BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF HAWAII

In the Matter of the Application of HAWAIIAN TELCOM SERVICES COMPANY, INC. and HAWAIIAN TELCOM, INC. For Approval to Sell Hawaiian Telcom Services Company, Inc.'s Directory Publishing Business and Other Related Matters.	DOCKET NO. 2007-0123

DECISION AND ORDER NO. 23825

Filed NOV. 13, 2007

At 1 o'clock P .M.

Karen Higashi

Chief Clerk of the Commission

ATTEST: A True Copy
KAREN HIGASHI
Chief Clerk, Public Utilities
Commission, State of Hawaii.
Karen Higashi

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In the Matter of the Application of)) HAWAIIAN TELCOM SERVICES COMPANY,) INC. and HAWAIIAN TELCOM, INC.)) For Approval to Sell Hawaiian) Telcom Services Company, Inc.'s) Directory Publishing Business and) Other Related Matters.))	Docket No. 2007-0123 Decision and Order No. 23825

DECISION AND ORDER

By this Decision and Order, the commission conditionally approves the joint application filed by HAWAIIAN TELCOM SERVICES COMPANY, INC. ("HTSC") and HAWAIIAN TELCOM, INC. ("HTI") (collectively, "Applicants") for commission approval to sell HTSC's directory publishing business to CBD Investor, Inc. (the "Buyer") and related matters.

I.

Background

A.

Application

On May 11, 2007, Applicants jointly filed their Application[1] requesting commission approval to sell HTSC's directory publishing business, known as Hawaiian Telcom Yellow Pages ("HT Yellow Pages" or "Directory Publishing Business"), to

[1]HTSC and HTI filed their Application; Attachments 1-4 and related exhibits; Verification; and Certificate of Service (collectively, "Application") on May 11, 2007.

Buyer (the "Proposed Transfer").[2] Applicants filed their Application pursuant to In re Paradise MergerSub, Inc., et al., Docket No. 04-0140, Decision and Order No. 21696, filed on March 16, 2005 ("Decision and Order No. 21696")[3] and, to the extent applicable, HAR chapters 6-61 and 6-80.

1.

Descriptions of Transferor and Transferee

a.

Applicants and Related Entities

In March 2005, the commission conditionally approved the merger transaction and other related matters described in the joint application filed by Paradise MergerSub, Inc., now known as Hawaiian Telcom Communications, Inc. ("HT Communications"); GTE Corporation ("GTE"); Verizon Hawaii Inc., now known as HTI; Bell Atlantic Communications, Inc., dba Verizon Long Distance; and Verizon Select Services Inc. ("VH Merger"). Essentially, through the VH Merger, control over HTI and related assets,

[2]Applicants served copies of the Application on the DIVISION OF CONSUMER ADVOCACY, DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS ("Consumer Advocate"), an ex officio party to this proceeding pursuant to Hawaii Revised Statutes ("HRS") § 269-51 and Hawaii Administrative Rules ("HAR") § 6-61-62. Applicants and the Consumer Advocate, the sole parties to this proceeding, are hereafter collectively referred to as the "Parties."

[3]Generically, the proceeding resulting in the issuance of Decision and Order No. 21696 will be referred to as the "VH Merger Docket."

including the Directory Publishing Business, were transferred from certain subsidiaries of Verizon Communications Inc. ("Verizon") to HT Communications and its parent company, which are ultimately controlled by the TC Group L.L.C., dba The Carlyle Group ("Carlyle"), a Delaware limited liability company.

HTSC, a Delaware corporation, is a wholly-owned subsidiary of HT Communications and an affiliate of HTI. HTSC is authorized to transact business in the State of Hawaii ("State") and its principal place of business is in Honolulu, Hawaii. HTSC is a telecommunications carrier as defined by HRS § 269-1, and is currently authorized by the commission to provide resold telecommunications services and intrastate resold wireless telecommunications services (known as, commercial mobile radio services or "CMRS") in the State.[4] Moreover, HTSC provides interstate toll service on a nationwide basis under the purview of the Federal Communications Commission, and owns and operates the Directory Publishing Business, the subject of the Proposed Transfer. HTSC was formed through the VH Merger transaction.

HTI, a Hawaii corporation, is also a wholly-owned subsidiary of HT Communications. Its principal place of business is in Honolulu, Hawaii. HTI was originally chartered in 1883 under the Kingdom of Hawaii, and is a public utility as defined

[4]HTSC received its certificate of authority to provide resold telecommunications services in the VH Merger Docket (see Decision and Order No. 21696 at 58-60) and later received its certificate of registration to provide CMRS in Decision and Order No. 21892, filed on June 24, 2005, in Docket No. 05-0097.

by HRS § 269-1 and is regulated by the commission under HRS chapter 269. HTI is the State's incumbent local exchange carrier ("ILEC"), as defined by section 252 of the federal Telecommunications Act of 1996, which provides local and intraLATA telecommunications services in Hawaii, on a statewide basis.

Under HAR § 6-80-63, HTI, as the State's ILEC, is required to publish white and yellow pages directory listings in the State and to provide such listings to customers of all telecommunications carriers, at no charge. HTI currently fulfills this requirement under an agreement with L.M. Berry and Company ("L.M. Berry"). In short, the "provision of services related to the Directory Publishing Business, which included the marketing, printing and distribution of the directories, was outsourced to L.M. Berry commencing as of the completion of the Carlyle acquisition in May 2005."[5]

b.

Buyer and Related Entities

Buyer, a Delaware corporation, is a wholly-owned indirect subsidiary of Local Insight Media, L.P., a Delaware limited partnership ("Local Insight"). Local Insight is a "portfolio company" of Welsh, Carson, Anderson & Stowe ("WCAS"),

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[5] See Application at 6.

which is a private equity investment firm.[6] According to Applicants, Local Insight, "the fifth largest directory publisher in the United States, is a leading provider of print directories and Internet-based local search services in the Greater Cincinnati area, Alaska and the Caribbean."[7] According to Applicants, Local Insight had pro forma total revenues of $220.7 million for the year ended December 31, 2006, and its "management has an established track record of successfully managing directory publishing assets, integrating acquisitions and delivering strong and consistent financial performance."[8]

2.

Issues

Stipulated Procedural Order No. 23501, filed on June 20, 2007 ("Procedural Order"),[9] sets forth the issues for this proceeding, which are:

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[6]Approximately 71% of Local Insight is owned by WCAS, while Spectrum Equity Investors, another private equity firm, owns an estimated 27% of Local Insight. See Application at 5.

[7]Id. at 4. Specifically, Local Insight indirectly owns: (a) CBD Media LLC (operating in the Cincinnati-Hamilton metropolitan area); (b) ACS Media LLC; (operating in Alaska); (c) Caribe Servicios de Informacion Dominicana, S.A. (operating in the Dominican Republic); and (d) 60% of Axesa Servicios de Informacion, S. en C., (operating in Puerto Rico). Id. at 4-5.

[8]Id. at 5.

[9]The Parties submitted their proposed Stipulated Procedural Order on May 29, 2007, which the commission approved on June 20, 2007. Moreover, on May 11, 2007, the Parties submitted their Stipulation for Protective Order, which the commission approved by Protective Order No. 23480, filed on June 5, 2007 ("Protective Order").

1. Whether the sale of HTSC's non-regulated directory publishing business, known as Hawaiian Telcom Yellow Pages, to CBD Investor, Inc., pursuant to that certain Purchase Agreement dated April 29, 2007, as set forth in Attachment 2 of Applicants' Application, submitted in this docket, together with the ancillary agreements, is reasonable and in the public interest, and should be approved.

2. Whether any other relief, as may be just, reasonable and/or otherwise applicable, should be granted under the circumstances.

3.

Proposed Transfer

a.

General Description

On April 29, 2007, HTSC, HT Communications, and Buyer entered into a Purchase Agreement to transfer HTSC's Directory Publishing Business to Buyer ("Purchase Agreement"). Applicants included a copy of the Purchase Agreement as Attachment 2 to the Application.

If approved, the Proposed Transfer is contemplated to occur in two stages. In the first stage, HTSC will contribute the assets and liabilities related to the Directory Publishing Business to Directory Co., LLC ("DC LLC"), a newly formed Delaware limited liability company. At this stage, HTSC will hold 100% of the membership interest in DC LLC. During the second stage, anticipated to occur immediately following the contribution, all of DC LLC's membership interests will be sold and transferred to Buyer.

b.

Terms and Conditions

If the Proposed Transfer is approved, HTSC's Directory Publishing Business will be sold to Buyer for the aggregate purchase price of $435 million, as set forth in Section 2.2 of the Purchase Agreement. This amount, at closing, is subject to certain adjustments related to working capital which are described in detail in Section 2.3 of the Purchase Agreement. Applicants note that Buyer received financing commitments for the entire purchase price of the Directory Publishing Business and, thus, there is no financing contingency to consummate the Proposed Transfer.

Article VI of the Purchase Agreement contains various conditions which must be satisfied, unless waived in writing by each of the transaction parties, to consummate the Proposed Transfer. Included as a condition of the Proposed Transfer is the requirement that commission approval of the Proposed Transfer is obtained without the imposition of conditions or restrictions on HTSC and its affiliates (including HT Communications and HTI) that would "reasonably be likely to be materially adverse" to HTSC and its affiliates in the reasonable judgment of HTSC.[10] Additionally, the effectuation of the Proposed Transfer is conditioned on the termination or expiration of all applicable waiting periods under the Hart-Scott-Rodino

[10] See Section 6.1(c) of the Purchase Agreement.

Antitrust Improvements Act of 1976.[11] Moreover, the obligations of HTSC and Buyer to effectuate the closing of the Proposed Transfer are conditioned on various representations and warrantees, and compliance with certain related agreements which are set forth in Sections 6.2 and 6.3 of the Purchase Agreement.

Furthermore, as part of the Proposed Transfer, the following ancillary agreements will be entered into prior to or as of the closing of the transaction:

1. Contribution Agreement: This agreement sets forth the specific terms and conditions upon which the assets exclusively relating to the Directory Publishing Business shall be transferred to Buyer (or its affiliate), and Buyer (or its affiliate) shall assume the liabilities relating to the Directory Publishing Business as of the close of the transaction.

2. Publishing Agreement for Official Listings/ Directories ("Publishing Agreement): This agreement will be entered into between HTI and Buyer (or its affiliate) and is for a term of 50 years. Under the Publishing Agreement, Buyer (or its affiliate) will fulfill HTI's obligation under HAR § 6-80-63 to publish and distribute white and yellow pages telephone directories at no charge to HTI or its subscribers. Buyer (or its affiliate) in exchange will be the exclusive official directory publisher of the white and yellow pages directory products that HTI is required to publish and distribute, as well as certain other print and digital directory products, including the *HTYellowPages.com* website. In doing so, Buyer (or its affiliates) will continue to publish the white and yellow page directories under the "Hawaiian Telcom" name.

3. Billing and Collection Services Agreement ("Billing and Collection Services Agreement"): This agreement will be entered into between HTI and Buyer (or its affiliate) under which HTI on behalf of and for consideration paid by Buyer (or its affiliate) will bill and collect from subscribers of local telephone exchange service in

[11] See Section 6.1(b) of the Purchase Agreement.

the State who purchase advertisements in certain telephone directory products from Buyer (or its affiliate) on the same billing statement on which HTI bills such subscribers for local telephone exchange service. This agreement would be for an initial 18-month term, with an option by Buyer (or its affiliate) to extend the term for one additional 12-month period.

4. License Agreement for Use of Directory Publisher Lists ("License Agreement"): This agreement will be entered into between HTI and Buyer (or its affiliate). Under this agreement, HTI will grant Buyer (or its affiliate) a non-exclusive, non-transferable restricted license, at a pricing schedule to be established by HTI, to receive and use the listing and delivery information of persons and businesses that order and/or receive local exchange telephone services from HTI in the State for purposes of publishing certain telephone directory products.[12]

C.

Justification for the Proposed Transfer

Applicants assert that the Proposed Transfer "is reasonable and consistent with the public interest, will not affect Applicants' fitness, willingness and ability to continue to provide their respective utility services, and will not have any adverse impact on Applicants' operations, management and customers in Hawaii."[13]

At the outset, Applicants state their intention to utilize "**the entire net sale proceeds from the sale of the Directory Publishing Business . . . to pay down the debt that was**

[12]The Contribution Agreement, Publishing Agreement, Billing and Collection Services Agreement, and the License Agreement are hereafter collectively referred to as the "Proposed Commercial Agreements."

[13]See Application at 13.

incurred in connection with the acquisition of Verizon's Hawaii assets in Docket No. 04-0140."[14] Thus, Applicants contend that the Proposed Transfer would improve their ability to fund their continuing operations and the circumstances upon which the commission based its conditional approval of the VH Merger. On the latter subject, Applicants elaborate that during the VH Merger Docket, concerns were raised regarding the proposed initial capital structure of the transaction; to mitigate these concerns the commission imposed an "Equity Commitment Condition" requiring Carlyle to infuse additional equity to reduce the capital structure at closing of the VH Merger from 82.5% debt to 76.3% debt. Applicants further note that the commission upon imposing the "Equity Commitment Condition" stated that "this condition will hopefully enable the Applicants [of Docket No. 04-0140] to reduce debt to . . . (65%) in a shorter period of time."[15]

Specifically, Applicants represent that their intention to utilize the entire proceeds from the Proposed Transfer to pay down debt would: (1) result in a less highly leveraged company; (2) allow HT Communications to obtain the commission established target of 65% debt sooner than contemplated during the VH Merger proceeding; (3) improve HT Communications' financial flexibility to access additional funds at reasonable terms; (4) provide an additional "cushion" to protect against unexpected increases

[14]Id. at 14 (emphasis in original).

[15]Id. (citing Decision and Order No. 21696 at 41) (internal quotes omitted).

in costs and reductions in revenues; and (5) enable HT Communications to address service quality issues without negatively impacting customers' rates.

In addition, Applicants claim that the Proposed Transfer would benefit Applicants and their customers by allowing Applicants to focus their efforts on their existing core telecommunications businesses and operations, as well as new businesses and operations to remain competitive in the "increasingly" competitive telecommunications environment and allow for future investment in infrastructure. Further, if approved, upon closing of the Proposed Transfer, the services currently outsourced to L.M. Berry under a fee agreement will be provided by Buyer (or its affiliate) pursuant to the Publishing Agreement at no charge to HT Communications.

Local Insight, according to Applicants, has the "operating experience, management know-how and financial wherewithal to undertake the obligations previously performed by HTSC (and outsourced to L.M. Berry) and to ensure that HTI continues to fully comply with . . . [the] directory listing requirement imposed by HAR § 6-80-63."[16] Related to this, Applicants contend that Local Insight: (1) has elected to continue to utilize the services of L.M. Berry and will assume the agreement between HT Communications and L.M. Berry to have it continue to provide services related to the Directory Publishing Business; and (2) already has a close commercial relationship

[16] Id. at 16.

with L.M. Berry in Cincinnati and Alaska and that this familiarity with L.M. Berry "will ensure an efficient post-closing transition."[17]

Moreover, Applicants assert that none of HTI and HTSC's employees will be adversely impacted by the Proposed Transfer and that HTI will generate additional revenues as a result of the Proposed Transfer from the services that HTI will be performing for or on behalf of Buyer (or its affiliate) under the Billing and Collection Services Agreement and the License Agreement.

B.

Consumer Advocate's Position

On September 21, 2007, the Consumer Advocate filed its Statement of Position ("CA's SOP"). As an initial matter, the Consumer Advocate recommended that the commission apply its public interest review standard regarding the Proposed Transfer based upon a required demonstration of "substantial net benefits" as opposed to a weaker "no detriment policy." The Consumer Advocate asserts that "[b]efore approving the sale or merger of regulated utility operations, and exposing ratepayers to risks and costs of changing ownership and operations, it is imperative that utility customers be assured of substantial and tangible net benefits."[18]

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[17] Id. at 16-17.

[18] See CA's SOP at 40.

In addition, the Consumer Advocate recommended approval of the Proposed Transfer and other requested relief; provided that the commission adopts certain regulatory conditions, negotiated with and agreed to by Applicants ("Stipulated Regulatory Conditions").[19] According to the Consumer Advocate, the Proposed Transfer will not result in significant change in the outsourced Directory Publishing Business since: (1) HTI has outsourced the Directory Publishing Business function to L.M. Berry since its 2005 acquisition by Carlyle; and (2) Buyer intends to continue the outsourcing arrangement with L.M. Berry. Moreover, since Buyer will assume the obligations to produce and deliver complete and timely directories, in compliance with all applicable legal requirements including those under HAR § 6-80-63, the Consumer Advocate contends that the Proposed Transfer should be largely transparent to HTI customers and the users of the directory products.

Nonetheless, the Consumer Advocate states that the Stipulated Regulatory Conditions are necessary to address its concerns regarding the sale of the Directory Publishing Business and approval of the Proposed Commercial Agreements, and recommends rejection of both should the commission not adopt the Stipulated Regulatory Conditions.

The Stipulated Regulatory Conditions, agreed to between the Parties are verbatim as follows:

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[19]The Consumer Advocate retained the services of Utilitech, Inc. to assist in its independent review of the Application. See CA's SOP at 1.

1. Beginning approximately 45 days following closing of the sale of the Hawaii Directory Publishing Business, HTI shall provide a coupon as part of the customer bill for all of its R1 residential access line customers, entitling the customer to receive one (1) free corded phone (GE Slimline or equivalent) per residential customer account. These coupons will be redeemable at Hawaiian Telcom's retail stores (or other selected locations) for the period of time set forth on said coupon (which time period will be no less than 30 days after the mailing date of the coupon).[20]

2. A directory publishing revenue credit, in the annual amount of $42.6 million per year, shall be deemed reasonable and added as regulated revenues into the calculation of HTI's earnings from 2008 to 2022 in all future rate cases, alternative form of regulation proceedings, or other proceedings before the Commission investigating HTI's earnings or financial performance. In the event of any future sale or transfer of the HTI regulated business, the acquiring entity shall agree in writing to be bound by this directory publishing revenue credit commitment.

3. Applicants shall use the entire net proceeds arising from the sale of the Hawaii Directory Publishing business to repay debt of HTCI that is outstanding as of the date of closing of the sale of the Hawaii Directory Publishing business.[21]

The Consumer Advocate maintains that the Stipulated Regulatory Conditions, attached as Attachment A to the CA's SOP,[22] and set forth verbatim above, will produce the required ratepayer public interest benefits. According to the Consumer Advocate, "[s]ubstantial and tangible net ratepayer benefits will result

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[20]In this condition, the Parties refer to HTI as "Hawaiian Telcom."

[21]In this condition, the Parties refer to HT Communications as "HTCI."

[22]<u>See also</u> calculations set forth in Confidential Schedule 1 of the CA's SOP.

from these conditions due to the coupons for free telephone handsets, the resolution of future regulatory treatment of directory imputation matters, and the significant repayment of currently outstanding debt."[23]

Without the imposition of the Stipulated Regulatory Conditions, the Consumer Advocate asserts that no meaningful benefits for HTI's customers exist apart from the reduction of financial risks associated with HT Communications' currently high consolidated debt levels. Additionally, the Consumer Advocate argues that the "Application clearly represents a net detriment to ratepayers in the amount of foregone directory revenues in the future."[24] On this matter, the Consumer Advocate states that the commission, like other state regulators, recognized income earned from the publication of directories when establishing the ILEC's revenue requirement in rate case proceedings, reducing the telephone revenues otherwise required from ratepayers. In the last rate proceeding, millions of dollars of directory advertising revenues were recognized as a contribution to the fixed cost of providing regulated telephone service.[25] The Consumer Advocate states that the Proposed Transfer would permanently eliminate the directory advertising revenues and

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[23] See CA's SOP at 40.

[24] Id. at 19.

[25] The exact estimate of directory advertising revenues recognized by the commission when it determined the revenue requirement to establish the ILEC's rates utilizing a 1995 test year (when HTI was operating as a subsidiary of GTE) was filed confidentially under the Protective Order.

income stream that has historically provided revenue support to the fixed overhead of the State's regulated ILEC business. Thus, absent any equitable sharing of directory advertising profits, HTI's revenue requirement would be increased and reported earnings and cash flows would be decreased during any future rate case or other financial review for regulatory purposes. Related to this, the Consumer Advocate contends that the commission in the VH Merger docket stated that approval of the transfer of directory assets would be conditioned on, among other things, HTI's agreement to allow imputation of revenues consistent with a related regulatory condition imposed in Decision and Order No. 21696.

To address these concerns, the Consumer Advocate primarily proposes that the "large gain" from the sale of the Directory Publishing Business realized by HT Communications be shared with HTI's customers and be recognized as a regulatory asset and amortized for use as a revenue credit in replacement for imputation. Specifically, the Consumer Advocate's recommendation is for "long-term directory revenue credits to be recognized for ratemaking and financial analyses performed from 2008 through 2022, in annual amounts that have been agreed to by Applicants,"[26] which is set forth as Stipulated Regulatory Condition No. 2. The other two conditions (i.e., Stipulated Regulatory Conditions Nos. 1 and 3), were agreed to in an effort to provide consumers with immediate benefits from the Proposed Transfer. Under Regulatory Condition No. 1, each HTI

[26]See CA's SOP at 7.

residential customer would be provided a redeemable coupon for one free wireline telephone, providing them with an opportunity to obtain a hard-wired telephone that can be used during electricity outages (i.e., during storms and earthquakes), at no charge. Regulatory Condition No. 3 formally recognizes Applicants' commitment to utilize the entire net proceeds from the Proposed Transfer to reduce HT Communications' outstanding debt.

C.

Parties' Stipulation

On September 27, 2007, the Parties filed a Stipulation of Settlement Agreement In Lieu of Response/Rebuttal Statement to Consumer Advocate's Position Statement ("Stipulation"). The Stipulation formally memorializes the Parties' settlement and proposed resolution of all of the issues in this proceeding as set forth in the Procedural Order.[27] The Parties state that they

[27]With regards to their Stipulation, the Parties specify that "[e]ach of the regulatory conditions reflected herein, which have been agreed upon by the Parties, are in consideration and support of all of the other regulatory conditions set forth herein, and are expressly conditioned upon acceptance by the [c]ommission of each of the regulatory conditions set forth herein in their entirety and without modification or addition. In the event the [c]ommission declines to approve and/or adopt material parts or all or any of the matters agreed to by the Parties and as set forth in this Stipulation, either or both of the Parties reserve the right to withdraw from this Stipulation and to pursue any and all of their respective positions through further negotiations and/or additional filings and proceedings before the [c]ommission. For the purposes of this Stipulation, whether a term is material shall be left to the discretion of the Party choosing to withdraw from this Stipulation." See Stipulation at 5 n.8.

"understand and acknowledge that the [c]ommission is not bound by this Stipulation between the Parties, and that the [c]ommission, as the ultimate decision-making body, will determine whether the Parties' agreements in this proceeding are consistent with the public interest and applicable law[.]"[28]

In support of the Stipulation, the Parties state that they "agree that the Proposed Transfer is reasonable and in the public interest, and should be approved by the [c]ommission without any regulatory conditions except those conditions stipulated to between the Parties as set forth in the Consumer Advocate's Position Statement [(i.e., the Stipulated Regulatory Conditions).]"[29] In the Stipulation, the Parties contend that the imposition of the three agreed-upon conditions will provide Applicants' customers with additional benefits beyond those specified in the Application; and describe and elaborate on each specific condition.

Specifically, the Parties state that the corded phones to be distributed under Stipulated Regulatory Condition No. 1 do not rely on power from the respective electric utilities and as such can remain operational during electricity failures or blackouts. With regards to Stipulated Regulatory Condition No. 2, the Parties assert that through this condition "ratepayers will not be disadvantaged by the Proposed Transfer in future regulatory proceedings occurring during this period [(i.e.,

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[28]Id. at 4.

[29]Id. at 5 (footnote omitted).

beginning 2008 through 2022)] and are assured of both immediate and long term participation in the benefits arising from such sale."[30] Finally, with regards to Stipulated Regulatory Condition No. 3, the Parties contend that the sale of the Directory Publishing Business at this time allows Applicants to maximize the amount of debt that they will be able to pay off from the transaction proceeds. The Parties explain that favorable market conditions and utilization of the competitive bidding process resulted in Applicants receiving a favorable purchase price for the directory assets. This factor coupled with Applicants' financial losses during their formative years would allow Applicants to utilize accumulative tax losses to offset the gains realized through the Proposed Transfer, reducing the estimated tax resulting from the sale, which will also be applied toward reducing debt.

Overall, the Parties concur that imposition of the Stipulated Regulatory Conditions ensures that the Proposed Transfer will not affect Applicant's fitness, willingness, and ability to provide utility services in the State and that the proposed transaction will not adversely impact their utility operations, management, or customers. Thus, the Parties assert that the Proposed Transfer is "reasonable and in the public interest, and should, therefore be . . . approved by the

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[30] Id. at 8 (citing CA's SOP at 35) (internal quotes omitted).

[c]ommission with the adoption of only . . . the [Stipulated Regulatory Conditions] without modification."[31]

II.

Discussion

A.

Proposed Transfer

State law confers the supervision and regulation of "all public utilities" and the administration of HRS chapter 269 on the commission.[32] As set forth in HRS § 269-7, the commission is vested with broad powers to review and examine the operations of a public utility, including its financial transactions. HRS § 269-7(a) states, in relevant part:

> The public utilities commission . . . shall have power to examine into the condition of each public utility, the manner in which it is operated with reference . . . the issuance by it of stocks and bonds, and the disposition of the proceeds thereof, the amount and disposition of its income, and all its financial transactions, its business relations with other persons, companies, or corporations, its compliance with all applicable state and federal laws and with the provisions of its franchise, charter, and articles of association, if any, its classifications, rules, regulations, practices, and service, and all

[31] Id. at 15. Applicants state that they have been working towards addressing all matters to allow the Proposed Transfer to close by the end of calendar year 2007 in an effort to avoid having to pay interest payments on debt that will be paid down through the proceeds of the sale. Thus, Applicants respectfully request a commission decision and order approving the Proposed Transfer by November 15, 2007. The Consumer Advocate states that it does not oppose Applicants' timing request. Id. at 15-16.

[32] See HRS § 269-6.

> matters of every nature affecting the relations and transactions between it and the public or persons or corporations.

HRS § 269-7(a).

Additionally, the commission, in Decision and Order No. 21696, expressly required HT Communications, HTI, and its affiliates to obtain commission approval:

> prior to selling, divesting, transferring, mortgaging or encumbering, in any manner, the directory assets being transferred in this proceeding [(i.e., Docket No. 04-0140)], until further ordered by the commission.[33]

Approval under HRS § 269-7(a) "requires a finding that the proposed . . . [transaction] is reasonable and consistent with the public interest."[34] "A transaction is said to be reasonable and consistent with the public interest if the transaction will not adversely affect the . . . [utility's] fitness, willingness, and ability to provide public utility service in the State as authorized in its permit, certificate, or franchise."[35] Since a specific standard of review was not set forth in Decision and Order No. 21696, the commission will apply

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[33]This regulatory condition was referred to in Decision and Order No. 21696 as the "Transfer Restriction Condition." See Decision and Order No. 21696 at 47, 55-58.

[34]See In re The Gas Company, LLC, et al., Docket No. 05-0242, Decision and Order No. 22449, filed on May 3, 2007, at 21 (internal quotes omitted).

[35]Id. (internal quotes omitted).

the established HRS § 269-7(a) standard in its review of the Proposed Transfer.[36]

Here, having reviewed the entire record, the commission finds that the Proposed Transfer and the Proposed Commercial Agreements, with the adoption and imposition of the Stipulated Regulatory Conditions, are reasonable and consistent with the public interest. Generally, the Proposed Transfer should be transparent to Applicants, their customers, and the users of the directory services given that, among other things, Buyer will be retaining the services of L.M. Berry--the entity to whom Applicants have outsourced the provision of services (i.e., marketing, printing, and distribution) since 2005. According to Applicants, Buyer will be assuming the current agreement between HT Communications and L.M. Berry to have L.M. Berry continue to provide services related to the Directory Publishing Business.[37] Additionally, under the Publishing Agreement, Buyer will be required to fulfill HTI's obligations under HAR § 6-80-63 to publish and distribute white and yellow pages directories, at no

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[36]While the commission understands the underlying rationale for the Consumer Advocate's argument for adoption of the "substantial net benefits" test over a "no detriment policy," the commission finds it unnecessary to make such a determination at this time, as the Parties agree that either test is satisfied by adoption of the Stipulation. See Stipulation at 5 n.7 (the Parties "agree and stipulate that the public interest standard is met under either of the Parties' respective standards of review and as a result would not object to the [c]ommission not deciding the Parties' difference of opinion on this matter in the instant docket.").

[37]See Application at 16.

charge to HTI or its subscribers.[38] In exchange, Buyer will be the exclusive official directory publisher of the white and yellow pages directory products in Hawaii and, in so doing, will continue to utilize the "Hawaiian Telcom" name.[39] Applicants also represent that none of their employees will be adversely impacted by the Proposed Transfer (due to the L.M. Berry outsourcing arrangement, HTSC only has one employee); and that "HTI's employees and HT Communications' management will remain in place as a result of the Proposed Transfer, without any interruption or change in their respective employment arrangements, positions, and responsibilities".[40]

Moreover, the Proposed Transfer results in HTI generating additional revenues through services that it would be providing to Buyer (or its affiliates) under the Proposed Commercial Agreements, specifically the Billing and Collection Services Agreement and License Agreement. However, primarily, the Proposed Transfer should benefit Applicants' operations and services, and their customers since Applicants intend to utilize the entire net sale proceeds from the Proposed Transfer to pay down HT Communications' existing debt levels (formally memorialized as Stipulated Regulatory Condition No. 3). Use of the proceeds to pay down debt would result in, at minimum, a less highly leveraged company which should improve HT Communications' financial flexibility to access

[38] Id. at 10.

[39] Id.

[40] Id. at 17.

additional funds at reasonable terms. Applicants also stress that paying down debt with the proceeds of the transaction would allow HT Communications to achieve the commission "established" target of 65% debt sooner than anticipated during the VH Merger proceeding and would provide Applicants with the additional "cushion" to address any unexpected financial conditions. With increased financial stability, the commission believes that Applicants should be in a better position to invest in infrastructure, and provide new and innovative offerings to their customers.

Nevertheless, the Stipulated Regulatory Conditions are an integral part of the commission's approval of the Proposed Transfer and are necessary to ensure that the Proposed Transfer does not result in a material detriment to HTI's customers. Of particular concern is that the Proposed Transfer would result in the permanent elimination of the directory advertising revenues and income stream that the commission has historically recognized in its rate review proceedings to reduce the fixed cost of providing regulated telephone services to the ILEC's customers. Due to this loss, the Proposed Transfer would most likely result in increased future regulated telephone rates under traditional ratemaking methodologies. This was a concern for the commission during the VH Merger proceeding for which the commission imposed the Transfer Restriction Condition, requiring HTI and its affiliates to obtain commission approval prior to transferring the Directory Publishing Business. When imposing the Transfer

Restriction Condition on HTI and its affiliates in Decision and Order No. 21696, the commission was concerned that Carlyle would divest itself of the directory assets before all of the benefits of the Rate Case Moratorium Condition[41] would be realized, so it conditioned commission approval of the transfer of directory assets on, among other things, HTI's "agreement to allow the imputation of revenues in an amount consistent with the Rate Case Moratorium Condition."[42]

Stipulated Regulatory Condition No. 2 would address the commission's concerns described above and appropriately satisfy the previously articulated imputation requirement. Under this condition, the gains on the sale of the Directory Publishing Business would be attributed to ratepayers "to fund an annual directory revenue credit at a rate of $42.6 million per year for <u>each</u> year 2008 through 2022, to be applied for future regulatory purposes."[43] This condition is in keeping with the commission's articulated imputation requirement set forth in the VH Merger

[41]The Rate Case Moratorium Condition is one of 14 conditions that were proposed by the Consumer Advocate and approved by the commission in Decision and Order No. 21696. Under this condition, absent a commission waiver, HTI agreed to not file an application for a general rate increase utilizing a prospective test year earlier than calendar year 2009. Among other things, under this condition HTI agreed to not object to the imputation of 67% of its affiliate's revenues from local directory operations as part of HTI's test year annual revenue requirement in any general rate increase case using a test year earlier than calendar year 2009. <u>See</u> Decision and Order No. 21696 at 29-30.

[42]<u>Id.</u> at 47.

[43]<u>See</u> CA's SOP at 33 (emphasis in original) (internal quotes omitted).

proceeding.[44] Moreover, the gains would also be used to provide immediate ratepayer benefits in the form of coupons for free telephone handsets, as set forth in Stipulated Regulatory Condition No. 1.

With regards to the annual revenue credits, the Consumer Advocate states that these credits may have very little financial impact on HTI in the future due to the potential for future regulation of the ILEC to be in a form other than the traditional method. According to the Consumer Advocate, if HTI does not file a traditional rate case in the future, there may be no forum for implementation of the agreed-upon annual revenue credits and the existing rate levels approved in Docket No. 94-0298 (the ILEC's last rate case proceeding which utilized a 2005 test year) would remain in place which includes the embedded directory revenues found to be reasonable at that time. Alternatively, should the commission be asked to consider an alternative form of regulation for HTI, the Consumer Advocate maintains that any consideration of HTI's financial performance, financial condition, or earnings would rely upon financial data that is adjusted to impute the agreed-upon directory revenue credits. The Consumer Advocate maintains that in this manner, "ratepayers cannot be disadvantaged by Applicants['] sale of the . . . [Directory Publishing Business] in future regulatory proceedings and are assured of both immediate and long term

[44] Id. at 34.

participation in the benefits arising from such sale."[45] The commission agrees.

Accordingly, the commission concludes that the proposed Stipulated Regulatory Conditions should be adopted by the commission and imposed as conditions for our approval of the Proposed Transfer. The commission finds these conditions to be appropriate under the facts and circumstances of this proceeding to address regulatory concerns related to the Proposed Transfer and to ensure that the Proposed Transfer is consistent with the public interest.

Based on the foregoing, the commission finds Applicants fit, willing, and able to provide their utility services in the State upon consummation of the Proposed Transfer and the contemplated Proposed Commercial Agreements. The commission also finds the Proposed Transfer and the contemplated Proposed Commercial Agreements to be reasonable and consistent with the public interest; provided that Applicants adhere to and comply with the Stipulated Regulatory Conditions listed in Section I.B above. Thus, the commission concludes that the Proposed Transfer and the Proposed Commercial Agreements, described in the Application, should be approved subject to Applicants' adherence to and compliance with the Stipulated Regulatory Conditions.

The commission makes clear that its approval of the Proposed Transfer and the related Proposed Commercial Agreements herein, is based on the Application filed in this proceeding

[45] Id. at 35.

including, among other things, the Purchase Agreement and the record established in this docket regarding the transfer. Any material changes regarding any aspect of the Proposed Transfer including a modification of the terms or conditions of the Purchase Agreement would require additional and separate commission approval for compliance with the Transfer Restriction Condition set forth in Decision and Order No. 21696.

B.

Monitoring Reports

Consistent with its approval of the Proposed Transfer and the related Proposed Commercial Agreements, the commission finds it prudent, at this time, to impose specific reporting requirements to ensure the continuing quality of the directories and to monitor Stipulated Regulatory Conditions Nos. 1 and 3. The commission is concerned about the continued quality of the directories once the Proposed Transfer is fully consummated. The commission is also concerned about the level of debt under which Applicants will be operating in light of the commission's directive in Decision and Order No. 21696 and other matters currently before the commission. Moreover, the commission is concerned that the coupons for the free corded phones under Regulatory Condition No. 1 be redeemed by those who need them the most since travel to HTI's retail store (or another specific location) is required for redemption. The commission fully expects Applicants to uphold its stated objective to distribute as many of these phones as possible as set forth on page 8 of the Stipulation. To address these concerns, the commission will impose the monitoring reports described below.

First, HTI shall submit a service quality report with data that allows the commission to monitor the quality of the directories and ensure that it remains at least at current levels ("Directory Monitoring Report"). These reports should segregate publisher-related errors and errors related to HTI's own activities. As such, the commission directs the Parties to stipulate to appropriate metrics for the reports. HTI shall submit the Directory Monitoring Report on an annual basis until ordered otherwise by the commission. The first report should be submitted within six months of the consummation of the transaction. Along with the first report, HTI shall, to the extent reasonably possible, submit three to five years of historical data for the agreed upon measures to provide a baseline for evaluation purposes.

Second, Applicants shall submit a debt reduction plan with a targeted debt to equity ratio consistent with the directives of Decision and Order No. 21696 ("Debt Reduction Plan"). Specifically, the plan should identify the projected date when Applicants (and HT Communications) expect to obtain the targeted 65% debt level established by the commission and provide comments and explanations for any intervening years that are projected to have substantial changes in debt or equity levels. Applicants shall submit the Debt Reduction Plan within 60 days of the date of this Decision and Order and provide updates, as necessary, until otherwise ordered by the commission.

Finally, to enable the commission to evaluate the benefits of Stipulated Regulatory Condition No. 1 for future application, Applicants shall file a report identifying the: (1) number of coupons issued; (2) total number of phone coupons redeemed; and (3) the total cost of the program within three months of the completion of the program ("Phone Redemption Report").

III.

Orders

THE COMMISSION ORDERS:

1. The Proposed Transfer and the contemplated Proposed Commercial Agreements, as described in the Application are approved pursuant to the Transfer Restriction Condition set forth in Decision and Order No. 21696 and HRS § 269-7(a), as applicable; provided that Applicants adhere to and comply with the Stipulated Regulatory Conditions, set forth in Section I.B of this Decision and Order.

2. Once fully executed and when reasonably practicable, Applicants shall submit copies of the Proposed Commercial Agreements to the commission and serve copies on the Consumer Advocate.

3. Within 30 days after closing of the Proposed Transfer, Applicants shall provide the commission and the Consumer Advocate with written notice of the consummation of

the subject transaction and an accounting that demonstrates adherence to and compliance with Stipulated Regulatory Condition No. 3.

4. Within six months of the consummation of the Proposed Transfer, HTI shall submit its first Directory Monitoring Report adhering to the parameters and requirements set forth in Section II.B of this Decision and Order. Thereafter, HTI shall submit its Directory Monitoring Report on an annual basis until ordered otherwise by the commission.

5. Within 60 days of the date of this Decision and Order, Applicants shall submit a Debt Reduction Plan consistent with Section II.B of this Decision and Order.

6. Within three months of the completion of the program, HTI shall submit a Phone Redemption Report as described in Section II.B of this Decision and Order.

7. Applicants shall timely comply with all of the regulatory conditions and other requirements set forth above, as applicable. Failure to comply with any of these conditions and requirements may constitute cause to void this Decision and Order, and may result in further regulatory action as authorized by State law and commission rules and regulations.

DONE at Honolulu, Hawaii NOV 13 2007.

PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

By: Carlito P. Caliboso, Chairman

By: John E. Cole, Commissioner

By: Leslie H. Kondo, Commissioner

APPROVED AS TO FORM:

Ji Sook Kim
Commission Counsel

2007-0123.eh

CERTIFICATE OF SERVICE

I hereby certify that I have this date served a copy of the foregoing Decision and Order No. 23825 upon the following parties, by causing a copy hereof to be mailed, postage prepaid, and properly addressed to each such party.

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DATED: NOV 13 2007