itself, reveal the likely

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Sandwich Isles "puts in stark relief NECA's current claims that the Paniolo cable is not in the public interest, is not a prudent investment or used and useful" and that the investment is consistent with past Commission decisions approving new submarine cables); GVNW Comments at 16-17 ("A prudent carrier must analyze both the short term costs as well as the price over the longer term."). In prior decisions engaging in a balancing of equities under the "used and useful" analysis, the Commission has held that it is not necessary to fully resolve disputes over the prudence of a particular subset of costs. *Phase I Special Access Tariffs Investigation Order*, para. 38 & n.58 ("although the LECs and the User Parties engage in a spirited debate as to whether the decision to make this investment was prudent, we do not find it necessary to resolve this argument as to every dollar of PSV in the LECs' rate bases"). Likewise, here we find it unnecessary to precisely resolve these questions, instead resting our decision on the balancing of equities discussed in the text above. We also find non-dispositive the various cost estimates in the record for alternative cable capacity, which do not appear comparable to the Paniolo lease at issue here. *See, e.g.*, Sandwich Isles Comments at 14-18; Sandwich Isles White Paper at 31.

[71] "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 [a reasonable] time." NECA Comments at 21. We are unpersuaded by Sandwich Isles' claim that NECA inherently is behaving inconsistently by denying particular lease costs for inclusion in the pool while simultaneously issuing a report that "proudly trumpets the large amount of fiber being installed by rural LECs on the U.S. mainland." Sandwich Isles White Paper at 2. As an initial matter, the NECA report does not claim that the carriers' fiber deployment costs were fully recovered through the NECA pool. Moreover, we make clear that the same Commission rules apply to everyone, including the basic "used and useful" framework set out in Commission precedent.

[72] Sandwich Isles cites certain reports making general predictions about growth in traffic in the U.S., which we do not find informative as to the expected demand for this particular cable for particular services for particular time periods. *See* Sandwich Isles Reply at 8 n.18. It also quotes an excerpt from a study—not itself in the record—that appears to rely on nationwide demand estimates. Sandwich Isles Comments at 11-12. Moreover, each of these predictions of increased demand arise in significant part from anticipated growth in traffic for services that are not interstate access services provided through the NECA pool. *See, e.g.*, AT&T Reply at 3 ("[Sandwich Isles] accepted that regulators have a duty to exclude 'investment and expenses made for some other purpose or in excess of the current and reasonable future needs.' It then proceeded to justify the lease of the fiber optic network based on a study of bandwidth needed to provide information services and entertainment over a 20 year period.") (footnotes omitted). We discuss in greater detail below the uncertainty regarding the particular services likely to be carried on the cable in the future. *See infra* para. 23.

[73] *See, e.g.*, Sandwich Isles Comments at 4; Sandwich Isles White Paper at 19.

[74] *See, e.g.*, Sandwich Isles Comments at 4 (stating that "for a variety of reasons outside of its control, only a portion of the projected approximately 20,000 home sites have been completed and occupied"); NECA Reply at 6 & n.22 (citing reports that Sandwich Isles previously had projected it would serve 20,000 customers by 2005, and thus questioning the reliability of Sandwich Isles' current projections regarding the size of its end-user customer base). We note that the Department of Hawaiian Home Lands stated that "[t]he Department's current goal is to deliver 1,000 homestead lease awards per year or a total of 5,000 homestead lease awards in the five years from 2007 through 2011. In the last two years, we have awarded more than 700 homestead leases, and we have a realistic opportunity to award an additional 3,500 homestead leases in the remaining years. Furthermore, the Department is committed to conveying homestead leasehold lots to each holder of a homestead lease within three years of a beneficiary's receipt of a homestead lease." Letter from Kaulana H.R. Park, Chairman, Hawaiian Homes (continued....)

demand for cable capacity that would result from services provided to these customers,[75] nor is there other data in the record in that regard.[76] For its part, Sandwich Isles also "expects that other providers will make substantial use of the network," but has not quantified such anticipated usage.[77] In sum, although Sandwich Isles characterizes the existing submarine cables as inadequate to meet future demand, there is no data in the record to substantiate that claim, either as to current demand[78] or as to projected demand for any future time period.[79]

23. Moreover, although we find it reasonable to anticipate some additional future demand for cable capacity—particularly as advanced services are made available, the record does not reveal the likely share of that demand attributable to services that would be provided outside the NECA tariff. Sandwich Isles' own statements make clear that some of the future demand for cable capacity is likely to come from unregulated services or services provided to other carriers under contract.[80] Given the Commission's

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Commission, Department of Hawaiian Home Lands, to Chairman Julius Genachowski, *et al.*, FCC, WC Docket No. 09-133, at 1-2 (filed Sept. 15, 2009).

[75] NECA contends that "[e]ven 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." NECA Comments at 20. NECA states further that it "believes this cable has the capacity potential to serve the entire 500,000+ combined customer base of Hawaiian Telcom and Sandwich Isles." *Id.* at 20 n.67. *See also, e.g.*, AT&T Reply at 2 (contending that Sandwich Isles "did not need to lease an entire high-capacity fiber optic network to serve the needs of its present and foreseeable telecommunications customers").

[76] Sandwich Isles cites certain submarine cable precedent for the importance of weighing demand as a factor in its analysis. *See* Sandwich Isles White Paper at 28 (citing *TAT-10 Section 214 Order*). In contrast to Sandwich Isles' characterization of that decision, however, it did not rest on speculation that the deployment of the new cable would, in itself, lead to increased demand. Rather, the Commission cited the applicants' quantification of four-year estimates of demand for cable capacity and their calculation of the percentage of pre-existing cable capacity that would be utilized if the new cable was not deployed. *TAT-10 Section 214 Order*, 7 FCC Rcd at 446, paras. 12-13. Indeed, the petitioners themselves did not rest their claims on the expectation that the mere addition of a new cable would inherently lead to sufficient demand. *See, e.g.*, *TAT-10 Section 214 Order*, 7 FCC Rcd at 446, para. 9 ("In addition, they expect unprecedented demand for service to Northern Europe due to the recent political events in Eastern Europe and Germany.").

[77] Indeed, we agree with NECA that, in circumstance such as this, it would have been sensible for Sandwich Isles "to obtain significant customer commitments for use of the cable capacity in advance of embarking on an investment of this magnitude." NECA Reply at 5 n.21. Although there is nothing concrete and quantifiable in the record upon which to rely, the record does suggest some promise in this regard for the future. *See, e.g.*, Letter from David Cosson, counsel for Sandwich Isles, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 09-133, 3 (filed Dec. 11, 2009) (Sandwich Isles Dec. 11, 2009 *Ex Parte* Letter); Sandwich Isles July 30, 2010 *Ex Parte* Letter.

[78] Sandwich Isles concedes that "Hawaiian Telcom's present network generally has the capacity to carry the current volume of its subscribers' traffic." Sandwich Isles Reply at 12. And NECA reports that data provided by Sandwich Isles "for the 2009 annual tariff filing" showed "no evidence of material demand growth." NECA Reply at 3.

[79] We also are not persuaded that prior RUS loan approvals—subsequently suspended—demonstrate that there would be sufficient demand for the cable. *See, e.g.*, Sandwich Isles Comments at 6, 9-11; Sandwich Isles Reply at 12; Sandwich Isles White Paper at 9-10. As a threshold matter, the RUS application process occurred in the early 2000s, and RUS ultimately suspended its funding. *See generally id.* Against that backdrop, and given that RUS has not to date resumed providing that funding, we do not find it reasonable to rely on the original RUS decision.

[80] Sandwich Isles Comments at 21; Sandwich Isles Reply at 9 & n.21; Sandwich Isles Dec. 11, 2009 *Ex Parte* Letter at 3. *See also, e.g.*, GVNW Comments at 14 (the network will also be capable of providing sufficient bandwidth for evolving data and video broadband communications needs for the foreseeable future"); AT&T Reply at 3 (arguing (continued....)

recognition that ratepayers may not be forced to pay a return except on investments that can be shown to benefit them, our equitable analysis must consider the fact that some future demand for cable capacity is likely to come from customers of services provided outside the NECA tariff.[81]

24. *Recovery through NECA Pool.* NECA suggests that it could be inequitable to recover the lease costs through the NECA pooling process; given the limited number of Sandwich Isles' customers, most of the costs would be borne by ratepayers of other NECA pooling carriers.[82] As Sandwich Isles notes, however, "the purpose of the [NECA] pool as a means of rate averaging is to assist high cost areas such as Hawaii."[83] We agree that the inherent nature of the NECA pooling process results in the costs of individual carriers—particularly the highest-cost carriers—being recovered from ratepayers of other carriers. So long as the costs included in the NECA pool are consistent with Commission regulations, including this order,[84] we do not view the cost-sharing role of the NECA pool, in itself, as an equitable consideration either for or against inclusion of any particular amount of lease costs.

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that Sandwich Isles is attempting "to justify the lease of the fiber optic network based on a study of bandwidth needed to provide information services and entertainment over a 20 year period"); AT&T Aug. 20, 2010 *Ex Parte* Letter at 2 (the appropriate analysis "also includes determining whether Sandwich Isles has properly allocated the cost of this multipurpose network between regulated telephone service and nonregulated video and Internet access services."). We note that rate-of-return carriers, such as Sandwich Isles, provide the transmission used as part of broadband Internet access services as a regulated common carrier service. *See, e.g., Appropriate Framework for Broadband Access to the Internet over Wireline Facilities; et al*, CC Docket Nos. 02-33, 01-337, 95-20, 98-10, WC Docket Nos. 04-242, 05-271, Report and Order and Notice of Proposed Rulemaking, 20 FCC Rcd 14853, 14927, paras. 138 (2005). *See also* NECA Reply at 8 n.29 ("the costs of the transport lease from Paniolo used to transport Internet traffic from the Sandwich Isles' HHL service areas to the interconnection point with Internet Service Providers is recovered in Digital Subscriber Line (DSL) rates of NECA pool members").

[81] "Equally central to the used and useful concept, however, is the equitable principle that the ratepayers may not fairly be forced to pay a return except on investment which can be shown directly to benefit them.." *AT&T Phase II Order*, 64 FCC 2d at 38, para. 112.

[82] *See, e.g.*, NECA Comments at 4, 21 (discussing potential impact on broadband "take rates" and on the NECA pools); NECA Reply at 7-8 ("even with a rate increase of 1,000% [through the creation of a new Hawaii-specific rate band], or a demand increase of 1,000%, the vast majority of the new lease costs would become an obligation of other pool members and their rate payers"). We note that AT&T notes that "Sandwich Isles is a NECA 'Band 8' company" and that "[a]ny increase in Band 8 rates will further exacerbate traffic pumping by CLECs that mirror the Band 8 tariff rates." AT&T Aug. 20, 2010 *Ex Parte* Letter at 2; AT&T Reply at 3 n.15. We note that issues regarding "traffic pumping" or "access stimulation" are raised in a pending rulemaking proceeding, and we believe that is the more appropriate forum to address such concerns. *See Establishing Just and Reasonable Rates for Local Exchange Carriers*, WC Docket No. 07-135, Notice of Proposed Rulemaking, 22 FCC Rcd 11629 (2007).

[83] Sandwich Isles White Paper at 34.

[84] We note that Sandwich Isles suggests that "the U.S, via the tariff pooling mechanism; can unquestionably afford to update broadband facilities in all 50 states, including the ones with the highest cost." Sandwich Isles White Paper at 7. Our equitable considerations above give weight to the efforts of Sandwich Isles to bring advanced services to Hawaii, in light of Sandwich Isles' unique role. *See supra* para. 20. However, insofar as Sandwich Isles suggests a new, broader role for the NECA pooling process than that established by the Commission, we do not endorse such an approach here. By the same token, we are not persuaded by concerns about possible financial hardship insofar as remedying such concerns would require us to allow for cost recovery from ratepayers beyond that permitted by the Act and Commission regulations. *See, e.g.*, Sandwich Isles White Paper at 14 ("As SIC now has contractual obligations of $15 million not $1.9 million, NECA's position will force SIC (and likely Paniolo Cable Co.) into bankruptcy.").

25. Balancing the forgoing equitable considerations, we conclude that 50 percent of Sandwich Isles' Paniolo cable network lease expenses subject to dispute should be included in its revenue requirement to be recovered through the NECA pool. We find that, just as 50 percent recovery was appropriate on the particular facts of the PSV cable case,[85] this allocation provides appropriate recovery for Sandwich Isles investors through NECA tariffed rates in light of the benefits arising from the investment. Moreover, in the future, as the cable increasingly is used for services provided outside of the NECA tariff, that associated portion of the lease costs will be ascertainable and will not be subject to inclusion in the NECA pool under the framework adopted in this order.[86] Likewise, just as we find it appropriate to require customers of services provided through the NECA tariff to bear a portion of the cable lease beyond that actually used for the provision of their services, so, too, do we find it appropriate to attribute a portion of the cable lease costs to the other services ultimately expected to be provided over that cable, given that the customers of those services also will receive benefits. Thus, we decline to allow 100 percent recovery of the cable lease costs from the NECA pool.[87]

3. Other Issues

26. Sandwich Isles contends that NECA did not clearly identify its concerns and adequately inform Sandwich Isles of the potential that not all the costs of the cable lease would be included in the pool.[88] Although the overall record appears at least somewhat mixed, there do appear to have been a number of occasions both before and after Sandwich Isles signed the Paniolo lease where NECA raised concerns about whether and to what extent the lease costs would be included in the NECA pool.[89] Moreover, we agree with NECA that "[w]ith an investment the size of the instant cable construction, a

[85] *See supra* para. 14.

[86] *See, e.g.*, Sandwich Isles Reply at 9 ("If others use capacity on a non-tariffed basis, the costs reported to the pool will be reduced."); *id.* at 9 n.21 ("In any event, if there are non-regulated uses of the Paniolo network, Sandwich Isles will adjust the cost allocated to the NECA pool in accordance with Commission rules."); Sandwich Isles Aug. 5, 2010 *Ex Parte* Letter at 2 (noting "the necessity of undersea cables for intrastate service in Hawaii"). Although the discussion in the record focuses most extensively on the possible use of the cable to provide non-regulated services or to provider services to other carriers outside the NECA tariff, the same issues arise with respect to future use of the cable for the provision of intrastate services. *See, e.g.*, AT&T Aug. 20, 2010 *Ex Parte* Letter at 2 n.5.

[87] Under the circumstances here, we find that this responds to the concerns of commenters that some unquantified percentage of utilization of the submarine cable today is for services provided outside the NECA tariff. *See, e.g.*, AT&T Aug. 20, 2010 *Ex Parte* Letter at 2 n.5.

[88] *See, e.g.*, Petition at 6; Sandwich Isles Comments at 25-26; Sandwich Isles Reply at 10-11; Sandwich Isles White Paper at 11-12. *See also* ATA Comments at 2; GVNW Comments at 10-11.

[89] *See generally* NECA Comments at 8-12, Apps. B-O (describing the discussions between NECA and Sandwich Isles, and attaching associated correspondence); NECA Reply at 4-5 (describing discussions). *See also* NECA Comments at 9 n.29 ("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."). We also agree with NECA that, although NECA does not have a formal "due process" obligation, the NECA processes and this Commission proceeding provided Sandwich Isles a reasonable opportunity to be heard. *See, e.g.*, NECA Reply at 4 & n.12.

prudent investor would have been expected to obtain a more definitive answer than" those up on which Sandwich Isles appears to have relied.[90]

27. We also reject Sandwich Isles' claim that NECA had a general duty to accept the lease costs it submitted for inclusion in the pool.[91] As Sandwich Isles acknowledges, NECA's Commission-established role requires it to ensure, to the best of its ability, that its tariff filings comply with Commission rules.[92] Sandwich Isles appears to interpret that obligation unduly narrowly, as excluding relevant Commission precedent governing what costs are "used and useful" and therefore eligible for inclusion in the revenue requirement.[93] To the contrary, NECA—just like carriers that file their own tariffs—must comply not only with the codified "accounting, cost allocation, jurisdictional separations, and access charge rules,"[94] but the "used and useful" standards and related ratemaking requirements adopted in prior Commission orders, as well. Given that the "used and useful" standard is "[t]he starting point for developing or reviewing a rate filing,"[95] an alternative interpretation could enable pooling carriers to undermine NECA's roles and evade Commission regulation.

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[90] NECA Reply at 4 n.14 ("Both Sandwich Isles and its consultant, GVNW, attempt to make much of the fact that letters in 2007 and 2008 from NECA to Sandwich Isles indicated only that it 'may' not approve funding. . . . With an investment the size of the instant cable construction, a prudent investor would have been expected to obtain a more definitive answer than this.").

[91] *See, e.g.*, Sandwich Isles White Paper at 36-39 (arguing that NECA's role is administrative and that, as the agent of the pooling carriers, it has limited ability to deviate from the costs submitted by such carriers); Sandwich Isles White Paper at 42-43 (arguing that NECA should have included Sandwich Isles' costs and left any challenge to the resulting rates to the tariff review process). To the extent that NECA's comments could be read to suggest that it has an expanded role in light of the Commission's elimination of the section 214 application process, we agree with Sandwich Isles that the adoption of blanket section 214 authority did not expand NECA's overall role. Sandwich Isles White Paper at 40-41. That is not the sole basis for NECA's actions, however, and therefore does not resolve our analysis. Likewise, we are unpersuaded by Sandwich Isles' claim that NECA exceeded its designated role based on arguments NECA made in the context of a different Commission proceeding on a distinct set of issues. *See* Sandwich Isles White Paper at 39 (discussing NECA comments on universal service reform proposals).

[92] *See* Sandwich Isles White Paper at 38. Although Sandwich Isles argues that NECA deviated from its practice of relying on RUS funding approvals, *see* Sandwich Isles White Paper at 46, NECA appears to dispute the existence of such a practice, correctly observing that "the RUS does not make findings that costs incurred through its loan program are includible in a regulated rate base, nor does it have the regulatory authority to do so." Letter from Joe A. Douglas, Vice President, Government Relations, NECA, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 09-133 at 2 (filed June 18, 2010) (NECA June 18, 2010 *Ex Parte* Letter). To the contrary, as discussed above, NECA is bound by the Commission's accounting, cost allocation, jurisdictional separations, and access charge rules.

[93] *See* Sandwich Isles White Paper at 39.

[94] *Safeguards to Improve the Administration of the Interstate Access Tariff and Revenue Distribution Processes*, Report and Order and Order to Show Cause, 10 FCC Rcd 6243, 6260, para. 40 (1995) (*NECA Safeguards Order*). *See also, e.g.*, *Safeguards to Improve the Administration of the Interstate Access Tariff and Revenue Distribution Processes*, Notice of Proposed Rulemaking, 8 FCC Rcd 1503, 1507, para. 18 (1993) ("NECA's efforts to understand a rule's meaning should not focus on developing either an industry consensus regarding that meaning or an interpretation that accommodates divergent LEC viewpoints. Such efforts are unlikely to lead to a correct interpretation. Instead, NECA must exercise its own independent interpretive judgment and then implement its interpretation.").

[95] *Investigation of Access and Divestiture Related Tariffs, Memorandum Opinion and Order*, 97 FCC 2d 1082, para. 16 (1984) ("The starting point for developing or reviewing a rate filing is establishing an overall revenue requirement. A carrier is entitled to charge rates which recover allowable expenses and a reasonable return on the investment in property used and useful for service to the public. This amount is the revenue requirement.").

28. Further, we reject the notion that NECA's actions here were inconsistent with its Commission-established role.[96] Although we agree that a balancing of exceptional, equitable considerations of the sort present here can lead to a different "used and useful" determination than consideration of actual usage alone, we make clear that it is the role of the Commission—not NECA or individual carriers—to make such an equitable adjustment.[97] Indeed, the Commission previously has stated that "LECs that disagree with NECA's interpretations of our rules are free to present their arguments to the Commission, either in comments on those filings or petitions for declaratory rulings."[98] Particularly where significant revenues are at issue, we encourage carriers not to delay in raising appropriate issues with the Commission for formal resolution, and we likewise advise NECA to confirm that pooling carriers are aware that this is the proper avenue for ultimate resolution of such disputes.[99]

C. Implementation

29. Based on our analysis above, we require NECA to recognize 50 percent of Sandwich Isles' Paniolo cable network lease expenses subject to dispute in its revenue requirement for ratemaking purposes.[100] Moreover, in light of our analysis above, and the timing of filing of the Sandwich Isles petition, we find it appropriate to apply our decision retroactively, to the 2009 annual access tariff filing.[101] The Commission has previously allowed for a mid-course correction.[102] We also recognize that for accounting purposes, NECA's contract with its members allows for a 24-month period in which the member may revise its costs.[103] We note that both of these processes are at the parties' disposal.

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[96] We are not persuaded by Sandwich Isles that NECA's objectivity is called into question because, in this proceeding, NECA's outside counsel is from the same law firm as Hawaiian Telcom's outside counsel. Sandwich Isles White Paper at 43-44. We note that NECA responds, among other things, that the outside law firm at issue has erected a legal screen so that different attorneys in the firm represent NECA and Hawaiian Telcom, and the lawyer representing NECA does not consult with Hawaiian Telcom or Hawaiian Telcom's attorney regarding this proceeding. NECA June 18, 2010 *Ex Parte* Letter at 3.

[97] NECA itself espouses this view. *See, e.g.*, NECA Reply at 5 n.19 ("In any event, both parties to the pooling agreement are obligated to comply with all applicable FCC rules and orders. Thus, Sandwich Isles had an independent obligation to confirm its actions were consistent with FCC rules, and it is the FCC, not NECA, that will ultimately determine whether Sandwich Isles' proposal satisfies the Commission's standards.").

[98] *NECA Safeguards Order*, 10 FCC Rcd at 6260-61, para. 44.

[99] We note that Sandwich Isles and NECA continued their discussion of these issues after the filing of the instant Petition, and we do not want to discourage such actions. *See, e.g.*, Letter from Joe A. Douglas, Vice President, Government Relations, NECA, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 09-133 at 1 (filed Nov. 25, 2009).

[100] *See supra* note 30. NECA is required to implement this Declaratory Ruling going forward for the term of Sandwich Isles' lease agreement. Although the Commission recognizes that the lease expenses are scheduled to increase over time, Sandwich Isles also plans to lease capacity to other carriers, which would reduce the portion of total cable lease expenses included in its revenue requirement. *See* Sandwich Isles Comments at 21.

[101] *Cf. Amendment of Part 69 of the Commission's Rules to Ensure Application of Access Charges to All Interstate Toll Traffic,* Memorandum Opinion and Order, 2 FCC Rcd 2154, paras 21-23 (1987) (concluding, under the circumstances, that retroactive sharing of certain traffic-sensitive revenues would serve the public interest).

[102] *See, e.g., Annual 1991 Access Tariff Filings; National Exchange Carrier Association; Universal Service Fund and Lifeline Assistance Rates*, Transmittal No. 452, Memorandum Opinion and Order, 6 FCC Rcd 3792, 3807, para. 127 (Com. Car. Bur. 1991) (noting prior NECA mid-course tariff filings based on revised cost studies).

Accordingly, we direct NECA, within thirty (30) days of the release of this Declaratory Ruling, to take appropriate steps to implement this ruling.

IV. ORDERING CLAUSE

30. Accordingly, IT IS ORDERED, pursuant to Sections 1, 4(i), 201-205, and 226(h)(1)(A) of the Communications Act of 1934, as amended, 47 U.S.C. §§ 151, 154(i), 201-205, and 226(h)(1)(A) that this Declaratory Ruling is ADOPTED.

FEDERAL COMMUNICATIONS COMMISSION

Sharon E. Gillett
Chief, Wireline Competition Bureau

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[103] *See* Letter from Joe A. Douglas, Vice President, Government Relations, NECA, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 09-133, at 1 (filed Sept. 21, 2010). *See also generally* Letter from Richard Askoff, Executive Director, NECA, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-29 (filed Jan. 28, 2005) (Report on Timing of NECA Pool True-Up Submissions and FCC Form 492 Interstate Earning Monitoring Reports); *Report On Timing Of NECA Pool True-Up Submissions and FCC Form 492 Interstate Earnings Monitoring Reports*, WC Docket No. 05-29, Public Notice, 20 FCC Rcd 2303 (Wir. Comp. Bur. 2005) (seeking comment on report).