

In the Matter of)
)
Sandwich Isles Communications, Inc.) WC Docket No. 10-90

Released: December 5, 2016

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1. In this Order, the Federal Communications Commission (Commission) takes action to protect the Universal Service Fund (USF or Fund) from waste, fraud and abuse based on the results of an extensive investigation extending over nine months, conducted by the Universal Service Administrative

Company (USAC) regarding circumstances surrounding universal service high-cost support received by Sandwich Isles Communications, Inc. (Sandwich Isles, SIC or Company) from 2002 to June 2015 (USAC Report).¹ In addition to examining whether past amounts of support were consistent with Commission rules, USAC reviewed Sandwich Isles' current corporate structure and finances to enable the Commission to determine whether to lift or modify the Commission's current suspension of Sandwich Isles' high-cost support.²

2. Based on the USAC Report and our own review, we conclude that Sandwich Isles improperly received payments in the amount of \$27,270,390 from the federal high-cost support mechanisms from 2002 to June 2015. We direct USAC to take action immediately to recover that amount from Sandwich Isles. In addition, we find that an amount to be determined of the inflated management fees paid by Sandwich Isles to its parent company Waimana Enterprises, Inc. (Waimana or WEI) were excessive, and that Sandwich Isles failed to provide sufficient information to justify its reported management fees. Therefore, we disallow all management fees above the average amount paid by comparable entities for the period 2002 to 2015.³ We direct USAC to calculate the total amount of improper payments for inflated management fees and then initiate action to recover those amounts from Sandwich Isles. We direct Sandwich Isles to resubmit its cost studies and high-cost forms for costs incurred in 2013, 2014, and 2015, within 60 days after the date of this Order so that USAC can determine the proper amount of high-cost support that should have been disbursed to Sandwich Isles in 2015 and 2016 and the amounts that should be disbursed in 2017 consistent with our findings in this Order.⁴ This includes taking all necessary steps to modify its cost studies so that the identified violations do not result in overpayments in future periods.

3. Given the number of violations of the affiliate transaction rules we find today, we also direct USAC to undertake an investigation of Sandwich Isles' affiliate transactions for costs incurred in calendar year 2016 to ensure that Sandwich Isles accurately reports its costs going forward.

II. BACKGROUND

A. Regulatory Framework

4. Smaller incumbent local exchange carriers (LECs), such as Sandwich Isles that operate under rate-of-return regulation at the federal level receive high-cost support based on historical costs.⁵

¹ Memorandum from Universal Service Administrative Company to FCC Wireline Competition Bureau, Investigation of Sandwich Isles Communications, Inc. (May 13, 2016) (USAC Report).

² USAC Report at 1.

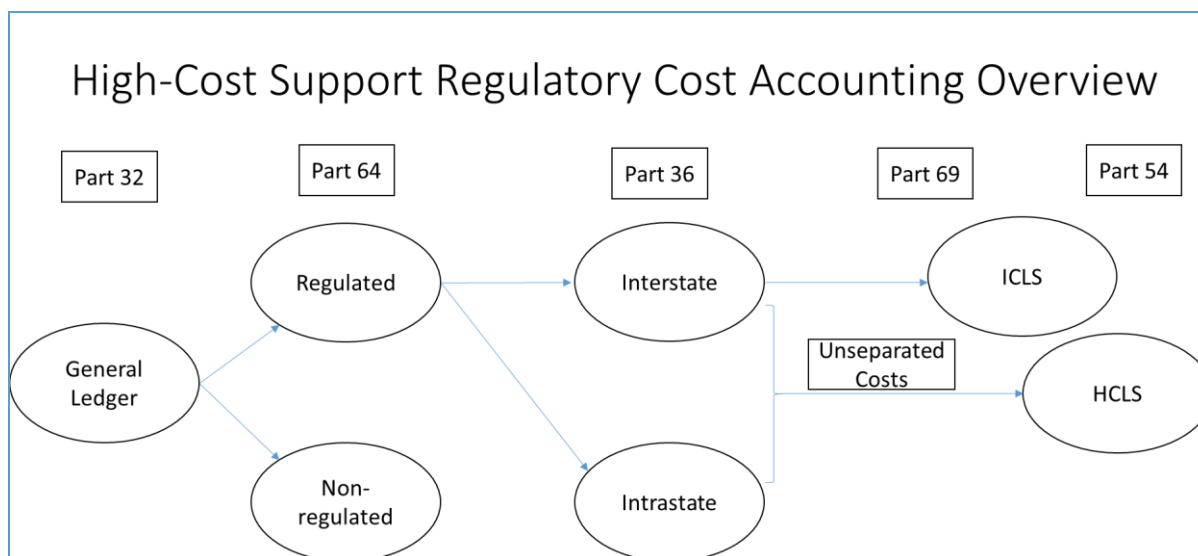
³ In calculating the amounts that USAC shall collect from Sandwich Isles for excessive management fees, we direct USAC to disallow the management fees in excess of \$1,237,355, which is the average amount of the comparable entities' average management fees for 2012, 2013, and 2014, and apply that approach for each year, from 2002 to 2015. See USAC Report at 78.

⁴ See *infra* para. 14 & n. 33 (detailing the forms that carriers are required to submit to calculate high-cost support mechanisms). Prior to disbursing high-cost support to Sandwich Isles, USAC must receive all necessary certifications from the Hawaii Public Utilities Commission pursuant to section 54.314(a) of the Commission's rules. See 47 CFR § 54.314(a). Sandwich Isles also has ongoing obligations to its customers to continue to provide interstate telecommunications pursuant to section 214(e)(3) of the Communications Act of 1934, as amended, and may not discontinue service without the Commission's express authorization. See 47 U.S.C. §§ 214(a) & (e)(3); 47 CFR § 63.71. See also Letter from Matthew S. DelNero, Chief, Wireline Competition Bureau, FCC, to James Arden Barnett, Jr., Esq., Counsel to Sandwich Isles, dated Jan. 8, 2016 (reminding Sandwich Isles of its obligation to maintain uninterrupted service to its customers).

⁵ Cost companies are those companies that receive compensation for the use of their facilities in originating and terminating interstate services on the basis of their actual interstate costs of performing those functions. Average schedule companies receive support based on formulas developed based on the reported costs of the cost companies.

(continued....)

Rate-of-return companies must comply with the Commission's regulatory cost accounting rules, including Parts 32, 36, 64, and 69.⁶ Pursuant to Part 54, such companies receive high-cost support based on their costs as determined by the Commission's cost accounting rules. The chart below depicts a summary of the regulatory cost accounting process that is used to calculate high-cost support.



1. Uniform System of Accounts (Part 32)

5. As a first step in the regulatory cost accounting process, rate-of-return companies record their costs, including investments and expenses, into various accounts in accordance with the Uniform System of Accounts (USOA) prescribed by Part 32 of the Commission rules.⁷ Section 220 of the Communications Act of 1934, as amended, requires the Commission to prescribe a uniform system of accounts for telephone companies.⁸ Part 32 of the Commission's rules implements the requirements of section 220 and contains the USOA.⁹

6. The USOA is an historical financial accounting system that discloses the results of operational and financial activities in a manner that enables both the companies' management and policy-making agencies to assess their results. The USOA performs four general functions. First, the USOA sets forth a standard chart of accounts and directs companies how to record certain transactions in their books of account. Second, the USOA establishes rules for a carrier's affiliate transactions. Third, the USOA specifies accounting treatment for depreciation expenses. Finally, the USOA requires carriers to maintain property records of all telecommunications plant in service (TPIS).

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Connect America Fund et al., Report and Order, Order and Order on Reconsideration, and Further Notice of Proposed Rulemaking, 31 FCC Rcd 3087, 3096-97, para. 20 (2016) (*Rate-of-Return Reform Order*).

⁶ See 47 CFR Parts 32, 36, 54, 64, and 69.

⁷ Part 32 specifies the asset, liability, equity, revenue and expense accounts that must be maintained to record amounts for preparation of a carrier's financial statements for its regulated and nonregulated activities. See, e.g., 47 CFR §§ 32.14 and 32.23.

⁸ 47 U.S.C. § 220.

⁹ See 47 CFR Parts 32.

2. Allocation of Regulated and Non-regulated Costs (Part 64)

7. The second step in the regulatory cost accounting process requires rate-of-return companies to directly assign or allocate investments, expenses, and revenues between regulated and nonregulated activities using the rules contained in Part 64.¹⁰

8. Section 254(k) of the Communications Act of 1934, as amended, requires the Commission, with respect to interstate services, to establish any necessary cost allocation rules, accounting safeguards, and guidelines to ensure that services included within the definition of universal service bear no more than a reasonable allocation of joint and common costs of facilities used to provide these services.¹¹ The requirements in Part 64, Subpart I of the Commission's rules are based on the Commission's authority under section 201 and 220 of the Act.¹² Part 64, Subpart I prescribes procedures for the allocation of carriers' costs between regulated and nonregulated activities. Subpart I requires that all incumbent LECs subject to separation of regulated and nonregulated costs use the attributable cost method of cost allocation, and lists a number of cost allocation principles that such carriers must follow.¹³ The Part 64, Subpart I rules protect consumers by preventing cross-subsidization between regulated and nonregulated activities provided by carriers subject to the cost allocation requirements. These rules ensure that carriers compete fairly in nonregulated markets and that regulated ratepayers do not bear the risks and burdens of the carriers' competitive, or nonregulated, ventures.

3. Jurisdictional Separations (Part 36)

9. The third step in the regulatory cost accounting process for high-cost support is that rate-of-return companies separate their regulated investments, expenses and revenues between the intrastate and interstate jurisdictions in accordance with Part 36 (Jurisdictional Separations).¹⁴ The Part 36 jurisdictional separations rules contain procedures and standards for dividing telephone company investment, expenses, taxes, and reserves between the state and the federal jurisdictions. For rate-of-return companies, separated costs form the basis for interstate access charges with which the companies receive compensation for the use of their facilities to originate and terminate interstate telecommunications services. The separations procedures to determine the allocation of costs between state and interstate jurisdictions existed for decades.¹⁵

¹⁰ 47 CFR §§ 64.901–04. Specifically, when a carrier subject to the Act uses the same facilities to provide both telephony service and a nonregulated service such as video, the carrier must allocate the costs of such facilities between these services. *See also* 47 C.F.R. § 32.14(a) (providing that “regulated accounts shall be interpreted to include the investments, revenues and expenses associated with those telecommunications products and services to which the tariff filing requirements contained in Title II of the Communications Act of 1934... are applied...”); 47 CFR § 32.23 (describing nonregulated activities).

¹¹ 47 U.S.C. § 254(k).

¹² 47 U.S.C. §§ 201, 220.

¹³ Average schedule companies do not perform cost studies and do not perform cost allocations pursuant to Part 64, subpart I.

¹⁴ *See* 47 CFR Part 36. The separations procedures set forth in Part 36 are designed primarily for the allocation of property costs, revenues, expenses, taxes and reserves between state and interstate jurisdictions. 47 CFR § 36.1(b). As noted above, the jurisdictional separations process begins with the Uniform System of Accounts, Part 32 of the Commission's rules. *See* 47 CFR § 36.2(f). For purposes of jurisdictional separation, “the Commission distinguishes traffic sensitive costs from non-traffic sensitive costs... these terms refer respectively to exchange company costs that vary with the extent of phone usage and those that do not.” *See City of Brookings Municipal Telephone Co. v. FCC*, 822 F.2d 1153 (1987).

¹⁵ Historically, the separations process was contained in the 1947 edition of the National Association of Regulatory Utility Commissioners (NARUC) - FCC separations manual (the 1947 Separations Manual).

10. The division of costs between the state and federal jurisdictions is necessary for the calculation of state and federal earned rates of return. In addition to allocating costs between the federal and state jurisdictions, Part 36 also historically performed a universal service function. Specifically, Part 36 historically permitted carriers that serve high-cost areas to allocate additional local loop costs to the interstate jurisdiction through a so-called “Expense Adjustment” and to recover those costs through the high-cost loop support (HCLS) mechanism, thus making intrastate telephone service in high-cost areas more affordable.¹⁶

4. Access Charges (Part 69)

11. Finally, the fourth step in the regulatory cost accounting process for high-cost support is that rate-of-return companies apportion their interstate-regulated costs among the interexchange services and rate elements that form the cost basis for the incumbent LECs’ interstate access tariffs, in accordance with Part 69 of the Commission’s rules.¹⁷ Consistent with Part 69, carriers must submit “cost studies” – data on cost, demand and access revenue to the National Exchange Carrier Association (NECA), which files tariffs on behalf of many of the smaller, rate-of-return LECs.¹⁸ Pursuant to section 69.601(c), carriers must include with their data submissions to NECA a certification providing that, “based on information known to me or provided to me by employees responsible for the preparation of the data in this submission, . . . the data have been examined and reviewed and are complete, accurate, and consistent with the rules of the Federal Communications Commission.”¹⁹

12. Sections 201 and 202 of the Communications Act of 1934, as amended, require that rates, terms and conditions for telecommunications services be just and reasonable, and prohibit unjust or unreasonable discrimination.²⁰ Part 69 implements, in part, these sections of the Act by establishing rules that perform the following major functions. First, the Part 69 rules establish the rate structure for access charges to be paid by interexchange carriers to LECs for the origination and termination of long distance calls, as well as the access charges to be paid directly by end users. These rate structure rules establish the access charge rate elements as well as the nature of the charges, such as whether they are assessed on a per-minute or a flat-rate basis. Second, the Part 69 rules govern how rate-of-return LECs calculate their access charge rates.

5. Universal Service (Part 54)

13. Part 54 contains rules governing the federal universal service programs, including the high-cost support mechanisms.²¹ The federal high-cost program (also known as the Connect America Fund) is designed to ensure that consumers in rural, insular, and high-cost areas have access to modern communications networks capable of providing voice and broadband service, both fixed and mobile, at rates that are reasonably comparable to those in urban areas. The local exchange telephone industry is, for the most part, characterized as an industry with large, fixed capital investments that represent a high

¹⁶ In 2014, the relevant provisions contained in Part 36 were moved to Part 54 without substantive change. The Expense Adjustment currently is codified at 47 CFR § 54.1310.

¹⁷ See 47 CFR Part 69.

¹⁸ Carriers also provide operating data pertaining to working loops, exchange counts and non-traffic sensitive data to NECA. Pursuant to Commission rules, NECA is responsible for, among other duties, collecting cost data, including revenue, expense, and investment data, from all pooling LECs to develop specific revenue requirements in order to recover incurred costs allocated to the interstate jurisdiction under the Commission’s jurisdictional rules in 47 CFR Part 36. See generally 47 CFR § 69.601(a).

¹⁹ See 47 CFR § 69.601(c). Moreover, the required certification states that, “[p]ersons making willful false statements in this data submission can be punished by fine or imprisonment under the provisions of the U.S. Code, Title 18, Section 1001.” *Id.*

²⁰ 47 U.S.C. §§ 201, 202.

²¹ See 47 CFR Part 54.

percentage of total costs. Historically, the Commission has recognized that incumbent telephone companies make large amounts of capital investment and in some areas cannot recover all of their costs from end user rates.²² The high-cost program allows eligible telecommunications carriers (ETCs) that serve high-cost areas to recover some of their costs from the Fund. High-cost support provided to an ETC must be used “only for the provision, maintenance, and upgrading of facilities and services for which the support is intended.”²³

14. USAC, as the Administrator of the federal universal service support mechanisms, is responsible for day-to-day administration of the high-cost program.²⁴ Generally speaking, HCLS provides support for some loop costs that otherwise would be recovered in the intrastate jurisdiction, while interstate common line support (ICLS) provides support for that portion of the interstate common line revenue requirement that is not recovered from end users through subscriber line charges. Cost companies receive high-cost support based on information contained in their cost studies. Pursuant to the rules, carriers are required to submit certain data necessary to calculate HCLS payments to NECA, certifying that it is accurate to the best of their knowledge, and NECA in turn transmits that information to USAC.²⁵ For rate-of-return cost companies such as Sandwich Isles, NECA performs a twenty-six step calculation, which determines a study area’s total unseparated cost per loop, and ultimately the company’s HCLS.²⁶ USAC collects information necessary to calculate ICLS payments on FCC Forms 507, 508, and 509. Carriers and their agents submitting those forms are required to certify that the information contained therein is accurate to the best of their knowledge.²⁷

15. In the *USF/ICC Transformation Order*, the Commission comprehensively reformed universal service funding for high-cost, rural areas, adopting fiscally responsible, accountable, incentive-based policies to preserve and advance voice and broadband service while ensuring fairness for consumers who pay into the Universal Service Fund.²⁸ It did not fundamentally alter the major support mechanisms in place for rate-of-return carriers at the time, specifically HCLS and ICLS. Among other things, however, the Commission adopted a new rule that established a \$250 per line per month cap on high-cost support, exclusive of Connect America Fund Intercarrier Compensation Replacement support (\$250 cap).²⁹

²² See *Moultrie Independent Telephone Company et al.*, Order, 16 FCC Rcd 18242, 18247, para. 11 (2001).

²³ 47 CFR § 54.7; see also 47 U.S.C. § 254(e).

²⁴ In general, USAC is charged with collecting and distributing universal service funds. See 47 CFR §§ 54.701(a), 702(b).

²⁵ See 47 CFR § 69.601(c). NECA analyzes cost data, performs certain calculations, and then transmits the information to USAC for use in determining HCLS payments to eligible carriers. See 47 CFR §§ 54.54.1305-54.1307. HCLS predates the enactment of section 254 and the creation of USAC. See *Fed.-State Joint Bd. on Universal Serv.*, Report and Order, 12 FCC Rcd 8776, 8939-40, para. 300-302 (1997) (*Universal Service First Report and Order*) (subsequent history omitted).

²⁶ See, e.g., *Connect America Fund High-Cost Universal Serv. Support*, 27 FCC Rcd 4235, 4238-39, para. 9 (WCB 2012).

²⁷ Agents for the reporting carrier certify that they are authorized to submit the information reported on forms on behalf of the reporting carrier, and to the best of their knowledge, the information reported is accurate. Furthermore, the agents certify that the cost data provided is compliant with the Commission’s cost allocation rules and does not reflect duplicative assignment of costs to the consumer. Moreover, the required certification on the FCC Forms used to collect cost information for purposes of ICLS states that, “[p]ersons making willful false statements in this data submission can be punished by fine or imprisonment under the provisions of the U.S. Code, Title 18, Section 1001.”

²⁸ *Connect America Fund et al.*, Report and Order and Further Notice of Proposed Rulemaking, 26 FCC Rcd 17663 (2011), *aff’d sub nom In re: FCC 11-161*, 753 F.3d 1015 (10th Cir. 2014) (*USF/ICC Transformation Order*).

²⁹ 47 CFR § 54.302; *USF/ICC Transformation Order*, 26 FCC Rcd at 17765, para. 274 (adopting section 54.302).

B. Corporate Ownership and Structure of Sandwich Isles

16. *Sandwich Isles Communications, Inc.* Sandwich Isles, a Hawaii corporation, was designated as an ETC in 1997 to provide service to customers on the Hawaiian Home Lands.³⁰ According to Sandwich Isles, by virtue of a license granted by the State of Hawaii Department of Hawaiian Home Lands (DHHL), it assumed the obligation to provide wireline communication services on the Hawaiian Home Lands.³¹

17. Sandwich Isles is a wholly owned subsidiary of Waimana Enterprises, Inc. (WEI or Waimana). Sandwich Isles presently employs approximately 80 people and provides and/or receives business services from Waimana and several affiliate companies owned and/or controlled by Albert Hee and three separate irrevocable trusts for the benefit of Albert Hee's three adult children, Adrienne Hee, Breanne Hee, and Charlton Hee (Hee Children Trusts).

18. Following its designation as an ETC, Sandwich Isles has consistently participated in the high-cost support program as a cost company. From at least 2000 through 2015, Sandwich Isles submitted an annual cost study to NECA and other data submissions to USAC. As to each cost study, a Sandwich Isles official certified the accuracy of the cost study data pursuant to section 69.601(c) of the Commission's rules.³² This data was used to determine its annual amounts of HCLS. Sandwich Isles also certified as to the accuracy of information contained in the high-cost forms filed for ICLS.³³ Based on data submitted, as of June 2015, Sandwich Isles had received approximately \$249,227,589 from the Fund's high-cost support program since 2002.³⁴

19. *Waimana.* Waimana is a Hawaii corporation formed in 1988 and is the direct holding company for Sandwich Isles. From the time of its incorporation until approximately 2013, Albert Hee owned 100 percent of Waimana's stock.³⁵ In or about 2013, Albert Hee's ownership interest in Waimana was reduced to 10 percent. The remaining 90 percent ownership interest in Waimana was divided among the Hee Children Trusts.³⁶ In addition to Sandwich Isles, Waimana served, and continues to serve, as a

³⁰ Sandwich Isles was designated an ETC on May 14, 1997, and the Company's tariff became effective on December 17, 1997. *Sandwich Isles Communications, Inc. Petition for Waiver of Section 54.302 of the Commission's Rules*, WC Docket No. 10-90 and WT Docket No. 10-208, at 1, 12 (filed December 30, 2011) (*Sandwich Petition*).

³¹ *Sandwich Petition* at iii. According to the *Sandwich Petition*, the Hawaiian Home Lands consist of approximately 70 non-contiguous parcels, which total 203,500 acres on six islands. *Id.* at 9.

³² 47 CFR § 69.601(c). For cost study years 2000 and 2001, Judy Ushio signed the certifications as SIC's authorized official. For cost study years 2002-2013, Abigail Tawarahara signed SIC's cost study certifications. *See, e.g., Sandwich Isles Communications, Inc. National Exchange Carrier Association Cost Studies, Years 2000 – 2013*, Attachment A, Cost Study Certification Form.

³³ *See* 47 CFR §§ 54.903(a)(3)(4). In order to receive ICLS, Sandwich Isles was required to submit the following forms to USAC: (1) FCC Form 507 Interstate Common Line Support Mechanism Line Count Report; (2) FCC Form 508 Interstate Common Line Support Mechanism Projected Annual Common Line Requirement Form; and (3) FCC Form 509 Interstate Common Line Support Mechanism Annual Common Line Actual Cost Data Collection Form.

³⁴ USAC Report at 5.

³⁵ *See* Testimony of Kristy Morgan, Transcript of Jury Trial (Day 2) at 30:13-16, *United States v. Hee*, No. CR 14-00826 SOM (D. Haw. Apr. 27, 2015) (*Hee Trial Transcript*); Response to USAC *Investigation*, Audit Inquiry - "3_Corporate Ownership Interest Chart."

³⁶ *See* Testimony of Albert Hee, *Hee Trial Transcript*, Day 9 at 135-36. The [BEGIN CONFIDENTIAL] [REDACTED]

[END CONFIDENTIAL]. *Id.* Sandwich Isles, as a domestic or international telecommunications carrier, was required to file an application for approval of transfer of control when Waimana changed its ownership pursuant to section 214 of the Communication Act of 1934, as amended. *See* 47 U.S.C. § 214; 47 CFR §§ 63.03; 63.04 and 63.24(c). No such application was filed.

holding company for numerous corporate entities that are owned or controlled by Albert Hee and/or the Hee Children Trusts.³⁷

20. According to SIC, Waimana provides [BEGIN CONFIDENTIAL] [REDACTED]

[REDACTED] [END CONFIDENTIAL].³⁸

Sandwich Isles paid Waimana an average of [BEGIN CONFIDENTIAL] [REDACTED] [END CONFIDENTIAL] percent of Waimana's annual revenue.³⁹ From 2002-2015, Waimana received more than [BEGIN CONFIDENTIAL] [REDACTED] [END CONFIDENTIAL] agreement executed between the companies.⁴⁰ At various times, the Waimana Board of Directors was comprised of Albert Hee, Wendy R. Hee, Adrienne Hee, Breanne Hee-Kahalewai, and Charlton Hee.⁴¹

21. *Paniolo Cable Company, LLC (Paniolo Cable)*. Paniolo Cable is the owner of a fiber optic cable network leased by Sandwich Isles to provide telephone services in its exchange areas. Sandwich Isles received monthly payments from the NECA pool for certain costs associated with the Paniolo Cable lease.⁴² Paniolo Cable was owned by Blue Ivory, LLC (Blue Ivory), and the sole managing member of Blue Ivory was Blue Ivory Hawaii Corp. (Blue Ivory Corp).⁴³ Blue Ivory was owned entirely in equal shares by the Hee Children Trusts.⁴⁴ [BEGIN CONFIDENTIAL] [REDACTED] [END CONFIDENTIAL] served as the sole, uncompensated officer and director of Blue Ivory Corp.⁴⁵

³⁷ Waimana's corporate structure consists of several affiliate companies each owned directly or indirectly by Albert Hee and/or the Hee Children Trusts.

³⁸ See SIC Response to USAC Investigation, Initial Requested Document, Request No. 3.

³⁹ See Waimana 2002 through 2014 Internal Statement of Profit and Loss; see also *Sandwich Isles Communications, Inc. Petition for Waiver of Section 54.302 of the Commission's Rules*, Order, 28 FCC Rcd 6553, 6560-61, para. 17 (WCB 2013) (*Sandwich Isles Waiver Order*) (highlighting concern with the significant payments that Sandwich Isles paid to Waimana).

⁴⁰ See *id.*

⁴¹ See, e.g., Testimony of David Chinaka, *Hee Trial Transcript*, Day 3 at 7; Testimony of Breanne Hee-Kahalewai, *Hee Trial Transcript*, Day 9 at 44.

⁴² The NECA pool is an averaging mechanism to smooth out access rates for small carriers over a larger base of costs and revenues. Small telephone companies are allowed to participate in the voluntary cost and revenue pools associated with the access tariff filed by NECA. NECA calculates and files rates based on overall pool costs of small telephone companies, who in turn share in pool revenues in proportion to their costs. See 47 CFR § 69.601.

⁴³ See *Sandwich Isles Waiver Order*, 28 FCC Rcd at 6556, para. 7; *Actions Taken Under Cable Landing License Act*, Public Notice, 24 FCC Rcd 5300 (IB 2009); SIC Response to USAC Inquiry, Item 3_Corporate Ownership Interest Chart. According to SIC, [BEGIN CONFIDENTIAL] [REDACTED]

[REDACTED] [END CONFIDENTIAL] See SIC Response to USAC Investigation No. 60.

⁴⁴ Joint Application for Authority under the Cable Landing License Act and Section 1.767 of the Commission's Rules to Transfer Control of Cable Landing License Holder Paniolo Cable Company, LLC, File No. SCL-T/C-2009-0225-00003, at 2 (filed Feb. 25, 2009) (Paniolo Cable Transfer Application). Previously, at least in 2009, the Blue Ivory Corp officer and trustee of Hee Children Trusts was Janeen-Ann A. Olds. See *id.*; see also Comments of AT&T, Sandwich Isles Communications, Inc. Petition for Declaratory Ruling, WC Docket No. 09-133, at 2, n. 7 (filed April 28, 2016).

⁴⁵ See SIC Response to USAC Investigation, Inquiry No. 3 "Corporate Ownership Interest Chart."

23. *Ho'opa'a Insurance Corporation (Ho'opa'a)*. Ho'opa'a, a Hawaii corporation, was wholly owned by Waimana.⁴⁹ According to Sandwich Isles, Ho'opa'a provided insurance services to [BEGIN CONFIDENTIAL] [END CONFIDENTIAL], including Sandwich Isles. Waimana provided [BEGIN CONFIDENTIAL] [END CONFIDENTIAL]

25. *Corporate Directors and Officers.* During the period of 2000 through 2013, several individuals held simultaneous, overlapping positions as directors and officers among the companies owned and/or controlled by Albert Hee. In particular, the overlapping directors and officers during this period often included Robert Kihune, Randall Ho, and Janeen-Ann A. Olds.⁵² Robert Kihune served as a director of Waimana, Sandwich Isles, ClearCom and Ho`opa`a, and as an officer of Waimana, Sandwich Isles, and Ho`opa`a.⁵³ Randall Ho similarly served as a director and officer of Sandwich Isles and Ho`opa`a.⁵⁴ Janeen-Ann A. Olds was previously the trustee of the Hee Children Trusts, President of Blue Ivory Corp. and Counsel for Waimana and Sandwich Isles.⁵⁵ In [BEGIN CONFIDENTIAL] [REDACTED] [END

⁵⁵ See Paniolo Cable Transfer Application at 6-7.

CONFIDENTIAL], Janeen-Ann A. Olds became the President/CEO of SIC and served in that capacity until **[BEGIN CONFIDENTIAL]** [REDACTED] **[END CONFIDENTIAL]**.⁵⁶ In addition to overlapping officers and directors of the companies, the employees of the companies performed functions and tasks on behalf of the companies as directed. In some instances, but not all, the overlapping duties of the employees were based upon a management agreement between the affiliate companies.

26. Appendix A contains a corporate organizational chart setting forth Waimana's subsidiaries and affiliates, including Paniolo Cable.

C. Sandwich Isles History

27. Sandwich Isles entered into loan agreements with the Rural Utilities Service (RUS), executed between 1997 and 2001.⁵⁷ The loans were made pursuant to Title VI of the Rural Electrification Act of 1936,⁵⁸ to finance the acquisition and installation of equipment needed for a telecommunications network in Hawaii. Sandwich Isles borrowed an aggregate of \$166,749,150 from RUS (RUS Loan).⁵⁹ Commencing on January 1, 2013, SIC became obligated to make monthly installment payments of principal and interest in the aggregate amount of **[BEGIN CONFIDENTIAL]** [REDACTED] **[END CONFIDENTIAL]** on the RUS Loan.⁶⁰ In April 2013, Albert Hee, then President of Sandwich Isles, sent a letter to the Secretary of Agriculture stating that Sandwich Isles was unable to continue making the principal and interest payments on the RUS Loan.⁶¹

28. Sandwich Isles originally planned to use funding from the RUS Loan to finance new construction that included additional switching facilities, Digital Subscriber Line equipment, local outside distribution facilities, and completion of a terrestrial undersea fiber network.⁶² RUS, however, did not approve using the RUS Loan for building a terrestrial undersea network.⁶³ Sandwich Isles overcame this hurdle by entering into a lease agreement for the undersea fiber network with Paniolo Cable with annual lease costs of \$15 million.⁶⁴ Paniolo Cable received financing to build the inter-island network from Deutsche Bank.⁶⁵

29. In June 2009, Sandwich Isles filed a petition for declaratory ruling requesting all of its cable lease costs to be recovered through the NECA pooling process.⁶⁶ In determining the percentage of

⁵⁶ See <http://www.bloomberg.com/profiles/people/17869006-janeen-ann-ahulani-olds>.

⁵⁷ RUS is an agency of the Department of Agriculture through which loans are made to persons providing telephone service in rural areas as a means of assuring the availability of adequate telephone service to the widest number of rural users of such service. See <http://www.rd.usda.gov/about-rd/agencies/rural-utilities-service>.

⁵⁸ See 7 U.S.C. §§ 901 to 950bb-2.

⁵⁹ White Paper of Sandwich Isles Communications, Inc. In Support of Inclusion of its Undersea Cable Costs in the NECA Pool, WC Docket No. 09-133, at 9-10, filed June 4, 2010 (Sandwich White Paper).

⁶⁰ See Response to USAC Investigation, Request No. 3.

⁶¹ See Letter from Albert S.N. Hee, President, Sandwich Isles, to Honorable Tom Vilsack, United States Secretary of Agriculture (filed April, 25, 2013) (RUS Letter).

⁶² 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 69.22(hh) of the Commission's Rules*, Order, 20 FCC Rcd 8999, 8999-9000, 9004, para. 11 (WCB 2005) (*Bureau Order on Waiver of Study Area Boundary*).

⁶³ Sandwich Petition at 2.

⁶⁴ *Petition for Declaratory Ruling of Sandwich Isles Communications, Inc.*, Declaratory Ruling, 25 FCC Rcd 13647, 13648-49, para. 5 (WCB 2010) (*Sandwich Declaratory Ruling*).

⁶⁵ See *id.* at 13648-49, para. 5, n18.

⁶⁶ Sandwich Isles filed the petition because NECA had formally notified the company that only \$1.9 million could be recovered through the traffic sensitive pool, an amount significantly lower than the lease with Paniolo Cable.

(continued....)

Sandwich Isles' lease costs to be included in the NECA common line pool, the Wireline Competition Bureau (Bureau) found that 50 percent of Sandwich Isles' lease expenses in excess of the \$1.9 million amount that NECA concluded was "used and useful" could be included in the common line revenue requirement for recovery in the NECA pool.⁶⁷

30. In December 2011, Sandwich Isles requested a ten-year waiver of the newly adopted rule establishing a \$250 per line per month cap on high-cost universal service support.⁶⁸ The Bureau denied the waiver request, concluding that Sandwich Isles had certain expenses that appeared grossly excessive and unreasonable.⁶⁹ At the time, Sandwich Isles' corporate expenses were 623 percent greater than the average for companies of similar size.⁷⁰ Additionally, Sandwich Isles had spent millions of dollars with affiliated and related entities for services that appeared unrelated to the provision of a broadband-capable network.⁷¹

31. At the time the Bureau acted on Sandwich Isles' waiver request, Albert Hee owned 100 percent of the Waimana stock.⁷² Waimana was engaged primarily in providing management services to its subsidiary corporations, Sandwich Isles and ClearCom, which are owned 100 percent by Waimana.⁷³

D. Albert Hee's Criminal Tax Fraud Conviction

32. On March 25, 2015, a federal grand jury sitting in the District of Hawaii charged Hee in a second superseding indictment (Indictment) with six counts of criminal tax fraud and one count of corruptly impeding the administration of the internal revenue laws in violation of Title 26, United States Code, Sections 7212(a) and 7206(1), respectively.⁷⁴ The Indictment alleged that Albert Hee caused Waimana to pay personal and family expenses on his behalf and to falsely deduct the payments as legitimate business expenses.⁷⁵ The Indictment states that Albert Hee caused WEI to pay a total of \$4,063,294.39 of his personal expenses for the time period 2002 to 2012 for the benefit of Albert Hee's children and many other services directly benefiting Albert Hee. The over four million dollars in personal

(Continued from previous page)

Sandwich Declaratory Ruling, 25 FCC Rcd at 13649-50, para. 8. As noted above, NECA is an intra-industry, not-for-profit corporation charged by the Commission with administering the Commission's interstate access charge system and associated revenue pools. *See generally* 47 CFR § 69.901(a); *see also* https://www.neca.org/About_Us.aspx.

⁶⁷ *Sandwich Declaratory Ruling*, 25 FCC Rcd at 13650, para. 9. This amount was calculated at \$8.45 million annually --- calculated as \$15 million less \$1.9 million times 50 percent plus \$1.9 million. The Bureau has explained "that the expenses associated with the Paniolo [Cable] agreement are considered transport and switched access, not common line loop costs, and therefore are not recoverable through the Universal Service Fund for loop costs, except to the extent permitted as part of intercarrier compensation recovery consistent with the *Sandwich Isles Declaratory Ruling* and the Commission's *USF/ICC Transformation Order*." *Sandwich Isles Waiver Order*, 28 FCC Rcd at 6561-62, para. 19.

⁶⁸ *Sandwich Petition* at 1.

⁶⁹ *Sandwich Isles Waiver Order*, 28 FCC Rcd 6553.

⁷⁰ *Id.* at 6553, para. 1.

⁷¹ *Id.* at 6558, para. 12.

⁷² *See id.*; *see also* Testimony of Defendant, Albert Hee, *Hee Trial Transcript*, Day 9 at 135-136.

⁷³ *U.S. vs. Albert S.N. Hee*, Superseding Indictment, CR. No. 14-00826 HG, at paras. 6-7 (Dec. 14, 2014) (Indictment).

⁷⁴ Second Superseding Indictment, *United States v. Albert S.N. Hee*, No. 14-cr-00826-SOM (D. Haw. June 23, 2015) (ECF No. 55). The original indictment of Albert Hee was filed on September 17, 2014, and the superseding indictment was filed on December 17, 2014.

⁷⁵ The Indictment further alleged that Albert Hee failed to report the receipt of the payments on his own tax returns, and as a result, Hee unlawfully reduced his corporate and individual tax liability in violation of 26 U.S.C. § 7206(1).

expense payments which Albert Hee did not report as income resulted in personal federal taxes due and owed in the amount of \$425,988. On July 13, 2015, Albert Hee was convicted on all counts and sentenced to a total of 46 months in federal prison on January 6, 2016.

33. During the 11-day trial by jury, which began on June 23, 2015, the United States presented testimonial and documentary evidence that Albert Hee directed Waimana, as well as its subsidiaries, to pay personal expenses for the sole benefit of him and his family from 2002 through 2013. Among other witnesses, Nancy Henderson, Hee's personal assistant, and several accountants (who provided accounting services to Albert Hee, Waimana, and other affiliate companies) testified regarding the bookkeeping and accounting processes used at the direction of Hee.

34. Nancy Henderson, who reported directly to Albert Hee and had been employed at Waimana for 15 years, testified that Hee "had final authority on any decision" at Waimana.⁷⁶ In that regard, Nancy Henderson explained that Hee personally authorized and directed numerous expenses that were for the benefit of him and his family to be reimbursed or directly paid by Waimana. Nancy Henderson further explained that Hee, and no one else, requested and approved corporate checks to be issued for his personal expenses, and that the checks were often signed by Hee, who maintained signatory authority over the companies' accounts.⁷⁷ Moreover, Hee personally instructed Nancy Henderson on how to record and categorize the personal expenses and payments in Waimana's books as business expenses incurred by Waimana or an affiliate company.⁷⁸

35. Several of Waimana's accountants testified that they relied on Albert Hee and Waimana "for the proper recording of transactions in the books of account" and "for the substantial accuracy of the financial records" in order to prepare the financial statements and tax returns for Waimana and its affiliated companies, including Sandwich Isles and ClearCom.⁷⁹

36. Testifying on his own behalf, Albert Hee asserted that he did not play a role in the categorization of his personal expenses. Notwithstanding his assertions, Hee acknowledged, "I make a decision on what charges go to what company, whether there's a business purpose, and then it's dealt with by the accountants[.]"⁸⁰

37. Two of Hee's children, Adrienne Hee and Charlton Hee also corroborated Albert Hee's authority and control over Waimana, SIC and other affiliate companies during the period of 2002 through 2012. Although the Hee Children Trusts had significant ownership interests in several companies, both Adrienne Hee and Charlton Hee testified to having no role in the management of the companies during the aforementioned period.⁸¹ Rather, Adrienne Hee explained that she was enrolled as a full-time college student from the fall 2004 to June 2009, a graduate student from September 2010 to June 2013, and, during summer breaks, interned in various positions on the mainland and attended summer school

⁷⁶ Trial Tr. vol. 2, 47 and 51.

⁷⁷ See, e.g., Gov't Ex. 4-101; Trial Tr. vol. 2, 54-58 (discussing payment of Hee's masseuse as "consulting services").

⁷⁸ *Id.*

⁷⁹ See, e.g., Trial Tr. vol. 3, 8-9.

⁸⁰ Trial Tr. vol. 9, 194-195. See also Trial Tr. vol. 10, 8.

⁸¹ Breanne Hee-Kahalewai, Hee's third adult child, returned to Hawaii in 2012 to work at SIC. At the end of 2013, Breanne Hee-Kahalewai became the Director of Corporate Services at SIC and, beginning in or about 2013, joined the WEI Board of Directors. See Trial Tr. vol. 9, 44. Following Hee's criminal conviction, as of August 26, 2015, SIC informed the Commission that WEI Board of Directors was comprised of Albert S.N. Hee, Wendy R. Hee, Adrienne Hee, Breanne Hee-Kahalewai, and Charlton Hee. See Data Submission from Frederick M. Joyce, Counsel for Sandwich Isles, WC Docket No. 09-133, filed August 4, 2015.

programs.⁸² Adrienne Hee further conceded that she did not work at Waimana from July 1, 2010, through June 30, 2011, while enrolled in graduate school even though Waimana payroll records reflected otherwise and that, at the time of her testimony, she had been employed at other companies located on the mainland since approximately January 2014.⁸³

38. Charlton Hee similarly testified that he did not have a management role in the companies affiliated with Waimana and for most of the relevant period, was otherwise employed with third-party entities outside of Hawaii. Charlton Hee testified that from the fall of 2008 to the spring of 2012, he was a college student on the mainland and after returning to Hawaii had made “art and sculpture” his stated occupation.⁸⁴ Charlton Hee also testified regarding his limited, part-time employment at Waimana after returning from college in 2012. Notably, Charlton Hee stated that his duties at Waimana were the same as in 2004, when he was in the ninth grade: to work “on the weekends out at the Mililani property” driving the tractors to “cut grass.”⁸⁵ Charlton Hee further testified that in December 2012, he worked full-time for one or two months as a field technician installing telephone cables and emergency phone lines.⁸⁶ At the time of his testimony, Charlton Hee testified that he had been working for a Hawaii state agency for the past four months, while continuing to receive a salary from Waimana.⁸⁷

39. The Government presented substantial evidence of instances in which Albert Hee authorized the use of corporate funds for his personal expenses. For example, from at least 2003 through 2012, Hee approved payments to his personal masseuse totaling more than \$90,000 for personal massages and directed the payments to be recorded as “consulting services.”⁸⁸ Hee also directed Waimana and its affiliates to reimburse him for cash advances, meals and personal travel; the reimbursed expenses totaled at least \$119,909.19, which included \$55,232.23 for family vacations to France and Switzerland in 2008, Disney World in 2010, Tahiti in 2010, and the island of Hawaii in 2011.⁸⁹

40. The Government demonstrated that Albert Hee directed the use of corporate funds to benefit his family. For instance, Hee instructed Nancy Henderson to use company funds to make payments towards his three children’s undergraduate and graduate education expenses and directed the payments to be recorded in corporate accounts as “educational expenses.”⁹⁰ Waimana paid at least \$630,103.39 towards the education of Hee’s children.⁹¹ In addition, Hee directed Waimana in 2008 to purchase a \$43,000 SUV and a home in California for \$1.3 million, using funds from Waimana and an affiliate company,⁹² near the university that two of Hee’s children (Charlton Hee and Breanne Hee-

⁸² Trial Tr. vol. 5, 12-25, 39-40. Although Adrienne Hee testified in depth regarding the numerous summer employment positions she held on the mainland, her resume indicated that she was employed as a “workhand” for SIC during the summers of 2004-2008, *see* Trial Tr. vol. 5, 39-42, in which she “[o]perated heavy machinery, including bulldozers, tractors, and skid steer loaders, charged with the upkeep of a 3,000-square-foot nursery, and the implementation of an irrigation system.” Trial Tr. vol. 5, 41.

⁸³ Trial Tr. vol. 5, 30-36; Gov’t Ex. 4-86.

⁸⁴ Trial Tr. vol. 4, 8, 29-30.

⁸⁵ Trial Tr. vol. 4, 31-32.

⁸⁶ Trial Tr. vol. 4, 31, 43.

⁸⁷ Trial Tr. vol. 4, 47-48.

⁸⁸ *See, e.g.*, Gov’t Ex. 4-101; Trial Tr. vol. 2, 54-58 (discussing payment of Hee’s masseuse as “consulting services”).

⁸⁹ Trial Tr. vol. 8, 186, 194, 197.

⁹⁰ Trial Tr. vol. 2, 62, 67, 71-72, 79; Gov’t Exs. 3-103, 3-104, 3-105, 3-106, 4-82L, 4-82P, 4-82O.

⁹¹ Gov’t Exs. 3-91 through 3-106, 4-82E through 4-82G, 4-82I, 4-82L, 4-82O, through 4-82Q.

⁹² Gov’t Exs. 3-3, 4-82K, 4-100.

Kahalewai) attended.⁹³ While enrolled at the university, the two children lived in the home and used the SUV for their personal use.⁹⁴

41. The Government demonstrated that Hee instructed Nancy Henderson to place his wife and children on Waimana's payroll and dictated their salaries and benefits.⁹⁵ Although receiving a full-time salary and benefits, Nancy Henderson testified that Wendy Hee was in the office "occasionally" or "every couple of months" and saw Wendy Hee do work in the office "one time."⁹⁶ Charlton Hee further testified that Wendy Hee "stayed at home" to care for the family from about 2001 through 2013.⁹⁷ Similarly, Nancy Henderson and the Hee children testified about the Hee children receiving a salary and benefits from Waimana while attending school full-time on the mainland and while employed elsewhere.⁹⁸ Nevertheless, business records show that Wendy Hee and the children were paid \$1,680,685.92 in salary and benefits from 2002 through 2012.⁹⁹

E. USAC Investigation

42. On July 28, 2015, at the direction of the Commission's Chief Financial Officer, Office of Managing Director (OMD), USAC suspended high-cost funding to Sandwich Isles pending completion of further investigation and/or other ameliorative measures to ensure that any funding provided is used solely in a manner consistent with Commission rules and policies.¹⁰⁰ On August 7, 2015, USAC informed Sandwich Isles that its high-cost program support was suspended, beginning with the disbursement for July 2015.

43. On August 5, 2015, the Bureau issued a memorandum to USAC directing USAC's Internal Audit Division (IAD) to investigate whether Sandwich Isles received any improper payments from the federal high-cost support mechanism from 2002 to June 2015.

44. At the beginning of the investigation, the Bureau directed USAC to develop a factual record that would enable the Commission to evaluate whether to lift or modify the hold on high-cost support. The Bureau also directed USAC to determine if there were sufficient assurances that the high-cost support amounts provided on a going forward basis would be used consistent with the Commission's rules. The scope of the investigation focused on Sandwich Isles' affiliated entities and transactions, Sandwich Isles' corporate structure, and testing of reported costs affecting disbursements between 2002 to June 2015.¹⁰¹ Beginning in August 2015 through April 2016, USAC and Commission staff held weekly meetings by telephone with Sandwich Isles to discuss inquiries and documentation needed for the

⁹³ Gov't. Ex. 3-3, 4-100.

⁹⁴ See Trial Tr. vol. 4, 14, 20-25, 27-28.

⁹⁵ Trial Tr. vol. 2, 53, 73.

⁹⁶ Trial Tr. vol. 2, 52.

⁹⁷ Trial Tr. vol. 4, 34.

⁹⁸ Trial Tr. vol. 4, 28, 31, 33; Trial Tr. vol. 5, 16, 31-32.

⁹⁹ See, e.g., Gov't Exs 4-86 through 4-99.

¹⁰⁰ Section 54.707 authorizes USAC to "suspend or delay . . . support amounts provided to a carrier if the carrier fails to provide adequate verification . . . upon reasonable request, or if directed by the Commission to do so." 47 CFR § 54.707.

¹⁰¹ USAC Report at 1.

investigation.¹⁰² Throughout the investigation, there were over 350 inquiries made of Sandwich Isles that included submission of over 3,200 files.¹⁰³

45. On September 28, 2015, the Hawaii Public Utilities Commission (HPUC) issued an order stating that “there remains uncertainty as to whether all federal high-cost support provided to [Sandwich Isles] . . . was used and will be used only for the provision, maintenance, and upgrading of facilities and services for which the support is intended, pursuant to 47 C.F.R. § 54.314(a).”¹⁰⁴ The HPUC concluded that it could not make the necessary certification required under section 54.314(a) of the Commission’s rules for the high-cost support provided to Sandwich Isles in the preceding calendar year (2014) or the coming calendar year (2016).¹⁰⁵

46. On December 3, 2015, Sandwich Isles filed an Emergency Petition for Review claiming that the Commission’s suspension of funding of high-cost support was in violation of the Commission’s rules.¹⁰⁶ As of the date of this Order, the Commission has held Sandwich Isles’ high-cost support covering the period of July 2015 to [November 2016].

47. On February 5, 2016, USAC sent to Sandwich Isles a draft report containing USAC’s exceptions and observations from the investigation for the period 2002 to June 2015. Sandwich Isles submitted a response to the draft report on February 25, 2016. After reviewing Sandwich Isles response and requesting further documentation from Sandwich Isles regarding matters raised in the response, USAC finalized its report and submitted the final report on May 13, 2016, to both the Bureau and Sandwich Isles. On the same day, the Bureau sent a letter to Sandwich Isles’ legal counsel noting that any comments to the USAC Report should be submitted to the Bureau by June 13, 2016.¹⁰⁷

48. In its final report summarizing the results of its investigation, USAC identified eight exceptions that it concluded resulted in \$27,270,390 in overpayments in the past, or could result in overpayments at some point in the future, from the high-cost program to Sandwich Isles.¹⁰⁸ The greatest exceptions, in terms of monetary recovery from the Fund, related to the misclassification of Category 1

¹⁰² *Id.*

¹⁰³ In the USAC Report, USAC notes that Sandwich Isles was responsive to most, but not all, of the requests for information. USAC Report at 1. For example, USAC did not receive the financial information of Sandwich Isles affiliates, including those entities that had contractual relationships with Sandwich Isles and receiving funds from Sandwich Isles. USAC also notes that because of time constraints, it focused on those matters with the largest impact to the Fund. USAC Report at 2. For example, given that recovery of costs for cable and wire facilities is a large component of the amounts that Sandwich Isles is eligible to receive from the high-cost program, versus the costs for payroll fees, throughout the investigation, USAC focused significantly more on cable and wire facilities costs rather than corporate operational costs.

¹⁰⁴ Hawaii Public Utilities Commission, Instituting a Proceeding to Investigate Whether Designated Eligible Telecommunications Carriers Participating in the High-Cost Program of the Universal Service Fund Should be Certified by the Commission Pursuant to 47 Code of Federal Regulations § 54.314(a), Decision and Order No. 33167, Docket No. 2015-0083 at 29 (Sept. 28, 2015) (2015 HPUC Order). Section 54.314(a) states, in relevant part, that a state must file an annual certification with USAC and the Commission “. . . that all federal high-cost support provided to such carriers within that State was used in the preceding calendar year and will be used in the coming calendar year only for the provision, maintenance, and upgrading of facilities and services for which the support is intended.” 47 CFR § 54.314(a).

¹⁰⁵ 2015 HPUC Order at 30.

¹⁰⁶ Emergency Petition of Sandwich Isles Communications, Inc. for Resumption of Payments Terminated by Unauthorized Order, CC Docket No. 96-45, WC Docket Nos. 09-133, 10-90, Emergency Petition for Review, filed Dec. 3, 2015.

¹⁰⁷ See Letter from Mathew S. DelNero, Chief, Wireline Competition Bureau, FCC, to James Arden Barnett, Jr., Esq., Counsel to Sandwich Isles, dated May 13, 2016.

¹⁰⁸ USAC identified eight exceptions, of which five of them had monetary findings. USAC Report at 4.

Cable and Wire Facilities (Exception 1) and an adjustment to the reimbursable cost of leased water mains (Exception 2).¹⁰⁹ USAC also presented six observations from the investigation, focusing on two of them – Complexity of Corporate Structure (Observation 1) and Transactions Involving Relatives to Albert Hee (Observation 2) – as the most significant areas of concern that increase the risk of waste, fraud and abuse in the high-cost program. USAC reported that it was unable to come to a determination regarding the validity of the Waimana management fees given that Sandwich Isles did not submit details on how each invoice related to Sandwich Isles' obligations under section 54.7 of the Commission's rules to use support for the provision, maintenance, and upgrading of facilities and services.

49. On June 13, 2016, Sandwich Isles provided to the Bureau its comments to the USAC Report (June 13 Sandwich Isles Comments).¹¹⁰ Sandwich Isles seeks modification and reduction of the total net monetary effect calculated by USAC. In particular, Sandwich Isles argues that the monetary effect with respect to Exception 1 should be reduced and that the monetary effect with respect to Exception 5 (Exorbitant Expenses) should be eliminated.¹¹¹

50. On September 30, 2016, the HPUC issued an order consistent with its action the prior year, stating that "there remains uncertainty as to whether all federal high-cost support provided to [Sandwich Isles] . . . was used and will be used only for the provision, maintenance, and upgrading of facilities and services for which the support is intended, pursuant to 47 C.F.R. § 54.314(a)."¹¹² The HPUC concluded that it could not make the necessary certification required under section 54.314(a) of the Commission's rules for the high-cost support provided to Sandwich Isles in the preceding calendar year (2015) or the coming calendar year (2017).¹¹³

III. DISCUSSION

51. Based on the USAC Report and our own review, we conclude that Sandwich Isles improperly received payments in excess of \$27,270,390 from the federal high-cost support mechanisms from 2002 to June 2015. First, as detailed in Section III.A., we find that Sandwich Isles violated Part 36 and Part 54 of the Commission's rules by misclassifying account 2410 - cable and wire facilities costs, resulting in overpayments of high-cost support totaling \$26,320,270.

52. Second, as detailed in Section III.B.2, we find that Sandwich Isles received improper payments from the Fund for inflated and improper management fees charged by Waimana, its parent company, from 2002 through June 2015.¹¹⁴ Through the guise of management fees that Waimana invoiced to Sandwich Isles, we find that Sandwich Isles consistently violated the Commission's affiliate transactions rules which require that services purchased by a carrier from an affiliate be recorded at the

¹⁰⁹ *Id.*

¹¹⁰ See Response of Sandwich Isles Communications to the Universal Service Administrative Company Final Audit Report, June 13, 2016 (June 13 Sandwich Isles Comments).

¹¹¹ See generally June 13 Sandwich Isles Comments.

¹¹² Hawaii Public Utilities Commission, Instituting a Proceeding to Investigate Whether Designated Eligible Telecommunications Carriers Participating in the High-Cost Program of the Universal Service Fund Should be Certified By the Commission Pursuant to 47 Code of Federal Regulations § 54.314(a), Decision and Order No. 33955, Docket No. 2016-0093, at 19 (Sept. 30, 2016) (2016 HPUC Order). On October 31, 2016, Sandwich Isles filed a complaint in Hawaii Circuit Court against HPUC claiming that Sandwich Isles has met the HPUC certification requirements and that the state commissioners treated the company unfairly. See <http://www.staradvertiser.com/2016/12/01/hawaii-news/suit-blames-puc-for-loss-of-u-s-funds/>.

¹¹³ 2016 HPUC Order at 19.

¹¹⁴ As discussed more fully below, in calculating the amounts that USAC shall recover from Sandwich Isles for excessive management fees, we direct USAC to disallow the management fees in excess of \$1,237,355, which is the average amount of the comparable entities average management fees for 2012, 2013 and 2014, and apply that amount for each year, from 2002 to 2015.

lower of fair market value or fully distributed cost.¹¹⁵ When Sandwich Isles received high-cost support for these inflated management fees, Sandwich Isles violated section 54.7 of the Commission's rules which require "carriers to use federal universal support only for the provision, maintenance, and upgrading of facilities and services for which the support is intended."¹¹⁶

53. Third, as detailed in Section III.B.3.a, we conclude that Sandwich Isles received improper payments for ineligible payments that it made to its affiliate, ClearCom, totaling \$711,355 pursuant to a water mains lease by violating the Commission's affiliate transactions rules.

54. Fourth, as detailed in Section III.B.3.b, we find that Sandwich Isles is not eligible to recover the costs for the costs for use of the temporary office space on the Pine Spur property it owned while at the same paying rent in Honolulu, Hawaii. The updated monetary effect, after consideration of the \$250 per line cap, for the duplicate Pine Spur expenses is an underpayment of (\$1,445) for HCLS for 2015 disbursements.

55. Fifth, as detailed in Section III.B.4, we find that Sandwich Isles received improper payments in the amount of \$175,090 for the costs associated with bonuses given that such expenses were imprudent and unreasonable.

56. Sixth, as detailed in Section III.C.1, we find that Sandwich Isles received improper payments in the amount of \$65,120 by misclassifying accumulated amortization pursuant to Commission rules.¹¹⁷

57. Below is a table setting forth the findings and amounts of improper payments that Sandwich Isles received from the Fund from 2002 to June 2015:

Investigation Results	Improper Payments
Misclassification of Category 1 Cable and Wire Facilities Costs ¹¹⁸	\$26,320,270
Inflated and Improper Waimana Management Fees ¹¹⁹	To Be Determined (TBD)
Improper Allocation of ClearCom water mains lease ¹²⁰	\$711,355
Relocation of Property ¹²¹	(\$1,445)

¹¹⁵ 47 CFR § 32.27(c)(2).

¹¹⁶ 47 CFR § 54.7.

¹¹⁷ 47 CFR § 32.3400; 47 CFR §§ 54.1305(c) and (d). This calculation is based on overpayments of \$123,535 minus underpayments of ICLS support of \$58,415 after incorporating the per line limit cap. See USAC Report at 4, 40.

¹¹⁸ See USAC Report at Exception 1 (Misclassification of Category 1 Cable).

¹¹⁹ See *id.* at Exception 2 (Inflation of Management Fees Paid by SIC to Waimana Enterprises Inc.); Observation 2 (Transactions Involving Relatives of Albert Hee); Observation 4 (Waimana Income Statement); Observation 5 (Comparison of SIC to Other Entities).

¹²⁰ See *id.* at Exception 3 (Improper Allocation of ClearCom Watermains).

¹²¹ Under Exception 6 (Higher Cost of the SIC Relocation from Honolulu, Hawaii to Mililani, Hawaii) of the USAC Report, USAC calculated overpayments based on costs incurred in 2013 and disbursed in 2015. It did not calculate 2014 costs, which would have been disbursed in 2016.

Investigation Results	Improper Payments
Ineligible Corporate Bonuses and Activities ¹²²	\$175,090
Ineligible Corporate Operational Expenses - Taxes ¹²³	\$65,120
Total Net Monetary Effect ¹²⁴	\$27,270,390 plus an amount TBD

In addition, the table below breaks out these improper payments by year:

Disbursement Year	Improper Payments ¹²⁵
2004	(\$183,062)
2005	\$711,449
2006	\$1,801,244
2007	\$2,741,905
2008	\$3,828,619
2009	\$4,937,666
2010	\$4,772,365
2011	\$3,420,021
2012	\$3,362,901
2013	\$1,554,370
2014	\$221,681
2015	\$101,231
Total Net Monetary Effect	\$27,270,390 plus amount TBD

58. In light of the Commission's findings in this Order, we order Sandwich to submit a response within 60 days of the release of this Order explaining why the Commission should not terminate the 2005 waiver granted to Sandwich to be treated as an incumbent local exchange carrier serving the Hawaiian Homelands for purposes of receiving high-cost universal service support and thereby make it ineligible to continue receiving such support.¹²⁶ That waiver relied on the minimal effect of the requested waiver on the universal service fund, the public interest benefits claimed from anticipated delivery of service to subscribers, the unavailability of service by other parties, and the lack of any record evidence to sustain claims that Sandwich was using universal service support for improper purposes or was not complying with the Commission's accounting, reporting, and auditing rules. We direct the Bureau to

¹²² See USAC Report at Exception 5 (Exorbitant Expenses).

¹²³ Under Exception 4 of the USAC Report (Unsupported or Misclassified Cost Study Amounts), USAC calculated overpayments in the amount of \$123,535. Through USAC's investigation of this issue, it also found that the total amount of ICLS support for SIC resulted in an underpayment in the amount of \$58,415 after incorporating the per line \$250 cap. See USAC Report at 4, 40. As a result, we have netted these overpayments and underpayments to total an amount of \$65,120 in improper payments.

¹²⁴ Of the \$27,270,390 in improper payments, Sandwich Isles has acknowledged \$2,048,572 as improper. In Sandwich Isles June 13 Comments, it agreed that it misallocated C&WF in CAT 1 totaling \$1,215,626. See Sandwich Isles June 13 Comments. As noted in the USAC Report, Sandwich Isles acknowledged that it received improper payments in the amount of \$744,864 for improper allocation of costs regarding the ClearCom Water Mains lease and \$88,082 for ineligible corporate operation expenses. See USAC Report at 33, 43.

¹²⁵ See USAC Investigation, SIC Examination Report - "Exception Summary 2.4.16.xlsx."

¹²⁶ See generally *Bureau Order on Waiver of Study Area Boundary*, 20 FCC Rcd 8999.

issue a Public Notice seeking comment by the same deadline from the HPUC, DHHL and all other interested stakeholders regarding the continued applicability of the prior study area waiver.

59. Our actions today do not diminish in any way the Commission's commitment to provide uninterrupted telecommunications service for customers on the Hawaiian Home Lands. Sandwich Isles has ongoing obligations to its customers, under both the Communications Act and Commission rules, to continue to provide interstate telecommunications services and may not discontinue service without the Commission's express authorization. As we consider these issues going forward, our overriding objective is to ensure that the people of the Hawaiian Home Lands continue to be served.

A. Misclassification of Category 1 Cable and Wire Facilities Costs

1. Background

60. Congress has directed the Commission to ensure that "[c]onsumers in all regions of the Nation, including low-income consumers and those in rural, insular and high cost areas . . . have access to rates charged for similar services in urban areas."¹²⁷ The Commission has four universal service programs, one of which is the federal high-cost program (also known as the Connect America Fund).¹²⁸ Within the high-cost program, rate-of-return companies receive high-cost universal service support to help defray the costs for building and maintaining telecommunications plant from the local telephone central offices to customer premises where those costs are particularly high, as in rural areas.¹²⁹ To fund these universal support mechanisms, telecommunications carriers are required to contribute, on an equitable and nondiscriminatory basis, to the Fund.¹³⁰ The Commission has an ongoing obligation to use universal service funds efficiently and to protect the Fund from waste, fraud and abuse.

61. Incumbent local exchange carriers subject to rate-of-return regulation historically have received universal service support based on the costs of providing local loop service, which included a return on investment at 11.25 percent.¹³¹ The two primary high-cost support mechanisms for carriers such as Sandwich Isles are HCLS and ICLS.¹³² These mechanisms reimburse carriers in high-cost areas for some of the investments and expenses of providing the local loop portion of their networks.

62. For decades, HCLS has been determined based on telecommunications plant in service and working loops.¹³³ Section 54.1310 of the Commission's rules defines how the "Expense Adjustment"

¹²⁷ 47 U.S.C. § 254(b).

¹²⁸ 47 U.S.C. § 254(e)(3).

¹²⁹ 47 U.S.C. § 254(e); 47 CFR § 54.7. Prior to the Telecommunications Act of 1996 (the '96 Act), support was provided through implicit subsidies between carriers. After the Commission implemented the universal service provisions of the '96 Act, support was provided through explicit payments from the Fund. *See generally Universal Service First Report and Order*.

¹³⁰ 47 U.S.C. § 254(d). Carriers generally pass on their contributions to the Fund to their customers as a charge on customer bills.

¹³¹ In the 2016 *Rate of Return Order*, the Commission modified the authorized rate of return from 11.25 percent to 9.75 percent, with a phased transition. *Rate-of-Return Order*, 31 FCC Rcd at 3107, para. 51.

¹³² *See supra* para. 14 (describing HCLS and ICLS). The Commission recently modified support for rate-of-return companies so that high-cost support mechanisms now provide support for broadband lines regardless of whether the customer subscribes to voice service. *See Rate-of-Return Reform Order*, 31 FCC Rcd at 3119-20, para. 86.

¹³³ Sections 54.1301 through 54.1310 of the Commission's rules set forth the procedures for calculating HCLS. *See* 47 CFR §§ 54.1301-54.1310; 47 CFR Part. 36, App.; *see also MTS and WATS Market Structure, Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board*, Decision and Order, 50 Fed. Reg. 939 (1985) (Part 67 Order).

to determine HCLS is calculated.¹³⁴ Carriers receive HCLS based on their unseparated loop costs,¹³⁵ depending on the number of working loops they serve. The Commission defines a “working loop” as “a revenue producing pair of wires” between the telephone company's central office and a customer's premise.¹³⁶ The HCLS formula depends on the difference between the average loop cost per working loop in the study area and the national average loop cost per working loop.¹³⁷ The information to be submitted by carriers to NECA for purposes of these calculations includes costs, such as investments and depreciation, from certain limited categories of accounts (specifically, subcategory 1.3 and 4.13), and the number of working loops in the study area.¹³⁸

63. In order to have “working loops,” a carrier must have telecommunications plant in service (TPIS).¹³⁹ TPIS includes the original cost of the investment in the outside plant (account 2410 – cable and wire facilities (C&WF)), which is used for calculating HCLS.

64. In order to ensure that high-cost support is provided where it is most needed and to protect against wasteful and imprudent investments for companies subject to rate-of-return regulation, the Commission only provides HCLS for investment in C&WF loop plant that is booked under account 2410, which by definition is plant in service.¹⁴⁰ Thus, carriers are only permitted to place C&WF costs in account 2410 when the facilities are in use, serving subscribers. Similarly, ICLS provides support for costs that form the “common line revenue requirement” as calculated pursuant to Part 69, which includes costs recorded in account 2410.¹⁴¹

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The term “working loops” appears throughout the HCLS rules. *See, e.g.*, 47 CFR §§ 54.1303 (calculation of Rural Growth Factor based on working loops); 54.1305(i) (requirement that carriers submit the number of working loops, defined as Exchange Line C&WF loops); 54.1309 (loop costs calculated per working loop).

¹³⁴ The “Expense Adjustment” is another term for the calculation that determines the amount of HCLS that is provided. Historically, support was provided through implicit subsidies by reclassifying intrastate expenses as interstate expenses. *See supra* para. 10 & n. 16.

¹³⁵ *See, e.g., USF/ICC Transformation Order*, 26 FCC Rcd at 17743-44, para. 216 n.347. The term “unseparated” refers to the costs incurred before the Part 36 jurisdictional separations process.

¹³⁶ *See* 47 CFR § 36, App. (defining working loop as “a revenue producing pair of wires, or its equivalent, between a customer's station and the central office from which the station is served”). This language has been in Part 36 for decades. The requirement that a working loop be “revenue producing” of necessity presumes that there is a customer at the end of loop paying for service. *See supra* para. 61.

¹³⁷ As noted above, these average figures and the Expense Adjustments are provided annually to the Commission by NECA which calculates HCLS on the basis of information submitted by the carriers. *See* 47 CFR §§ 54.1307; 54.1305.

¹³⁸ *See* 47 CFR §§ 54.1305(b)-(i) (setting forth gross plant investment in Exchange Line (C&WF) and working loops for universal service support purposes).

¹³⁹ *See* 47 CFR §§ 32.2001; 32.2410; 54.1305. TPIS includes accounts 2110 through 2690. Several accounts are used to calculate HCLS, including account 2410.

¹⁴⁰ Section 54.1308 specifies that C&WF Exchange Line subcategory 1.3 investment is used to calculate HCLS support. 47 CFR § 54.1308(a)(1). Section 36.154 defines how Exchange Line C&WF is allocated between subcategories, including subcategory 1.3. 47 CFR § 36.154. Section 32.2410 specifies that the cost C&WF shall be recorded in Account 2410. 47 CFR § 32.2410. Section 36.151 specifies that C&WF, Account 2410, includes the “following types of *telecommunications plant in service*.” 47 CFR § 36.151(a) (emphasis added).

¹⁴¹ *See* 47 CFR §§ 54.901-54.904. ICLS provides for recovery of costs associated with the common line revenue requirement, including subscriber line cable and wire facilities. 47 CFR § 69.304. For ratemaking purposes, the rate base consists of the interstate portion of accounts that have invested in plant that is “used and useful in the efficient provision of interstate telecommunications services.” *See* 47 CFR § 65.820. This includes the cost of telecommunications plant in service recorded in Accounts 2110 through 2690 as well as the cost of property held for future telecommunications use recorded in Account 2002. While carriers are permitted to include investment for

(continued....)

65. The Commission provides high-cost support for costs recorded in account 2410 to support existing subscribers, rather than some potential future needs. Limiting support to telecommunications plant in use is important in part because those receiving high-cost support have an incentive to invest in order to receive the authorized return on investment, historically 11.25 percent. If carriers could earn a return on investments that are not actually in use, they would have an incentive to be overly optimistic in their anticipation of future demand, to the detriment of ratepayers. It is not an efficient use of the Fund to allocate costs for investment in plant that might be used at some point in the future. This limit in support is consistent with our longstanding recognition that our efforts to advance universal service must be balanced against the universal service contribution burden on all consumers. Indeed, the Commission has found and the courts have reiterated, if the universal service burden is too high, the affordability of service will be placed in jeopardy, undermining the very purpose of the universal service program.¹⁴² These requirements are also consistent with the “used and useful” principles in ratemaking that serve as a protection against inefficiencies and abuse.¹⁴³

66. The Universal Service Fund is a finite source, and the Commission has structured its program to ensure that only those investments that actually serve customers (or in some limited cases, will come into service within a short time frame) qualify for support. By putting such a constraint on high-cost support, the Commission has sought to ensure that the funds are directed to investments that merit support and help customers, while avoiding funding of projects that serve no useful purpose. The requirement that plant be “in service” and loops be “working” is consistent with the fundamental used and useful ratemaking principle that recognizes that only those investments that are reasonable and deployed in service to customers should be deemed legitimate expenses and thus earn the authorized rate of return.

67. In order to understand how Sandwich Isles has violated the Commission’s rules, it is necessary to examine category 1, which is the category that includes subcategory 1.3. Because only local loop costs are eligible for support, carriers have an incentive to categorize certain investments and expenses as the local loop to the subscriber’s premises, rather than other network costs that are not supported.

68. Under the Commission’s rules, there are four categories of C&WF. Category (CAT) 1 is exchange line C&WF, and this category is defined in section 36.152(a)(1) as “facilities between local central offices and subscriber premises” used for certain purposes.¹⁴⁴ Facilities between central offices and premises consist primarily of “loops” which are defined as “a pair of wires, or its equivalent, between a customer’s station and the central office from which the station is served.”¹⁴⁵ Category 1 is further

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future use in their common line revenue requirement, there is a limit on inclusion of such costs. Under account 2002, a carrier is permitted to allocate capital investment costs for C&WF held for imminent use, which is defined in our rules as two years. *See* 47 CFR § 32.2002. When the C&WF property is put into use, the costs are moved from account 2002 to account 2410. If the property is held for longer than two years (not for imminent use), such costs are moved to Non-operating Plant account 2006. *See* 47 CFR § 32.2006. *See In the Matter of Revision of the Unif. Sys. of Accounts & Fin. Reporting Requirements for Class A & Class B Tel. Companies (Parts 31, 33, 42, & 43 of the FCC's Rules) in the Matter of Revision of the Unif. Sys. of Accounts & Fin. Reporting Requirements for Class A & Class B Tel. Companies (Parts 31, 33, 42, & 43 of the FCC's Rules)*, Report and Order, 60 Rad. Reg. 2d (P & F) 1111 (1986). *Application of Rochester Tel. Corp.*, 9 FCC Rcd 2285 (1994).

¹⁴² *See, e.g., Vermont Public Service Board v. Federal Communications Commission*, 661 F.3d 54, 65 (D.C. Cir. 2011) (finding that, in the context of section 254, “as the Commission rightly observed, it has a responsibility to be a prudent guardian of the public’s resources.”); *Universal Service First Report and Order*, 12 FCC Rcd at 8845-46, para. 125.

¹⁴³ *American Tel. and Tel. Co.*, Phase II Final Decision and Order, 64 FCC Rcd 2d 1, at 39, para. 114 (*AT&T Phase II Order*).

¹⁴⁴ 47 CFR §§ 36.152(a).

¹⁴⁵ *See* 47 CFR § 36, App. (defining working loop as “a revenue producing pair of wires, or its equivalent, between a customer’s station and the central office from which the station is served”).

divided into subcategories, including subcategory 1.3, which is defined as “subscriber or common lines that are jointly used for local exchange service and exchange access for state and interstate inter-exchange service.”¹⁴⁶ Cost for category 1 facilities are apportioned to subcategories based in part on the calculation of an “average cost per working loop,” which is determined by dividing the category 1 costs by the total working loops in all the categories.¹⁴⁷ Allocating costs based on the number of working loops in each subcategory presumes that the only costs included are those associated with “working loops.”

69. The critical role of “working loops” in both the definition of the Expense Adjustment and the process for allocating category 1 costs among subcategories reflects and confirms the underlying premise (explained in less technical terms above) that subcategory 1.3 includes only facilities between central offices and subscriber premises that are currently in service and are currently producing revenue. Only costs associated with “working loops” (thus defined) are to be included in the calculation of HCLS. Loops that are not currently in service and revenue producing do not receive HCLS and should not be reported under subcategory 1.3. Instead, the costs for such loops should be recorded in property held for future telecommunications use (32.2002) or non-operating plant (32.2006).

2. Discussion

70. Based on USAC’s investigation and our own review of the record, we find that Sandwich Isles misclassified its C&WF under the high-cost program rules, resulting in \$26,320,270 of improper payments over the course of more than ten years.¹⁴⁸ This misclassification is a serious issue, as Sandwich Isles effectively claimed money for building facilities to serve customers, when in fact those facilities were not connected to customer premises because the land remained undeveloped. Sandwich Isles has included facilities that are not in use in account 2410 which is inconsistent with Commission rules.

71. As noted above, under the Commission’s rules, high-cost support is provided based on the number of “working loops” in a carrier’s study area.¹⁴⁹ Section 54.1305(i) states:

For universal service support purposes, working loops are defined as the number of working Exchange Line C&WF loops used jointly for exchange and message telecommunications service, including C&WF subscriber lines associated with pay telephones in C&WF Category 1, but excluding WATS closed end access and TWX service. These figures shall be calculated as of December 31st of the calendar year preceding each July 31st filing.¹⁵⁰

72. USAC’s investigation of category 1 C&WF costs relates to costs recorded by SIC in the TPIS C&WF account 2410.¹⁵¹ As noted in Exception 1 of its report, USAC reviewed Sandwich Isles’ previously filed cost studies, including traffic studies that were part of the cost studies, and maps that Sandwich Isles provided upon USAC’s request. USAC also requested that Sandwich Isles explain its methodology for allocating C&WF costs to each category of facilities.¹⁵² Sandwich Isles indicated that it

¹⁴⁶ See 47 C.F.R. § 36.154.

¹⁴⁷ *Id.*

¹⁴⁸ The \$26,320,270 improper payments impact HCLS - \$17,545,800, ICLS - \$8,777,605, and Safety Net Additive – (\$3,135). See USAC Report at 15.

¹⁴⁹ See *supra* para. 62-69 (describing working loops).

¹⁵⁰ 47 CFR § 54.1305(i). The appendix to Part 36 defines a working loop as: “A revenue producing pair of wires, or its equivalent, between a customer's station and the central office from which the station is served.” 47 CFR § 36, App.

¹⁵¹ USAC Report at 6. The TPIS C&WF account 2410 includes the costs for calculating HCLS and ICLS. Therefore, section 32.2002 of the Commission’s rules does not apply to this finding of improper payments. See *infra* paras. 85-86 (explaining how section 32.2002 does not apply in this case).

¹⁵² USAC Report at 7.

directly allocated costs to all C&WF categories, except CAT 1, based on traffic studies and allocated the remaining costs to CAT 1.¹⁵³

73. Based on the evidence before us, we find that Sandwich Isles' allocation methodology resulted in substantial C&WF costs being allocated to CAT 1 even though these facilities were not directly connecting local central offices and subscriber premises.¹⁵⁴ First, we find that Sandwich Isles misallocated C&WF to CAT 1 where there were no subscriber premises (routes without subscribers). Second, we find that Sandwich Isles misallocated C&WF as CAT 1 when they should have been allocated to either CAT 2, CAT 3 or CAT 4 pursuant to Commission rules (routes between central offices). We make these findings based on our assessment of the information contained in the USAC Report and our own review of the data that Sandwich Isles submitted to the Commission staff with its June 13 Sandwich Comments.

74. *Routes without Subscribers.* During its investigation, USAC examined the information provided by Sandwich Isles detailing which routes related to which exchanges, and crosschecked with the Sandwich Isles subscriber data, including address and the year each subscriber received service, to determine whether such facilities connected directly with subscriber premises. When USAC provided Sandwich Isles with its initial exceptions noting which routes USAC believed did not serve any subscribers as of the relevant time period, Sandwich Isles agreed, in part, with USAC's analysis. Sandwich Isles identified certain routes it agreed were improperly classified as CAT 1. Specifically, Sandwich Isles agreed that "[BEGIN CONFIDENTIAL] [REDACTED] [END CONFIDENTIAL] route did not service any subscriber premises during the 2007-2013 time period when it was in service" and that "one segment of the [BEGIN CONFIDENTIAL] [REDACTED] [END CONFIDENTIAL] route did not serve subscribers during the 2009-2013 period." We make the same conclusion and find that Sandwich Isles misclassified these facilities as CAT 1 during the time periods in question.

75. In opposing Exception 1 in the USAC Report, Sandwich Isles attempts to bolster its argument by claiming that because homes were planned to be built in the Hawaiian Home Lands, it was entitled to reimbursement from the Fund for its cost of building out the telecommunications infrastructure for such planned developments, even though ultimately, few homes were ever actually built or occupied. In the June 13 Sandwich Isles Comments regarding the final USAC Report, Sandwich Isles states that all other routes identified in Exception 1 "were constructed pursuant to definite SIC plans and Hawaii state government obligations to provide telecommunications services [Exception 1(B)]."¹⁵⁵ Sandwich Isles also submitted a letter from the DHHL (DHHL letter) that it asserts summarized its obligations to provide telecommunications services on Hawaiian Home Lands. The DHHL letter, which is dated December 13, 2002, states that Sandwich Isles is to build the telecommunications infrastructure on new developments in Hawaiian Home Lands. The letter further states that DHHL has been challenged to place 20,000 qualified native Hawaiians onto Hawaiian Home Lands during the next five years. As a result, DHHL states that it anticipated that development activity would increase significantly over the next few years.¹⁵⁶ The DHHL letter includes two attachments – one which describes 28 commercial projects and telecommunication infrastructure required from 2002 to 2008 and another that provides several project completion schedules for land development projects from 2003 to 2006. Several of the projects from the second attachment reflect vacant lots that were either under design or under construction.¹⁵⁷

¹⁵³ *Id.* at 8-15.

¹⁵⁴ *Id.* at 10.

¹⁵⁵ June 13 Sandwich Comments at 6. *See* Letter from David Cosson, Counsel to Sandwich Isles Communications, Inc., to Marlene H. Dortch, Secretary, FCC, GN Docket No. 96-45 (filed Apr. 25, 2005) (David Cosson Letter).

¹⁵⁶ *See Bureau Order on Waiver of Study Area Boundary*, 20 FCC Rcd at 9004, 9008, paras. 11 n.54, 19. *See* David Cosson Letter.

¹⁵⁷ *See Bureau Order on Waiver of Study Area Boundary*, 20 FCC Rcd at 9004, para 11. In 2005, the Bureau acknowledged Sandwich Isles' plans to construct the backbone infrastructure to connect the Hawaiian Homelands

76. The DHHL letter and attachments confirm planned telecommunication infrastructure for sites that did not yet have homes.¹⁵⁸ Sandwich Isles' agreement with the DHHL does not change its obligations to correctly allocate its C&WF pursuant to Commission rules. If there is no subscriber loop as specified under Commission rules – a connection to an actual home or business -- the costs for such facilities cannot be allocated under CAT 1 C&WF. Mere plans that future subscribers could be located in such areas is not enough to justify allocation of costs for such facilities under CAT 1.¹⁵⁹ Just as Sandwich Isles acknowledged that there were no subscribers at the end of the loops for routes [BEGIN CONFIDENTIAL] [REDACTED] [END CONFIDENTIAL], as detailed above, and that it incorrectly allocated such network costs to CAT 1, the same reasoning applies here.

77. Moreover, the DHHL letter demonstrates that SIC itself volunteered to fund this and similar expensive projects, accepting responsibility for costs that the DHHL itself had anticipated paying.¹⁶⁰ Thus, this situation is better viewed not as an obligation, but as an expensive voluntary undertaking from which SIC would reap the benefits of a substantial authorized rate of return while causing the high-cost fund to subsidize its “extremely costly projects.” The DHHL letter states, in this regard: “It has been ten (10) years now since you first proposed finding the funds to build the telecommunications infrastructure on the Hawaiian home lands. During that time, DHHL has moved from skepticism to expecting SIC to provide funding in all of our new developments. While the Department may never fully understand how Rural Utilities Service and SIC are able to fund our extremely cost projects, rest assured that we understand and appreciate the value of being able to redirect the millions of dollars we would have spent for projects such as telephone infrastructure to building more homes.”¹⁶¹

78. In short, Sandwich Isles initially proposed funding these build-outs to increase its own revenues and returns. If these were projects that ultimately served inhabitants, and thus were useful and used, the high-cost rules would permit subsidies. But that is not what happened, and the costly project ultimately served few if any customers. Sandwich Isles cannot override these rules merely because it chose to pursue a speculative venture. Therefore, SIC was proceeding at its own risk in building out the telecommunications infrastructure well before the homes themselves were constructed and occupied.

79. *Routes Between Central Offices.* With respect to routes within Sandwich Isles' network between central offices, we conclude after reviewing the data submitted by Sandwich Isles, that facilities used to provision traffic from one subscriber located in one exchange through a central office and out to another central office connecting with subscriber premises in a different exchange were interexchange in nature, and as a result, do not qualify as CAT 1 facilities.¹⁶² Such facilities should have been classified as CAT 2 (wideband and exchange trunk), CAT 3 (interexchange facilities), or CAT 4 (host/remote message). Under the Commission's rules, the cost of C&WF applicable to interexchange facilities shall

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using RUS loan funds, although Sandwich Isles did not have firm data on the number of potential subscribers. See DHHL Annual Reports, <http://dhhl.hawaii.gov/icro/annual-reports/> (describing Sandwich Isles telecommunications infrastructure projects) (last visited Dec. 5, 2016). See June 13 Sandwich Comments at Attachment, 127-130.

¹⁵⁸ Sandwich Isles' legal counsel has documented that DHHL confirm planned telecommunication infrastructure for sites. See David Cosson Letter.

¹⁵⁹ See *supra* para. 62-69 (describing in-service and working loops).

¹⁶⁰ See David Cosson Letter.

¹⁶¹ June 13 Sandwich Comments at Attachment, 127-128.

¹⁶² USAC Report at 13-14. Unlike CAT 3 interexchange C&WF, CAT 1 includes cable and wire facilities between local central offices and subscriber premises. See GVNW Comments, GN Docket No. WC 09-133, at 14 (Aug. 31, 2009). (GVNW Comments). See also *Bureau Order on Waiver of Study Area Boundary*, 20 FCC Rcd at 9004, para. 11.

be directly assigned where feasible to CAT 3.¹⁶³ NECA Reporting Guideline 4.23 further amplifies how carriers are to comply with the Commission's C&WF categorization rules, noting "where an entire cable or aerial wire is assignable to one category, its cost and quantity are, where practicable, directly assigned."¹⁶⁴ Section 36.153(a)(1)(i)(A) and (B) of the Commission's rules states that the categorization is to be made "from an analysis of cable engineering and assignment records."¹⁶⁵ These rules apply equally to fiber facilities.

80. *Sandwich Isles Working Pair Comments.* In its comments on the final USAC Report, Sandwich Isles indicated that its consultant, GVNW Consulting, Inc. (GVNW), provided certain, but not all, working pair reports that highlighted end users and their locations.¹⁶⁶ [BEGIN CONFIDENTIAL]

[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

[REDACTED] [END CONFIDENTIAL] Based on our review of the documentation and USAC's Report, we find that costs were incurred for multiple C&WF that were not working loops for several years, and as a result, should not have been classified as CAT 1 for those years.¹⁶⁸ The monetary finding associated with CAT 1 excludes any subsidies paid once the loops became working loops as defined by the Commission rules.

81. For example, in the June 13 Sandwich Comments, Sandwich Isles submitted the working pair report for the [BEGIN CONFIDENTIAL] [REDACTED] [END CONFIDENTIAL] and claimed that the company correctly classified such facilities as CAT 1.¹⁶⁹ This facility, however, [BEGIN CONFIDENTIAL] [REDACTED]

[REDACTED] [END CONFIDENTIAL] also reflects toll, extended area service (EAS), special service, and host remote, which indicates that C&WF would be allocated to categories other than CAT 1 only.

82. As another example, Sandwich Isles provided a [BEGIN CONFIDENTIAL] [REDACTED] [END CONFIDENTIAL]¹⁷¹ however, according to the working pair reports, these facilities do not reflect any subscribers (working loops). Sandwich Isles asserts that the major portions of the Commission's rules (36.151 through 36.157) allow for a company to allocate facilities among two or more categories, which includes CAT 1.¹⁷² A company however, is allowed to allocate facilities to CAT 1, only if that portion of

¹⁶³ 47 CFR § 36.156(b). The cost of C&WF applicable to this category shall be directly assigned where feasible.

¹⁶⁴ NECA Reporting Guideline 4.23.

¹⁶⁵ 47 CFR § 36.153(a)(1)(i)(A) and (B).

¹⁶⁶ June 13 Sandwich Comments at Attachment, 56-116.

¹⁶⁷ USAC Report at 7.

¹⁶⁸ See *supra* paras. 63-69 (describing property held for future use and non-operating plant). While carriers may record the cost of property held for future telecommunications use within two years (see 47 CFR § 32.2002), such amounts are allowed for the rate base (see 47 CFR § 65.820) but are not allowed for calculating high-cost loop support. See *supra* paras. 61-69 (describing HCLS). See GVNW Comments at 4, 8-9.

¹⁶⁹ June 13 Sandwich Comments at Attachment, 73.

¹⁷⁰ See AIR 383.

¹⁷¹ June 13 Sandwich Comments at Attachment at 83 and 91.

¹⁷² June 13 Sandwich Comments at 4.

the facility qualifies as a working loop. Based on the facts before us, and the examples provided above, Sandwich Isles classified facilities as CAT 1 without meeting this requirement.

83. We agree with Sandwich Isles that it is common in rural areas for interoffice facilities to include circuits that branch off from the main route to serve nearby subscribers, but do not agree that all portions of such networks can be allocated to CAT 1. Given that some of the C&WFs at issue include circuits that are applicable to other categories of plant, Sandwich Isles was required to allocate such facilities to other categories, such as CAT 2, CAT 3, or CAT 4.¹⁷³ If C&WF investment is used wholly in facilities to connect digital loop carriers and subscriber locations, and does not include extended area service, Host Remote or Special Access circuits, the C&WF investment associated with the facility would be directly assigned to Exchange Line C&WF-CAT 1. If, however, the facilities include circuits that would be applicable to other categories of plant, the investment would not be directly assigned to CAT 1.¹⁷⁴

84. We find that the working pair reports, submitted as part of the June 13 Sandwich Comments, include facilities other than CAT 1. Based on the record, we therefore have determined that Sandwich Isles has failed to demonstrate that the \$26,320,270 calculated for Exception 1 should be reduced. We conclude that it was feasible for Sandwich Isles to assign the C&WF used to provision service from one exchange to another exchange as interexchange services under CAT 3 before allocating the remaining portion of such facilities to CAT 1. Therefore, we conclude that Sandwich Isles misallocated costs used to determine high-cost support.

85. *Property Held for Future Telecommunications Use.* The June 13 Sandwich Isles Comments on the final USAC Report note that “at the very minimum, SIC should be able to recover the costs of these route segments pursuant to Section 32.2002 of the Commission’s rules [].”¹⁷⁵ Section 32.2002 of the Commission’s rules pertain to property held for future telecommunications use. As previously explained, the high-cost mechanisms reimburse carriers in high-cost areas for some of the investments and expenses of providing the local loop portion of their networks based on TPIS and working loops.¹⁷⁶ In calculating HCLS, the rules require plant to be “in service” and loops to be “working.”¹⁷⁷ Sandwich is not entitled to recover costs booked in account 2002 through HCLS.

86. While account 2002 includes the original cost of property owned and held for no longer than two years under a definite plan for use in telecommunications service,¹⁷⁸ this account is not relevant to USAC’s investigation of the misallocation of CAT 1 C&WF costs. The relevant Part 32 account that was subject to investigation was category 1 C&WF costs in account 2410 – cable and wire facilities.¹⁷⁹ This portion of the USAC investigation focused on SIC’s costs recorded to account 2410, and how the misallocation of such costs resulted in a monetary finding.¹⁸⁰

¹⁷³ 47 CFR § 36.152(a)-(c) (setting forth requirements for allocating C&WF).

¹⁷⁴ See *supra* para. 58-66, Appendix B (explaining Commission’s rules on allocation of C&WF). As noted above, our application of these rules is also consistent with NECA’s guidance it provides to carriers regarding the allocation of C&WF. See NECA Reporting Guidelines, 4.23.

¹⁷⁵ June 13 Sandwich Comments at 9.

¹⁷⁶ See *supra* para. 60-66 (describing TPIS). See 47 CFR §§ 32.2001. TPIS includes accounts 2110 through 2690.

¹⁷⁷ See, e.g., 47 CFR §§ 54.1303; 54.1305; 54.1309. See *infra* Appendix B (explaining the twenty-six step algorithm).

¹⁷⁸ 47 CFR § 32.2002.

¹⁷⁹ See *supra* para. 71-76 (describing the misallocation of category 1). See also Appendix B – Chart: Cat. 1 C&WF HCLS & ICLS Regulatory Cost Accounting Overview.

¹⁸⁰ See *supra* para. 67 (describing the monetary impact of the misallocation of category 1 on HCLS, ICLS and Safety Net Additive). As noted above, account 2002 is for property held for imminent use, that is, within two years. When
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87. *Prior Audits.* The June 13 Sandwich Isles Comments on the final USAC Report note that audits conducted by USAC and the Commission's Office of Inspector General (OIG) prior to USAC's investigation do not include CAT 1 exceptions. This argument is not persuasive. The Commission is not precluded from undertaking a more in-depth examination of these issues based on a more fully developed factual record.

88. Those USAC and OIG audits varied in scope and timeframe and are not similar to the investigation undertaken by USAC summarized in the USAC Report before us. The audits performed by USAC and OIG typically are performance audits. The Commission's rules require USAC, or any independent auditor hired by USAC conducting audits of the beneficiaries of the Fund, to conduct "such audits . . . in accordance with generally accepted government auditing standards [GAGAS]."¹⁸¹ Under GAGAS, performance audits provide findings or conclusions based on evaluation of sufficient, appropriate evidence against criteria.¹⁸² The objectives of performance audits vary widely and can cover a broad range of financial and nonfinancial matters. Such audits typically examine a wide range of issues, focusing on materiality and using sampling procedures for a limited number of transactions. On the other hand, investigations (attestation engagements) consist of obtaining sufficient, appropriate evidence to express an opinion on whether the subject matter is based on (or in conformity with) the criteria or the assertion is presented (or fairly stated) based on the criteria.¹⁸³

89. In 2010, as part of its annual beneficiary audit program to assess compliance of a selected sample of all ETCs, USAC engaged KPMG to conduct a performance audit of Sandwich Isles for the twelve-month period ended June 30, 2007. Further, the Commission's OIG started a review of Sandwich Isles' receipt of high-cost program disbursements in 2010, which was discontinued prior to completion.¹⁸⁴ OIG did not issue a report in conjunction with its review of Sandwich Isles. The USAC performance audit and the OIG review focused on one year, while the USAC Report before us focused on a period of more than 10 years.

90. The scope of the USAC investigation was Sandwich Isles' affiliated entities and transactions, Sandwich Isles' corporate structure, and testing of amounts reported for high-cost purposes affecting disbursements between 2002 to June 2015.¹⁸⁵ Beginning in August 2015 through April 2016, USAC and Commission staff held weekly meetings by telephone with Sandwich Isles to discuss inquiries and documentation needed for the investigation.¹⁸⁶ Throughout the investigation, there were over 350 inquiries made of Sandwich Isles that included submission of over 3,200 files. This investigation

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the property is put into use, the costs are to be moved from account 2002 to TPIS account 2001. *See also* Appendix B – Chart: Cat. 1 C&WF HCLS & ICLS Regulatory Cost Accounting Overview. If the property is held for longer than two years (not for imminent use), such costs are to be moved to Non-operating Plant account 2006. Whether such costs could properly be recorded in account 2002 is beside the point, however, with respect to the improper HCLS payments received, as Sandwich Isles improperly recorded these amounts in account 2410, and HCLS is not available for costs recorded in Account 2002. Moreover, with respect to the ICLS, USAC only calculated an improper payment for instances where the facilities recorded in account 2410 had not been in service. We decline to calculate the amount of ICLS support the company would have been entitled to receive because carriers only have two years to amend their cost studies. As a result, Sandwich Isles must bear the consequence of its failure to record the costs in the proper accounts.

¹⁸¹ 47 CFR § 54.702(n).

¹⁸² *See* United States Government Accountability Office, Government Auditing Standards (August 2011). *Comprehensive Review of Accounting Requirements*, Report and Order, 15 FCC Rcd 8690, 8696, para. 11 (2000).

¹⁸³ *Id.*

¹⁸⁴ June 13 Sandwich Comments Attachments at 124.

¹⁸⁵ USAC Report at 1.

¹⁸⁶ *Id.*

included significantly more detailed testing than the previous USAC and OIG audits. The USAC Report and the exceptions identified therein were based on a more focused and substantial review than the prior USAC and OIG inquiries, and the fact that prior audits did not make similar findings is not relevant to this inquiry under these circumstances. Further, we note that such reports are not binding on the Commission's own conclusion of whether a company is in compliance with Commission rules, particularly here where a much more extensive factual record has been developed.¹⁸⁷ For these reasons, we find that the fact that prior audits did not make findings in this area does not preclude the Commission from independently reviewing Sandwich Isles' data regarding the misclassification of CAT 1 C&WF in the record before us.

91. *Statute of Limitation.* We reject Sandwich Isles' assertion that 28 U.S.C. §1658(a) bars recovery by the Commission of Fund overpayments beyond the four-year period prescribed by that statute of limitations. While 28 U.S.C. §1658(a)¹⁸⁸ may limit the Commission's judicial remedy, that is, its ability to sue Sandwich Isles to recover the overpayments, it does not bar or limit the Commission's administrative remedies to collect that debt.¹⁸⁹ Under the Debt Collection Improvement Act (DCIA), which requires the Commission to collect debts owed to the Fund, the Commission is empowered to collect debt owed to it by a number of means, including administrative offset and recoupment.¹⁹⁰ Congress has not enacted a statute of limitations constraining the agency's ability to recover funds under either section 254 or the DCIA and this agency lacks the authority to self-impose an absolute bar on its ability to recover funds wrongfully disbursed. Specifically, there are constitutional constraints on an agency's ability to waive collection of legitimate Government debts in the absence of express statutory authority.¹⁹¹

92. We therefore reject Sandwich Isles' argument that the Commission previously adopted an absolute five-year limitations period for recovery of Fund monies. As we have stated, the Commission lacks authority to impose an absolute bar on collection of debt because that is a function that rests exclusively with the Congress and would be inconsistent with the agency's obligation under the DCIA to pursue improper payments. Further, Sandwich Isles fails to mention several significant orders issued

¹⁸⁷ Cf. 47 CFR § 54.703 (Commission conducts de novo review of requests for review of USAC decisions).

¹⁸⁸ We do not address the question of whether the four-year statute of limitations in 28 U.S.C. §1658(a) or the six-year statute of limitations in 28 U.S.C. §2415(a) would apply here if the Commission were to sue Sandwich Isles for recovery of Fund overpayments.

¹⁸⁹ *BP America Production Co. v. Burton*, 549 U.S. 84 (2006). In *Burton*, the Court found that the word "action" as used in 28 U.S.C. §2415(a), another federal limitations statute, referred to court actions only and not to administrative proceedings. *Id.* at 99. See also *Thomas v. Bennett*, 856 F. 2d 1165, 1168-1169 (the statute of limitations in 28 U.S.C. §2415(a) simple eliminates the suing party's judicial remedy and does not circumscribe its right to offset); *Gerrard v. U.S. Office of Education*, 656 F. Supp. 570, 574 (N.D. Cal. 1987) (holding that a lapsed statute of limitations did not prevent the United States from collecting a debt by offset). Further, the cases cited by Sandwich Isles in support of its argument are not persuasive as each involved a court action to collect debt.

¹⁹⁰ 31 U.S.C. § 3701 *et seq.*; see also 31 CFR § 900.1 *et seq.* (Federal Claims Collection Standards, implementing the DCIA).

¹⁹¹ The two constitutional constraints to an agency-imposed limitations period arise under the Property Clause and the Appropriations Clause. The Supreme Court has held that, "Power to release or otherwise dispose of the rights and property of the United States is lodged in the Congress by the Constitution, Art. IV, § 3, cl. 2." *Royal Indemnity Co. v. United States*, 313 U.S. 289 (1941). An administrative limitations period that results in the automatic compromise or release of obligations conflicts with this provision. See also *Fansteel Metallurgical Corp. v. U.S.*, 172 F. Supp. 268, 270 (1959) (Property Clause requires collection of payments improperly made). An agency's failure to seek repayment of debt owed to it also creates tension with the Appropriations Clause, Art. I, § 9, cl. 7 ("No Money shall be drawn from the Treasury, but in consequence of Appropriations made by Law). See also *Office of Personnel Management v. Richmond*, 496 U.S. 414, 434 (1990) ("[T]here can be no estoppel [barring recoupment of funds], for courts cannot estop the Constitution"). Government funds must be spent as Congress provided "and not according to the individual favor of Government agents." *Id.* at 428.

after 2007 that clarify the agency's recovery obligations. As the Bureau explained in its *Premio* decision, consistent with our precedent, "the Commission's direction to USAC to initiate and complete investigations within five years is a *policy preference, not an absolute bar to recovery*."¹⁹² In deciding *Premio*, the Bureau cited to the *Lakehills Order* where the Commission found that "USAC's recovery of government funds paid to an applicant or service provider who has no just right to keep the funds is not barred by the passage of time."¹⁹³ Thus, Congress has not imposed a statutory limitations period on the collection of debt under section 254 or the DCIA, and construing any Commission order as an attempt to do so would be impermissible because, as noted above, only Congress may impose such absolute limitations on debt recovery.

93. The fact that the Commission adopted a rule in 2007 requiring all high-cost recipients to maintain specific forms of documentation for at least five years from the receipt of funding does not exonerate recipients from all other applicable retention requirements. As the Commission expressly noted when it adopted the five-year document retention requirement, "[t]o the extent other rules or any other law require or necessitate documents be kept for longer periods of time (e.g., to support the account balances in the Part 32 Uniform System of Accounts, continuing property records, pole attachment calculations, plant equipment age, cost, or useful life, depreciation rates) . . . high cost program recipients must keep documents for such longer periods of time as required or necessary under such other rules or law and make such documents available to the Commission and USAC."¹⁹⁴ That statement made clear that the rule adopted in 2007 did not disturb other requirements already in place regarding documentation for the existence of assets.

94. For example, LECs are required to keep records and accounts in accordance with Part 32 – The Uniform Systems of Accounts (USOA) longer than five years. Specifically, LECs are also required to be in compliance with the record retention and basic property records rules in sections 32.12 and 32.2000, respectively, which have been in effect since 1987. The LECs' financial records are to be kept in accordance with generally accepted accounting principles (GAAP) in sufficient particularity to show fully the facts pertaining to all entries in these accounts.¹⁹⁵ Section 32.2000(e)(2)(iv) requires that "[t]he basic property records must be maintained throughout the life of the property."

¹⁹² *In the Matter of Request for Waiver of Review of a Decision of the Universal Service Administrator by Premio Computer, Inc. et al.*, Order, 29 FCC Rcd 8185, 8186, para. 6 (WCB 2014) (*Premio*) (emphasis added); *Schools and Libraries Universal Service Support Mechanism*, Fifth Report and Order, 19 FCC Rcd 15808, 15809, para. 1 (2004) ("Fifth Report and Order") ("[W]e announce *our policy* regarding the timeframe in which USAC and the Commission will conduct audits or other investigations relating to use of E-rate funds.") (emphasis added). Although Sandwich Isles relies upon the *USF Management Review Order* as support for its suggestion that the Commission is barred from fund recovery by a self-imposed and absolute limitations period, that 2007 Order simply extended to the high-cost program the same policy preferences that the Commission previously applied to the E-rate program. Like the policy expressed in the context of the E-rate program, the 2007 *USF Management Review Order* did not (and could not) impose an absolute bar on recovery of funds that would compromise the agency's constitutional and statutory obligation to collect debt owed to it.

¹⁹³ *Request for Review of Decisions of the Universal Service Administrator by Joseph M. Hill Trustee in Bankruptcy for Lakehills Consulting, LP*, Order, 26 FCC Rcd 16586, 16601, para. 28 (2011) (*Lakehills Order*). See also *United States v. Wurts*, 303 U.S. 414, 416, 58 S.Ct. 637, 638 (1938) ("The Government's right to recover funds, from a person who received them by mistake and without right, is not barred unless Congress has 'clearly manifested its intention' to raise a statutory barrier [to recovery].") (citations omitted).

¹⁹⁴ *Id.* (emphasis added).

¹⁹⁵ 47 CFR § 54.320(b). See also *USF Management Comprehensive Review Order*, 22 FCC Rcd at 16383-84, para. 24 (2007) (adopting document retention rule for high-cost). Subsequently, the Commission extended the document retention requirement to 10 years from the receipt of funding. See *USF/ICC Transformation Order*, 26 FCC Rcd at 17864, para. 621; 47 CFR § 54.320(b).

95. Sandwich Isles also appears to argue that it is not bound by the Commission's ten-year retention requirements for high-cost program recipients. It seems to suggest that if the retention period were adopted only to align record retention with the False Claims Act, then somehow that retention period is inapplicable due to Sandwich Isle's misguided assertion that the False Claims Act (31 U.S.C. 3729 *et seq*) does not apply to programs disbursing funds through the Universal Service Fund. These arguments are both irrelevant to its defenses and misguided substantively. First, this action involves an administrative proceeding to recoup erroneously disbursed funds and not a case for damages under the False Claims Act. Second, even if the False Claims Act were relevant here, Sandwich Isles has failed to acknowledge the most recent precedent under that statute pertaining to its definition of federal funds, which rejected the analysis in *Shupe* and instead held that disbursements for USF programs are covered by that statute.¹⁹⁶ Finally, the time has long passed for any collateral attack such as this on the viability of the Commission's document retention rules for its high-cost program, rules that have been in effect since 2011 and that are designed to provide an additional mechanism to protect the program from overcharges such as those made by Sandwich Isles. We note further that the USF is a permanent federal appropriation established by Congress and that, as noted, the Commission is obligated to seek recovery of wrongfully disbursed funds consistent with federal law. Thus, Sandwich Isles' misguided and irrelevant arguments about the viability of document retention periods or applicability of the False Claims Act, which is not even at issue here, have no bearing on the Commission's action for administrative recovery of overcharges.

96. Based on the USAC Report and our own analysis and review of the record, we conclude that Sandwich Isles misclassified facilities that should have been CAT 2, CAT 3, or CAT 4, as CAT 1 facilities in cost studies for the period from 2003 to 2013, and accordingly received more support than it otherwise should have received under our Part 54 rules. As a result, SIC received overpayments of \$26,320,270 from the Fund. We direct USAC to initiate actions to recover these amounts. Given that this finding has the potential to affect future high-cost disbursements in 2016 and onward, we direct Sandwich Isles to submit any future cost studies consistent with these findings regarding allocation of C&WF.

B. Sandwich Isles Received Excess USF Support Because of Unreasonable Affiliate Transactions

1. Background

97. A number of rules and principles are important in determining what is properly in a carrier's regulated revenue requirement when seeking recovery of expenses through the high-cost program.¹⁹⁷ As noted above, for cost companies, high-cost support is determined in part based on cost information that is submitted to determine the regulated revenue requirement. Compliance with our cost allocation rules is critical for carriers receiving high-cost support based on their reported costs, as incorrect allocations will result in support amounts in excess of what a carrier is entitled to. The purpose of the Commission's cost allocation rules is "to protect ratepayers from bearing the costs and risks of nonregulated activities. The rules are intended to deter unreasonable cost shifting both from cost misallocations of joint and common costs and from affiliate transactions."¹⁹⁸

¹⁹⁶ See *United States ex rel. Todd Heath v. Wisconsin Bell, Inc.*, 111 F.Supp.3d 923 (E.D. Wis. 2015), *interlocutory appeal denied* (2016) (rejecting the holdings in *U.S. ex rel. Rene Shupe v. Cisco Systems, Inc.*, 769 F.3d 379 (5th Cir. 2014).

¹⁹⁷ A revenue requirement is how much money is needed by a telecommunications company to cover its operating and capital costs of providing service to its customers.

¹⁹⁸ *Allocation of Costs Associated with Local Exchange Carrier Provision of Video Programming Services*, CC Docket No. 96-112, 11 FCC Rcd 17211, 17216, para. 9 (1996); see also *Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities*, Order on Reconsideration, 2 FCC Rcd 6283, 6283, para. 1 (1987)

(continued....)

98. In evaluating whether particular costs can be included in a carrier's revenue requirement, the Commission allows recovery through regulated rates only when a cost is "used and useful" in the provision of regulated services, specifically, only if it is "necessary to the efficient conduct of a utility's business, presently or within a reasonable future period."¹⁹⁹ The "used and useful" principles serve as a protection against inefficiencies and abuse. The Commission has held that "imprudent or excessive investment, for example, is the responsibility and coincident burden of the investor, not the ratepayer."²⁰⁰

99. The Commission's affiliate transaction rules focus specifically on what costs may properly be included in the regulated revenue requirement for transactions between affiliated entities. These rules require that services purchased by a carrier from an affiliate be recorded at the lower of fair market value or fully distributed cost.²⁰¹ When services are provided by a carrier to an affiliate, it shall be recorded at no less than the higher of fair market value or fully distributed cost.²⁰² If an affiliate exists solely to provide services to members of the carrier's corporate family, all services the carrier purchases from that affiliate shall be recorded at fully distributed cost.²⁰³

100. In adopting the affiliate transactions rules, the Commission sought to address the incentives that traditional rate-of-return regulation gives carriers regarding transactions with affiliates. Because those transactions occur at less than arm's length, carriers may be motivated to pay excessive amounts for assets and services obtained from their nonregulated affiliates because they are able to pass increases in their costs on to ratepayers. Carriers regulated on a rate-of-return basis also have incentives to undercharge nonregulated affiliates when the undercharges can be offset by increased charges to ratepayers.²⁰⁴ The affiliate transaction rules ensure that the ratepayer receives the most reasonably advantageous result from the transaction and protects the ratepayer from subsidizing the carrier's affiliate activities. In addition, the ratepayer will not incur unwarranted costs associated with the various affiliate transactions. Because the high-cost program provides support for regulated costs that exceed certain thresholds, failure to comply with the cost allocation rules also will result in inflated high-cost support amounts.

101. Related-party transactions are financial arrangements between entities, board members and/or their employees where there is a special connection between the parties (e.g., a blood relative or business relationship).²⁰⁵ In the context of Sandwich Isles, a related party includes any employee; any immediate family member of an employee; and an owner of voting shares or immediate family member of such owner.

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(One of the chief goals of Part 64 of the Commission's rules is to "discourage carriers from subsidizing the costs of nonregulated services by shifting nonregulated costs to regulated activities. . .").

¹⁹⁹ *American Tel. and Tel. Co.*, Phase II Final Decision and Order, 64 FCC Rcd 2d 1, at 38, para. 111 (*AT&T Phase II Order*).

²⁰⁰ *Id.* at 38, para. 112.

²⁰¹ 47 CFR § 32.27(c)(2). Fully distributed cost is an accounting method to distribute all costs among a company's various products and services.

²⁰² 47 CFR § 32.27(c)(1).

²⁰³ 47 CFR § 32.27(c)(3).

²⁰⁴ *Amendment of Parts 32 & 64 of the Commission's Rules to Account for Transactions Between Carriers & Their Nonregulated Affiliates*, 8 FCC Rcd 8071 (1993).

²⁰⁵ Affiliate transactions are between related business entities. Related-party transactions would include affiliate transactions and transactions between related individuals.

2. Inflated and Improper Waimana Management Fees

102. As part of its investigation, USAC closely examined the affiliate transactions between Waimana and Sandwich Isles, including the management services that Waimana provided to Sandwich Isles.²⁰⁶ [BEGIN CONFIDENTIAL] [REDACTED]
[REDACTED]
[REDACTED] [END CONFIDENTIAL].²⁰⁷ In addition to providing management services to Sandwich Isles, USAC noted that [BEGIN CONFIDENTIAL] [REDACTED] [END CONFIDENTIAL] provided management services to [BEGIN CONFIDENTIAL] [REDACTED] [END CONFIDENTIAL]. During the period 2002 to 2014, Sandwich Isles' annual management fees ranged from a low of [BEGIN CONFIDENTIAL] [REDACTED] [END CONFIDENTIAL] in 2007, to as much as [BEGIN CONFIDENTIAL] [REDACTED] [END CONFIDENTIAL] in 2010.²⁰⁸ Although Sandwich Isles opposed production of most of the financial documents regarding Sandwich Isles' affiliates, USAC learned that during the course of the period under investigation, most of the revenue that Waimana received — in some years as high as [BEGIN CONFIDENTIAL] [REDACTED] [END CONFIDENTIAL] — came directly from Sandwich Isles.²⁰⁹

103. In USAC's testing of Waimana management fees, the management fees were broken out into office costs, which included both rent and office supplies, service costs and direct costs, which included incidentals such as hotel expenses. Under Observation 5 (Comparison of SIC to Other Entities) and Observation 2 (Transactions Involving Relatives of Albert Hee) within the USAC Report, USAC compared Sandwich Isles management fees and salaries to entities comparable to Sandwich Isles.²¹⁰ USAC reported that Sandwich Isles' management fees were [BEGIN CONFIDENTIAL] [REDACTED] [END CONFIDENTIAL] higher than the average management fees assessed by entities with a comparable number of working loops for 2012, 2013, and 2014, respectively.²¹¹

104. Based on our review of the information before us, including the testimony provided in the Hee federal trial and USAC's Report, we find that Sandwich Isles recovered from the high-cost program expenses under the guise of management fees involving related party transactions that were in violation of the Commission's affiliate transaction rules, were not used and useful, and were imprudent based on the size of the company and the number of local loops within its network. USAC sampled a sizeable number of invoices that Waimana sent to SIC for management fees and determined that many of the fees paid by Sandwich Isles to Waimana were not reasonable in light of the services rendered.²¹² For example, [BEGIN CONFIDENTIAL] [REDACTED]
[REDACTED]
[REDACTED] [END CONFIDENTIAL] Further, substantial evidence

was presented at trial that Mr. Hee controlled the accounting within all of the companies affiliated with Waimana, including Sandwich Isles, and directed the Sandwich Isles employees to label personal expenses as business expenses for the benefit of the Hee family.²¹³ For example, the trial records indicate

²⁰⁶ USAC Report at 17.

²⁰⁷ *Id.* at 22.

²⁰⁸ We also note that Sandwich Isles received over \$23 million in high-cost support in 2009.

²⁰⁹ See Waimana 2002 through 2014 Internal Statement of Profit and Loss.

²¹⁰ USAC Report at 78, 79-81.

²¹¹ *Id.*

²¹² See *supra* paras. 32-41.

²¹³ See *supra* para. 36.

that Albert Hee spent \$96,000 for personal massages which were deducted under Waimana as “consulting fees.”²¹⁴

105. During the course of the investigation, Sandwich Isles failed to provide to USAC sufficient documentation upon request in explaining how the management fees paid by Sandwich Isles to Waimana were directly related to Sandwich Isles’ obligations to provision USF-supported services.²¹⁵ Based on the documentation that Sandwich Isles provided to USAC, we find that SIC failed to demonstrate that these expenses involving related-party transactions were “used and useful” in the provision of regulated services, and, specifically, has failed to establish that management fees of this magnitude were “necessary to the efficient conduct of [its] business, presently or within a reasonable future period.”²¹⁶ Further, we find that many of these expenses violated the Commission’s affiliate transaction rules when Sandwich Isles paid Waimana higher amounts for services than what a company of similar size, based on employees and customer lines, would pay. Pursuant to section 54.707, the Commission may direct USAC to withhold support if a carrier fails to provide adequate verification of support amounts.²¹⁷ We find under the circumstances presented here that Sandwich Isles failed to demonstrate it was entitled to support based on these inflated management fees, and we direct USAC to recalculate support amounts accordingly.

106. As a result, we will disallow the Waimana management fees to the extent they are above the average of management fees paid by entities of comparable size. We adopt USAC’s approach in determining the management fees of entities comparable in size to Sandwich Isles.²¹⁸ Given the evidence before us of the exorbitant amount of management fees that were paid from Sandwich Isles to Waimana, and the evidence that many of such expenses did not go towards the provision, maintenance, and upgrading of facilities and services for which the support is intended, we find that Sandwich Isles should not have recovered more than what comparable entities paid in management fees. We direct USAC to initiate actions to recover all amounts paid from Sandwich Isles to Waimana above the amounts of the average of what similarly-situated companies pay in management fees for the period 2002 to 2015. In calculating the amounts to recover from Sandwich Isles for excessive management fees, we direct USAC to disallow the management fees in excess of \$1,237,355, which is the average amount of the comparable entities average management fees for 2012, 2013 and 2014, and apply that approach for each year, from 2002 to 2015.²¹⁹

a. Waimana Payments for Rent and Office Supplies

107. As part of its investigation, USAC determined that Waimana charged Sandwich Isles **[BEGIN CONFIDENTIAL]** [REDACTED] **[END CONFIDENTIAL]** for office space in Honolulu, Hawaii and office supplies during the period 2002 to 2013 --- as detailed under Exception 2 (Inflation of Management Fees Paid by SIC to Waimana Enterprises Inc.) of the USAC Report. USAC also notes that Sandwich Isles reported that it paid Waimana over **[BEGIN**

²¹⁴ See, e.g., Gov’t Ex. 4-101; Trial Tr. vol. 2, 54-58 (discussing payment of Hee’s masseuse as “consulting services”).

²¹⁵ USAC Report at 19. The burden is on recipients of support to retain records sufficient to demonstrate that the support received was consistent with the universal service high-cost program rules. 47 CFR § 54.320(b).

²¹⁶ *American Tel and Tel. Co.*, Phase II Final Decision and Order, 64 FCC 2d 1, at 38, para. 111 (1977).

²¹⁷ 47 C.F.R. § 54.707(a).

²¹⁸ USAC selected rate-of-return carriers that reported management fees and had loops that ranged from 3,500 to 4,500 in 2015. See generally USAC Report at 78.

²¹⁹ USAC Report at 78. The comparable entities average management fees were \$1,309,934 for 2012, \$1,236,013 for 2013, and \$1,166,118 for 2014, which averages to \$1,237,355. *Id.*

CONFIDENTIAL [REDACTED] **[END CONFIDENTIAL]** for office costs from 2002 to 2013.²²⁰ Given that the commercial real estate company that contracted directly with Waimana for the office space charged Waimana only \$45,000 per month, USAC questioned the additional **[BEGIN CONFIDENTIAL]** [REDACTED] **[END CONFIDENTIAL]** more per month that Waimana charged Sandwich Isles, along with the fact that **[BEGIN CONFIDENTIAL]** [REDACTED] **[END CONFIDENTIAL]** ²²¹

108. In its initial draft exceptions, USAC found that Sandwich Isles had not provided evidence that the **[BEGIN CONFIDENTIAL]** [REDACTED] **[END CONFIDENTIAL]** per month that Sandwich Isles was paying to Waimana was being used for office supply expenses, printer paper, coffee, etc.²²² Further, in addition to the **[BEGIN CONFIDENTIAL]** [REDACTED] **[END CONFIDENTIAL]** in monthly payments, USAC identified other Waimana invoices issued to Sandwich Isles that appeared also to charge office supplies, indicating that Sandwich Isles was being charged twice for the same services and office equipment.²²³

109. In response to USAC's initial exceptions, Sandwich Isles stated that the additional amount per month that Waimana charged Sandwich Isles, above the rent amount charged to Waimana, was used to offset the costs of **[BEGIN CONFIDENTIAL]** [REDACTED] **[END CONFIDENTIAL]**.²²⁴ Further, Sandwich Isles claimed that Waimana had **[BEGIN CONFIDENTIAL]** [REDACTED] **[END CONFIDENTIAL]** and as a result did not violate the Commission's affiliate transaction rules.²²⁵ Sandwich Isles further contended that Waimana had capped the charges for SIC's share of common area maintenance, insurance, telephone, legal, photocopying, postage, parking and office supplies at **[BEGIN CONFIDENTIAL]** [REDACTED] **[END CONFIDENTIAL]** per month and that in some instances, the expenses exceeded those amounts.²²⁶

110. We find that Sandwich Isles has failed to demonstrate that the **[BEGIN CONFIDENTIAL]** [REDACTED] **[END CONFIDENTIAL]** per month beginning in 2002 was for legitimate, used and useful office expenses, and we therefore disallow those amounts above the average of management fees paid by entities of comparable size. USAC was unable to determine whether these expenses were justified given that Sandwich Isles failed to produce explanations as to how the "office expenses" were in compliance with sections 54.7 and 32.27 of the Commission's rules. Under section 54.707 of the Commission's rules, carriers must provide adequate verification of support amounts to ensure payments are disbursed consistent with Commission rules.²²⁷ We conclude that Sandwich Isles failed to provide a valid business purpose or relevant documentation to support the additional **[BEGIN CONFIDENTIAL]** [REDACTED] **[END CONFIDENTIAL]** billed per month. We also find it unreasonable that the actual office supply costs consistently would be at least **[BEGIN CONFIDENTIAL]** [REDACTED] **[END CONFIDENTIAL]**

²²⁰ *Id.* at 22. In calendar years 2009, 2011, 2012, and 2013, Waimana charged Sandwich Isles **[BEGIN CONFIDENTIAL]** [REDACTED] **[END CONFIDENTIAL]** in "office costs".

²²¹ Gov't Ex. 11-053.0001; 11-058.0001.

²²² USAC Report at 18.

²²³ USAC Report at 17-18.

²²⁴ *Id.* at 21-22.

²²⁵ *See Id.* at 22-24; *see also* 47 CFR § 32.27(c)(2) (requiring that an affiliate can charge a carrier services at the lower of fair market value or fully distributed cost).

²²⁶ USAC Report at 24.

²²⁷ 47 CFR § 54.707.

[END CONFIDENTIAL] per month over the course of 13 years. Moreover, there is significant evidence in the record that Sandwich Isles routinely paid to Waimana amounts of money that did not go towards the “provision, maintenance and upgrading of facilities and services for which the support is intended.”²²⁸

111. In Albert Hee’s trial, the federal government provided evidence of numerous instances in which Hee authorized the use of corporate funds for his personal expenses.²²⁹ Albert Hee testified in federal court that “I make a decision on what charges go to what company, where there’s a business purpose, and then it’s dealt with by the.”²³⁰ In 2008, a year in which Sandwich Isles paid Waimana over [BEGIN CONFIDENTIAL] [REDACTED] [END CONFIDENTIAL] in management fees, representing [BEGIN CONFIDENTIAL] [REDACTED] [END CONFIDENTIAL] of Waimana’s total revenue, Waimana purchased a \$43,000 SUV automobile and a home in California for \$1.3 million in which the Hee children resided while attending a university.²³¹ USAC found that Sandwich Isles paid Waimana for rental of fitness equipment and personal gasoline for Albert Hee in the amount of over [BEGIN CONFIDENTIAL] [REDACTED] [END CONFIDENTIAL].²³² USAC also identified invoices charged to Sandwich Isles and paid to Waimana for [BEGIN CONFIDENTIAL] [REDACTED] [REDACTED] [END CONFIDENTIAL].

112. These are not careless, inadvertent mistakes. Taken together, these examples paint a clear picture: the management fees paid by SIC effectively were a scheme that provided additional funding to Waimana for the personal benefit of the Hee family. Sandwich Isles paid excessive management fees to Waimana, which in turn enabled SIC to recover higher amounts than it would otherwise have been entitled to from the high-cost program. We must address this pervasive pattern of abuse of public funds. SIC failed to document that those costs labeled as “office expense” actually produced the benefit of maintaining Sandwich Isles’ offices. Accordingly, we find that SIC has failed to meet the requirements of section 54.7 and 54.320, and these excessive expenses are disallowed.

b. Other Expenses Paid as Management Fees

113. We also find other improper expenditures that were not necessary for the provision of supported services and should not have been recovered from the Fund.

114. As a part of the Waimana management fees, Sandwich Isles paid Waimana for [BEGIN CONFIDENTIAL] [REDACTED] [END CONFIDENTIAL].²³³ When USAC requested documentation from Sandwich Isles to justify the millions of dollars that Sandwich Isles paid to Waimana on an annual basis, many of the invoices revealed expenditures that were not used and useful to Sandwich Isles’ obligations to offer telecommunications services.

115. Under Observation 2 (Transactions Involving Relatives of Albert Hee), USAC noted that some Sandwich Isles employees were receiving a salary from both Sandwich Isles and Waimana, and as a result, recording the costs of such salaries as an expense recovered from the Fund.²³⁴ Additionally, Albert Hee’s children, Breanne Hee, Charlton Hee, and Wendy Hee, were receiving salaries from Waimana, while attending college full-time and living in a different jurisdiction, outside of Hawaii. Based on the federal trial, business records show that Mrs. Hee and the children were paid by Waimana \$1,680,685.92

²²⁸ 47 CFR § 54.7.

²²⁹ See *supra* Section II.D, Albert Hee’s Criminal Tax Fraud Conviction.

²³⁰ See *supra* para. 36.

²³¹ Gov’t Exs. 3-3, 4-82K, 4-100.

²³² USAC Report at 20.

²³³ *Id.* at 71.

²³⁴ Gov’t Ex. 12-005.0001 at 72; USAC Report at 73-76.

in salary and benefits from 2002 through 2012.²³⁵ [BEGIN CONFIDENTIAL] [REDACTED] [END CONFIDENTIAL] we find that Fund was effectively supporting the amounts of such Waimana salaries paid to Mrs. Hee and her children.²³⁶

116. Under Observation 4 (Waimana Income Statement Anomaly), USAC noted that in 2014, Waimana's total expenses were [BEGIN CONFIDENTIAL] [REDACTED] [END CONFIDENTIAL], but the management fees charged to Sandwich Isles for that same year totaled [BEGIN CONFIDENTIAL] [REDACTED] [END CONFIDENTIAL]. Under the Commission's affiliate transaction rules, the regulated entity can only be charged by the affiliate at the lower of fully distributed cost or fair market value for services rendered from an affiliate.²³⁷ When reviewing Waimana's financial statements, the difference between the total expenses and the management fee revenues indicate that Sandwich Isles was charged at least [BEGIN CONFIDENTIAL] [REDACTED] [END CONFIDENTIAL] more for services than Waimana incurred to render such services.²³⁸ This calculation is based on the assumption that Waimana's [BEGIN CONFIDENTIAL] [REDACTED] [END CONFIDENTIAL] attributed to performing services to Sandwich Isles, even though Waimana also [BEGIN CONFIDENTIAL] [REDACTED] [END CONFIDENTIAL].²³⁹ When USAC provided Sandwich Isles an opportunity to respond to this concern, Sandwich Isles stated that it "takes issue with and does not agree with the assertions and implications of the observations."²⁴⁰ We are not persuaded that this is an adequate response given the totality of the record.

117. We find that the other management fees including services and incidental fees were unreasonable, excessive, and in many cases unrelated to Sandwich Isles' obligations under section 54.7 of the Commission's rules. Given all of the facts before us, we are compelled to find that a significant amount of the management fees paid by Sandwich Isles to Waimana and recovered from the Fund were improper and outside the scope of Sandwich Isles' obligations to provision USF-supported services. As discussed above, we direct USAC to disallow all management fees paid by Sandwich Isles to Waimana for the period 2002 to 2015 in excess of \$1,237,355 per year.²⁴¹ Moreover, Sandwich Isles may not receive support going forward for management fees paid to Waimana absent detailed documentation regarding the legitimate business purpose of each expenditure.

3. Ineligible Payments to an Affiliate, ClearCom

a. Water Mains Lease

118. Sandwich Isles entered into an agreement with ClearCom, an affiliate, to sublease a portion of abandoned water mains, which ClearCom leased from the Honolulu Board of Water Supply.²⁴² The Honolulu Board of Water designated approximately 30 miles for available use for Sandwich Isles.²⁴³

²³⁵ See *supra* para. 41.

²³⁶ As noted above, as another example, at the federal trial, the government provided evidence that Mr. Hee approved Waimana payments to his personal masseuse totaling more than \$90,000 for personal massages and directed the payments to be recorded as "consulting fees." See, e.g., Gov't Ex. 4-101; Trial Tr. vol. 2, 54-58.

²³⁷ 47 CFR § 32.27(c)(2).

²³⁸ USAC Report at 78.

²³⁹ *Id.* at 78.

²⁴⁰ *Id.*

²⁴¹ See *supra* para. 106, n. 219.

²⁴² USAC Report at 27, Exception 3 (Improper Allocation of ClearCom Water Mains).

²⁴³ *Id.* at 28-29.

According to Sandwich Isles, the abandoned water mains serve as underground conduits for laying fiber facilities in and around Honolulu. Sandwich Isles provided USAC with a schedule of when the company began using certain sections of the water mains and the amounts paid to ClearCom.²⁴⁴ In comparing such information to the Sandwich Isles cost studies that SIC submitted to NECA, which formed the basis for high-cost support calculations, USAC discovered that the cost studies included the costs of portions of the water mains that Sandwich Isles was not using, thereby causing Sandwich Isles to overpay ClearCom. Based on these facts, USAC removed the unused portions of water mains from what Sandwich Isles submitted as costs and calculated the overpayments from the Fund for disbursement years 2004 through 2015, for a total of \$711,355. Sandwich Isles does not dispute USAC's calculations of overpayments for these costs.²⁴⁵

119. For the reasons detailed above, we conclude that Sandwich Isles received \$711,355 in improper payments for the amounts it paid to ClearCom for unused portions of the water mains. Sandwich Isles violated section 32.27(c)(2) of the Commission's rules for recording the transaction between Sandwich Isles and ClearCom above the lesser of fair market value or fully distributed cost.²⁴⁶ Based on the evidence before us and Sandwich Isles' lack of documentation to demonstrate that this was an arms-length transaction in which an affiliate paid the lesser of fair market value or fully distributed cost, we find the support amounts that Sandwich Isles received for the amounts it paid to ClearCom as improper. Under these circumstances, Sandwich Isles has failed to demonstrate that expenses of this amount were necessary for the provision of supported services. Given that certain parts of the water mains were not in use during the relevant period, Sandwich Isles failed to demonstrate the cost of leasing such property was "necessary."²⁴⁷ We direct USAC to initiate action to recover this support received for costs of the water mains that were not used. We direct Sandwich Isles to make necessary adjustments to its allocations in its cost studies for the periods after June 2015 to ensure that any future recovery for costs associated with the lease of the water mains is consistent with Commission rules and this Order.

b. Prepayment of Rent/Relocation of Property

120. Towards the end of 2013, Waimana terminated its real estate lease in Honolulu, Hawaii and moved itself and Sandwich Isles to property owned by Sandwich Isles in Mililani, Hawaii, which is called "Pine Spur."²⁴⁸ [BEGIN CONFIDENTIAL] [REDACTED]
[REDACTED]
[REDACTED] [END CONFIDENTIAL].²⁵⁰

121. In 2014, Sandwich Isles paid ClearCom \$3 million, interest-free, in prepaid rent to serve as the capital to enable the build-out of the new building on Pine Spur in Mililani, Hawaii.²⁵¹ In addition

²⁴⁴ *Id.*

²⁴⁵ USAC Report at 30.

²⁴⁶ 47 CFR § 32.27(c)(2).

²⁴⁷ See *AT&T Phase II Order*, 64 FCC at 38, para. 111.

²⁴⁸ USAC Report at 54-55. Sandwich Isles entered into a Purchase and Sale Contract with a third-party to buy the Pine Spur property for the amount of [BEGIN CONFIDENTIAL] [REDACTED] [END CONFIDENTIAL]. It is not clear from the record, what, if anything, Sandwich Isles did with this property in relation to its obligations for provisioning telecommunications services before 2014, when it moved its headquarters to this property.

²⁴⁹ *Id.* at 54.

²⁵⁰ Sandwich Isles has explained that [BEGIN CONFIDENTIAL] [REDACTED] [END CONFIDENTIAL].

²⁵¹ Information on file in EB-IHD-15-0019603; USAC Report at 54. USAC indicates that the \$3 million payment to ClearCom was made in 2014 and was recorded as a prepaid asset, rather than an expense, so such costs would not be (continued....)

to the prepaid rent to ClearCom, Sandwich Isles incurred expenses for temporary office space, including construction of temporary trailers, septic systems and other building costs. Under Exception 6 (Higher Cost of the SIC Relocation from Honolulu, Hawaii to Mililani, Hawaii) in the USAC Report, USAC indicates that Sandwich Isles paid over \$900,000 in calendar year 2013 for the temporary space, in addition to the rent in Honolulu, Hawaii, and over \$3.1 million in calendar year 2014 for the new space, including the \$3 million to its affiliate, ClearCom.²⁵²

122. Sandwich Isles argued that the move to Pine Spur and the prepaid rent to ClearCom was implemented as a cost-cutting effort because the rent for property in Honolulu, Hawaii would cost over \$500,000 per month.²⁵³ Sandwich Isles' plan was to move its headquarters to a permanent building at Pine Spur that would be [BEGIN CONFIDENTIAL] [END CONFIDENTIAL] and constructed by ClearCom.²⁵⁴ [BEGIN CONFIDENTIAL] [END CONFIDENTIAL] thereby saving over \$500,000 in rent for what it would have paid for the office space in Honolulu, Hawaii.²⁵⁵ [BEGIN CONFIDENTIAL] [END CONFIDENTIAL] and record the prepaid rent to a general support expense account and recover the costs from the Fund.²⁵⁶

123. While we encourage carriers to achieve operational efficiencies that result in lower operational expenses, we are not persuaded that it was reasonable for Sandwich Isles to pay both the office space in Honolulu, Hawaii, which cost \$585,439 a year, and the costs for temporary space at Pine Spur of \$835,207 in calendar year 2013.²⁵⁷ In its response, Sandwich Isles did not explain why it was necessary for it to pay both the rent in Honolulu, Hawaii, costing \$585,439 annually, and at the same time pay for use of the temporary office space at Pine Spur. Based on our review of the record, we conclude that these duplicative costs are not reasonable, and the costs associated with Pine Spur should not have been recovered from the Fund. The updated monetary effect, after consideration of the per line limit cap, is an underpayment of (\$1,445) for HCL for 2015 disbursements.²⁵⁸

124. We find that the \$3 million in prepaid rent described in Exception 2 of the USAC Report runs afoul of the Commission's affiliate transactions rule. The Commission's affiliate transactions rules require that services sold by an affiliate to the carrier shall be recorded at "the lower of fair market value and fully distributed cost."²⁵⁹ Sandwich Isles made a decision to give \$3 million to an affiliate [BEGIN CONFIDENTIAL] [END CONFIDENTIAL] which would construct [BEGIN CONFIDENTIAL] [END CONFIDENTIAL] a building on land owned by Sandwich Isles. Further, Sandwich Isles failed to submit any documentation to prove that the labor associated with such a transaction was appropriately allocated to [BEGIN CONFIDENTIAL] [END CONFIDENTIAL]

(Continued from previous page) _____ immediately recovered through high-cost support in 2016, but recovered over time. Information on file in EB-IHD-15-0019603; USAC Report at 59.

²⁵² *Id.* at 55.

²⁵³ Gov't Ex. 11-053.0001.

²⁵⁴ Gov't Ex. 11-053.0001.

²⁵⁵ Gov't Ex. 11-053.0001.

²⁵⁶ Sandwich Isles had indicated that from [BEGIN CONFIDENTIAL] [END CONFIDENTIAL] [END CONFIDENTIAL] USAC Report at 57.

²⁵⁷ Gov't Ex. 11-053.0001.

²⁵⁸ The reduction of rent expenses caused additional high-cost support as a result of the corporation operations expense limitation. See 47 CFR § 54.1308(a)(4). See *supra* at para. 13-15 (describing the high-cost program).

²⁵⁹ 47 CFR § 32.27(c).

CONFIDENTIAL] Pursuant to section 54.707, given the lack of documentation regarding the nature of the transaction between the affiliates, and that **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** we find that Sandwich Isles has failed to demonstrate that it paid the lower of fair market value and fully distributed cost for rent for this office space. We therefore conclude that Sandwich Isles should not receive support based on these expenditures.

125. We conclude that the \$3 million payment to ClearCom in 2014 violated the Commission's affiliate transactions rules, and therefore SIC is not permitted to recover from the Fund amounts above the "lower of fair market value and fully distributed cost" for rent of office space. Given the USAC findings in Exception 6 regarding duplicate payments for rent, we direct Sandwich Isles to ensure that such rent payments are not included in future cost studies that may be used to calculate high-cost support, including revision of Sandwich Isles' 2016 cost study.

4. Ineligible Corporate Bonuses and Activities

126. *Bonuses.* In its review of Sandwich Isles' financial information, USAC noted that Sandwich Isles issued to Waimana a **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]**.²⁶⁰ The company claimed that the **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** bonus consisted of accrued bonuses to **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** **[END CONFIDENTIAL]** USAC reports that it did not receive documentation on how the bonus amounts were determined, only that the Waimana board members approved the bonuses.²⁶¹ This bonus was recorded to a variety of regulated accounts within Sandwich Isles' cost studies for the 2012 through 2014 disbursement years.²⁶²

127. **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** for 2014, which was 45 percent of his 2013 salary.²⁶³ Sandwich Isles reported to USAC that it **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]**.²⁶⁴ Based on Board minutes from 2003, Sandwich Isles established a policy that **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** **[END CONFIDENTIAL]** After reviewing the facts surrounding the issuance of the bonuses and the amounts, USAC concluded that both **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** **[END CONFIDENTIAL]** bonuses were excessive and unreasonable.

128. In a response to these issues, Sandwich Isles claims that it is common in the telecommunications industry for companies to award bonuses to their executives of \$100,000, \$200,000 or even \$400,000 when the company makes a profit and that bonus amounts equal to **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** percent of a company's annual net income for its **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** do not appear unreasonable,

²⁶⁰ USAC Report, Exception 5 (Exorbitant Expenses) at 47-48.

²⁶¹ *Id.* at 47-8. USAC reports that the Waimana board members during this period were **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]**. *Id.* at 48. **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** **[END CONFIDENTIAL]** **[END CONFIDENTIAL]** *Id.* at 48.

²⁶² USAC Report at 48.

²⁶³ *Id.* at 48.

²⁶⁴ *Id.*

²⁶⁵ *Id.* at 49.

130. While the Commission has not set specific dollar amounts with respect to whether bonuses, salaries, benefits or other forms of compensation are excessive or reasonable, it has reiterated its commitment “to balance the various objectives of section 254(b) of the Act, including the objective of providing support that is sufficient but not excessive so as to not impose an excessive burden on consumers and businesses who ultimately pay to support the Fund.”²⁷³ Under the “used and useful” standard, the Commission considers whether to compensate the carrier for the use of the property in question in providing public service.²⁷⁴ Ratepayers should not be forced to pay a return except on investments that cannot be shown to benefit them.²⁷⁵ Imprudent or excessive investments are the responsibility of the carrier, not the ratepayer.²⁷⁶

²⁶⁶ *Id.* at 49-50. In its response, Sandwich Isles specifically states: “USAC provides no indication as to how or why \$100,000, \$200,000 and/or \$400,000 bonuses might be ‘excessive’ or ‘exorbitant’ as a general proposition, or for companies of SIC’s size, or for companies with profits or financial circumstances similar to those of SIC. Certainly, on their face, annual bonuses of up to [BEGIN CONFIDENTIAL] [REDACTED] [END CONFIDENTIAL] of a company’s annual net income for its [BEGIN CONFIDENTIAL] [REDACTED] [END CONFIDENTIAL] do not appear to be ‘unreasonable’ or ‘excessive’ or ‘exorbitant’ under any standard of which SIC is aware, and certainly not under any standard that the FCC has enacted.” *Id.* at 49-50.

²⁶⁷ *Id.* at 50.

²⁶⁸ *Id.* at 49 – 51; June 13 Sandwich Comments at 14-15.

²⁶⁹ USAC Report at 51.

²⁷⁰ *Id.* at 51. These are also the years when Sandwich Isles received some of the highest amounts of high-cost support. *See id.* at 5 (setting forth the amounts of support from 2002 to 2015).

²⁷¹ *Id.* at 51.

²⁷² June 13 Sandwich Comments at 15-16 (citing *In the Matter of Connect America Fund et al.*, Report and Order, Order and Order on Reconsideration, Further Notice of Proposed Rulemaking, FCC 16-33, para. 345, released March 30, 2016).

²⁷³ *USF/ICC Transformation Order*, 26 FCC Rcd at 17682, para. 57. See also *Connect America Fund et al.*, Fifth Order on Reconsideration, 27 FCC Rcd 14549, 14557, para. 22 & n.42 (2012) (*Connect America Fund Fifth Order on Reconsideration*); *Alenco Communications, Inc. v. FCC*, 201 F.3d 608, 620-21 (5th Cir. 2000) (*Alenco*) (“The agency’s broad discretion to provide sufficient universal service funding includes the decision to impose cost controls to avoid excessive expenditures that will detract from universal service”).

²⁷⁴ *AT&T Phase II Order*, 64 FCC Rcd at 38, para. 111-12.

275 *Id.*

276 *Id.*

131. Based on the record before us, and the unique circumstances presented, we find that the [BEGIN CONFIDENTIAL] [REDACTED] [END CONFIDENTIAL] and the bonus to [BEGIN CONFIDENTIAL] [REDACTED] [END CONFIDENTIAL] are imprudent, and unreasonable. First, Sandwich Isles, unlike the vast majority of rate-of-return carriers, was receiving support in excess of the \$250 per line cap. When the [BEGIN CONFIDENTIAL] [REDACTED] [END CONFIDENTIAL] was disbursed in 2014, SIC received \$16,174,833²⁷⁷ in high-cost support to serve 3,659 lines,²⁷⁸ over \$368 per line per month, well over the capped amount. In justifying such high bonuses, Sandwich Isles relies on the notion that it is common for telecommunications companies, both big and small, to award bonuses to its executives, and that it should have such discretion to determine the appropriate compensation.²⁷⁹ That discretion, however, is not unbounded. Sandwich Isles paid higher amounts of executive compensation compared to other telecommunications companies of similar size at a time when it was relying heavily on universal service support to maintain its operations.²⁸⁰ At the time it began accruing these bonuses, it had a pending request for waiver of the \$250 per line cap. In 2013, the Bureau denied that request, noting that Sandwich Isles expenses were significantly higher than companies of similar size. At that time, it would have been prudent for the company to reevaluate its compensation practices and take all reasonable measures to bring expenses in line. SIC nonetheless continued to accrue these bonuses and ultimately disbursed the accumulated amount in 2014. This was not reasonable under the specific circumstances presented.

132. Second, at the time Sandwich Isles made these bonus payments, ultimately borne by ratepayers and contributors to the Fund, it was failing to pay its obligations of the RUS loan. In other words, Sandwich Isles made the decision to issue two significantly high bonuses in 2014 --- [BEGIN CONFIDENTIAL] [REDACTED] [END CONFIDENTIAL] --- at the same time it had stopped paying amounts under a federal government loan.²⁸¹ This is a significant, distinguishing factor from the compensation practices of other rate-of-return carriers.

133. Given Sandwich Isles' financial situation and the specific circumstances presented here, we conclude it was imprudent and unreasonable for the company to pay [BEGIN CONFIDENTIAL] [REDACTED] [END CONFIDENTIAL] and employees bonuses when it was relying almost exclusively on government funds to maintain operations, and at the same time chose not to pay on its obligations on the RUS Loan. USAC concluded in the final USAC Report that the payment of the bonus to [BEGIN CONFIDENTIAL] [REDACTED] [END CONFIDENTIAL] resulted in a net overpayment in 2011 through 2014 of \$175,090.²⁸² We agree with USAC's calculations on the monetary impact of the [BEGIN CONFIDENTIAL] [REDACTED] [END CONFIDENTIAL] to the Fund as improper payments and direct USAC to initiate actions to recover this amount. We also find that Sandwich Isles should revise its cost study for 2014 so as not to include the amounts of [BEGIN CONFIDENTIAL] [REDACTED] [END CONFIDENTIAL] bonus. We direct USAC to deny any claims from

²⁷⁷ USAC Report at 5.

²⁷⁸ NECA reports that as of 2014, SIC had 3,659 loops. *See* NECA, Universal Service Fund Data: NECA Study Results, 2014 Report.

²⁷⁹ USAC Report at 49-50.

²⁸⁰ *See id* at 79-81 [BEGIN CONFIDENTIAL] [REDACTED] [END CONFIDENTIAL].

²⁸¹ *See generally* RUS Letter.

²⁸² USAC Report at 53. Financial records indicate that this bonus was transferred directly to Waimana accounts to ultimately pay approximately \$974,000 to Albert Hee's criminal defense attorneys. *See* EB-IHD-15-00019603.

Sandwich Isles that include [BEGIN CONFIDENTIAL] [REDACTED] [END CONFIDENTIAL] bonus in any future requests for recovery from the Fund.²⁸³

134. *Employee Activities.* In a 2015 Public Notice, the Commission reminded rate-of-return carriers receiving support from the high-cost support mechanisms that they were not permitted to recover certain types of expenditures through the high-cost program that were not necessary for the provision of supported services.²⁸⁴ For example, the Commission specifically called out a list of expenditures such as charitable donations, membership fees in clubs and organizations, personal expenses of family members, food, and personal travel as items that may not be recovered through universal service support.²⁸⁵

135. In reviewing Sandwich Isles expenses incurred in 2013 through 2015, USAC identified a number of instances where Sandwich Isles paid for annual parties, country club fees for its executive staff, various sponsorships and contributions to entities that were not related to the company's provisioning of telephone service.²⁸⁶ Sandwich Isles has claimed that its sponsorships and donations [BEGIN CONFIDENTIAL] [REDACTED] [END CONFIDENTIAL] should be permissible expenses given that the company serves residents on the Hawaiian Home Lands. While such organizations are related to the interests of Hawaiian Home Lands, we are not persuaded based on the facts before us that such donations and sponsorships are necessary for the provisioning of telecommunications service. As a result, all of the donations and sponsorships noted in the USAC Report are not eligible for recovery from the Fund. In its report, USAC did not calculate the monetary effect of such expenses on the Fund given that such costs impact future disbursements to Sandwich Isles.²⁸⁷ SIC may not include such amounts in its cost studies used to calculate high-cost support amounts; to the extent such costs have been included, SIC must correct its cost studies. We direct USAC to ensure that Sandwich Isles does not include such amounts in future cost studies used to calculate future high-cost payments.²⁸⁸

C. Other Issues and Concerns

1. Ineligible Corporate Operational Expenses – Taxes

136. In its investigation, USAC identified under Exception 4 various unsupported or misclassified cost study amounts for accumulated amortization, operating taxes, and deferred income taxes, which impact HCLS, Local Switching Support (LSS) and ICLS.²⁸⁹ Based on the information that Sandwich Isles submitted to USAC during the investigation, USAC found that Sandwich Isles misclassified accumulated amortization and had not reduced accumulated amortization for adjustments made to accounts related to the water mains. Accumulated amortization includes amounts associated with amortization of capital leases (account 2681) and leasehold improvements (account 2682).²⁹⁰ Further, USAC found unsupported amounts for operating taxes were included in several of Sandwich Isles' cost studies. Operating taxes include: operating investment tax credits (account 7210); operating Federal income taxes (account 7220), operating state and local income taxes (account 7230); and operating other taxes (taxes related to regulated operations, other than Federal, state, and local income taxes and payroll

²⁸³ USAC Report at 53.

²⁸⁴ *All Universal Service High-Cost Support Recipients are Reminded that Support Must Be Used for its Intended Purpose*, Public Notice, 30 FCC 11821, 11822 (2015) (*Public Notice on Ineligible Expenditures*).

²⁸⁵ *Id.*

²⁸⁶ USAC Report at 48, 64-65.

²⁸⁷ *Id.* at 48, 65.

²⁸⁸ See generally *Public Notice on Ineligible Expenditures*, 30 FCC 11821.

²⁸⁹ USAC Report at 31.

²⁹⁰ 47 CFR § 32.3400.

related taxes, account 7240).²⁹¹ USAC also found instances where Sandwich Isles received overpayments in HCLS, LSS and ICLS for deferred operating income taxes. Deferred operating taxes (account 7250) include amounts that relate to items from regulated operations which have been deferred to later periods as a result of comprehensive inter-period tax allocation related to temporary differences that arise from regulated operations.²⁹² Sandwich Isles either did not further address the exceptions or agreed with USAC's exceptions.

137. For the reasons detailed above, we agree with USAC and conclude that Sandwich Isles received improper payments for the amounts it received in HCLS, LSS and ICLS for accumulated amortization, operating taxes, and deferred income taxes in the amount of \$65,120.²⁹³ Sandwich Isles violated section 54.1305(c) and (d) of the Commission's rules regarding documentation supporting its filings.²⁹⁴ We direct Sandwich Isles to file any future cost studies consistent with this Order.

2. Compliance with Affiliate Transaction Rules

138. Given our findings today that Sandwich Isles violated the Commission's affiliate transactions rules and the concerns raised within the USAC Report, we are concerned that Sandwich Isles is not currently complying with the Commission's affiliate transactions rules. We direct USAC to review in depth Sandwich Isles' affiliate transactions for costs incurred in calendar year 2016. We direct USAC to conduct this investigation beginning July 2017.²⁹⁵

139. Transactions between the incumbent LEC and the affiliate must comply with the Communications Act, Commission rules and orders, and must not be anti-competitive. The affiliate transaction rules were intended to ensure that the ratepayer received the most reasonably advantageous result from the transaction and does not subsidize the carriers' affiliate activities. The Fund will not reimburse unwarranted costs associated with various affiliate transactions. To preserve the integrity of the Fund and ensure that high-cost support provided to Sandwich Isles on a going forward basis is used only for the provision, maintenance, and upgrading of facilities and services for which the support is intended, we direct USAC to conduct an investigation of Sandwich Isles' affiliate transactions for 2016 and ensure that its costs are properly reported so as to prevent the company from cross-subsidizing its services.

140. *USAC Concerns.* During the course of USAC's investigation, USAC expressed concerns with Sandwich Isles' corporate structure and the various transactions that occurred between the Sandwich Isles and its affiliates.²⁹⁶ Based on the limited information that USAC received regarding the affiliates, the facts indicate that such affiliates (including Waimana, ClearCom, Ho'opa'a, Paniolo Cable **[BEGIN CONFIDENTIAL]**) [REDACTED] **[END CONFIDENTIAL]**.²⁹⁷ In reviewing the contracts between Sandwich Isles and the affiliates, USAC noted that it was difficult to understand the break-out of costs and the services subject to such agreements.

141. For example, under Observation 6 (Reversal Journal Entry for Prepaid Rent for Network Infrastructure) of the USAC Report, USAC raises a concern regarding a transaction between Sandwich Isles and ClearCom, in which Sandwich Isles paid ClearCom \$6 million based on a contract to purchase

²⁹¹ 47 CFR § 32.7200.

²⁹² 47 CFR § 32.7250.

²⁹³ This calculation is based on overpayments of \$123,535 minus underpayments of ICLS support of \$58,415 after incorporating the \$250 cap. See USAC Report at 4, 40.

²⁹⁴ 47 CFR § 54.1305(c). During earlier periods, this rule was codified in Part 36.

²⁹⁵ The results of USAC's investigation of SIC's 2016 costs will impact 2018 disbursements.

²⁹⁶ USAC Report at 71-72.

²⁹⁷ *Id.* at 72.

assume responsibility for different unregulated activities. We are concerned, however, in the particular situation before us that the corporate structure has been set up in a manner that enables SIC to evade scrutiny of payments between affiliates and of how it separates regulated versus unregulated expenses. To ensure transactions between the carrier and affiliate are consistent with the Commission's high-cost rules, including the affiliate-transaction rules, it is essential that such entities maintain segregation of duties and the necessary documentation to prove such expenses were incurred and are eligible for recovery from the Fund.

146. To ensure that Sandwich Isles is in compliance with the affiliate transaction rules, we direct USAC to review all of the affiliate transactions between Sandwich Isles and its affiliates for calendar year 2016. As part of this review, we direct USAC to review all documentation related to the affiliate transactions that Sandwich Isles undertakes in calendar year 2016. As part of this review, we direct USAC to review all of Sandwich Isles' fiscal practices, including the procedures it undertakes to determine the "lower of fair market value and fully distributed cost" for the expenses Sandwich Isles paid to its affiliates. Additionally, USAC must review all documentation to determine if the expenses are necessary to provide for the provision, maintenance, and upgrading of facilities and services for which the support is intended. If Sandwich Isles fails to produce such documentation upon USAC's request, SIC is prohibited from including such expenditures in its cost studies going forward.

147. During the course of USAC's investigation, it requested documentation regarding the affiliates' financial statements to ensure that such entities were providing the services for which Sandwich Isles paid, especially because most of the affiliates had few, if any, employees. Sandwich Isles asserted that the affiliates are not regulated by the Commission and are not subject to the high-cost support rules and as a result, anything outside of the transactions with Sandwich Isles are outside the scope of a USF investigation.³⁰⁹ We disagree with Sandwich Isles that such information is not relevant or outside the scope of any audit or investigation of Sandwich Isles. While Paniolo Cable and ClearCom do not directly receive high-cost support, [BEGIN CONFIDENTIAL] [REDACTED]

[REDACTED] [END CONFIDENTIAL]. We find that, given the specific circumstances before us, [BEGIN CONFIDENTIAL] [REDACTED]

[REDACTED] [END CONFIDENTIAL], it is necessary to examine more closely the activity of the affiliates and related entities with the same ownership. As a result, we direct Sandwich Isles to produce all requested documentation related to Sandwich Isles' affiliates, including Waimana, ClearCom and Paniolo Cable, upon USAC's request for the investigation of Sandwich Isles' affiliate transactions. If USAC does not receive sufficient documentation to confirm that all payments that Sandwich Isles makes to such affiliates, or entities with the same ownership, are in compliance with Commission rules, we direct USAC to find any such payments to said affiliate as an ineligible expense that cannot be recovered from the Fund.

148. Given the breadth of improper payments that Sandwich Isles received for past amounts of high-cost support, we direct Sandwich Isles to resubmit its cost studies for costs incurred in 2013, 2014 and 2015 within 60 days after the date of this Order so that USAC can determine the proper amount of high-cost support to Sandwich Isles for 2015, 2016 and 2017 consistent with our findings in this Order. Once it is determined how the Company will reimburse the Fund, the Commission's Chief Financial Officer will direct USAC to lift the suspension of the Company's high-cost support.³¹⁰

³⁰⁹ USAC Report at 68-69.

³¹⁰ Prior to disbursing high-cost support to Sandwich Isles, USAC must receive all certifications required by the Hawaii Public Utilities Commission pursuant to section 54.314(a) of the Commission's rules. See 47 CFR § 54.314(a).

149. As we have discussed in detail above, we conclude that Sandwich Isles received \$27,270,390 in overpayments from the federal high-cost mechanism for the period from 2002 to June 2015. We also disallow all management fees paid by Sandwich Isles to Waimana above the average amount paid by comparable entities for the period 2002 to 2015 and direct USAC to calculate the total amount of improper payments and initiate action to recover those amounts from Sandwich Isles.³¹¹ Under 31 U.S.C. section 3701(b)(1)(C), these overpayments are recoverable and constitute a debt due and payable by Sandwich Isles to the Federal Government immediately. Payment must be made to USAC within 30 days from the date of a demand letter to Sandwich Isles from USAC, after which the amount will be considered delinquent and charges of collection, interest and penalties as provided for under 31 U.S.C. section 3717 and 47 CFR section 1.1940 will accrue and administrative sanction, including, but not limited to, the Commission's "Red Light" rules at 47 CFR section 1.1910, will apply. Moreover, we notify Sandwich Isles that under 31 U.S.C. § 3716, we, including USAC, may apply administrative offset to collect some or all of the debt.

IV. ORDERING CLAUSES

150. Accordingly, IT IS ORDERED, pursuant to the authority contained in sections 4(i), 4(j), 220, and 254 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 154(i), 154(j), 254, that this Order IS ADOPTED.

151. IT IS FURTHER ORDERED that Sandwich Isles Communications, Inc. owes the Federal Government \$27,270,390 for overpayments received from 2002 to June 2015 and an additional amount related to inflated management fees to be calculated by the Universal Service Administrative Company consistent with this Order.

152. IT IS FURTHER ORDERED that USAC shall pursue collection action against Sandwich Isles Communications, Inc. consistent with this Order.

FEDERAL COMMUNICATIONS COMMISSION

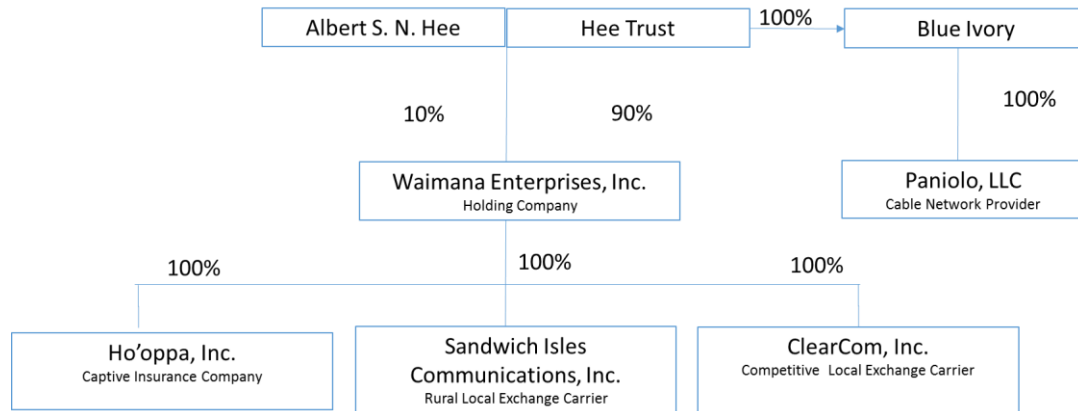
Marlene H. Dortch
Secretary

³¹¹ In calculating the amounts that USAC shall collect from Sandwich Isles for excessive management fees, we direct USAC to disallow the management fees in excess of \$1,237,355, which is the average amount of the comparable entities' average management fees for 2012, 2013 and 2014, and apply that approach for each year, from 2002 to 2015. *See* USAC Report at 78. *See also supra* para. 42 (noting that the Commission has held Sandwich Isles' high-cost support covering the period July 2015 to November 2016).

APPENDIX A

ORGANIZATIONAL DIAGRAM¹

Sandwich Isles Communications, Inc. Affiliates



¹ This organizational diagram was created through review of both SIC and FCC provided organizational charts and through inquiries with SIC obtained through January 5, 2016. The exhibit does not include certain entities that may have been affiliated with SIC but had ceased operations by 2013.

APPENDIX B

CATEGORY 1 CABLE AND WIRE FACILITIES COSTS SEPARATIONS PROCEDURES

1. The first step for jurisdictional separations is the segregation of cost of plant into categories. The basic method of making this segregation is the identification of the plant assignable to each category and the determination of the cost of each category.¹ The second step is the apportionment of the cost of the plant in each category among exchange, state toll and interstate toll by the application of appropriate *usage factors* or by direct assignment.²

2. The 1947 Separations Manual specified that the book cost of the circuits used wholly for a single service was assigned directly to that service. The book cost of circuits used jointly for both intrastate and interstate services was allocated between the services on the basis of “relative use measured by the conversation-minute-miles of traffic for each service using the facilities jointly.”³

3. In 1969, the Commission adopted procedures for the allocation of the costs of subscriber plant. These revisions describe the procedures for the allocation of “only the book costs” of plant in these categories. The procedures adopted in 1969 were incorporated by reference into Part 67 of the Commission’s rules.⁴ At that time, for the purposes of jurisdictional separations, the costs of subscriber plant (subscriber line outside plant, subscriber line circuit equipment, station equipment and associated land and buildings) assigned to message telephone services was allocated to the interstate operations in each state or study area by the application of a usage “traffic sensitive” factor to the study area message telephone subscriber plant book costs.

4. In 1983, the Federal-State Joint Board recommended procedures for the allocation of the costs of subscriber plant based on non-traffic sensitive (NTS) local exchange plant costs. In the 1983 Federal-State Joint Board Recommendations, it stated that “a major portion of the NTS local exchange costs which are allocated to the interstate jurisdiction through separations ultimately will be paid for directly by subscribers through flat charges instead of being bundled into the message charges for interstate services.”⁵ At that time, the Federal-State Joint Board found that a permanent high-cost factor based on “unseparated” (total intrastate and interstate) NTS local exchange costs, excluding CPE and inside wiring, should be adopted to protect “universal service.”⁶

5. In 1984, the Commission amended Part 67, among other things adopting procedures for allocating NTS and traffic sensitive (TS) local exchange plant costs between the interstate and intrastate jurisdictions. This order established Subpart F of Part 67 as Universal Service and expanded the Part 67 glossary to include a definition of a subscriber line and working loops.

¹ Historically, the 1947 Separations Manual stated that “the fundamental basis on which separations among exchange, state toll and interstate toll services are made, is the *use of telephone plant in each of the services.*” That language subsequently was codified in Part 36. 47 CFR § 36.1(c).

² Cooperative efforts and studies undertaken by the industry, state regulatory agencies through NARUC, and the Commission beginning in 1941 were incorporated into what was popularly known as the NARUC-FCC Separations Manual in 1947. *See American Telephone & Telegraph Co. and the Associated Bell System Companies Charges for Interstate and Foreign Communication Service*, Memorandum Opinion and Order, 3 FCC Rcd 2d 307, 309-311 (1966). The Separations Manual was codified into the Commission’s rules in 1969. *1969 Separations Order*, 16 FCC 2d 317 (emphasis added).

³ *1969 Separations Order*, 16 FCC 2d at 319.

⁴ *Id.*

⁵ Jurisdictional Separations Procedures; Federal-State Joint Board Recommendations, 48 FR 46556-02.

⁶ *Id.* at para. 9.

6. The Commission first used the term “subscriber’s premises” in the context of universal service in the separation rules adopted in 1984. At that time, it held that “NTS local exchange plant includes CPE, inside wiring, the line from the subscriber’s premises to the central office, and certain central office equipment. This portion of local exchange plant is termed non-traffic sensitive because the costs associated with it do not vary with usage. Instead they [the costs] are incurred to provide individual subscribers with dedicated circuits to the local central office and thus are largely a function of *the number of subscribers connected to the network*.”⁷

7. In 1987, the Commission further amended the separations procedures, amending Part 67 and codifying the separations procedures as a new Part 36. The separation rules adopted in 1987 was where the category of “cable and wire facilities (C&WF)” was first used. Part 36.152(a)(1) states that “Exchange Line C & WF Excluding Wideband—Category 1—This category includes C & W facilities between local central offices and subscriber premises used for message telephone, TWX subscriber lines, private line, local channels, and for circuits between control terminals and radio stations providing very high frequency maritime service or urban or highway mobile service.”⁸

8. The Telecommunications Act of 1996 codified the Commission’s historical commitment to promote universal service to ensure that all Americans have access to affordable, quality telecommunications services. Specifically, in section 254, Congress instructed the Commission to establish specific, predictable, and sufficient mechanisms to preserve and advance universal service.⁹ At that time, the Commission concluded that rural carriers would continue to receive high-cost support through the existing mechanism codified in Part 36, with some minor modifications.¹⁰

9. The purpose of high-cost universal service support is to help provide access to telecommunications service in areas where the cost of such service otherwise might be prohibitively expensive. Historically, this purpose has been achieved both through explicit monetary payments and implicit support flows to enable carriers to serve high-cost areas at below-cost rates. For decades, high-cost loop support (HCLS) has provided support based on embedded costs averaged over an entire study area: for cost companies, the rate-of-return carrier’s embedded loop costs determine the support payments the carrier will receive.¹¹ The term “embedded costs” refers to a carrier’s historic costs, as reflected in its books.

10. Carriers receive HCLS for a variable percentage of their unseparated loop costs, depending on the number of loops they serve. The term “unseparated” refers to the costs incurred before the Part 36 jurisdictional separations process.¹² For decades, the Commission has defined a loop as “the connection between the telephone company’s central office and the customer’s premises[.]”¹³ The

⁷ *Id.* at para. 10 (*emphasis added*).

⁸ See 47 CFR § 36.152(a)(1); see generally *Amendment of Part 67 (New Part 36) of the Commission’s Rules & Establishment of A Fed.-State Joint Bd.*, Recommended Decision and Order, 2 FCC Rcd 2582 (1987).

⁹ See *supra* para. [14] (describing universal service).

¹⁰ *Fed.-State Joint Bd. on Universal Serv.*, Report and Order, 12 FCC Rcd 8776, 8939-40, para. 300-302 (1997) (*Universal Service First Report and Order*) (subsequent history omitted). In 2014, the Commission relocated the HCLS rules from Part 36 Subpart F to Part 54 Subpart M, without substantive change.

¹¹ A “study area” is a geographic segment of a carrier’s telephone operations, generally corresponding to its entire service territory within a state. The Commission froze all study area boundaries effective November 15, 1984. See *MTS and WATS Market Structure, Amendment of Part 67 of the Commission’s Rules and Establishment of a Joint Board*, Decision and Order, 50 Fed. Reg. 939 (1985) (*Part 67 Order*). See also 47 CFR Part. 36, Appx.

¹² See *supra* para. [9] (describing the Part 36 separations process).

¹³ *Universal Service First Report and Order*, 12 FCC Rcd at 8891, para. 209 & n. 523.

“variable percentage” of a carrier’s unseparated loop costs refers to the percentage allocations in the high-cost loop support calculation.¹⁴

11. As reflected in section 36.1(c), the fundamental basis for separations is the “use of telecommunications plant” in each of the operations. This basis was true in 1947 when the separations manual was adopted; this was the case in 1969 through the application of a “traffic sensitive” factor; this basis existed in 1983 when “subscriber’s premises” was added to the rules, and this remains in our rules today. For decades, high-cost support has been determined based on telecommunications plant in service (TPIS) and working loops. In order to have “working loops,” a carrier must have telecommunications plant in service. TPIS includes the original cost of the investment in the outside plant (account 2410 – cable and wire facilities (C&WF)).¹⁵

12. The local loop is that portion of the network consisting of the copper and fiber optic wires, telephone poles, underground conduits, junction boxes and other electronics necessary to connect a subscriber’s premises to the carrier’s public network. As their names imply, the HCLS and ICLS mechanisms of the high-cost support program are solely intended to provide support to loops, and not to support other parts of the carrier’s network, such as the local switch or interexchange trunks. Under these mechanisms, carriers such as Sandwich Isles that choose to make capital expenditures beyond their local loop have to recover those costs from sources other than USF (such as from their customer base).

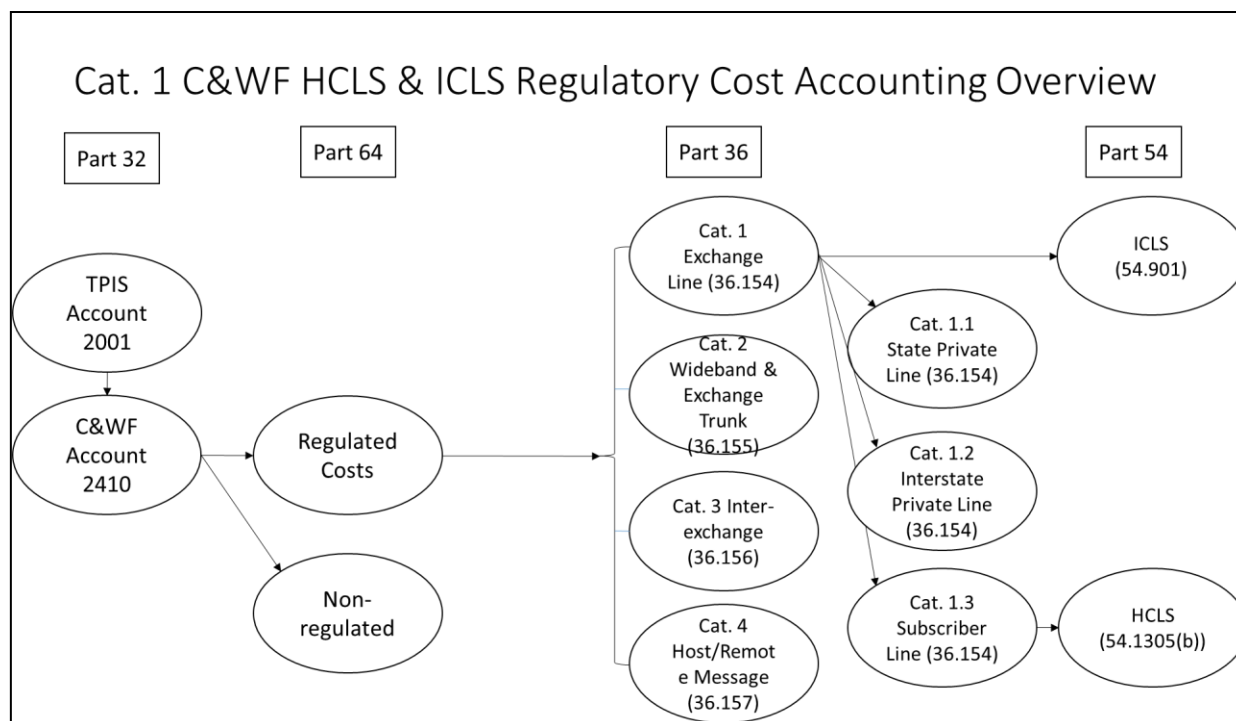
13. Rate-of-return companies are required to submit cost information in which they separate the costs of C&WF based on the operations of such facilities.¹⁶ The chart below depicts a summary of the regulatory accounting process, showing how category 1 C&WF costs are used in determining both HCLS and ICLS.¹⁷

¹⁴ See *supra* para. 16 (describing the algorithm for high-cost loop support for cost companies).

¹⁵ See 47 CFR §§ 32.2001; 32.2410; 54.1305. TPIS includes accounts 2110 through 2690. Several accounts are used to calculate HCLS, including account 2410.

¹⁶ See 47 CFR § 54.1305.

¹⁷ See *supra* paras. 5-8 (describing the regulatory framework of Parts 32 and 64).



14. Under the Commission's rules, there are four categories of C&WF:

- Category (CAT) 1 is exchange line C&WF excluding wideband. Section 36.152(a)(1) defines CAT 1 C&WF as “facilities between local central offices and subscriber premises used for message telephone, private line, local channels, and for circuits between control terminals and radio stations providing very high frequency maritime service or urban or highway mobile service.”¹⁸ Carriers thus can only apportion to CAT 1 C&WF the costs for facilities that are used to connect an exchange's central offices to subscriber premises in that same exchange.
- Facilities between the customer premises and the central office used for the delivery of traffic to and from the end user – “Loops”
 - Category 1.1 – Intrastate Private Line
 - Category 1.2 – Interstate Private Line
 - Category 1.3 – Subscriber Lines¹⁹
- CAT 2 C&WF refers to wideband and exchange trunk facilities, including exchange line wideband and C&WF between local central offices and wideband facilities.²⁰
- CAT 3, interexchange C&WF is used for message toll and toll private line services.²¹

¹⁸ 47 CFR § 36.152(a)(1).

¹⁹ See 47 C.F.R. § 36.154.

²⁰ 47 CFR § 36.152(a)(2). The procedures for apportioning the cost of exchange C&WF among the operations are set forth in sections 36.154 and 36.155. 47 CFR §§ 36.154, 36.155.

²¹ 47 CFR § 36.152(b). The procedures for apportioning the cost of interexchange C&WF among the operations are set forth in section 36.156. 47 CFR § 36.156.

- CAT 4 host/remote message C&WF is used when a message circuit switching function is performed at the host central office and applies to C&WF between host offices and all remote locations.²²

15. Of these C&WF categories, the only costs supported by the HCLS mechanisms are those allocated to Category 1.3 loops.²³

16. In addition, the Commission has established four cost categories for Central Office Equipment.²⁴ These are:

- Category 1 – Operator Systems Equipment²⁵
- Category 2 – Tandem Switching Equipment²⁶
- Category 3 – Local Switching Equipment²⁷
- Category 4 – Other Equipment
 - Category 4.1 – Circuit Equipment
 - 4.11 – Wideband Exchange Line Circuit Equipment
 - 4.12 – Exchange Trunk Circuit Equipment
 - 4.13 – Exchange Line Circuit Equipment²⁸

17. Again, of these Central Office Equipment categories, the only costs supported by HCLS are those allocated to Category 4.13.²⁹

18. Under the Commission's rules, incumbent LECs with subscriber loop costs that exceed 115 percent of the national average loop costs are eligible for HCLS pursuant to Subpart M of Part 54 of the Commission's rules.³⁰ Incumbent LECs with study areas of fewer than 200,000 subscriber loops receive a greater percentage of HCLS for these "above-average" loop costs.³¹ HCLS provides support for Category 1.3 working loops, where the working loop is a revenue producing pair of wires, or its equivalent, between a customer's station (i.e. the physical location of a home or business) and the central

²² 47 CFR § 36.152(c). The procedures for apportioning the cost of these facilities among the operations are set forth in section 36.157. 47 CFR § 36.157.

²³ See 47 CFR § 54.1308(a) (describing how the calculation of unseparated loop cost for purposes of HCLS includes Exchange Line C&WF subcategory 1.3 investment). See also NECA Reporting Guidelines, 4.23 Spare Fiber CW&F Investment (2004) (*NECA Reporting Guideline 4.23*). ICLS provides for recovery of costs associated with the common line revenue requirement, including subscriber line cable and wire facilities. 47 CFR § 69.304. See *supra* para. [61] (describing ICLS).

²⁴ See 47 CFR § 36.122.

²⁵ See 47 CFR § 36.123.

²⁶ See 47 CFR § 36.124.

²⁷ See 47 CFR § 36.125.

²⁸ See 47 CFR § 36.126.

²⁹ See 47 CFR § 54.1308(a) (describing how the calculation of unseparated loop cost for purposes of HCLS includes Exchange Line CO Equipment Category 4.13 investment).

³⁰ 47 CFR § 54.1301.

³¹ 47 CFR § 54.1310(c), (d).

office from which the station is served. The Subpart M high-cost loop support algorithm uses factors derived from the ratio of loop-related investment to total investment.³²

³² 47 CFR § 54.1305(b)-(i) (setting forth gross plant investment in Exchange Line (CW&F) and working loops for universal service support purposes).

**JOINT STATEMENT OF COMMISSIONERS
MIGNON CLYBURN AND AJIT PAI**

Re: *Sandwich Isles Communications, Inc.*, WC Docket No. 10-90.

Today, the Commission speaks with a unified voice as we take action to restore the integrity of the Universal Service Fund. In this order, we seek to recover more than \$27 million of federal subsidies that Hawaiian telecommunications carrier Sandwich Isles improperly accrued—subsidies that were intended to benefit the people of the Hawaiian Homeland but instead lined the pockets of the company’s owner. (The company’s conduct was egregious enough that earlier this year, its founder was sentenced to 46 months in prison following his conviction for “corruptly interfering with the Internal Revenue Service in the calculation and collection of his taxes, and with filing six false individual tax returns.”) In companion orders, we end the ability of Sandwich Isles to force other rural telephone companies to fund its self-dealing and we propose a forfeiture of almost \$50 million for its misconduct. Steps like these are essential if the American people are to have confidence in our stewardship of a program meant to benefit all American consumers.