



DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS  
STATE OF HAWAII

In the Matter of the Arbitration of	)	DEPUTY DIRECTOR'S FINAL ORDER
	)	REGARDING ARBITRATOR'S
OLELO COMMUNITY MEDIA	)	DECISION FILED ON JULY 27, 2012;
	)	EXHIBIT "A"
vs.	)	
	)	
TIME WARNER ENTERTAINMENT	)	
COMPANY, L.P. DBA OCEANIC TIME	)	
WARNER CABLE	)	

**DEPUTY DIRECTOR'S FINAL ORDER REGARDING  
ARBITRATOR'S DECISION FILED ON JULY 27, 2012**

**I. INTRODUCTION**

Pursuant to Decision and Order No. 346 ("D&O 346"), Time Warner Entertainment Company, L.P, dba Oceanic Time Warner Cable ("Oceanic") is obligated to make annual Capital Fund Payments to the designated Public, Educational, and Governmental ("PEG") Access Organization on Oahu, which is currently Olelo Community Media ("Olelo")<sup>1</sup>. Every five (5) years, D&O 346 requires Oceanic to meet with the Oahu PEG Access Organization and develop a schedule of Capital Fund Payments (for the purchase of PEG access facilities and equipment) to be submitted to the Director who then has the sole discretion, taking into account the overall public interest, to approve, deny, or modify the amounts and schedule of capital fund payments. D&O 346 also provides that if Oceanic and the Oahu PEG Access Organization are unable to agree and develop a schedule of Capital Fund Payments, the Director shall have the sole authority to arbitrate and designate a schedule for the parties.

For the period of 2012 to 2014, Oceanic and Olelo were unable to agree on a schedule of Capital Fund Payments. In a June 24, 2011 letter, both parties jointly requested that DCCA institute proceedings to arbitrate the dispute regarding the Capital Fund Payments for 2012, 2013, and 2014. On July 21, 2011, DCCA Director Keali'i Lopez recused herself from the matter and appointed then DCCA Deputy Director Everett Kaneshige to arbitrate and designate a Capital Fund Payment schedule for the 2012 to 2014 time period. In a July 28, 2011 letter to the parties, Deputy Director

<sup>1</sup> Olelo's current agreement with DCCA expires on December 31, 2012.

In addition, under HRS section 440G-8.3, Olelo has submitted an application to be designated as Oahu's PEG Access Organization under a new contract with DCCA. The effect of the Arbitrator's Decision on any such new contract shall be subject to further Order by the Director.

Kaneshige informed them that he decided that DCCA's Office of Administrative Hearings ("OAH") would be conducting the arbitration process. OAH subsequently assigned Senior Hearings Officer David Karlen to be the Arbitrator. From the end of November 2011 to January 2012, both Oceanic and Olelo participated in lengthy arbitration hearings before the Arbitrator.

After Deputy Director Kaneshige left DCCA, Director Lopez appointed the undersigned Deputy Director to receive and review the Arbitrator's Decision, and issue a Final Order that designates a schedule of annual Capital Fund Payments by Oceanic to Olelo for 2012 to 2014.

On July 27, 2012, the Arbitrator issued his Arbitrator's Decision on the matter. See, attached Exhibit "A".

Pursuant to D&O 346<sup>2</sup> and the authority delegated by the Director of DCCA, the Deputy Director hereby issues this Deputy Director's Final Order ("Final Order").

**II. FINDINGS OF FACT AND CONCLUSIONS OF LAW**

Except as otherwise provided in this Final Order, the Deputy Director adopts all of the Arbitrator's Findings of Fact and Conclusions of Law.<sup>3</sup>

**III. FINAL ORDER**

The Deputy Director adopts the Arbitrator's Decision as follows<sup>4</sup>:

**A. CAPITAL FUND AMOUNTS FOR 2012 TO 2014**

Based on the Findings of Fact and Conclusions of Law, the Deputy Director determines that the following are reasonable amounts of PEG capital funds for 2012 to 2014:

1. 2012

Equipment costs as agreed to by the experts -	\$1,974,076.00
Software upgrades	<u>75,120.00</u>
Total	\$2,049,196.00

<sup>2</sup> See, Section IV.J.2 of D&O 346.

<sup>3</sup> By adopting the Arbitrator's Conclusions of Law, the Deputy Director agrees with the Arbitrator that "Oceanic's Capital Payments under this Decision cover Olelo's capital expenditures for all sectors of "P" (i.e., public), "E" (i.e., education), and "G" (i.e., government access programming and activities, excluding the PEG access equipment and facilities at the Hawaii State Capitol and for the City and County of Honolulu Administration)". (Emphasis added). See, page 29 of the Arbitrator's Decision.

<sup>4</sup> If there is any conflict between this Final Order and the Arbitrator's Decision, this Final Order shall control and apply.

2. 2013

Equipment costs as agreed to by the experts -	\$1,083,842.00
Furniture	<u>16,000.00</u>
Total	\$1,099,842.00

3. 2014

Equipment costs as agreed to by the experts	\$501,798.00
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B. CAPITAL FUND PAYMENTS FOR 2012 TO 2014

1. For the Capital Fund Payments for 2012 to 2014, the Deputy Director hereby orders that:

- a. For 2012, Oceanic shall pay Olelo \$1,514,084.00 less \$1,776.00 (for Hawaiian Telcom's estimated 2012 Capital Fund Payment to Olelo) for a total amount of \$1,512,308.00 within forty-five (45) calendar days from the date of this Final Order; and Olelo shall be responsible for the remaining \$535,112.00 out of its capital reserves;
- b. For 2013, Oceanic shall pay Olelo \$823,000.00 less \$16,443.00 (for Hawaiian Telcom's estimated 2013 Capital Fund Payment to Olelo) for a total amount of \$806,557.00 on or before January 31, 2013; and Olelo shall be responsible for the remaining \$276,842.00 out of its capital reserves; and
- c. For 2014, Oceanic shall pay Olelo \$501,798.00 less \$42,744.00 (for Hawaiian Telcom's estimated 2014 Capital Fund Payment to Olelo) for a total of \$459,054.00 on or before January 31, 2014.

2. If Hawaiian Telcom's Capital Fund Payment to Olelo for any particular year is less than the estimated amount(s) in Section III.B. above, Olelo may request the Director to order Oceanic to pay Olelo the difference between the estimated amount and the amount Olelo actually received from Hawaiian Telcom. Conversely, if Hawaiian Telcom's Capital Fund Payment to Olelo for any particular year exceeds the estimated amount(s) above, Oceanic may request the Director to reduce Oceanic's Capital Fund Payment to Olelo for the following year by the excess of the amount paid by Hawaiian Telcom over the estimated amount.

3. The Deputy Director notes that the minimum annual Capital Fund Payment amount of \$823,000.00 referred to in the Arbitrator's

decision<sup>5</sup> is not guaranteed beyond the 2012 to 2014 time period, and Olelo is not entitled to continue receiving that amount after 2014 (i.e., Olelo shall not rely on receiving this specific amount in the future from Oceanic). Pursuant to D&O 346, the Director reserves the right to determine new Capital Fund Payment amounts and modify such amounts, when necessary.

C. OUTSTANDING ISSUES

1. The Deputy Director acknowledges that the following Capital Fund Payment issues were not covered by the Arbitrator's Decision and shall be subsequently reserved for further discussion between DCCA and the designated Oahu PEG Access Organization:
  - a. Olelo's use of interest and investment income from its capital reserves for 2012 to 2014 (see, pages 28 – 31 of the Arbitrator's Decision);
  - b. The effect of Olelo's fund raising on the amount of Capital Fund Payments by Oceanic (see, pages 32 – 33 of the Arbitrator's Decision); and
  - c. The amount of Capital Fund Payments for the PEGNet and Hawaii Educational Network Consortium ("**HENC**").
2. The Deputy Director further notes that the Federal Communications Commission ("**FCC**") currently has a pending proceeding in which one of the core issues is whether video streamed over the Internet can qualify as a "channel" of cable programming pursuant to the federal Communications Act. See, Media Bureau Seeks Comment on Interpretation of the Terms "Multichannel Video Programming Distributor" and "Channel" as Raised in Pending Program Access Complaint Proceeding, Public Notice, MB Docket No. 12-83, DA 12-507 (March 30, 2012). The Deputy Director therefore reserves the right to revisit the Conclusions of Law on this matter after the FCC addresses this issue in relevant proceedings.

D. PEG ACCESS EQUIPMENT AND FACILITIES AT THE HAWAII STATE CAPITOL AND FOR THE CITY AND COUNTY OF HONOLULU ADMINISTRATION

1. Finally, as mentioned in the Arbitrator's Decision,<sup>6</sup> the "issue concerning whether [Oceanic] is responsible for government access programming facilities and equipment at the Hawaii State

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<sup>5</sup> See, page 28 of the Arbitrator's Decision.

<sup>6</sup> See, page 29 of the Arbitrator's Decision.

Capitol and for the City and County of Honolulu Administration (i.e., Exhibits 95, 96, and 97) [was] beyond the scope of [the arbitration] proceedings”, and was therefore excluded from the arbitration.<sup>7</sup>

2. However, after the arbitration hearing was concluded, Oceanic and Olelo submitted letters to DCCA regarding Oceanic’s Capital Fund Payments to Olelo for government PEG access services.<sup>8</sup> In general, Oceanic asserts that its provision of Franchise Required Channels (“FRCs”) under D&O 346 relieves them of the obligation to provide any funding to Olelo for government programming. Conversely, Olelo asserts that Oceanic is still required to provide funding for producing and cablecasting government programming on Olelo’s channels despite the provision of the FRCs.
3. Because the parties have asked DCCA to address Oceanic’s interpretation of D&O 346 on the related issue of Capital Fund Payments for government programming at the Hawaii State Capitol and for the City and County of Honolulu Administration, the Deputy Director believes that it is appropriate to resolve the issue in this Final Order.
4. Under Section IV.E. of D&O 346, Oceanic is required to provide five (5) digital channels (i.e., FRCs) to the State Legislature, Executive, and various Counties for governmental programming. Oceanic is required to provide direct connections to its headend from the State Capitol, Honolulu Hale, and neighbor island County government offices.<sup>9</sup> While Oceanic is solely responsible for all costs for the connection to the government agencies, D&O 346 specifically states that the governmental agencies that are connected to the FRCs are responsible for the costs of facilities and equipment to implement and operate each of these FRCs. *Id.*
5. Under Section IV.F. of D&O 346, Oceanic is also required to provide seven (7) PEG access channels for PEG access programming, including governmental programming. These channels are directly connected from Oceanic’s headend to the designated PEG Access Organization, and D&O 346 specifically states that the PEG Access Organization is responsible for the costs of facilities and equipment to implement and operate each of these channels. *Id.* The PEG access channels are separate from the FRCs, and Capital Fund Payments are used to pay for the

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<sup>7</sup> See, page 29 of the Arbitrator’s Decision.

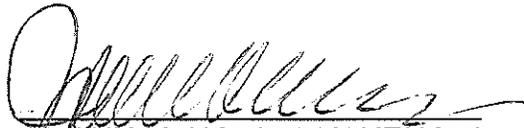
<sup>8</sup> See, the May 23 and June 8, 2012 letters from Olelo; and June 1, 2012 letter from Oceanic.

<sup>9</sup> DCCA understands from Oceanic that two (2) FRCs, one to the State Legislature and another to Honolulu Hale, have been provisioned; however, as of the date of this Final Order, these channels are not yet activated.

costs of PEG access facilities and equipment. See, Sections I.A.14. and IV.J. of D&O 346.

6. Although the FRCs and PEG Access Channels are both used for governmental programming, the FRCs and PEG Access Channels are separate and distinct channels, and are prescribed in different Sections of D&O 346. The Oahu PEG Access Organization is responsible for the operation and management of PEG access channels, and governmental entities (i.e., the Hawaii State Legislature, and various County governments) are responsible for programming on the FRCs. In addition, D&O 346 mandates different types of funding for the facilities and equipment to implement and operate each type of channel. Contrary to Oceanic's assertion, D&O 346 does not contain any provision indicating that the furnishing of FRCs obviates or nullifies Oceanic's responsibility to provide Capital Fund Payments to Olelo for facilities and equipment for government programming on the PEG access channels operated by Olelo. Absent any explicit or implicit language to the contrary, the FRCs and Capital Fund Payments are clearly separate requirements that are mutually exclusive. Thus, the satisfaction of one requirement does not negate the other, and Oceanic is required to comply with both requirements under D&O 346.
  
7. Given the Findings in this Section, the Deputy Director orders that Oceanic is responsible to provide funding for government PEG access programming facilities and equipment at the Hawaii State Capitol and for the City and County of Honolulu Administration. The amount of Capital Fund Payments for government PEG access programming at the Hawaii State Capitol and for the City and County of Honolulu Administration shall be determined separately by the Deputy Director.

DATED: Honolulu, Hawaii, 1/27/ \_\_\_\_\_, 2012.



JO ANN M. UCHIDA TAKEUCHI  
Deputy Director  
Department of Commerce and  
Consumer Affairs



DEPT. OF COMMERCE  
AND CONSUMER AFFAIRS

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OFFICE OF ADMINISTRATIVE HEARINGS HEARINGS OFFICE  
DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS  
STATE OF HAWAII

In the Matter of the Arbitration of

CTV-2011-1

OLELO COMMUNITY MEDIA

ARBITRATOR'S DECISION

vs.

TIME WARNER ENTERTAINMENT  
COMPANY, L.P. DBA OCEANIC TIME  
WARNER CABLE.

**ARBITRATOR'S DECISION**

**I. INTRODUCTION**

Time Warner Entertainment Company, L.P. dba Oceanic Time Warner Cable ("**Oceanic**") operates on Oahu under a cable franchise issued by the Department of Commerce and Consumer Affairs ("**DCCA**"). The latest renewal of that franchise is contained in DCCA's Decision and Order No. 346 ("**D&O 346**") dated January 14, 2010.

Under Section V of D&O 346, the term of the franchise renewal was twenty years from the effective date of D&O 346 subject to the conditions set forth in Section V.

Olelo Community Media ("**Olelo**") is the currently designated Public, Educational and Government ("**PEG**") Access Organization on Oahu.

"Exhibit A"

Section IV.J, beginning at page 27 of D&O 346, provides for Capital Fund Payments from Oceanic to Olelo. For the year 2010, Section IV.J.1 of D&O 346 requires Oceanic to pay Olelo \$823,000.00 as the annual payment for 2010.

Section IV.J.2, beginning at page 27 of D&O 346, provides for additional Capital Fund Payments commencing in 2011. Of relevance to the proceedings herein, it provides that:

“Commencing on January 31, 2011, and on January 31<sup>st</sup> of each year thereafter, [Oceanic] shall make annual Capital Fund Payments to the Director or the Director’s designee, unless otherwise ordered by the Director. [Oceanic] and [Olelo] shall meet and develop a plan and schedule for the Capital Fund Payments for the PEG Access Facilities and Equipment for the remaining balance of the first five-year period (2011-2014) and submit said agreed-upon schedule to the Director by August 1, 2010. The Director, in the Director’s sole discretion, and taking into account whether the plan serves the overall public interest, may approve, deny, or modify the proposed amount and schedule of Capital Fund Payments, and the timing of those payments may be subject to further order.

. . .

In the event that [Oceanic] and [Olelo] are unable to agree and develop a schedule in good faith for Capital Fund Payments, the Director shall have the sole authority to arbitrate and designate a schedule for the parties.”

(Emphasis added)

By letter dated June 24, 2011, Olelo and Oceanic jointly informed the Director of the DCCA that they had reached an impasse on a schedule for Capital Fund Payments to Olelo for the annual payments due in 2012, 2013, and 2014. Due to that impasse, and pursuant to Section IV.J.2 of D&O 346, the parties jointly requested that DCCA institute proceedings to arbitrate the dispute regarding the Capital Fund Payments for those three years.

DCCA Director Keali’i Lopez responded in a letter dated July 21, 2011. Noting that she formerly held the position of Chief Executive Officer of Olelo, she recused herself from the matter and appointed DCCA Deputy Director Everett Kaneshige to arbitrate and

designate a schedule for Capital Fund Payments by Oceanic to Olelo for the January 31, 2012, January 31, 2013, and January 13, 2014 annual payments.

By letter to the parties dated July 28, 2011, DCCA Deputy Director Kaneshige stated that he had “decided to have the arbitration process conducted by our department’s Office of Administrative Hearings (OAH).” OAH assigned the undersigned Hearings Officer to the matter, and the parties were informed of that by letter from the OAH dated August 1, 2011. The Hearings Officer will subsequently, therefore, be identified herein as the “Arbitrator”.

Effective at the close of business on January 31, 2012, Mr. Kaneshige left DCCA for another State position. By letter to the parties dated February 21, 2012, the Director appointed DCCA Acting Deputy Director Jo Ann Uchida Takeuchi to continue and conclude the arbitration and designation of a schedule for Capital Fund Payments by Oceanic to Olelo for the 2012, 2013, and 2014 annual payments. Subsequently, Ms. Takeuchi received a permanent appointment as Deputy Director of DCCA.

There were extensive proceedings, including discovery, prior to the commencement of the arbitration. After several postponements requested by the parties, the arbitration hearing commenced on November 30, 2011. Hearings were also held on December 1 and December 2, 2011. At that point, it was clear that the proceedings would not be completed and that several more hearing days were necessary. By agreement of the parties, hearings also took place on January 20, and January 23 through 25, 2012.

On January 4, 2012, Olelo filed its Motion to Exclude Evidence and Testimony About Performance of and Activities Relating to the PEG Agreements. On January 6, 2012, Olelo filed its Errata and Supplement to that Motion. On January 13, 2012, Oceanic filed its

Memorandum in Opposition to said Motion. Oral argument on the Motion was held on January 16, 2012.

In its Pre-Hearing Brief, Oceanic argued that Olelo has improperly spent capital funds in the past to meet operating expenses, had “misappropriated” certain amounts of restricted capital funds, “misappropriated” interest income from capital reserves to be used as operating income, and otherwise used capital funds inappropriately. For these alleged past misdeeds, Oceanic argued that Olelo should devote \$1,576,494.00 of its unrestricted operating funds to pay for Olelo’s current capital costs and thereby reduce Oceanic’s actual Capital Fund Payments for 2012 to 2014 by that amount. See, Oceanic’s Pre-Hearing Brief, Section VI.B at pages 25 to 29, and its table on page 33 of that brief. In that table, the entire sum of \$1,576,494.00 was listed as “Misappropriated PEG Capital Funds (2006-2010).”

The Arbitrator determined that these Oceanic claims concerning past performance and alleged misappropriation of capital funds could not be raised in this arbitration as they were beyond its scope. The claims should be appropriately resolved in the course of DCCA’s regulatory functions. Accordingly, these claims could not be used in this present proceeding to reduce or offset the amount of Capital Fund Payments eventually found to be due for the 2012 to 2014 time period.

During the first week of January 2012, the parties’ experts met and resolved several issues, thus considerably streamlining the remainder of the case. In addition, the Arbitrator further streamlined the case by ordering that the direct testimony of the parties’ experts be submitted in writing one day in advance of their scheduled appearance. Nevertheless, the matter was still lengthy and complicated. In addition to seven days of testimony, resulting in 1,188 pages of transcript, there were over 175 exhibits plus substantial pre-hearing and post-

hearing briefs submitted by parties. Having considered all of the evidence and the arguments of the parties, the Arbitrator issues the following Findings of Fact, Conclusions of Law, and Decision.

## II. FINDINGS OF FACT

1. In its Pre-Hearing Brief filed November 8, 2011, at page 21, Olelo requested a total of \$11,435,450.00 in Capital Fund Payments according to the following schedule:

- a. \$1,690,500.00 for calendar year 2011;
- b. \$4,851,160.00 for calendar year 2012, due on January 31, 2012;
- c. \$3,129,440.00 for calendar year 2013, due on January 31, 2013; and
- d. \$1,764,350.00 for calendar year 2014, due on January 31, 2014.

2. On or before January 10, 2011, well before the parties' joint request for arbitration in their letter of June 24, 2011, the parties had settled their disagreements on the Capital Fund Payment to be made for calendar year 2011. The settlement amount was \$823,000.00, which was approved by the DCCA. See, Exhibits R6 and R7.<sup>1</sup>

3. The parties' joint request for arbitration referred only to payments for 2012, 2013, and 2014.

4. In light of the settlement of January 2011 and the lack of reference to payments for 2011 in the parties' joint request for arbitration, Olelo did not adequately explain why it included a request in this arbitration for \$1,690,500.00 for 2011. During the course of the arbitration, Olelo eventually withdrew its request for any Capital Fund Payment for 2011. See, TR page 607, lines 18 to 22 (January 20, 2012).

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<sup>1</sup> Unless otherwise noted, Olelo's exhibits are identified by number and Oceanic's exhibits are identified by an "R" before the exhibit number.

5. The \$823,000.00 settlement amount for 2011 was the same amount required for the Capital Fund Payment for 2010 by D&O 346. In addition, it was the same amount of the Capital Fund Payments for 2004, 2005, 2006, 2007, 2008, and 2009. See, Exhibit 8. Currently, this amount works out to roughly \$3.00 per Oceanic cable subscriber.

6. Olelo's actual capital funding budget for 2011 was \$1,358,112.00. Pursuant to the settlement with Oceanic referred to above, Olelo received \$823,000.00 in a Capital Fund Payment from Oceanic for 2011. The remainder, \$535,112.00, was obtained by using funds from Olelo's capital reserves. See, TR page 712, lines 4 to 20.

7. Olelo maintains two types of reserves. Generally speaking, Olelo's capital reserves can only be used for capital expenses while Olelo's operating reserves can be used for both operating expenses and capital expenses.

8. During the course of the arbitration hearing, Olelo reduced the total amount of its claim by eliminating the claim for a 2011 Capital Fund Payment and eliminating portions of its claim for Capital Fund Payments for the years 2012 to 2014. Eventually, Olelo's claim was reduced to a total of \$6,283, 271.00, which is broken down as follows:

- a. \$3,021,185.00 for 2012;
- b. \$2,036,481.00 for 2013; and
- c. \$1,225,605.00 for 2014.

See, Olelo's Rebuttal Exhibit 4.

9. The agreement of the experts resulting from their meetings during the first week of January, 2012, concerned Olelo's technical equipment needs for 2012 through 2014 and the prices for that equipment. This agreement was accepted by the parties and is now

binding on the parties. The agreement was reflected in items highlighted in yellow on Exhibit 94 and is for a total of \$3,559,716.00, which is broken down as follows:

- a. \$1,974,076.00 for 2012;
- b. \$1,083,842.00 for 2013; and
- c. \$501,798.00 for 2014.

10. The agreement between Oceanic and Olelo extended only to Olelo's technical equipment needs and the prices for that equipment. Oceanic, however, did not agree that it should actually pay those amounts to Olelo through the Capital Fund Payments for the years in question. Instead, Oceanic argued that it did not need to make payments for the equipment needs that were agreed upon due to such things, for example, as credits claimed from other sources or its advocacy of the use of Olelo's reserves to cover the payments.

11. The spreadsheets that make up Exhibit 94 also contain equipment items highlighted in pink. As to these items, Oceanic agreed as to their quantity and price but disagreed as to whether they are capital expenses that must be funded by Oceanic's Capital Fund Payments. Those items remained at issue in the arbitration.

12. The spreadsheets that make up Exhibit 94 also contain items that are not highlighted in any color. Those items were not discussed by the parties' experts and remain at issue in the arbitration.

13. The following findings of fact concern, in Olelo's words, the "remaining disputed items in this arbitration" as set forth in Section III.D of Olelo's Post-Hearing Brief.

**A. CONTINGENCIES**

14. Olelo requested \$116,000.00 for what it terms are "contingencies." Olelo estimated the requested amounts for contingencies based on past experience and expenditures

for specific equipment needs but there was no certainty that the expected contingencies would occur.

**B. SOFTWARE**

15. Olelo requested \$93,844.00 for software.<sup>2</sup>

16. The software identified by Olelo in connection with its request to purchase was agreed to by the parties' experts insofar as price, quantity, and appropriateness to purchase are concerned. However, these requested purchases were within the group of purchases where Oceanic disagreed as to whether they fit into the category of capital equipment that could be purchased by using Capital Fund Payments.

17. Prior to the arbitration, most of the software items were listed in Olelo's budgets as "updates" to the editing software presently used by Olelo which is known as Final Cut Pro.

18. The "updates" were placed in the budget as "placeholders" to keep the software "functional" and no specific updates were contemplated.

19. Software "updates" provide bug fixes and minor software enhancements. They are generally applied over software that is already installed. They are often available by free download.

20. Software "upgrades" are newer versions of existing software that provide new applications or increased functionality.

21. During the meetings of the experts in the first week of January 2012, the experts agreed that Olelo's request for a new software program called Adobe Premier Pro

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<sup>2</sup> Olelo states at page 30 of its Post-Hearing Brief that the amount requested for software is \$93,844.00. Oceanic states at page 21 of its Post-Hearing Brief that Olelo is requesting \$106,960.00. The difference in these figures, \$13,116.00, is requested by Olelo under the category title of "Cisco Smartnet Firmware/Warranties" discussed below.

was appropriate. The experts also agreed on what the reasonable price of the software should be. The agreed upon price was \$740.00 per program. Olelo noted that this program was on Lines 48, 219, 229, 532, 638, 740, 841, 939, 1026, and 1085 of the 2012 Budget in Exhibit 94.

22. Line 48 in the 2012 Budget, however, refers to a different type of software with a different unit price. Olelo did not present testimony that would establish this software as an upgrade.

23. Line 638 in the 2012 Budget has an incorrect price of \$720.00 for the Adobe Premier Pro.

24. The correct total purchase price for Adobe Premier Pro in the 2012 Budget is \$65,120.00.

25. The experts did not agree on whether this was a capital purchase.

26. The Adobe Premium Pro is a new editing program that will replace the Apple Final Cut Pro software. It is a program that can be migrated from computer to computer, will be useable for an indefinite period of time, and is necessary to ensure proper operation of Olelo's editing system and to effectively prolong the useful life of the hardware. It has more applications and functionality than the Apple program. The Adobe Premium Pro program is an "upgrade" and not an "update."

27. Line 252 of the 2012 Budget in Exhibit 94 allocated \$10,000.00 for AFD automation software for Master Control. Although not included in the original Olelo budgets, the experts included this software and agreed on the need for it and its price. The experts did not agree on whether this was a capital purchase.

28. This AFD software will not replace existing software. Instead, it is added to the hardware and provides additional functionality. It is an “upgrade” and not an “update.”

29. Line 38 of the 2014 Budget in Exhibit 94 allocated \$3,184.00 for SAN MP Media Management software. The experts agreed on the need for his software and its price. The experts did not agree on whether this was a capital purchase.

30. Olelo’s Post-Hearing Brief, at pages 28 to 29, discusses the nature of this software but contains no citations to the record pertaining to it. It cites only to general testimony of Oceanic’s experts concerning upgrades versus updates. Olelo’s expert witness, Mr. Kit Kawamata, testified that he did not know enough about this software. All he knew was that Mr. Allan Popkin, Oceanic’s expert, and Mr. Chris Lam, Olelo’s computer expert, talked about it. See, TR page 704, lines 12 to 22. Neither Mr. Popkin nor Mr. Lam testified during the arbitration.

31. Olelo has not produced sufficient evidence to establish that the SAN software would be an “upgrade.”

32. The total cost of the software considered above does not equal the total amount of \$93,844.00 requested by Olelo. Neither Olelo’s nor Oceanic’s closing briefs identified any additional line items in Exhibit 94 for the Arbitrator to consider in the category of software.

**C. CISCO SMARTNET FIRMWARE/WARRANTIES**

33. In Line 38 of its 2012 Budget, Olelo listed Cisco Firmware Updates/Smartnet warranty/hardware warranty/1 year/support contract for \$3,279.00.

34. In Line 36 of its 2014 Budget, Olelo listed three such purchases for a total of \$9,837.00.

35. Olelo asserts at page 30 of its Post-Hearing Brief that “[t]his is a warranty and is similar to an extended maintenance contact that supplies the updates over a period of time.”

36. The testimony of Mr. Donn Yabusaki, Olelo’s former Technology Director<sup>3</sup>, at TR page 322, line 21, through page 322, line 13, that is cited twice on page 31 of Olelo’s Post-Hearing Brief, describes the items as “updates for existing security appliances.”

37. Olelo requested a total of \$13,116.00 for such warranties.

**D. INTERNET STREAMING EQUIPMENT AND SERVERS**

38. Olelo requested \$260,802.00 for equipment to enable Internet streaming of Olelo's programming.

39. Internet streaming allows Olelo's programming to be viewed on Oahu and elsewhere around the world by means other than channels carried by Oceanic’s cable television facilities. Access would be by the Internet rather than by cable television. As stated in Olelo’s Post-Hearing Brief at page 31: “Streaming equipment is used to air, store and provide on-demand access to programs over the internet.”

**E. EQUIPMENT COSTING LESS THAN \$500.00 AND FURNITURE/ MISCELLANEOUS**

40. The total amount requested by Olelo for bundled items under \$500.00, furniture and/or miscellaneous is \$85,000.00. This request is composed of several individual items.

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<sup>3</sup> Mr. Yabusaki, formerly employed by Olelo, is currently the Cable Television Administrator at DCCA, and has been in that position since September 2011. In a pre-hearing ruling, the Arbitrator held that Mr. Yabusaki could testify about factual circumstances predating his move from Olelo to the DCCA but that he could not provide any opinion testimony in the arbitration.

41. Line 67 of the 2012 Olelo Budget allocates \$5,000.00 for replacement office furniture and fixtures for its Mapunapuna facility.

42. The testimony of Mr. Yabusaki at TR page 365, lines 9 to 18, cited by Olelo at page 36 of its Post-Hearing Brief, states that this item is to give “flexibility to Olelo as they run into these unanticipated situations where they need, say, to purchase a desk or a chair somewhere along the year.” At TR page 552, lines 3 to 10, Mr. Yabusaki described this as a contingency fund with no particular furniture specified.

43. At the present time, this is a contingency request.

44. Line 9 of the 2013 Budget also allocated \$15,000.00 for replacement office furniture for the Mapunapuna facility with no particular furniture specified.

45. Line 64 of the 2013 Budget allocated \$5,000.00 for replacement office furniture with no particular furniture specified.

46. Referring to Line 67 of the 2012 Olelo Budget regarding replacement office furniture, Mr. Yabusaki testified at TR page 365, lines 12 to 13: “Actually, you’ll probably see this in there every year.”

47. At the present time, the requests in Lines 9, 64, and 67 of the 2013 Olelo Budget are contingency requests.

48. Line 335 of the 2013 Budget allocates \$2,000.00 for appliances and miscellaneous replacement items, including a refrigerator in Olelo’s lunchroom.

49. In testimony cited in Olelo’s brief at page 37, Mr. Yabusaki stated with respect to this line item: “That’s pretty much a placeholder...we kind of didn’t know what the life would be. So we had that in there kind of as a bookmark.” See, TR page 416, lines 18 to 24.

50. At the present time, the request in Line 335 of the 2013 Budget is a contingency request.

51. Line 417 of the 2013 Budget allocated \$7,000.00 for replacement office furniture for its Waianae facility. Due to client needs, Olelo claimed that there was a greater need for replacement of furniture at this facility. The pricing estimate was based on past expenditures on similar equipment.

52. Line 527 of the 2013 Budget similarly allocated \$5,000.00 for replacement of furniture in its Kahuku facility on the same basis as Line 417.

53. Line 630 of Olelo's 2013 Budget allocated \$3,000.00 for replacement office furniture for the Wahiawa facility. No special client needs are involved with this Line item. There was no evidence of any specific need at any particular time period for this replacement office furniture.

54. At the present time, the request in Line 630 of the 2013 Budget is a contingency request.

55. Line 730 of Olelo's 2013 Budget allocates \$4,000.00 for replacement office furniture for the Palolo/Kaimuki facility. There was evidence that the furniture at this facility was starting to deteriorate. See, TR page 420, line 25, to page 421, line 12.

56. Line 826 of the 2013 Budget allocates \$4,000.00 for replacement office furniture for the Windward facility. Contrary to the contention in Olelo's Post-Hearing Brief, there is no clear evidence in the record, TR page 422, lines 1 to 5, that the furniture presently at this facility is deteriorating.

57. At the present time, the request in Line 826 of the 2013 Budget is a contingency request.

58. Line 913 of the 2013 Budget allocates \$5,000.00 for replacement office furniture for the Waipahu facility. Despite Olelo's claim in its Post-Hearing brief that the furniture presently at this facility is deteriorating, Olelo did not present any evidence in the record regarding deterioration at this facility.

59. At the present time, the request in Line 913 of the 2013 Budget is a contingency request.

60. Line 66 of the 2014 Budget allocates \$30,000.00 for major office furniture replacement for items that are anticipated to require replacement. There was no evidence of any specific need at any particular time period for this replacement office furniture.

61. At the present time, the request in Line 66 of the 2014 Budget is a contingency request.

**F. TRAINING**

62. Olelo requested a total of \$102,000.00 for staff training expenses.

63. The training would be on specific pieces of equipment purchased in connection with the transition to digital operations.

64. Although listed as "HD" (high definition) training on Olelo's Budget documents, the specific line items on those documents refer to basic training for digital equipment. See, Olelo's Post-Hearing Brief at page 39.

**G. FACILITY-RELATED EXPENSES**

65. Olelo keeps one set of books. As testified to by Olelo, these books are kept in accordance with Generally Accepted Accounting Principles ("GAAP"). See, TR pages 1178, 1183 to 1184

66. Olelo's audited financial statements confirmed that Olelo's management represented to the auditors that Olelo's financial statements were prepared according to GAAP.

67. Olelo's expert witness did not testify that Olelo kept its books based on the tax rules as opposed to GAAP. Instead, she merely assumed that to be the case.

68. Repairs and maintenance are not capitalized under GAAP and are treated as ordinary operating expenses.

69. Olelo's draft capital assets policy, Olelo Exhibit 109, recognizes the principle that costs of repairs and maintenance that keep capital assets in ordinary efficient operating condition during the asset's normal lifecycle shall be expended.

70. As stated in Olelo Exhibit 109 at page 7, Olelo has chosen to make its entire building a single fixed asset with an estimate useful life of 39 years when it states:

"Depreciation

- A. Depreciation is the allocation of the total acquisition cost of a capital asset over its estimated useful life.
- B. Olelo uses the straight-line depreciation method. Straight-lined depreciation is calculated by dividing the total asset cost by estimate useful life in years.
- C. The following table provides classification for fixed assets and estimate useful life.

Building and Building Improvements	39 years"
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71. Pursuant to Olelo's Exhibit 109, other assets such as furniture and fixtures, various types of equipment, and vehicles have estimated useful lives ranging from three (3) to seven (7) years.

72. Olelo's Exhibit 109 has no fixed asset class for any type of building component and no estimated useful life for any type of building component.

73. Olelo's Fixed Asset List, Oceanic Exhibit R-65 at page OL000926, lists the "Building" at 1122 Mapunapuna St. 96819 as one asset.

74. Olelo's Fixed Asset List, Oceanic Exhibit R-65 at pages OL000927 to OL000928, lists several entries under the title of "Building Improvement."

75. The fact that Olelo decided to capitalize certain repair items and/or improvements to the building does not change the fact that Olelo capitalized the building as a whole.

76. When repairs were made to the building in the past, Olelo did not change the useful life of the building in its financial reports.

77. Olelo did not introduce into evidence any portions of its tax returns that dealt with depreciation of its fixed assets.

78. Repairs or improvements to the building would be properly classified as capital expenses if: (a) they extended the life of the building; or (b) they increased the building's productive value.

79. In the case of a nonprofit entity such as Olelo, increasing the building's productive value would not be measured by an increase in revenue. Rather, it would be measured by an increase in services.

80. Olelo's expert witness testified that tax rules apply and those tax rules would allow Olelo to capitalize various components of the building such as the roof.

81. The opinion of Olelo's expert witness was partly based on the federal cost accounting standards. She relied upon Cost Accounting Standard 9904.409-50(4), which is found in 48 CFR chapter 99. That standard states that:

"Estimated service lives for tangible capital assets for which the contractor has no available data or no prior experience for similar assets shall be established based on a

projection of the expected actual period of usefulness, but shall not be less than asset guideline period (mid-range) established for asset guideline classes under Internal Revenue Procedures which are in effect as of the first day of the cost accounting period in which the assets are acquired. Use of this alternative procedure shall cease as soon as the contractor is able to develop estimates which are appropriately supported by his own experience.”

82. The opinion of Olelo’s expert witness was also based on Olelo using a useful life of 39 years for its building, a length of time she assumed was due to the tax rules because GAAP would use a 40-year useful life. However, she did not know the actual basis that Olelo used to determine the usable life of the building. See, TR page 1072, line 25, to page 1073, line 3.

83. Olelo never developed another estimate of the useful life of the building after it prepared its first estimate.

84. Cost Accounting Standard 9904.44-30(a)(1) defines an asset accountability unit as follows:

*“Asset accountability unit means a tangible capital asset which is a component of plant and equipment that is capitalized when acquired or whose replacement is capitalized when the unit is removed, transferred, sold, abandoned, demolished, or otherwise disposed of.”* (Emphasis in original).

85. Olelo never capitalized any component of its building when it was acquired. Olelo’s expert witness admitted that Olelo listed the building as a whole as a fixed asset when it was acquired, and, for tax purposes, it was not broken up into components. See, TR page 1087, lines 3 to 14.

86. Olelo has never disposed of any identifiable component of its building that it now seeks to capitalize.

87. Olelo’s expert witness did not know for a fact that Olelo actually used tax standards as opposed to GAAP. See, TR page 1075, lines 11 to 15.

**H. GOVERNMENT PROGRAMMING**

88. Olelo requested almost \$600,000.00 for capital funding for state and local governmental access programming. See, Olelo's Post-Hearing Brief at page 60. This amount pertains to PEG access facilities and equipment at both the Hawaii Legislature and the City and County of Honolulu Administration

89. This concludes the Findings of Fact specifically relating to the "remaining disputed items in this arbitration" as set forth in Section III.D of Olelo's Post-Hearing Brief.

**I. CAPITAL FUND RESERVES**

90. As of mid-January 2012, Olelo had \$1,481,599.00 in its capital reserve fund (after paying for its 2011 capital expenses). See, TR page 744, lines 11 to 13.

**J. OPERATING FUND RESERVES**

91. As of mid-January 2012, Olelo had an effective operating reserve of \$2,652,001.00. See, TR page 744, lines 11 to 15.

**K. INTEREST FROM OLELO'S CAPITAL RESERVE**

92. In the past, Olelo used interest and investment income from its capital reserve account for operating expenses. As of the time of the hearing, Olelo intended to continue that practice.

93. Oceanic's expert witness testified that interest and investment earnings from Oceanic's restricted capital reserves accounts should be maintained in those accounts and not be transferred to an unrestricted fund where it could be used for operating expenses. He based his conclusion on the terms of Oceanic's franchise restricting the use of the capital funds provided to Olelo. See, TR pages 1027 to 1028.

94. Olelo's expert witness testified GAAP Financial Accounting Standard No. 124, paragraphs 8 and 9, provides that interest and investment income on restricted funds is not allocated to the restricted assets unless there is a specific donor requirement that it be allocated to those assets.

95. No evidence was introduced that, to date, the DCCA has ever established a policy or rule, one way or another, on the use of interest and investment income from capital funds.

96. Oceanic's expert witness estimated that Olelo would receive approximately \$224,561.00 in interest and investment income for 2012 to 2014 through the use of its restricted cash and investments. That estimate assumed that the capital reserve amounts would remain at current levels.

97. Olelo passed a board resolution in 1991 stating that all interest earned from Olelo's investments should be treated as unrestricted funds. Oceanic had a designated representative on the Olelo board at the time and continued to have a representative on the Board until 2011. During the time Oceanic had a representative on the Olelo Board, that representative never raised an objection concerning Olelo's unrestricted use of interest earned on capital funds.

98. If capital reserves are used for the purchase of capital equipment during the 2012 to 2014 time period, Oceanic admits that the amount of interest generated over those three years would be less. The uncertainty of the timing of any drawing by Olelo upon its capital reserves, plus the vagaries of the economy in general, make any estimate of the future interest and investment income from Olelo's capital reserves purely speculative.

**L. GRANT INCOME, DONATIONS, AND OTHER INCOME**

99. Over the past few years, there has been a continuing dialogue between DCCA and Olelo concerning Olelo's ability to obtain funding from sources other than Oceanic and other cable operators. Olelo admitted at the hearing that the DCCA has encouraged Olelo to seek out such other types of funding.

100. To date, Olelo has not raised significant amounts of funds from other sources although there are some nascent plans to do so. Olelo has also received a consultant's report about potentially raising additional funds from private fundraising. At the present time, however, the results projected from the consultant's report are purely speculative and may well be totally unrealistic.

101. In addition, receiving funding from grants is not all "net" funding that could possibly be applied to reduce Oceanic's capital payments. Grant funding for a specific purpose often involves spending grant funds on those specific purposes without allowing for any "net" funds to be used for non-grant purposes.

102. Oceanic requests a deduction of approximately \$1 million from the capital payments it must make over the 2012 to 2014 period on account of projected Olelo fundraising from other sources.

**M. FUNDS FROM HAWAIIAN TELCOM**

103. Pursuant to DCCA Decision and Order No. 352 ("**D&O 352**"), Hawaiian Telcom was granted a cable franchise and is now authorized to provide cable television services to subscribers on Oahu.

104. D&O 352 requires Hawaiian Telcom to pay Olelo \$3.00 per subscriber per year for 2012, 2013, and 2014 for PEG capital purposes.

105. Oceanic estimated that Hawaiian Telcom would have about 592 video subscribers on Oahu by the end of 2011; about 5,481 subscribers by the end of 2012; and about 14,248 subscribers by the end of 2013. According to Oceanic's estimates, this projected increase in subscribers would be expected to contribute \$60,075.00 to Olelo for PEG capitol funds through the end of 2014.

106. Oceanic's estimates were based upon Oceanic's experience on the mainland with another competing cable provider as well as other uncertain information. It was purely speculative as to how this mainland experience would translate to a start-up operation in Hawaii. That speculation also extends to Oceanic's projections of possible franchise fee revenue Olelo will also receive from Hawaiian Telcom from 2012 to 2014.

### **III. CONCLUSIONS OF LAW**

The following Conclusions of Law pertain to the specific "remaining disputed items" in this arbitration as set forth in Section III.D of Olelo's Post-Hearing Brief.

47 U.S.C. section 542(g)(2)(C) exempts from the definition of "franchise fee" the "capital costs which are required by the franchise to be incurred by the cable operator for public, educational, or governmental [PEG] access facilities". PEG access facilities include "channel capacity designated for [PEG] use [; and] facilities and equipment for the use of such channel capacity." See, 47 U.S.C. section 522(16)(A) and (B). "[T]his may include vans, studios, cameras, or other equipment relating to the use of public, educational, or governmental channel capacity." Alliance for Community Media v. F.C.C., 529 F.3d 763, 785 (6<sup>th</sup> Cir. 2008) citing H.R. Rep. No. 98-934, at 45.

**A. CONTINGENCIES**

For 2012, and certainly for 2013 and 2014, Olelo's contingency requests were speculative. It is more appropriate to provide for these contingencies, which may or may not occur, through the use of reserves.

For this reason, Olelo's request for contingencies in the specific amount of \$116,000.00 is not warranted.

**B. SOFTWARE**

Olelo's requests for software purchases with respect to the Adobe Premium Pro software and the AFD automation software for Master Control are requests for software "upgrades" that are capital purchases within the scope of Capital Fund Payments under Section IV.J. of D&O 346.

Olelo did not prove that its requested purchase of SAN MP Media Management was a request for a software "upgrade" that would be a capital purchase within the scope of Capital Fund Payments under Section IV.J of D&O 346.

Olelo's request for software purchase is warranted in the total amount of \$75,120.00 for 2012.

**C. CISCO SMARTNET FIRMWARE/WARRANTIES**

The evidence established that the Cisco Smartnet Firmware/Warranties were "updates" and not "upgrades.

Purchase of this item would not be a capital purchase within the scope of Capital Fund Payments under Section IV.J of D&O 346.

Olelo's request for a total of \$13,116.00 for this item is not warranted.

**D. INTERNET STREAMING EQUIPMENT AND SERVERS**

Oceanic argues that the FCC has held that PEG capital costs are limited to costs incurred in or associated with the construction of PEG access facilities and cites Morrone v. CSC Holdings Corp., 404 F. Supp. 2d 450, 454 (E.D.N.Y. 2005) for the proposition that “channel capacity” is limited to bandwidth dedicated to video use (i.e., television viewing).

Olelo relies on the definition of “PEG Access Facilities and Equipment” in Section I.A.2, at page 1 of D&O 346:

“Access Facilities and Equipment” or “PEG Access Facilities and Equipment” means (a) Channel capacity designated for PEG use; and (b) PEG access facilities, including but not limited to real property and equipment related to the use of such Channel capacity or any PEG activity.”  
(Emphasis added).

Olelo asserts that the words “or any PEG activity” refer to more than just use of channel capacity. Therefore, argues Olelo, as long as the streamed programs were first cablecast on Olelo’s channels, subsequent dissemination of these programs by other means (e.g., the Internet) is a “PEG activity.”

Olelo points out that the definition of “PEG Access Facilities and Equipment” in Oceanic’s prior franchise agreement did not contain words similar to “or any PEG activity.” However, Olelo was not a party to either of the two Oceanic franchise agreements, and does not present any evidence that the difference in phrasing between the prior franchise agreement and the current franchise agreement, D&O 346, refers to communication mediums beyond cable television. Further, the words “any PEG activity” must be read in the context of the definition of “PEG Access Organization” in Section 1.A.4 on page 2 of D&O 346, which definition relates only to channels on a cable television system.

This Decision makes no comment on whether internet streaming comes under the umbrella of Olelo's mission or whether it is a fulfillment of Olelo's obligations under Olelo's own contract with the DCCA. This Decision makes no comment on the application of federal law and is limited to interpreting and deciding the issue under the terms of D&O 346, which applies only to Oceanic's relationship with the DCCA.

For these reasons, Olelo's request for internet streaming related equipment in the total amount of \$206,802.00 is not warranted.

**E. EQUIPMENT COSTING LESS THAN \$500.00 AND FURNITURE/MISCELLANEOUS**

The \$7,000.00 request in Line 417 of the 2013 Budget, the \$5,000.00 request in Line 527 of the 2013 Budget, and the \$4,000.00 request in Line 730 of the 2013 Budget are warranted.

All other requests for furniture are in the nature of contingency requests and are not warranted.

**F. TRAINING**

Pursuant to Section IV.J.4 of D&O 346, Oceanic's Capital Fund Payments "shall be deemed to be capital contributions to the extent permitted under Section 542(g)(2)(c) of the Communications Act and shall not be used for operating expenses of the Director's designee." (Emphasis in original). The question here is whether training of Olelo's staff in the operation of new digital equipment is a capital expense or an operating expense.

Oceanic's expert witness advocated that GAAP should apply to Olelo's funding requests and determine whether a specific expenditure request could be capitalized.

Olelo's expert witness testified that federal cost accounting standards should apply because Olelo is a government contractor. However, Olelo is not a federal government

contractor. Olelo's expert witness provided no justification for her conclusion that federal cost accounting standards should apply to State of Hawaii contractors. In fact, she conceded that federal cost accounting standards do not apply to State contracts such as the one between Olelo and the State of Hawaii, and, further that Hawaii does not have cost accounting standards. See, TR page 1070, line 25, to page 1071, line 16.

Based on the evidence and testimony presented, the Arbitrator concludes that federal cost accounting standards do not apply to the determination of whether a requested Olelo expenditure is a capital expense or an operating expense.

Olelo's expert witness testified that the federal cost accounting standards would require reference to the federal tax rules where, as here, Olelo does not have experience with the particular assets in question. Because the federal cost accounting standards do not apply, there is no basis for this opinion that federal tax rules apply to the training expenses.

Furthermore, as noted in the Findings of Fact above, Olelo keeps its books and prepares its financial statements based on GAAP, and the assumption by Olelo's expert witness that Olelo's books are kept according to federal tax rules is incorrect.

The Arbitrator concludes the Oceanic's expert witness is correct that GAAP rules apply to determine whether an Olelo expenditure request is for capital expenses or operating expenses.

Expenditures are considered to be capital expenses when they create a future benefit, such as extending the useful life of an asset or increasing its productive value. See, TR page 951. For a nonprofit organization such as Olelo, an increase in productive value is determined by whether the expenditure provides for the provision of additional services. See, TR page 999.

Under federal law, training expenses are operating expenses and are not capital expenses. See, Alliance for Community Media v. F.C.C., 529 F.3d 763, 784 (6<sup>th</sup> Cir. 2008).

Olelo's draft capitalization policy does not mention training. Even if it did provide for capitalization of training, it would be contrary to GAAP and federal law.

Olelo's expert witness testified that even if federal tax rules generally applied, training is normally expensed rather than capitalized. She testified that only in unusual circumstances would training be capitalized (i.e., when it is primarily to obtain future benefits significantly beyond those traditionally associated with training provided in the ordinary course of business). She cited Cleveland Electric Illuminating Co. v. United States, 7 Cl. Ct. 220 (1985). This case, however, involved a conversion from fossil fuel plants to nuclear power plants with an accompanying substantial increase in danger to the workers operating the plant as well as the general public. The situation at issue herein is hardly akin to the substantial difference between operating a fossil fuel plant and a nuclear fueled power plant. It is more akin to the normal cost of training employees in operating new equipment in an existing business. Id. at 233.

For the reasons stated above, the staff training expenses requested by Olelo must be considered operating expenses. Olelo's request for staff training expenses of \$102,000.00 to be included in Oceanic's capital payments in the years 2012 to 2014 is therefore not warranted.

#### **G. FACILITY-RELATED EXPENSES**

Olelo's expert witness was incorrect in stating that the federal cost accounting standards "default" to tax principles when the contractor has no experience with an asset. What that standard actually requires when the contractor has no experience with the asset is

that: (a) the contractor has to come up with its own estimate that does not have to equal the federal guidelines as long as the contractor's estimate is not lower than the federal guidelines; and (b) this original estimate must be replaced as soon as the contractor is able to develop its own estimate based on its own experience.

Olelo's expert witness was incorrect in relying on federal cost accounting standards to justify capitalizing components of Olelo's building. First, those federal cost accounting standards are not tax rules. Second, the rule relied upon by the witness (see, Olelo's Rebuttal Exhibit "2") was 9904.404-30(a)(1) which refers to an "asset accountability unit." That does not apply here because no building component was capitalized upon purchase and no such unit was disposed of.

No basis was presented to the Arbitrator that Olelo must follow tax rules instead of GAAP rules pertaining to capitalization of repairs and improvements or capitalization of building components as opposed to the entire building.

In the case of the building, GAAP principles concerning the capitalization of repairs and improvements should apply. Even assuming for purposes of argument that tax principles might theoretically apply, Olelo has not used them.

Olelo has failed to demonstrate by a preponderance of the evidence that any of the requests for facility related requests are capital expenses that should be included in Oceanic's Capital Fund Payments.

In addition, in light of the above, the Arbitrator expresses no view on the debate between the parties concerning ownership of the Mapunapuna facility or partial use of that facility by subtenants who pay rent to Olelo.

## **H. GOVERNMENT PROGRAMMING**

The Arbitrator has previously ruled that the issue concerning whether TWE is responsible for government access programming facilities and equipment at the Hawaii State Capitol and for the City and County of Honolulu Administration (i.e., Exhibits 95, 96, and 97) is beyond the scope of these proceedings. See, TR pages 1043 to 1051.

This concludes the Conclusions of Law specifically related to the “remaining disputed items in this arbitration” as set forth in Section III.D of Olelo’s Post-Hearing Brief.

## **I. CAPITAL FUND RESERVES**

As noted above, although Olelo projected total capital expenses of \$1,690,500.00 for 2011, it eventually spent a total of \$1,358,112.00 in capital expenses during that year. In order to do that, Olelo used \$535,112.00 from its capital reserves to supplement the \$823,000.00 it received in Capital Fund Payments from Oceanic for 2011.

After that expenditure, Olelo still had \$1,481,599.00 remaining in its capital reserve fund. Olelo did not demonstrate any need to retain this entire amount in reserve for the years 2012 through 2014.

The Arbitrator concludes that two factors should be considered in determining Olelo’s use of its capital reserves for capital expenses for the 2012 to 2014 time period.

First, it appears to be appropriate for Olelo to continue to receive a minimum annual Capital Fund Payment of \$823,000.00 when the amount approved for capital expenditures exceeds \$823,000.00 for any year during the 2012 to 2014 time period. Receipt of that amount has been the pattern for several previous years (i.e., 2004 to 2011) by mutual agreement, and computes to roughly \$3.00 per Oceanic subscriber. Oceanic is also accustomed to providing this amount to Olelo, and the amount per subscriber is

approximately the same that Hawaiian Telcom will have to pay Olelo. If the amount of approved capital expenditures for any particular year is less than \$823,000.00, however, then Olelo should only receive that lesser amount for that year. The Arbitrator notes that Oceanic's Capital Fund Payments under this Decision cover Olelo's capital expenditures for all sectors of "P" (i.e., public), "E" (i.e., education), and "G" (i.e., government access programming and activities, excluding the PEG access equipment and facilities at the Hawaii State Capitol and for the City and County of Honolulu Administration as these two areas are beyond the scope of the arbitration).

Second, it is appropriate for Olelo to be required to use its capital reserves when its approved capital expenditures exceed \$823,000.00 in a particular year. Olelo has shown in 2011 that it is willing to do this on its own, with no need for any order from the DCCA, when it spent the significant sum of \$535,112.00 from its capital reserves. The Arbitrator concludes that it is appropriate at this time to cap Olelo's payments from its reserves at \$535,112.00 for any particular year during the 2012 to 2014 time period. That is an amount Olelo has shown it is capable of paying while preserving sufficient capital reserves for the future. No formula for the setting of capital reserves was presented at the arbitration, and future events may call for a re-evaluation of the use of Olelo's capital reserves. At this point, however, the Arbitrator concludes that the above method is a fair and predictable method for both parties. The Arbitrator notes that if the amount of approved capital expenditures for any particular year during the 2012 to 2014 time period exceeds \$823,000.00, Olelo should be limited to using \$535,112.00 of its reserves for its capital expenses for that year, and that Oceanic shall be responsible for the remainder.

When the DCCA questioned Olelo in the past about Olelo's large capital reserves, Olelo explained that it was keeping a large amount of reserves in preparation for the changeover to digital programming. Now that the changeover is to take place through purchase of equipment listed on Exhibit 94, it is appropriate for Olelo to utilize those capital reserves. It would not be in the public interest for Olelo to completely fulfill its equipment needs by means of capital funds payments from Oceanic while, at the same time, maintaining its present level of capital reserves because, in that scenario, Olelo would be unacceptably accumulating reserves for no discernible reason.

**J. OPERATING FUND RESERVES**

It is contradictory for Oceanic to assert that over \$1.9 million in expenses for proposed repairs, staff training, etc., should not come from capital funds and thus must come from operating reserves, and, at the same time, assert that virtually all of Olelo's operating reserves be used to pay for additional capital expenditures. Based on the decision herein, Olelo shall be required to use its operating funds in the amount of \$260,802.00 if it wants to purchase Internet streaming equipment; \$73,000.00 if it purchases all of the furniture it listed; \$102,000.00 for staff training; approximately \$1,453,000.00 if it wants to do all the projected repairs to its facilities; and over \$15,000.00 for software.

Given that situation, and given the inherent uncertainty of Olelo's operating expenses during 2012 to 2014, Oceanic's request to require Olelo to use operating reserves to pay for capital expenditures allowed by this decision, and thus reduce Oceanic's Capital Fund Payments during 2012 to 2014, is not warranted.

**K. INTEREST FROM OLELO'S CAPITAL RESERVE**

It would appear that Oceanic and Olelo agree that the GAAP Financial Accounting Standards should be consulted first in determining whether there are restrictions on the allocation of interest and investment income from capital reserves to unrestricted uses. Olelo's expert witness testified that she first looked to those GAAP Financial Accounting Standards. In addition, Oceanic has maintained throughout the arbitration that GAAP standards apply to Olelo.

The relevant GAAP Financial Accounting Standard allows interest and investment income from capital reserves to be allocated to unrestricted uses unless there is a specific donor requirement that it be allocated only to capital purchases.

The testimony of Oceanic's expert witness that the terms of D&O 346 contain such a restrictive requirement is an interpretation of D&O 346 that is not the appropriate subject of expert accountant testimony. Similarly, any implication in the testimony of Olelo's expert witness that the terms of D&O 346 do not include a restrictive requirement would likewise not be appropriate expert accountant testimony. In both cases, the experts would be providing what essentially are opinions on contract interpretation which is a matter of law for the Arbitrator to decide. Neither expert pointed to anything in the terms of D&O 346 itself where interpretation of that Order would benefit from expert testimony on this issue.

Neither Oceanic nor Olelo has referred to any federal statute, administrative rule, court decision, or administrative agency decision on this issue.

The issue raised by Oceanic concerning Olelo's past financial activities was, as noted above, excluded from the scope of this arbitration. As part of that issue, Oceanic complained about Olelo's past practice of using interest and investment income on capital funds for

unrestricted purposes. That issue would be part of a broader regulatory review and proceeding outside the forum of this arbitration.

In term of actual payments, the issue here may become moot or at least insignificant in amount depending on the future use by Olelo of its capital reserves during the years 2012 to 2014 as well as the investment situation in the general economy during those years.

Under these circumstances, it would not be appropriate to decide the issue raised herein when it will be part of a separate regulatory effort and the amount at stake in this proceeding is completely speculative. Accordingly, Oceanic's assertion that interest and investment income from capital reserves should be deducted from Oceanic's capital payments in the years 2012 to 2014 is dismissed without prejudice.

**L. GRANT INCOME, DONATIONS, AND OTHER INCOME**

There is a history between DCCA and Olelo concerning Olelo raising additional funds from other sources either to cover expenditures in areas outside of cable television activities, to provide a financial basis for continuing operations if cable revenue substantially decreases, or for other reasons.

The entire issue of obtaining other funding sources is an ongoing regulatory issue that goes beyond the scope of the present proceeding. The Arbitrator herein was not tasked with deciding such regulatory issues. Accordingly, the request by Oceanic to reduce its capital payments to Olelo on account of Olelo's anticipated fund raising efforts, actual fund raising efforts, or what Olelo should have done, but did not do, in the area of fundraising is dismissed without prejudice. These issues must be taken up in another forum within the scope of DCCA's regulatory activities.

**M. FUNDS FROM HAWAIIAN TELCOM**

Olelo's projected equipment needs and capital funds requirements for the years 2012 to 2014 were based on Olelo's overall needs. They were not based on any per subscriber need (i.e., so much equipment and so many expenses for servicing Oceanic customers versus the needs and expenses for servicing Hawaiian Telcom customers). Accordingly, it would be inappropriate to require Oceanic to provide all of Olelo's capital funds requirements while allowing Olelo at the same time to retain all capital funds provided by Hawaiian Telcom.

At this time, however, it is impossible to determine the amount of capital funds Hawaiian Telcom will provide Olelo. During the hearing, no figures were provided for Hawaiian Telcom's actual Capital Fund Payments for 2011, and Oceanic's projected figures are fairly speculative.

Accordingly, the Arbitrator has concluded that the Director shall withhold from distribution to Olelo \$1,776.00 from Oceanic's payment of capital funds in 2012; \$16,443.00 from Oceanic's payment of capital funds in 2013; and \$42,744.00 from Oceanic's payment of capital funds in 2014. When the Hawaiian Telcom payments of capital funds to Olelo are finalized for those respective years, the following shall take place:

1. If Hawaiian Telcom's payment for any particular year is less than the amount reserved, Olelo may apply to the Director for release of the difference between the reserved amount and the amount received from Hawaiian Telcom.
2. If Hawaiian Telcom's payment for any particular year exceeds the amount reserved, Oceanic may apply to the Director for: (a) release of the reserved amount back to Oceanic; and (b) a reduction in Oceanic's

capital funds payment to Olelo for that particular year equal to the excess of the amount paid by Hawaiian Telcom over the amount reserved.

**N. COSTS OF ARBITRATION**

The Capital Fund Payments at issue in this arbitration are not in the nature of an endowment. Olelo's reliance on Internal Revenue Regulation 1.263(a)-4(d)(6)(E) is not warranted.

Olelo has not provided any legal basis for an award against Oceanic of attorneys' fees or arbitration costs in this proceeding.

Olelo's argument that requiring it to bear its attorneys' fees and costs in this arbitration is a change in the terms of Olelo's PEG agreement with the DCCA is not properly before the Arbitrator. The scope of the arbitration did not include alleged changes in the Olelo-DCCA agreement. As Olelo has itself noted in its Motion to Exclude Evidence and Testimony About Performance of and Activities Relating to the PEG Agreements, the Arbitrator's power does not derive from any Olelo-DCCA PEG agreement and issues regarding any such agreement are not within the Arbitrator's jurisdiction.

**IV. DECISION**

**A. CAPITAL FUND AMOUNTS FOR 2012 TO 2014**

Pursuant to the foregoing Findings of Fact and Conclusions of Law, the Arbitrator hereby addresses Olelo's capital fund requests, and determines that the following are reasonable amounts of PEG capital funds for 2012 to 2014:

1. 2012

Equipment costs as agreed to by the experts - \$1,974,076.00

Software upgrades	<u>75,120.00</u>
Total	\$2,049,196.00

2. 2013

Equipment costs as agreed to by the experts -	\$1,083,842.00
Furniture	<u>16,000.00</u>
Total	\$1,099,842.00

3. 2014

Equipment costs as agreed to by the experts	\$501,798.00
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**B. CAPITAL FUND PAYMENTS**

The Arbitrator subsequently determines that the capital fund amounts in Section IV.A. above shall be apportioned as follows (i.e., the following are the amounts that: (1) Oceanic should provide Olelo in Capital Fund Payments, and (2) Olelo should contribute from its capital reserves):

1. 2012

For the capital fund amount of \$2,049,196.00, Oceanic shall pay Olelo \$1,514,084.00 within forty-five (45) calendar days from the date of this Decision, and Olelo shall be responsible for the remaining \$535,112.00 out of its capital reserves.

2. 2013

For the capital fund amount of \$1,099,842.00, Oceanic shall pay Olelo \$823,000.00 on or before January 31, 2013, and Olelo shall be responsible for the remaining \$276,842.00 out of its capital reserves.

3. 2014

For the capital fund amount of \$501,798.00, Oceanic shall pay Olelo \$501,798.00 on or before January 31, 2014.

C. RESERVE FOR HAWAIIAN TELCOM PAYMENTS

The Director shall withhold (i.e., deduct) from distribution to Olelo \$1,776.00 from Oceanic's payment of capital funds in 2012; \$16,443.00 from Oceanic's payment of capital funds in 2013; and \$42,744.00 from Oceanic's payment of capital funds in 2014. When the Hawaiian Telcom payments of capital funds to Olelo are finalized for those respective years, the following shall take place:

1. If Hawaiian Telcom's payment for any particular year is less than the amount reserved herein, Olelo may apply to the Director for release of the difference between the reserved amount and the amount received from Hawaiian Telcom.
2. If Hawaiian Telcom's payment for any particular year exceeds the amount reserved herein, Oceanic may apply to the Director for: (a) release of the reserved amount back to Oceanic; and (b) a reduction in Oceanic's capital funds payment to Olelo for that particular year equal to the excess of the amount paid by Hawaiian Telcom over the amount reserved.

D. OTHER ISSUES

As set forth in more detail above, Oceanic's claims of misappropriation and/or misapplication of capital funds from 2006 to 2010, and claims related to government

programming facilities and equipment at the Hawaii State Capitol and for the City and County of Honolulu Administration, are dismissed without prejudice because they are beyond the scope of this arbitration. In addition, Oceanic's claim that future interest and investment income on Olelo's capital reserves must be restricted to paying capital expenses is also dismissed without prejudice.

Olelo's claim for attorneys' fees and arbitration costs is denied. However, insofar as Olelo may claim entitlement to some or all of such fees and costs in connection with its PEG agreement with DCCA, such denial is without prejudice because that issue is beyond the scope of this arbitration.

DATED: Honolulu, Hawai'i, JUL 27 2012.



DAVID H. KARLEN  
Arbitrator

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**CERTIFICATE OF SERVICE**

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I hereby certify that a copy of the foregoing **DEPUTY DIRECTOR'S FINAL ORDER REGARDING ARBITRATOR'S DECISION FILED ON JULY 27, 2012** was served upon the following persons at the addresses shown below by mailing the same, postage prepaid, on 7/27/, 2012.

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