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October 28, 2010

FILED/ACCEPTED
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Federal Communications Commission
Office of the Secretary

By Hand Delivery

Marlene H. Dortch
Secretary
Federal Communications Commission
Office of the Secretary
445 12th Street, S.W.
Washington, D.C. 20554

Re: Sandwich Isles Communications Inc. Petition for Declaratory Ruling, WC Docket No. 09-133: Application for Review of AT&T Inc.

Dear Ms. Dortch:

Pursuant to Section 1.115 of the Commission's Rules, 47 C.F.R. § 1.115, enclosed are an original and five copies of the Application for Review of AT&T Inc. in the above-referenced proceeding. Please stamp and return one copy to our courier. AT&T is concurrently filing this Application via ECFS and serving copies on parties to the proceeding via First-Class mail.

Thank you for your attention to this matter and please call me with any questions.

Regards,

Brendan J. McMurrer

Enclosures

cc: Counsel of Record in WC Docket No. 09-133

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

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

APPLICATION FOR REVIEW OF AT&T INC.

TABLE OF CONTENTS

APPLICATION FOR REVIEW OF AT&T INC.

Pursuant to 47 C.F.R. § 1.115, AT&T Inc. ("AT&T") respectfully submits this application for Commission review of the September 29, 2010 Declaratory Ruling of the Wireline Competition Bureau ("Bureau") in the above-captioned docket.[1]

INTRODUCTION AND SUMMARY

The *Bureau Order* reverses the National Exchange Carrier Association's ("NECA") disallowance from Sandwich Isles Communication, Inc.'s ("Sandwich Isles") revenue requirement of speculative investments in undersea cable facilities that are not needed for the current or future provision of the regulated telecommunications services that Sandwich Isles provides pursuant to the NECA tariff. Sandwich Isles funded the new "Paniolo" cable at issue here – obligating itself to annual lease payments nearly *eight* times higher than it was paying for the capacity it leased on existing cables to meet its telephone customers' needs – to promote its own private interests in providing unregulated broadband and video services and in selling cable capacity at wholesale. As NECA properly ruled, because Sandwich Isles failed to demonstrate *any* present or future *telephone* service need for the Paniolo cable, the $15 million annual expense associated with that cable is neither "used and useful" nor "prudent investment" for its regulated services. It was therefore entirely appropriate for NECA to cap Sandwich Isles revenue requirement at the $1.9 million annual expense it was previously paying to lease voice grade capacity on one of the three existing cables that already served the Hawaiian Islands. The Bureau's decision to overrule NECA and authorize Sandwich Isles to inflate its revenue requirement with fully half of the excess Paniolo expense above the $1.9 million used and useful

[1] Declaratory Ruling, *In re Sandwich Isles Communications, Inc. Petition for Declaratory Ruling*, WC Docket No. 09-133, DA 10-1880 (Sept. 29, 2010) ("*Bureau Order*").

"baseline" is arbitrary and capricious, unsupported, and in direct conflict with established Commission precedent and policy.

The *Bureau Order* recognizes the "current lack of use of the [Paniolo] cable and a lack of substantial record evidence concerning future demand."[2] And the *Bureau Order* agrees that "ordinarily" the $1.9 million that NECA authorized would be "sufficient" and "reflect[] a reasonable application of the threshold 'used and useful' considerations."[3] Yet on the basis of "other equitable considerations," the *Bureau Order* saddles ratepayers of Sandwich Isles' regulated services with millions of dollars in expenses that do not – and will not ever – benefit them in any way. As demonstrated below, none of the equitable considerations discussed in the *Bureau Order*, individually or collectively, justify any departure from the used and useful baseline, much less the arbitrary 50 percent "split the baby" add-on the Bureau approved.

The *Bureau Order* notes "the Commission's recognition that ratepayers may not be forced to pay a return except on investments that can be shown to benefit them,"[4] but suggests that Sandwich Isles ratepayers may obtain some intangible benefits from the undersea cable "spare capacity" and "route diversity" provided by the Paniolo cable.[5] In fact, the record is replete with evidence that Sandwich Isles ratepayers (like those of other Hawaiian telephone service providers) already enjoyed robust route diversity and spare capacity by virtue of the three undersea cables that existed when Sandwich Isles undertook its Paniolo project: "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 or as to

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[2] *Bureau Order* ¶ 17.

[3] *Id.* ¶ 18.

[4] *Id.* ¶ 23.

[5] *Id.* ¶¶ 19, 21.

projected demand for *any* future time period."[6] The *Bureau Order's* contrary route diversity finding rests on Sandwich Isles' claim that the Paniolo cable was in fact recently needed to reroute traffic on an emergency basis when one of the existing cables was cut. But that claim was shown to be patently false,[7] and, even if true, could only have shown benefits to users of the *other* cables, not to Sandwich Isles' ratepayers – and Sandwich Isles would have been compensated by any such emergency users for those benefits. In short, there are no competing "equities" to balance here. None of the extra $13 million in annual costs caused by Sandwich Isles' decision to fund the Paniolo cable benefits its regulated ratepayers, and Sandwich Isles has no legitimate interest in forcing those ratepayers to bear *any* of those costs.

The *Bureau Order* cites "the special role of Sandwich Isles" as an additional factor of "particular importance."[8] Sandwich Isles, which "was established in response to a 1994 Hawaiian law passed to improve telecommunications services in rural areas of Hawaii,"[9] may well perform a valuable role in those communities. And state and federal policymakers might well conclude that Sandwich Isles should be encouraged to do more to provide advanced broadband and other services to Hawaiian home land areas that are scattered throughout the island state. But those are justifications for stimulus funds, universal service payments or other government subsidy programs, not for inflating regulated rate-of-return carrier access charges, which, by law, are limited to a reasonable return on plant used and useful in the provision of the

[6] *Id.* ¶ 22.

[7] *See, e.g.*, *Ex parte* letter from Thomas Lynch (counsel for Pacific Lightnet, Inc., dba Wavecom Solutions) to Marlene Dortch (FCC), WC Docket No. 09-133 (Sept. 23, 2010) ("*Wavecom Ex Parte*") ("Sandwich Isles falsely states . . . that following an outage on the TW Telecom Cable, Wavecom Solutions, lacking sufficient capacity, was forced to move its traffic to Hawaiian Telecom cable. To the contrary, Wavecom Solutions was able to manage the outage using its existing capacity, including its IRU on the Southern Cross Cable").

[8] *Bureau Order* ¶ 18.

[9] *Id.* ¶ 20.

basic telecommunications services. As it turns out, Sandwich Isles already receives some of the largest amounts of per-line high cost universal service support in the country.[10] Whatever the merit of arguments that Sandwich Isles should receive more (or less) support in light of its "special role," however, they provide no legitimate basis for inflating Sandwich Isles' regulated rate base.[11]

But even if the record could support *some* additional amount above the market lease rates Sandwich Isles was paying before it obligated itself to the Paniolo project, the "50 percent" add-on – which the *Bureau Order* plucks from thin air and which means that ratepayers will now pay more than three times more for "spare" capacity that will never be needed than for the capacity actually used to proved telephone service – is arbitrary and unsustainable. As the courts have repeatedly cautioned, even where the Commission may permissibly exercise line-drawing discretion, it must provide some reasoned basis for the line it draws.[12] But the *Bureau Order* provides no explanation at all for the choice of a 50 percent assignment – versus 20 percent or 10 percent or 0 percent – to regulated services that under even the most wildly optimistic growth projections will never use more than a tiny fraction of the new cable. Moreover, courts cannot

[10] *See* Federal Communications Commission Response to United States House of Representatives Committee on Energy and Commerce Universal Service Fund Data Request of June 15, 2010, Part 3 – Largest Per-Line Subsidies, by Study Area, at 1, *available at* http://energycommerce.house.gov/documents/20100708/Request3.pdf ("FCC House Response") (reporting that Sandwich Isles received approximately $24 million in high cost support in 2009 for just under 2,200 lines).

[11] *See, e.g.*, *Keyspan-Ravenswood, LLC* v. *FERC*, 348 F.3d 1053, 1057 (D.C. Cir. 2003) (an agency "cannot reasonably base its judgment on a criterion if that criterion bears no relationship to the underlying regulatory problem").

[12] *See, e.g.*, *Schurz Communications, Inc.* v. *FCC*, 982 F.2d 1043 (7th Cir. 1992) ("The possibility of resolving a conflict in favor of the party with the stronger case, as distinct from throwing up one's hands and splitting the difference, was overlooked"); *Texas Office of Public Utility Counsel* v. *FCC*, 265 F.3d 313, 328-29 (5th Cir. 2001).

defer to agency line drawing where, as here, the agency has justified the line-drawing exercise on improper considerations that bear no relation to the underlying regulatory problem.[13]

FACTUAL AND REGULATORY BACKGROUND

Sandwich Isles provides telephone services as a rate-of-return regulated incumbent local exchange carrier in primarily rural areas of the Hawaiian Islands. Sandwich Isles serves only about 2,000 access lines, less than 0.4% of the land lines in Hawaii. Yet, last year alone it obtained just short of $24 million in federal subsidies from the high cost universal service fund – nearly $11,000 for every access line.[14] Over the past three years, Sandwich Isles has collected about $72 million in universal service subsidies – about $37,000 per line – ranking first in the nation in per-line support among carriers with a material number of lines.[15]

Since it began operating in 1997, Sandwich Isles has leased excess capacity on one or more of the existing submarine cables that serve the Islands. There is no dispute that this leased capacity is sufficient to meet its customers' needs for regulated telephone services – indeed, Sandwich Isles concedes that the "present network generally has the capacity to carry the current volume of its subscribers' traffic." Sandwich Isles Reply at 12. Further, the capacity on the existing cables is readily available: as to Oahu, Maui, Kauai, and the Big Island, there is more than 200 Gbps capacity, and the record evidence demonstrates that "there is more than sufficient capacity" on the existing cables "to serve Sandwich Isles current customers on those islands as

[13] *See*, *e.g.*, *Alltel Corp.* v. *FCC*, 838 F.2d 551, 559 (D.C. Cir. 1988) ("We cannot defer to the Commission's selection of a precise point on a scale when the scale itself has 'no relationship to the underlying regulatory problem'").

[14] *See* FCC House Response, Part 3 – Largest Per-Line Subsidies, by Study Area, at 1.

[15] *See id.* at 1-6 (of the top ten study areas with largest per-line subsidies, only Sandwich Isles serves more than 350 lines).

well as customers Sandwich Isles may add over time."[16] As the *Bureau Order* concluded, "there is no data in the record to substantiate" the claim that existing cables are insufficient to serve either existing demand or projected demand "for any future time period." *Bureau Order* ¶ 22.

The record also confirms that there is existing route diversity and "backup arrangements for all interisland facilities."[17] NECA thus properly concluded that "Sandwich Isles had a number of [] reasonable alternatives to meet its transport capacity," and based on NECA's experience in assessing capacity needs of other small LECs, it concluded that Sandwich Isles could obtain adequate lease capacity for less than $2 million annually (and, indeed, was already doing so prior to the Paniolo commitment). NECA Comments, at 21-22.

Nevertheless, despite this existing capacity and the hefty sums of universal service subsidies that Sandwich Isles obtained and presumably used to provide regulated services, Sandwich Isles became involved in 2007 in a complex web of transactions involving affiliates of (or entities with close connections to) Sandwich Isles.[18] As a consequence, an entirely new high capacity cable – the largest in Hawaii – was constructed, and Sandwich Isles obligated itself to an exclusive lease of the entire capacity on this new, Paniolo cable. The initial yearly payments for this lease are approximately $15 million per year, and the lease payments increase over time and do not include costs for engineering, operating, and maintenance costs, for which Sandwich Isles is also responsible. *Bureau Order* ¶ 5 & n.19. As NECA found, Sandwich Isles new Paniolo lease payments were made at an "extraordinarily high cost relative to the number of subscribers." NECA Comments, at 2. Although Sandwich Isles speculates that 20,000 new

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[16] Comments of Hawaiian Telecom. Inc. ("HTI") & Masutomi Decl. ¶¶ 4-6; HTI Reply Comments, at 3 (there is "substantial interisland capacity").

[17] HTI Comments, at 3; Masutomi Decl. ¶¶ 7-8; HTI Reply Comments, at 2 ("all of [the interisland cables] are backed up by redundant capacity").

[18] *See* NECA Comments, at 11 nn.37-38.

residents might move to the areas it serves over the life of the lease, no one – including the Bureau – has agreed with this claim[19] or, in any event, that the demand associated with any increase in population would be sufficient to justify the Sandwich Isles lease payments.[20] In fact, NECA concluded that, even if a new rate band were developed to apply only in Hawaii, the costs of the Paniolo lease are so high that even if demand for Sandwich Isles regulated services increased tenfold, the resulting rates would pay for only 13 percent of the initial annualized lease costs – which would decline to only 7 percent by the final years of the lease.[21]

Based on the unambiguous facts and Sandwich Isles' clear failure to meet its cost justification burden, NECA took the highly unusual step of disallowing the Paniolo lease payments.[22] NECA concluded: i) Sandwich Isles' request for inclusion in the NECA pool of the entirety of the lease payments was improper under the "used and useful" approach, ii) Sandwich Isles' claim that demand would substantially increase were "seriously suspect," iii) inclusion of these costs "would significantly impact both ratepayers and pool members throughout the country," and iv) thus that the lease was an imprudent expenditure.[23] NECA's reasoning and conclusions are unassailable.

Under the Communications Act, the Commission has been provided the responsibility to ensure that the rates of regulated carriers like Sandwich Isles are just and reasonable (§ 201),

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[19] *See* NECA Comments, at 19-20 & n.65 (citing evidence that it would take more than 40 years, at best, for population to increase in the magnitude predicted by Sandwich Isles).

[20] *E.g., Bureau Order* ¶¶ 22-23.

[21] NECA Reply, at 7-8.

[22] *See* NECA Comments, at 3 (decisions to disallow costs of pool members are "never made lightly" and in this case, it was made only after "extensive analysis and research"); Verizon Comments at 3 (noting that NECA ordinarily takes a "deferential approach" to pool members' cost submissions).

[23] NECA Comments, at 1-4, 19-23; NECA Reply, at 1-8.

which includes the duty to deny rate recovery of imprudently incurred expenses. Under the Commission's rules, a small incumbent LEC may prove that its rates are just and reasonable either by filing its own tariff that cost-justifies its rates and otherwise complies with the Commission's rules, *see, e.g.*, 47 C.F.R. §§ 61.38-39, or by participating in a pool with other small incumbent LECs, resulting in a tariff that is administered by NECA. Sandwich Isles has chosen the latter approach, and, accordingly, as NECA explains in its comments, NECA should play a critical "gatekeeper" role in ensuring that the rates in the NECA tariff are just, reasonable, and "protect other rural LECs and interstate ratepayers."[24]

Under the FCC's rules, NECA member companies like Sandwich Isles have the responsibility to perform cost studies and to submit cost, demand, and access revenue data to NECA, and to certify that the data are "complete, accurate, and consistent with" the Commission's rules. *See id.* at 5 (citing 47 C.F.R. § 69.601(c)). These Commission rules require member carriers to maintain specific accounts and subaccounts, and specify, *inter alia*, what costs may be included in the accounts and how to separate regulated costs from unregulated costs. In order to file a tariff with reasonable rates that its that member companies can join NECA then critically reviews the data submitted, which in turn facilitates review by the Commission to determine if the rates meet the statutory standard and the other requirements of the Commission's implementing rules.

As the *Bureau Order* explained, NECA and the Commission both employ the "'used and useful' standard" in "evaluating whether particular investments can be included in a carrier's revenue requirement," such that rates based on that revenue requirement can be deemed just and

[24] NECA Comments, at 7; *see id* at 4-8.

reasonable.[25] Under the "used and useful" standard, the relevant considerations are 1) the need to compensate the investor for capital devoted to serving ratepayers; 2) the need to charge ratepayers for only those investments which benefit them; and 3) the need for such benefit to be either immediate or realized within a reasonable future period of time.[26] The policy of allowing only "used and useful" property to be included in a carrier's rate base is intended to ensure that current ratepayers bear only legitimate costs of providing service to them.[27]

ARGUMENT

The portion of the *Bureau Order* that actually applied the established used and useful standard concluded that only "the amount that Sandwich Isles was previously paying to lease voice grade capacity" – about $1.9 million – was appropriately included in the revenue requirement, because that "that amount" reflects a "reasonable application" of the "'used and useful'" standard, which "ordinarily" resolves revenue requirement questions like the one faced by NECA. Under this straightforward application of the used and useful standard, none of the Sandwich Isles lease payments should be included in its revenue requirement and thus recoverable from interstate ratepayers.

Although that should have been the end of the matter, the *Bureau Order* then proceeds to cite four "equitable" considerations, and based on three of those considerations – the Bureau agreed that the fourth clearly cut against Sandwich Isles – decided that fully half of the Paniolo lease expenses could be included within the NECA pool and thus could be recovered from interstate ratepayers. Specifically, the *Bureau Order* relied on the allegedly improved "route

[25] *Bureau Order* ¶ 12; NECA Comments, at 13-18.

[26] *American Tel. & and Tel. Co.*, Phase II Final Decision & Order, 64 F.C.C.2d 1 (1977).

[27] *Tennessee Gas Pipeline* v. *FERC*, 606 F.2d 1094, 1109 (D.C. Cir. 1979).

diversity" provided by the Paniolo cable (¶ 19), the supposedly "special role" of Sandwich Isles in providing services in Hawaii (¶ 20), and a perceived need for "some" spare capacity (¶ 21).[28]

In fact, none of these factors justifies the Bureau's departure from the used and useful standard, and, as discussed below, the cases cited in the *Bureau Order* for the proposition that the Commission has "on occasion" endorsed this type of balancing (¶ 14) are not remotely analogous. To be sure, the "particular facts of each case must be ascertained in order to determine what part of a utility's investment is used and useful," *AT&T Phase II Order*, and that inquiry may require a balance of competing carrier and consumer equities. But here, all of the equities fall on the side of disallowing the expense.

First, as to the "route diversity" cited in the *Bureau Order*, ratepayers already enjoyed the benefits of route diversity: there are and have been multiple cables serving Hawaii – at least two for all islands, and three for Oahu and the Big Island – and the record evidence clearly establishes that there were already "backup arrangements for all interisland facilities."[29] The belt and suspenders notion that ratepayers must fund half of the extraordinary costs of the Paniolo lease on the grounds that they might need that cable if the other two (or three) fail is patently arbitrary. No one reasonably buys a Mercedes as a backup way to get to work if they already have two cars and a public transit option for commuting.

Further, the outage discussed in the *Bureau Order* (¶ 19) does not remotely support the need for the Paniolo cable. In fact, the record evidence shows that Sandwich Isles' claims

[28] As to the fourth factor, which examined "anticipated demand" (¶ 22), the Bureau concluded that Sandwich Isles was "unable to quantify any meaningful projected demand for the near-term future." *Id.* This consideration – which (like the third consideration relating to spare capacity) really is not "equitable" in nature but bears on the third prong of the "used and useful" standard, *i.e.*, the requirement that such benefit be either immediate or coming within a reasonable future period of time – thus supports rejection of Sandwich Isles' Petition.

[29] HTI Comments, at 3; Masutomi Decl. ¶¶ 7-8; HTI Reply Comments, at 2 ("all of [the interisland cables] are backed up by redundant capacity").

regarding its backup role in that outage are "false[]" and that capacity on existing cables was fully sufficient to handle all traffic during the outage.[30] Finally, and in any event, even if Sandwich Isles' version of the facts were correct, any outage-related benefits associated with adding the Paniolo cable as a *third* backup option would be enjoyed by users of the *other* cables, not Sandwich Isles' ratepayers. And to the extent the new cable was used in an emergency, the benefits associated with that use should be compensated by the emergency users, not Sandwich Isles ratepayers.

Second, the allegedly "special" role of Sandwich Isles does not justify saddling its ratepayers with additional costs that indisputably do not benefit them. Sandwich Isles may well play an important role in delivering "modern broadband communications" and associated benefits to the communities it serves, but requiring ratepayers of regulated services to subsidize the costs of these advanced services is flatly inconsistent with the Commission's principle that costs should be borne the causer of the costs. Further, given the availability of other, explicit subsidies – as well as the nearly $40,000 per access line in USF support that Sandwich Isles has received over the last three years – the claim that Sandwich Isles needs a regulated rate windfall in order to provide these advanced services is simply unfounded, and appears to be a classic case of pouring good money after bad.

Third, the *Bureau Order*'s reliance on the need for "spare capacity" does not support the result that it reached. Preliminarily, the record overwhelmingly demonstrated that there was more than sufficient spare capacity on existing cables, and thus the Paniolo cable was not needed to provide either current services or spare capacity. Sandwich Isles conceded that the "present network generally has the capacity to carry the current volume of its subscribers' traffic,"

[30] *See* Wavecom *Ex Parte*, at 1-2 ("Wavecom Solutions was able to manage the outage using its own existing capacity").

Sandwich Isles Reply at 12, and, as the Bureau concluded, there is no evidence that the existing cables will not be adequate to serve all future capacity needs. Accordingly, there already was sufficient "spare capacity," and ratepayers should not be required to pay the very high costs of the Paniolo lease to obtain more "spare" capacity.

The *Bureau Order's* faulty reasoning was that it was "logical" to include spare capacity "once the decision was made to deploy the cable." *Id.* ¶ 21. But that assumes that the decision to deploy the cable was itself proper with regard to regulated services, and it was not. As NECA concluded and as the evidence showed, Paniolo was conceded even by Sandwich Isles to be not necessary "to carry the current volume of its subscribers' traffic." To return to the commuting example, while it is true that an agency building a bridge might include additional lanes to serve future demand, no agency could reasonably spend taxpayer dollars on "spare capacity" on a new bridge if there are already two (or three) bridges that all agree are sufficient to carry both current and future traffic.

In short, none of the so-called "equitable" factors cited in the *Bureau Order* actually supports the decision to allow Sandwich Isles to foist the costs of its new cable onto ratepayers that receive no benefits from the cable. Nor do the cases cited in the *Bureau Order* support the result it strains to reach. Rather, in those cases where recovery was allowed , the regulated entity had legitimate claims that its challenged investments were prudent when made to address reasonably anticipated demand for regulated services and that the facilities at issue were not fully utilized due to unforeseeable changed circumstances. That is precisely what occurred in the *Comsat* decision cited in the Bureau Order, where the Commission allowed recovery of the full investment of Comcast's satellites, including satellites that failed after launch.[31] There was no

[31] *See In the matter of Comsat*, 56 F.C.C.2d 1101 (1975).

dispute that the satellites, once launched successfully, were providing valuable services to ratepayers, and, given the risks inherent in launching these new satellites (which apparently were not otherwise reflected in rates), the Commission concluded that ratepayers could be required to pay for investments that were clearly prudently made when the satellites were launched, even if they later failed – a conclusion to which no party objected.[32] *Comsat* thus does not support the recovery of the Paniolo lease payments, because here there is no question that Sandwich Isles' investment was at no point in time reasonably believed necessary to benefit ratepayers of regulated services.

Likewise, the *Phase I Special Access Tariffs* decision does not support allowing recovery solely on equitable grounds, without regard to whether the carrier's investment provides benefits to ratepayers. At issue in that case was "Polyethylene shielded video" cables (PSV), which were conductors developed for local video transmission and which had been widely installed by the Bell System; however, as technology changed, many of the PSV cables could not be used for providing video.[33] The Commission refused to allow recovery from ratepayers for about $53 million of the PSV investment, because as to that portion, there was no dispute that it was "not used – indeed, has never been used – to provide service to video ratepayers." *Id.* ¶ 34. At the same time, the Commission permitted recovery of the remainder of the PSV investment because, as to these amounts, the Commission found that "video service customers have benefitted to

[32] *Id.* ¶¶ 80-91 (discussing capabilities of various satellites, including, for example, one series that "allowed simultaneous transmission of either four television programs or up to 1200 (later 1500) two-way voice-grade circuits, or some combination of television and voice-grade"); *id.* ¶ 93 ("Trial Staff has no serious quarrel with this approach and recommends that full recovery of failed satellites be allowed"); *id.* ¶ 92 (citing *Washington Gas* v. *Baker*, 118 F.2d 11 (D.C. Cir. 1950), which holds that in some circumstances it can be reasonable to include "abandoned property" in the rate base where ratepayers have not already paid higher rates, and investors have not earned higher returns, that reflects the risks that such property would become obsolete").

[33] *Phase I Special Access Tariffs*, 1986 WL 291617 (FCC Jan. 21, 1986); *see also Series 7000 Decision*, 88 F.C.C.2d 1656, ¶ 48 (1982).

some degree from [the] initial decision to include PSV cable in composite sheaths," and that this portion of the investment was appropriately made at the time even though the cables later became unnecessary for video services.[34] Indeed, even the ratepayers of video services conceded that part of the PSV cables were useful, and they did not seek to disallow *all* of the PSV investment.[35] These decisions thus provides no support for the outcome in the *Bureau Order*, where the Bureau, over the objections of ratepayers and NECA, allowed recovery of more than half of the Paniolo lease payments, even though none of the investment was necessary to serve current or future ratepayers.

Finally, and even assuming, *arguendo*, that some aspects of the Paniolo lease were properly recoverable, the Bureau's decision to allow 50 percent of the costs to be recovered is plainly arbitrary and would not withstand review. Nothing in the *Bureau Order* provides any grounds for selecting 50 percent as an appropriate level of recovery, and it is well-established that courts "cannot defer to the Commission's selection of a precise point on a scale when the scale itself has no relationship to the underlying regulatory problem." *Alltel*, 838 F.2d at 559. Here, the Bureau's decision allowing Sandwich Isles to recover 50 percent of the costs of a cable lease that even Sandwich Isles admits is not necessary to serve current demand is a self-evident "split the baby" approach that bears no relationship to the relevant facts or the governing law.

[34] *Id.* ¶ 41, citing *Series 7000 Decision* ¶ 88 ("In this case, video customers have benefitted from the economies of including PSV pairs in composite cables."); *see id.* (explaining that cables were appropriately deployed as mixed use facilities, because of economies of scale, but that "[i]nevitably" there is the possibility that "particular sub-facilities may become unnecessary because of changing conditions. . . . It would appear unfair to disallow this investment post facto as not used and useful when the PSV pairs themselves cannot be retired precisely because the overall composite cable remains in useful service. Since the composite cables themselves remain used and useful we will not disallow that part of the overall investment allocated to PSV").

[35] *Phase I Special Access Tariffs* ¶ 31.

As the D.C. Circuit has explained, "We recognize that in drawing a numerical line an agency will ultimately indulge in some inescapable residue of arbitrariness; even if 40% is a highly justifiable pick, no one could expect the Commission to show why it was materially better than 39% or 41%. But to pass even the arbitrary and capricious standard, the agency must at least reveal a rational connection between the facts found and the choice made. . . . . Yet [the Commission] appears to provide nothing but the conclusion that 'we believe that a 40% limit is appropriate to balance the goals.' What are the conditions that make 50% too high and 30% too low? How great is the risk presented by current market conditions? These questions are left unanswered by the Commission's discussion." *Time Warner Entertainment Co.* v. *FCC*, 240 F.3d 1126 (D.C. Cir. 2001) (citations omitted); *cf.* Bureau Order ¶ 17.[36]

Here, the record evidence, as well as the factors above, demonstrate that allowing any recovery, beyond the $1.9 million that is spent to lease existing cables, would be arbitrary. The Bureau apparently felt that only allowing recovery of half of the imprudent investment would somehow "balance" the equities and reduce the blow to ratepayers, but "[s]oftening an arbitrary and capricious rule does not necessarily cure it." *ALLTEL Corp.* v. *FCC*, 838 F.2d 551, 559 (D.C. Cir. 1988). Because that is exactly what the *Bureau Order* tries to do, the Commission should therefore reverse it, and affirm NECA's determination that none of the extraordinary costs of the Paniolo lease may be properly recovered from ratepayers.

[36] *See also, e.g.*, *Texas Office of Public Utility Counsel*, 265 F.3d at 328-29 (the Commission acted arbitrarily in selecting the amount of the USF, because it "failed to exercise sufficiently independent judgment in establishing the $ 650 million amount" and did not "explain how it actually derived that figure, and instead seems to invoke the Goldilocks approach to rulemaking: noting that "some commentators argue that the size of the interstate access universal service mechanism is too large [while] other commentators argue that the size . . . is too small," the FCC apparently believes that its approach is just right because it falls reasonably within the range of estimates.); *Schurz*, 982 F.2d at 1043 (no deference where the "impression created is of unprincipled compromises of Rube Goldberg complexity among contending interest groups viewed merely as clamoring suppliants who have somehow to be conciliated").

CONCLUSION

For the foregoing reasons, the Commission should grant AT&T's Application for Review and reverse the *Bureau Order*.

Dated: October 28, 2010

Respectfully submitted,

/s/ Robert Sutherland

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CERTIFICATE OF SERVICE

I hereby certify that on October 28, 2010, I caused a copy of the foregoing Application for Review to be served as indicated below to the following:

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