

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

In the Matter of:)
)
Walnut Hill Telephone Company)
)
Request for Review by Walnut Hill Telephone)
Company of a Decision of the Universal Service)
Administrator)
)
Petition for Waiver of Section 32.27(c) of the)
Commission's Rules.)
)

ORIGINAL

CC Docket No. 96-45
FILED/ACCEPTED

DEC 20 2011

**Federal Communications Commission
Office of the Secretary**

**REQUEST FOR REVIEW BY WALNUT HILL TELEPHONE COMPANY
OF A DECISION OF THE UNIVERSAL SERVICE ADMINISTRATOR AND
PETITION FOR WAIVER**

Walnut Hill Telephone Company ("Walnut Hill"), by its attorneys and pursuant to Sections, 1.3, 32.18, 54.719, and 54.722 of the Commission's Rules, hereby respectfully submits this Request for Review of a Decision of the Universal Service Administrator and Petition for Waiver, *nunc pro tunc*, of the requirements of Section 32.27(c) of the Rules. Application of the rule would require Walnut Hill to record certain equipment lease payments to an affiliate at a fully distributed cost and reduce the company's high-cost recovery, where the company could have avoided this outcome by choosing a more expensive leasing arrangement from a third party. Walnut Hill requests that the waiver include the period of time during which the lease payments were made in 2004 and 2005 through the present.

As described below, a waiver of the rule is justified, and the Universal Service Administrative Company's ("USAC") decision in Audit No. HC-2009-FL056/Follow-up Audit

HC 2007-166 to recover amounts associated with the equipment leases should be reversed. In support hereof, the following is shown:

I. Background

Walnut Hill is a small, rural, incumbent local exchange carrier providing exchange and exchange access telecommunications services in southwest Arkansas, study area code 401729, with approximately 4170 access lines.

From April 16, 2010, to August 4, 2010, Walnut Hill underwent an audit under the FCC's Office of the Inspector General audit program pertaining to disbursements made from the universal service fund ("USF") during the twelve-month period ended June 30, 2007. The audit was conducted by KPMG, LLP, which provided its final report to the USAC on August 4, 2010.¹

Part of KPMG's findings included a determination that twenty six lease payments made for vehicles and other work equipment by Walnut Hill to its parent company, Townes Telecommunications, Inc., ("TTI") were not recorded in compliance with Section 32.27(c)(3),² which requires services received by a carrier from an affiliate that exists solely to provide services to members of the carrier's corporate family be recorded at full distributed cost. Specifically, KPMG determined that Walnut Hill's use of the actual cost of equipment leased to Walnut Hill, rather than fully distributed cost, was a violation of the rule and resulted in HCL, LSS, and ICLS disbursements that were higher than they would have been had they been recorded at fully distributed cost.³ Based on this report, USAC determined it would recover

¹ *Walnut Hill Telephone Company Follow-up Audit Number HC-2009-FL056*, prepared by KPMG for USAC, August 4, 2010, relevant portions attached hereto as Appendix A. (KPMG Report).

² *KPMG Report* at 15.

³ *KPMG Report* at 15.

\$447,967 in high cost support in relation to the equipment lease discussed above, from future USF disbursements to Walnut Hill.⁴

Walnut Hill appealed USAC's decision by letter to USAC on the grounds that applying the rule to Walnut Hill created an unreasonable and uneconomical result, and asked USAC not to apply the rule in this circumstance.⁵ In its letter, Walnut Hill argued that it is unreasonable to expect a small company like Walnut Hill to purchase such equipment itself, due to the equipment's capital-intensive nature, and the fact that the lease rates from the corporate affiliate were less than those available through a third party.⁶ Thus, under the circumstances, the most reasonable and economic course for Walnut Hill was to lease the equipment from TTI. Walnut Hill demonstrated that it would have been charged a lease rate greater than the rate it paid if it had leased from a third-party vendor.⁷ In other words, Walnut Hill's lease expense was significantly reduced by leasing the equipment from TTI. Walnut Hill thus requested that USAC accept fair-market value data rather than the fully distributed cost to determine that Walnut Hill's USF disbursement was reasonable for the twelve month period ending June 2007.

While USAC recognized Walnut Hill's arguments, it nevertheless rejected the appeal without addressing the merits of Walnut Hill's argument, solely on grounds that only the Commission could waive application of the rule.⁸ Therefore, Walnut Hill respectfully submits this request for waiver, *nunc pro tunc*, of Section 32.27(c), and for review and reversal of USAC's decision to recover the funds in question.

⁴ Letter from Craig Davis, Director, High Cost, USAC, to Debi Nobles, Vice President, Regulatory Affairs for Walnut Hill, dated October 5, attached hereto as Appendix B.

⁵ Letter from Benjamin H. Dickens, Jr., of Blooston, Mordkofsky, Dickens, Duffy, & Prendergast, LLP, to High Cost and Low Income Division, USAC, dated Letter Nov 29, 2010, attached hereto as Appendix C.

⁶ *Id.*

⁷ *Id.*

⁸ Letter from Universal Service Administrative Company to Debi Nobles, Vice President, Regulatory Affairs for Walnut Hill, dated October 24, 2011, attached hereto as Appendix D.

II. Section 32.27 Requirements

Section 32.27(c) requires that, "For all other services sold by or transferred to a carrier from its affiliate, the services shall be recorded at no more than the lower of fair market value and fully distributed cost."⁹ Subpart (3) of the 32.27(c) further specifies that, "[a]ll services received by a carrier from its affiliate(s) that exist solely to provide services to members of the carrier's corporate family shall be recorded at fully distributed cost."¹⁰

III. Waiver Standard

Section 32.18 sets out the standard for a waiver of the provisions of the Part 32 accounting system. Under that section, waiver is appropriate where "such a waiver is in the public interest" and the applicant's request for waiver "expressly demonstrates that: existing peculiarities or unusual circumstances warrant a departure from a prescribed procedure or technique; a specifically defined alternative procedure or technique will result in a substantially equivalent or more accurate portrayal of operating results or financial condition, consistent with the principles embodied in the provisions of this system of accounts; and the application of such alternative procedure will maintain or improve uniformity in substantive results as among telecommunications companies."

⁹ 47 CFR 32.27(c).

¹⁰ 47 CFR 32.27(c)(3).

The Commission has, on several occasions, waived the accounting requirements of Section 32.27, where the public interest was served by allowing a carrier to avoid unnecessary expense,¹¹ albeit under different factual circumstances.

Section 1.3 of the Rules states, in relevant part, that “[a]ny provision of the rules may be waived by the Commission on its own motion or on petition if good cause therefor is shown.” According to controlling precedent,¹² a rule waiver “may be granted in instances where the particular facts make strict compliance inconsistent with the public interest if applied to the petitioner and when the relief requested would not undermine the policy objective of the rule in question.”¹³ The Commission has held that, “a waiver is appropriate if special circumstances warrant a deviation from the general rule, and such deviation would better serve the public interest than strict adherence to the general rule.”¹⁴

V. Argument

The requested waiver meets the standards of the Commission’s waiver rules and applicable precedent. Walnut Hill acted reasonably and in an economic fashion when it leased the equipment at issue from TTI. However, application of the rule would have the perverse effect of requiring Walnut Hill to have pursued a more costly alternative for the same services.

¹¹ See, e.g., In the Matter of US West, Inc.; Petition for Waiver of Section 32.27(c) of the Commission's Rules, 15 FCC Rcd 4400 (2000) (granting a waiver to allow US West to use fully distributed cost rather than incur the expense of a fair market valuation); In the Matter of Verizon Telephone Companies; Petition for Waiver of Section 32.27(c) of the Commission's Rules, 17 FCC Rcd 6997(2002); In the Matter of Qwest Services Corporation; Petition for Waiver of Section 32.27(c) of the Commission's Rules, 18 FCC Rcd 770 (2003).

¹² WAIT Radio v. FCC, 418 F.2d 1153 (D.C. Cir. 1969), *appeal after remand*, 459 F.2d 1203 (D.C. Cir. 1972), *cert. denied*, 409 U.S. 1027 (1972). Northeast Cellular Telephone Company v. FCC, 897 F.2d 1164(D.C. Cir. 1990).

¹³ See, e.g., In re Joint Waiver Request by Stratophone, LLC & SkyTel Spectrum, LLC, 25 FCC Rcd 8581, 8587 (F.C.C. 2010) at n54.

¹⁴ In the Matter of Request for Waiver of Section 54.611 of the Commission's Rules; Unicom, Inc. Anchorage, Alaska; Rural Health Care Universal Service Support Mechanism, 21 FCC Rcd 11240, 11243 (2006), citing Northeast Cellular.

As shown in the list of third-party lease rates obtained by Walnut Hill and provided to USAC in its letter of appeal,¹⁵ Walnut Hill would have paid a greater lease rate for most of the leased items if it had leased this equipment from a third party vendor.¹⁶ Taken in total, the lease rate from a third party vendor would have been approximately 15% to 20% higher, depending on whether equipment was leased at monthly or annual rates.

Granting the waiver thus satisfies the public interest requirements of both 32.18 and 1.3. The Commission's policy objective in promulgating its affiliate transaction rules was to protect the public (and underlying rates paid by the public and subject to regulation) from less than arm's length transactions which routinely occur in the carrier market. It is surely in the public interest, then, to avoid the application of the instant rule, where it would otherwise increase the cost of service.

Specifically, when the Commission last revised 32.27 to include the present language,¹⁷ it recognized that, "our current treatment of services that are neither tariffed nor subject to prevailing company prices made generally available may in fact reward a carrier that acts imprudently when buying ... and selling services to an affiliate."¹⁸ Previously, the rules required services purchased from a non-regulated affiliate at fully distributed cost, regardless of whether that figure was higher or lower than fair market value. The Commission was concerned that a carrier would intentionally pay more for services purchased from an affiliate, despite lower rates being available from third parties, which would in turn harm rate payers. In this case, the exact opposite effect is occurring: the rule is discouraging a carrier from paying less for services purchased from an affiliate, compared to higher rates available from third parties. Grant of the

¹⁵ See Appendix C at Attachment A.

¹⁶ *Id.*

¹⁷ In the Matter of Implementation of the Telecommunications Act of 1996: Accounting Safeguards Under the Telecommunications Act of 1996, 11 FCC Rcd 17539, 17541 (FCC 1996).

¹⁸ *Id.* at ¶145.

requested waiver would thus reward efficient behavior with consequent benefit for consumers, consistent with the Commission's policy.

The remaining requirements of Section 32.18 are satisfied as well. As described above, waiver is appropriate under Section 32.18 where a carrier shows i) existing peculiarities or unusual circumstances warrant a departure from a prescribed procedure or technique; ii) a specifically defined alternative procedure or technique will result in a substantially equivalent or more accurate portrayal of operating results or financial condition, consistent with the principles embodied in the provisions of this system of accounts; and iii) the application of such alternative procedure will maintain or improve uniformity in substantive results as among telecommunications companies.

Because Walnut Hill's affiliate lease payments were less than third party vendor rates for the same equipment, its choice was economic and warrants a departure from the rule. Moreover, its lease rates portray more accurate results for the cost of these services in the market, and should improve uniformity among its peers, since it would not have been artificially imputed to have utilized an uneconomic alternative. The request rule waiver therefore should be granted.

Walnut Hill also seeks review of the USAC decision. For reasons described in the foregoing discussion, the Commission should also review and reverse USAC's decision to recover funds associated with the leasing arrangements. USAC's decision to recover the funds at issue here appears based entirely upon its inability to waive application of the rule as requested by Walnut Hill. Therefore, grant of Walnut Hill's Petition for Wavier, *nunc pro tunc*, will remedy the issue identified by USAC as grounds for its decision, and the decision should subsequently be reversed.

VI. Conclusion

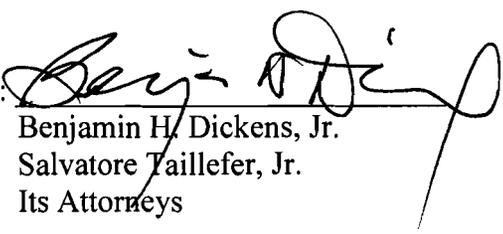
For the forgoing reasons, Walnut Hill respectfully requests the Commission grant its petition for waiver of Section 32.27(c) in the above-described circumstances and reverse the USAC decision to recover USF amounts associated with the above-referenced equipment.

Good cause exists to waive the requirements of Section 32.27(c) of the Commission's Rules because, as discussed above, application of the rule in this circumstance creates a perverse incentive that runs counter to the Commission's policy underlying its affiliate transaction rules. Therefore, the public interest will be served by granting the requested waiver, and the requested reversal of USAC's decision.

Since USAC's decision to recover the above-referenced amounts is based on its inability to waive Section 32.37(c), Walnut Hill also respectfully requests the Commission also reverse USAC's decision.

Respectfully submitted,

Walnut Hill Telephone Company

By: 

Benjamin H. Dickens, Jr.
Salvatore Taillefer, Jr.
Its Attorneys

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Filed: December 20, 2011

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

In the Matter of:)	
)	
Walnut Hill Telephone Company)	
)	
Request for Review by Walnut Hill Telephone Company of a Decision of the Universal Service Administrator)	
)	
Petition for Waiver of Section 32.27(c) of the Commission's Rules.)	CC Docket No. 96-45
)	

DECLARATION OF DEBORAH NOBLES

I, Deborah Nobles, do hereby, under penalty of perjury, declare and state as follows:

1. My name is Deborah Nobles. I am employed by Walnut Hill Telephone Company ("Walnut Hill") as Vice President of Regulatory Affairs. In that capacity, I am familiar with Walnut Hill's filings with the Universal Service Administrative Company ("USAC") and its compliance with the Commission's rules. I am also familiar with the audit conducted on behalf of USAC regarding Walnut Hill's compliance with the requirements of the Federal High Cost Universal Service Program for the period of time considered in the foregoing Request for Review by Walnut Hill of the Decision of the Universal Service Administrator and Petition for Waiver ("Petition for Review").
2. In accordance with Commission rule 54.721(b), I have review the factual assertions set forth in Walnut Hill's Petition for Review and hereby certify that such factual assertions are true and correct to the best of my knowledge.


Deborah Nobles

Dated: 12/20/11

CERTIFICATE OF SERVICE

The undersigned hereby certifies that on the 20th day of December, 2011, a copy of the foregoing **Request for Review by Walnut Hill Telephone Company of a Decision of the Universal Service Administrator and Petition for Waiver** was served upon the following by US Mail, postage prepaid:

Universal Service Administrative Company
2000 L Street NW, Suite 200
Washington, DC 20036

By: 
Salvatore Taillefer, Jr.

APPENDIX A



High Cost and Low Income Division

Certified Mail, Return Receipt Requested

September 28, 2010

RE: Results of the Follow-Up Audit to the 2007-2008 Federal Communications Commission (FCC) Office of the Inspector General (OIG) Audit

Dear Beneficiary:

Enclosed are the finalized report from, and the USAC High Cost Management Response to, the follow-up audit to your FCC OIG audit. Included in the High Cost Management Response may be directives required for the closure of audit findings and/or comments. Please complete any such follow-up measures and provide documentation of corrective actions to USAC High Cost within 60 days of receipt of this letter, if applicable.

As is the case with any administrative decision made by USAC, you have the right to appeal findings and/or comments within the audit and High Cost Management Response. You may appeal to USAC or the FCC, and the appeal must be filed within 60 days of receipt of this letter. Additional information about the appeals process may be found at <http://www.usac.org/hc/about/filing-appeals.aspx>.

If you have any questions, please contact the High Cost Program at 202-776-0200 or hcaudits@usac.org. Please direct all High Cost audit correspondence to either the e-mail address above or:

USAC
Attn: HC Audits
2000 L Street, NW
Suite 200
Washington, DC 20036

Sincerely,

High Cost Program Management

Enclosure: Final Audit Report



Walnut Hill Telephone Company
Follow-up Audit Number: HC-2009-FL056
(SAC Number: 401729)

Performance audit for the Universal Service Fund
disbursements made during the twelve-month period
ended June 30, 2007

Prepared for: Universal Service Administrative Company

As of Date: August 4, 2010

KPMG LLP
345 Park Avenue
New York, NY 10154

2. HC-2009-FL056-F02: Unsupported and Inappropriately Classified Expenses

Condition

Thirty of the 45 expense samples selected for testing were identified as exceptions. The details are as follows:

- a) Twenty six of the 30 exceptions related to lease payments, of \$94,717 per month, for Vehicles and Other Work Equipment, made by the Beneficiary to its parent company (TTI), were unsupported. In addition, these lease payments were not in compliance with FCC Rules and Orders governing affiliate transactions and were determined using a "fair market value" rate, when the Rules require that such transactions be recorded on a fully distributed cost basis. These expenses totaled \$2,117,978; \$1,059,010 for 2004 and \$1,058,968 for 2005.
- b) Two of the 30 exceptions related to expenses that were inaccurately recorded in a regulated account (Account 672015 – Other Expense), instead of a non-regulated expense account (Account 931145 – Internet Expense). These expenses totaled \$10,776 and were for

2005.

- c) Two of the 30 exceptions related to expenses that were inaccurately recorded in a plant non-specific account (Account 672012 - Telecommunications Expense), instead of a plant specific account (Account 6232 - Circuit Equipment Expense). These expenses totaled \$8,952 and were for 2004.

Criteria

According to 47 C.F.R. § 32.27(c)(3), "All services received by a carrier from its affiliate(s) that exist solely to provide services to members of the carrier's corporate family shall be recorded at fully distributed cost."

In addition, according to 47 C.F.R. § 32.12(a) and (b), "The company's financial records shall be kept in accordance with generally accepted accounting principles to the extent permitted by this system of accounts. The company's financial records shall be kept with sufficient particularity to show fully the facts pertaining to all entries in these accounts."

Further, according to 47 C.F.R. § 54.202(e), "All eligible telecommunications carriers shall retain all records required to demonstrate to auditors that the support received was consistent with the universal service high-cost program rules. These records should include the following: data supporting line count filings; historical customer records; fixed asset property accounting records; general ledgers; invoice copies for the purchase and maintenance of equipment; maintenance contracts for the upgrade of equipment; and any other relevant documentation. This documentation must be maintained for at least five years from the receipt of funding."

Cause

The preparation, review and approval processes related to the calculation of lease payments did not identify the requirement to perform the calculation at fully distributed cost. In addition, the expense reporting process did not identify the requirement to properly record costs to the appropriate regulated account, or detect the recording of non-regulated amounts to regulated accounts.

Effect

The exceptions identified above have an impact on HCL, LSS and ICLS disbursements. The monetary impact of this finding relative to disbursements made from the USF for the HCP for the twelve-month period ended June 30, 2007 is estimated as follows:

- HCL disbursements calculated in the 2004 and 2005 data submissions were \$249,807 higher than they would have been had amounts been reported properly.
- LSS disbursements calculated in the 2005 data submission were \$41,860 higher than they would have been had amounts been reported properly.
- ICLS disbursements calculated in the 2004 data submission were \$156,300 higher than they would have been had amounts been reported properly.