

**MINUTES**  
**SENATE FINANCE COMMITTEE**  
**May 20, 2003**  
**10:38 AM**

**TAPES**

SFC-03 # 106, Side A  
SFC 03 # 106, Side B  
SFC 03 # 107, Side A

**CALL TO ORDER**

Co-Chair Gary Wilken convened the meeting at approximately 10:38 AM.

**PRESENT**

Senator Lyda Green, Co-Chair  
Senator Gary Wilken, Co-Chair  
Senator Con Bunde, Vice Chair  
Senator Robin Taylor  
Senator Ben Stevens  
Senator Lyman Hoffman  
Senator Donny Olson

**Also Attending:** REPRESENTATIVE VIC KOHRING; REPRESENTATIVE LESIL MCGUIRE; MARK MYERS, Director Division of Oil and Gas, Department of Natural Resources; KRIS KNAUSS, Staff to Representative Pete Kott; LARRY PERSILY, Deputy Commissioner, Department of Revenue; LEONARD STENBERG, General Counsel, Alaska Communication Service; DANA TINDELL, Senior Vice President, Legal and Regulatory Affairs, General Communications Incorporated;

**Attending via Teleconference:** From an offnet location: KEVIN TABLER, Land and Government Affairs Manager, Unical; GARY ZIMMERMAN, General Manager, Avis Rental Car of Alaska; BOB DINDINGER, President and Chief Executive Officer, Alaska Travel Adventures; TERRY PARKS, Dollar Rental Car; ANDREW HALCRO, President, Alaska Rental Car

**SUMMARY INFORMATION**

HB 28-OIL & GAS ROYALTY MODIFICATION

The Committee heard from the sponsor, the Department of Natural Resources and an oil company.

#### HB 271-PASSENGER/RECREATIONAL VEHICLE RENTAL TAX

The Committee heard from the sponsor, the Department of Revenue and representatives from the rental car industry. Three amendments were considered but not adopted. The bill was reported from Committee.

#### HB 106-TELECOMMUNICATIONS & RCA ACTIONS

The Committee heard from the sponsor and representatives of the telecommunications industry.

#HB28

#### CS FOR SPONSOR SUBSTITUTE FOR HOUSE BILL NO. 28(FIN)

"An Act relating to adjustments to royalty reserved to the state to encourage otherwise uneconomic production of oil and gas; and providing for an effective date."

This was the first hearing for this bill in the Senate Finance Committee.

Co-Chair Wilken stated that this bill, "addresses oil and gas royalty modifications for marginal oil and gas fields. The new modification formula outlined in HB 28 allows the commissioner of Department of Natural Resources to negotiate a royalty rate that is in the best interest of the State."

Senator Taylor offered a motion to report the bill from Committee with individual recommendations and accompanying fiscal note.

Senator Taylor then objected to the motion for the purpose of taking testimony.

Co-Chair Wilken ordered the motion out of order.

REPRESENTATIVE VIC KOHRING, Sponsor, testified that in 1995 the legislature passed a law that provided for an oil royalty reduction. He relayed that the intent was to encourage development of marginal fields that are not profitable, including, new, existing and "mothballed" fields. He remarked that this statute "just hasn't worked" with the State receiving only one application for reduction that was not approved. He attributed the failure of the statute to its complexity and because it did not encourage industry participation. As a result, he sponsored the current

legislation, which simplifies and streamlines the process.

Representative Kohring explained this bill grants the commissioner of the Department of Natural Resources the authority to determine the level of reduction of royalty rates based on the economics of each field. He specified the reduction would be available for any marginal field or field that is not profitable in Alaska that could benefit from a royalty reduction. He noted the reduction would be applied on "a sliding scale basis", generally between three and 12.5 percent, based on the profitability of each field. He described the internal or contracted study that would be conducted to analyze fuel recovery, production rate and volume, and operating costs upon which the commission would base any decision whether to grant a reduction and at what percentage.

Representative Kohring stressed the importance to provide incentive to develop marginal fields to generate income for the State.

MARK MYERS, Director Division of Oil and Gas, Department of Natural Resources, testified that this bill would modify an existing royalty reduction statute, AS 38.05.180(j). He noted this statute had been previously amended, although some of the changes have proven cumbersome and unclear. He stated the existing statute is difficult to administer.

Mr. Meyers stated this legislation would simplify the process yet still provide the commissioner "the necessary tools" to evaluate, condition and accept or reject an application for royalty reduction. He detailed the application and approval process for participation. He listed three cases for which a royalty reduction could be granted: a delineated field that a producer claims would be uneconomic to develop, an existing field that has proven to be uneconomic possibly due to declining production or increasing operating expenses, and fields that are "shut in already". He acknowledged that determination of whether a field is uneconomic is a complex process that also must factor the price of oil, cost of transportation, economics and size of the reservoir and size of the wells.

Mr. Meyers pointed out that this legislation also allows a royalty structure that could "recapture dollars" if the economics of the field change.

Mr. Myers assured that a royalty reduction would not be granted without extensive analysis of all relevant factors and an understanding of the reasonable rate of return on the project.

Mr. Myers told of an application submitted by Unical, in which a

reduction was offered although the company chose to not participate, and another application submitted by Conico, which the Department denied because it was not determined to be in the public interest. He stressed the applications are given serious consideration and that instances exist whereby a royalty reduction could result in a field beginning production or remaining in production.

Mr. Myers cited current royalties are calculated at 12.5 to 16.66, and occasionally 20 percent. He recognized that a reduction to three percent would affect the economics of a field, although would not "materially change it in a very large scope." However, he emphasized the fiscal impact to the State is "very high".

[Note: tape interruption]

Co-Chair Wilken asked if this legislation allows for review.

Mr. Myers replied that this bill includes a provision allowing for a legislative review of the preliminary best interest findings. He explained that the Legislative Budget and Audit Committee or "designated members" of the legislature to obtain the confidential data. Therefore, he assured that the legislature could choose to be directly involved in the process. He qualified that later reviews or changes would be subject to the terms of the contract between the producers and the State. He exemplified a provision in contracts allowing for periodic economic review.

KEVIN TABLER, Land and Government Affairs Manager, Unical, testified via teleconference from an offnet location in support of the legislation. He expressed that it would help clarify and provide flexibility for the commissioner to process a royalty application. He remarked that current statutes create an "unworkable situation".

Senator Bunde commented he was encouraged by the testimony indicating that in the event of success, the State would have an opportunity to "recover on the upside".

Senator Olson asked the number of wells and amount of revenues in question.

Mr. Myers replied that the extent of this legislation would be highly variable and dependent upon companies' submission of applications. He knew of no pending applications. He noted some fields in the Cook Inlet are "late in their life of production" that would receive serious consideration if an application were submitted. He relayed that in review of other fields, it was

estimated that the revenue amount "could easily be in the hundreds of millions of dollars" over the life of the field to "as much as a few tens of millions of dollars differential in the royalty rate." He qualified that the State could recover revenue if the contract were "conditioned properly". He stated that under the provisions of this legislation, a contract could be written to provide a net fiscal effect of nearly zero. He spoke to the need that "the tail be very long" and the royalty managed efficiently to recover revenue resulting from a royalty reduced from 12.5 percent to three percent.

Senator Olson asked the outcome if the results are not as anticipated.

Mr. Myers assured that a full technical analysis would be conducted to ensure the reduction is warranted. He listed geological and geophysical engineering, studies of the reservoir, production history and detailed cost data, as included in the analysis. He furthered that this legislation allows the State to engage a consultant to review the analysis.

Mr. Meyers emphasized this legislation is a policy call.

Senator Taylor offered a motion to report the bill from Committee with individual recommendations and accompanying fiscal note.

There was no objection and CS SS HB 28 (FIN) MOVED from Committee with fiscal note #2 for \$150,000.

#HB271

CS FOR HOUSE BILL NO. 271(FIN)(efd am)

"An Act levying and providing for the collection and administration of excise taxes on the rental of passenger and recreational vehicles usable on highways and vehicular ways; and providing for an effective date."

This was the first hearing for this bill in the Senate Finance Committee.

Co-Chair Wilken stated that this bill, relating to a "personal and recreational vehicle rental tax", "imposes a ten-percent State tax on rental or lease of passenger vehicles and a three-percent State tax on lease or rental of recreational vehicles. Commercial vehicles and farm equipment are exempt and vehicles leased for more than 90 consecutive days are also exempt."

KRIS KNAUSS, Staff to Representative Pete Kott, testified that this bill was introduced at the request of the Governor with the intent to generate approximately \$6 million in revenue with a ten percent tax on rental cars and three percent tax on recreational vehicles (RVs). He remarked that with over 1.6 million visitors to Alaska, the Administration determined "it would be good to get something back from the tourism industry." He informed that approximately 100 businesses would be impacted and that government employees conducting government business would be exempt from the tax. He noted an amendment adopted by the House of Representatives changed the effective date from July 2003 to January 2004.

LARRY PERSILY, Deputy Commissioner, Department of Revenue, testified he was available to answer questions.

Amendment #1: This amendment deletes the following language from page 1 line 14 and page 2 lines 1 - 3 in Section 1.

Sec. 43.52.030. Levy of recreational vehicle rental tax. There is imposed an excise tax on the charge for the lease or rental of a recreational vehicle in this state if the lease or rental of the recreational vehicle does not exceed a period of 90 consecutive days.

Senator Bunde moved for adoption.

Co-Chair Wilken objected for an explanation.

Senator Bunde remarked that the majority of RV rentals occur within the Municipality of Anchorage, which already imposes an eight-percent tax. He calculated that another three-percent tax would "undoubtedly be burdensome on the industry". He informed that because of the current eight percent tax, customers are renting RVs in Canada for travel in Alaska.

Senator Bunde reported that an RV typically rents for \$200 per day or \$4,200 for a two-week rental. He calculated the current eight percent tax for this rental is \$338 and the proposed additional tax would be \$126, totaling \$464 total tax.

Co-Chair Wilken expressed these figures are "compelling" and that business should not be directed to Whitehouse, Yukon Territory. He removed his objection to the adoption of the amendment.

Co-Chair Green objected.

A roll call was taken on the motion.

IN FAVOR: Senator Taylor, Senator Bunde, and Co-Chair Wilken

OPPOSED: Senator Hoffman, Senator Olson, Senator B. Stevens, and Co-Chair Green

The motion FAILED (3-4)

The amendment FAILED to be adopted.

Amendment #2: This amendment changes the proposed tax rate on rental cars from ten percent to seven percent on page 1 line 12 of Section 1.

Senator Bunde moved for adoption.

Co-Chair Wilken objected for an explanation.

Senator Taylor relayed the national average is approximately 5.9 percent. He commented that although "everything costs more in Alaska" "nearly doubling the tax is probably not appropriate". He surmised that collecting a seven percent tax would generate revenue from this source without becoming burdensome to the industry. He added that some rental car companies are "economically stressed".

Senator Taylor estimated he pays a higher taxation rate when renting vehicles in Seattle, Washington and that he definitely pays a higher rate in the State of Hawaii.

Senator Bunde pointed out that many airports impose drop-off and pick-up fees separate from the tax.

Co-Chair Wilken directed attention to a chart compiled by the Montana Department of Revenue and provided by Representative Kott titled, "Table 2, Rental Car Tax, State-by-State Comparison" [copy on file.] This chart, Co-Chair Wilken pointed out, indicates the State of Illinois levies the highest rental car tax combination in the nation at 31.7 percent, the State of Washington levies the sixth highest tax at 21.5 percent, and Alaska ranks 47<sup>th</sup> at approximately six percent.

Co-Chair Wilken maintained his objection to the adoption of the amendment.

GARY ZIMMERMAN, General Manager, Avis Rental Car of Alaska, testified via teleconference from an offnet location to challenge the six percent total rental car tax in Alaska. He cited the eight percent Municipality of Anchorage tax as well as a ten-percent of gross fee paid to the State as an airport concession fee, which is

passed along to the consumer. He stated that rental agreements currently list the total tax paid by the lessee at 18 percent. This legislation, he calculated, plus a proposed statewide sales tax would make the total rental car tax 30 percent. He expressed this would be detrimental to business operations in Alaska. He spoke to the seasonality of the visitor industry in Alaska that does not occur in other states.

Co-Chair Wilken requested Mr. Persily reconcile the witness's testimony with the information contained in the aforementioned chart.

Mr. Persily explained that the chart does not include airport concession fees or municipal car rental taxes. He stated the chart reflects the highest sales tax six percent levied in Sitka for rental cars in Alaska. He agreed that the total current tax for car rentals in Anchorage is 18 percent. He noted that the airport concession fee could be avoided by renting vehicles off site.

Senator Bunde directed attention to the column on the chart titled "state sales tax" and suggested that if a seven percent State sales tax were imposed, Alaska would be equal to the highest tax.

Mr. Persily informed that several states impose a flat fee per rental, rather than a tax percentage. He stated that the chart calculated the flat fee as a percentage of the average \$50 daily car rental rate, and therefore varies based on the actual price of each car rental.

Senator Taylor recalled discussions on other tax proposals, such as a tax on pull tab operations where it was debated whether the State should exercise exclusive taxation authority. He suggested an alternative amendment to Amendment #2 to limit tax authority on car rentals to the State.

Co-Chair Wilken requested the witness continue with testimony on the legislation.

Mr. Zimmerman reported the car rental agencies operating in Anchorage and Fairbanks currently pay over \$4.5 million to the State in the form of a percentage of revenues. In addition, he estimated \$1.5 million is paid to the Division of Motor Vehicles in the form of vehicle registration and another \$.25 million for "coveted parking spaces" at the two airports. He challenged the assertion that the car rental industry or its customers do not contribute to the State economy. He opined that the proposal is a "very targeted tax" and that "a certain fairness issue is at state".

Mr. Zimmerman found it "inconceivable" that a customer renting an RV at \$200 per day would pay less tax than a customer renting a car for \$70 per day. He furthered those travelers who rent cars would stay at hotels and pay local bed taxes, as opposed to travelers who rent RVs and do not stay at hotels. He noted Senator Bunde's comments regarding the burden of the proposed tax on the RV rental industry and stressed that the burden would also exist for the car rental industry. He compared the percentage of the total vehicle rental charges on a two-week RV rental to that of a two-week car rental.

Mr. Zimmerman described the impacts, informing that 90 percent of transactions involve credit cards, in which the bank collects a percentage of the total charge. He stated that the rental companies therefore pay an amount equal to a portion of the tax to the bank, thus increasing operating expenses. He pointed out that this bill contains no provisions to help offset that cost to the car rental and motor home rental businesses.

Mr. Zimmerman cautioned that the vehicle rental industry is "facing very bleak market conditions", noting that deplanements in Anchorage has only increased four percent in the past six years. In Fairbanks, he furthered, the number of deplanements has been unchanged in the past six years and in the current year, Juneau and Kenai are experiencing decreased numbers of deplanements over the previous year. He stated that the situation is not expected to improve and relayed general concerns relating to tourism as well as the "general business climate"

Mr. Zimmerman addressed discussions held amongst members of the car rental industry several years prior about developing an offsite rental facility in Anchorage. However, he stated that customers would have to pay for construction of such a facility through a "pass through fee". He expressed that the proposed tax in this bill is poorly timed, given the current economic situation.

BOB DINDINGER, President and Chief Executive Officer, Alaska Travel Adventures, testified via teleconference from an offnet location about RV rental facilities located in Anchorage, Skagway and Seattle. He informed that the bulk of this business has been primarily in European travelers but has not fared well in recent years due to travel conditions. He agreed with Senator Bunde that a "major shift" of business has occurred from Anchorage to Whitehouse, Yukon Territory, caused by the passage of the Municipality of Anchorage rental tax. Mr. Dindinger also explained that it is more economical for travelers to fly from Germany to Whitehorse and tour Alaska, returning to Whitehorse to return to

Germany.

Mr. Dindinger stated that four of his competitors have gone out of business and he listed the changing numbers of rentals in Whitehorse and in Alaska. He furthered that his company has downsized its fleet. He expressed concern that a State tax would provide an additional disincentive for renting RVs in Alaska.

TERRY PARKS, Dollar Rental Car, testified via teleconference from an offnet location about the negative impacts on the industry since the events of September 11, 2001 and the more recent outbreaks of the Severe Acute Respiratory Syndrome (SARS). He stated that national rate reductions, despite no changes to fixed costs, have also impacted the Alaska businesses. He spoke to the difficulty in keeping employees employed and the need to increase the fleet.

Mr. Park assured that he was willing to contribute to the State and to pay taxes, as he attributed this as a responsibility.

Mr. Parks noted the cruise industries are owned outside of the United States and although they pay port fees, they pay no State taxes. He asserted that the cruise industry earnings are spend by the companies and it employees out of State, in comparison to locally owned business in which the earnings are reinvested in Alaska.

Mr. Parks emphasized the burden on rental industries to collect the funds and process the taxes, reiterating that the companies are not reimbursed for the additional credit card transaction charges. He also pointed out that some computer systems do not account multiple taxes.

ANDREW HALCRO, President, Alaska Rental Car, testified via teleconference from offnet location about the 100 employees of the company located in nine communities in Alaska. He spoke to the economic development at the Ted Stevens Anchorage International Airport and reminded that three years prior the State authorized the sale of bonds to finance the \$230 million expansion. He relayed that the car rental industry was not included in this process and identified problems with the project. As a result, he stated that the car rental industry formed a consortium to design and propose the construction of a four-story parking garage with two stories occupied by rental companies and financed by the rental industry.

Mr. Halcro calculated a State tax coupled with existing taxes and fees would total 28 percent. He estimated the proposed parking garage would cost \$40 million and would require a customer facility charge of approximately \$3.50 per day for each rental agreement.

The market, he stressed could not support this combination and therefore the parking garage project would not be constructed. He warned that the consequence of not proceeding with the private parking facility would be the rental industry and customers would be "at the mercy of the State at an airport that is now \$150 million over budget and really no solution in sight."

Mr. Halcro also spoke to the fairness issue, telling the co-chair that a Fairbanks resident traveling to Anchorage and renting a car for one day would pay a 20 percent State tax, plus an 8 percent local tax. He compared this to a traveler from out of State renting an RV, impacting the parks, highways and other State infrastructure, and paying only three percent in tax. He suggested that if the intent is to generate revenue from those who impact roadways and the State's infrastructure, the proposed tax should be implemented equally to all vehicle rentals.

SFC 03 # 106, Side B 11:26 AM

Mr. Halcro contended that the RV industry concern the business would "bleed" to Canada is no different than his concern that business would be lost to taxi cabs, shuttle buses and car rentals located away from airports.

Mr. Halcro expressed he understood the State's fiscal gap and as a result the car rental industry should "take full responsibility and my customers to take full responsibility in getting the State on a straight and narrow." He stated that in the previous year, the car rental businesses located at the Ted Stevens Anchorage International Airport paid over \$3.7 million in direct taxes to the Department of Transportation and Public Facilities.

Mr. Halcro told of recent purchase of land in Fairbanks by his company off airport property and the intention to construct a state of the art service facility. He stated that a new tax would be factored into any capital investment decisions.

Senator Olson asked former State Representative Halcro's opinion on Amendment #2.

It was determined Mr. Halcro had disconnected from the teleconference network.

Senator Bunde speculated on Mr. Halcro's position surmising that, "seven percent is better than ten percent."

A roll call was taken on the motion to adopt Amendment #2.

IN FAVOR: Senator Olson, Senator Bunde and Senator Hoffman

OPPOSED: Senator B. Stevens, Senator Taylor, Co-Chair Green and Co-Chair Wilken

The motion FAILED (3-4)

The amendment FAILED to be adopted.

Amendment #3: This conceptual amendment limits authority to levy a tax on car rentals to the State; clarifying that airport authorities and municipalities are not authorized to impose such a tax.

Senator Taylor moved for adoption and stated that varying tax rates and user fees exist in Anchorage and Fairbanks and subsequently this legislation would impact communities differently. He clarified this amendment provides that municipalities would be precluded from imposing taxes and fees on car rental businesses.

Senator Taylor spoke to various taxes imposed on alcohol and the confusion it creates. He talked about different taxing entities that do not communicate with each other and the eventual situation whereby a business could no longer operate due to excessive taxation. He characterized this amendment as a policy call. He suggested that more revenue could be generated for the State and that in some communities the overall tax rate would be reduced.

Senator B. Stevens moved to amend the amendment to include cruise ship destinations.

It was established that the amendment includes all communities, local governments and taxing authorities.

Mr. Persily asked if this would abolish those existing taxes currently imposed by local governments and airport authorities or instead "freeze" the current taxes.

Senator Taylor answered that all taxes would be eliminated, thus granting the State sole authority to impose taxes on vehicle rentals.

Mr. Persily noted the Municipality of Anchorage would lose approximately \$4.5 million in revenues beginning at the effective date of this bill. He asked if the intent is to also eliminate airport concession fees paid to the Department of Transportation

and Public Facilities.

Senator Taylor responded that State-imposed fees would not be affected. He remarked that revenues collected by airport authorities are deposited to the State general fund, although the legislature always "chooses" to appropriate the funds to the authorities.

Co-Chair Wilken maintained his objection to the adoption of the amendment.

A roll call was taken on the motion.

IN FAVOR: Senator Taylor and Senator Hoffman

OPPOSED: Senator B. Stevens, Senator Bunde, Senator Olson, Co-Chair Green and Co-Chair Wilken

The motion FAILED (2-5)

The amendment FAILED to be adopted.

Senator Taylor offered a motion to report the bill from Committee with individual recommendations and new fiscal note.

There was no objection and CS HB 271 (FIN)(efd am) MOVED from Committee with a \$96,500 fiscal noted dated 5/20/03 from the Department of Revenue.

AT EASE 11:36 AM / 11:43 AM

#HB106

CS FOR HOUSE BILL NO. 106(JUD) am

"An Act relating to retail tariffing standards in a competitive local exchange service area; and to exemptions from retail tariff filing requirements and certain other provisions in competitive telecommunications markets; setting a policy regarding unbundled network elements in the telecommunications market; relating to depreciation expense rates for certain telecommunications utilities; requiring the Regulatory Commission of Alaska to conduct an investigation, take certain actions, withhold certain actions, and issue a report; and providing for an effective date."

This was the first hearing for this bill in the Senate Finance Committee.

Co-Chair Wilken stated that this bill, sponsored by the House Judiciary Committee, "provides for changes in telecommunications utility regulations and rates and policies regarding carrier interconnection agreements. In addition, the RCA [Regulatory Commission of Alaska] of Alaska is required to submit a report to the Legislature within 180 days regarding the status of the telecommunication industry in Alaska." He noted testimony and questions would be limited to 15 minutes per witness.

REPRESENTATIVE LESIL MCGUIRE, Chair, House Judiciary Committee, spoke to the three months of bipartisan work invested in this legislation by the House Labor and Commerce Committee, as well as the House Judiciary Committee. She admitted the limited time available for the Senate to consider the complexities of this substantive bill, but remarked that the Senate Finance Committee "must put a certain amount of trust in your colleagues" serving in the House of Representatives. She asserted this bill is "absolutely necessary in the State of Alaska right now to keep telecommunications industry competitive." She suggested she could realize political consequences for her actions with this legislation, but considered this to demonstrate her commitment to the issue. She stressed the Legislature's duty is to set policy.

Representative McGuire characterized the RCA as similar to the judicial branch, and as a "quasi judicial agency" is responsible for issuing rulings on issues. She understood it is difficult for the RCA to issue rulings because these rulings establish policy. She therefore concluded that the legislature must intervene and set policies. She surmised that the RCA could then interpret and implement those policies in the same manner as the Alaska Court System implements laws passed by the Legislature.

Representative McGuire stated that the federal Telecom Act of 1996 specifically recognized that each state is unique and must establish policies to implement the Act. She informed that she worked for U.S. Senator Ted Stevens at the time the Act was under consideration and she recalled the Senator expressing that the Act was not "crafted with Alaska in mind in any sense whatsoever." Despite this, she opined, "we have been able to apply the '96 Telecom Act to Alaska in a way that is remarkable." She asserted that Alaska has become one of the most competitive telecommunications market in the U.S.

Representative McGuire asserted that, whether because of time constraints or lack of resources, the RCA has "failed to act timely in recognition to the shifts that have occurred in the marketplace." She said this bill, therefore requests the RCA to

consider "certain policies" in regard to tariff filings and unbundled network elements, which she considered the two most important factors a monopoly must address.

Representative McGuire spoke of assurances in the bill's language to require that the RCA must make the initial determination that "the carrier is in a competitive marketplace". She stated that this bill further clarifies that "a competitive marketplace isn't just defined by the service area." She expressed concerns over potential allegations that "if over 50 percent of the entire service area is competitive, then therefore the company is competitive." She remarked this argument would be undesirable and exemplified the community of Kodiak as being competitive while Nome is not and the subsequent deregulation of the provider of the entire service area, allowing it to operate without regulatory oversight in areas for which there is no competition. Therefore, she pointed out language addresses this in subsection (d)(1) of Sec. 42.05.433. Exemption from retail tariffs for telecommunications services in a competitive market., in Section 2 of the bill, which reads as follows.

(1) "competitive service area" means an area served by a local exchange carrier in which at least 50 percent of all retail customers have a choice of facilities-based service providers; the area may be

(A) the entire service area; or

(B) if the entire service area is not competitive, specifically identified communities within the service area that are competitive;

Representative McGuire emphasized the entire service area could be encompassed in a competitive service area, and gave Anchorage as an example. She considered this provision as "giving the RCA an additional set of tools in their tool belt to make decisions." However, she asserted this legislation requests the RCA to utilize certain tools and make decisions that have not been addressed by the RCA.

Representative McGuire pointed out specific timelines are imposed in this bill. She opined that it would be in the best interest of all parties, especially to the consumer, to resolve the issues in a timely manner.

Representative McGuire told the Committee that representatives of companies would testify to how this legislation would or would not benefit them, but stressed that the consumers are priority. She predicted that if the existing situation continues, competition would be eliminated. She explained that one company with "virtually

an equal market share in certain areas of Alaska" could not be regulated as if it were a monopoly. She remarked that such a company "with its hands tied behind its back, fighting up against its closest competitor within percentage points, and expect that that company would continue to succeed; it is an impossibility economically and I think we all understand that."

Representative McGuire expected it to be determined that Anchorage, Juneau and Fairbanks would be deemed to be competitive markets under the provisions of this legislation. She stated that carriers operating in these markets would not be required to undergo a "tariff rate filing case" because it is not required of competitors. She commented that this is a "recognition of capitalism; of free market; of the invisible hand; this is Economics 101." She told of her college courses in economics.

Representative McGuire assured that if "elements" were later found to indicate that the free market system has not operated as intended with regard to this matter, this bill would allow the RCA to revisit the issue and make a different determination.

Representative McGuire next pointed out that the Telecom Act requested monopolies to lease out portions of their unbundled network elements; those portions necessary to allow competition in the marketplace. She noted this has continued in Alaska and has "worked magnificently; wonderful for all of us." However, she stated that the monopoly company is forced to lease out their facilities for less than their costs. She attributed this in part to project labor agreements and to Alaska's "unique landscape" and existing equipment. She stated that the cost in Fairbanks to the incumbent carrier is \$32, yet it can only charge the competitor \$19, resulting in a monthly loss of \$500,000.

Representative McGuire asserted she presents this bill not on behalf of any company or lobbyist or individual.

Senator Bunde understood that while this legislation would provide the RCA with "more tools" it also requires the Commission to utilize those tools.

Representative McGuire affirmed.

Senator Bunde spoke to the importance of an independent judiciary and warned that once the legislature begins to intervene in the policy of the RCA, the Commission is no longer an independent entity.

Representative McGuire replied that the RCA should be maintained as

a quasi-judicial body in that the legislature should not be setting rates or determining dominant carriers. However she asserted it is "absolutely appropriate" for the legislature to set policy for the RCA. She stated that evidence exists that the legislature has provided inadequate direction to the RCA.

Senator Taylor noted receipt of an e-mail from Commissioner Dave Harbour of the RCA to Senator Bunde dated May 20, 2003 [copy on file], indicating that because Co-Chair Wilken had excused himself from Committee action regarding other legislation relating to the RCA, due to a conflict of interest, Mr. Harbour assumed Co-Chair Wilken would do the same with respect to this bill.

Co-Chair Wilken clarified he has a conflict on interest with HB 111 due to his involvement with a regulated water and sewer utility; however, this legislation relates to telecommunications and he has no conflict.

LEONARD STENBERG, General Counsel, Alaska Communication Service, in support of the House Judiciary committee substitute for this bill. He expressed that if "Alaska is to remain on the forefront of telecommunication policy, passage of this bill is essential." He opined that Alaska has the most competitive local exchange market in the nation; however, State laws still reflect the "old era of monopoly regulation." He furthered that this bill would be an important "first step" in "modernizing State law in Alaska."

Mr. Stenberg stated that this bill addresses "two major deficiencies in Alaska policy; first, fully consistent with federal law, it provides policy guidance to State regulators that will ensure fair pricing of facilities leased by one carrier to another carrier; second, it delivers on the promises of the federal Telecommunications Act of 1996 by deregulating local exchange markets once they have become competitive."

Mr. Stenberg recommended passage of the bill.

Senator Bunde relayed he has received differing reports that ACS has substantial assets and is financially strong, but also that the company is near bankruptcy. He asked the witness to clarify the solvency of the company.

Mr. Stenberg replied that ACS is a multi-faceted business with the local exchange operations a significant portion. He stated that the local exchange business is largely regulated and this is the area of greatest concern. He noted that other operations of ACS are not regulated and the financial status of those functions is irrelevant to this discussion. He told of a recent analysis of the return on

investment of the regulated business activities in Anchorage and found "it is extremely low". He qualified that the RCA would determine otherwise; however, he cited the rate of return for Anchorage business at zero to two percent. He informed that this rate of return stymies incentive to invest for the future.

Senator B. Stevens referenced the definition of competitive service area in Section 2, which he identified as "the trigger for deregulation" and asked how the definition was determined.

Mr. Stenberg responded that the "appropriate measure" is the presence of "facilities-based competition".

Senator B. Stevens interjected if this definition exists in federal law, or is utilized by the Federal Communications Commission (FCC) and how "50 percent of customers" as a litmus, was reached.

Mr. Stenberg answered that the amount is not contained in federal law, but rather was considered, discussed and agreed upon by the House of Representatives.

Senator B. Stevens asked if the State of Illinois is the only state with an established percentage of customers used in determining a competitive marketplace.

Mr. Stenberg affirmed and remarked that Alaska is "on the forefront" of this matter, as no other state has experienced the same "levels of competition". He noted that other criterion was considered, including market share data, and an "anti-trust concept".

Co-Chair Wilken requested the witness comment on the correspondence from Mr. Harbour.

Mr. Stenberg respectfully disagreed with the positions expressed in the e-mail. He qualified that the amendments to Section 2 adopted by the House of Representatives "left some language unclear; there's probably some technical clean-up that could be done there". However, he opined that these would not "constitute any kind of a policy issue" and he concluded, is not important for the Committee to discuss.

Mr. Stenberg next addressed Mr. Harbour's concerns with the competitive service area, and remarked that the target areas of Anchorage, Juneau and Fairbanks are identified. He pointed out that facilities-based competition is available to "virtually all" consumers in those communities. He added that when the FCC "de-tariffed" interstate long distance rates, it "realized that it may

not be true that every consumer has access to facilities-based competitors"; however, the FCC concluded that it was in the best interest of the public in general that deregulation occur "in that context".

Mr. Stenberg spoke to Mr. Harbour's comments relating to pricing for unbundled network elements. Mr. Stenberg opined that unfortunately, this "complicated area of law" in which the federal government has "created the obligation" for carriers, such as ACS, to share their network. He noted the federal government has provided "some broad policy guidance" in terms of how to establish prices for those lease facilities and then has delegated to the states "a great deal of discretion" to set those prices. He stated that in the establishment of those prices, policy calls must be made. He disagreed that the policy guidance proposed in this legislation is "in any way inconsistent with federal law."

Mr. Stenberg explained "accelerated depreciation", stressing that the "regulation of rates for lease facilities is fundamentally different than traditional rate regulation." He opined that the intent of traditional rate regulation was to "recover costs plus be allowed a reasonable profit." He stated that in relation to lease facilities, the federal government has instructed states to "throw out everything we know about traditional rate regulation" and that regulators should instead be "attempting to emulate what a new company's costs would be if that new company were to go out and build an efficient new network." He surmised that such a new company would use accelerated depreciation in determining its internal economics. He remarked this is logical as well as "factually shown to be true," in that the chief competitor of ACS has utilized this method in facilities it has invested in. Therefore, he surmised that if the goal were to emulate the actions and costs of a new company, accelerated depreciation is "absolutely appropriate."

Mr. Stenberg furthered that when changing to a competitive environment from a monopoly situation, increased demands for innovation, investment as well as increased risks, arise. He gave an example of increased risks in that costs might not be recovered on some facilities. He cited this as another reason for allowing accelerated depreciation.

Senator Bunde, noting the highly specialized field of utility laws and asked if the witness was available for consultation during "creation" of this bill.

Mr. Stenberg replied that he testified "at some length" before a subcommittee to the House Labor and Commerce Committee, as well as

the House Judiciary Committee.

DANA TINDELL, Senior Vice President, Legal and Regulatory Affairs, General Communications Incorporated testified in opposition to the bill, as it is "anti-competitive and anti-consumer". She continued reading a statement into the record as follows.

It is bad public policy done at that eleventh hour and should not be passed. CS HB 106 promised local telephone companies with monopoly power to raise rates whether or not there is competition. Moreover, CS HB 106 permits local telephone companies with monopoly power to raise its competitors' costs, thus [inaudible] any ability of competition to keep rates down where there is competition. In a market where one competitor controls another competitor's costs, you cannot have true competition.

In addition, this bill, as a result of last minute floor amendments, is internally inconsistent and it is not clear in its intent. It is difficult to tell what the Legislature's intent is because it has been cut and pasted with words of previous sections left in the bill that are inconsistent with amendments that have been made on the floor in the House.

Without exception, legislators that rose on the House floor to speak on this bill discussed the complexity of these issues. This bill changes the way utilities are regulated. It doesn't give intent language; it actually changes the way utilities are regulated. There are serious public policy issues at state. Please do not move a bill that changes the way utilities are regulated without serious thought. This is a complex bill. It reverses past RCA decisions. It effects pending decisions now before the RCA and in our view will diminish local telephone competition in the marketplace.

The Governor has just appointed three new commissioners to the RCA. There are a total of five commissioners to the RCA, which means that that is a 60 percent turnover. The RCA is in the middle of a proceeding to deregulate the competitive markets for local services. They have not completed that proceeding. Both ACS and GCI have filed pleadings in that proceeding.

Please allow the RCA to do its work. It is an evidentiary body; it can engage in discovery; it can get the actual facts on the record. With the new RCA and no possibility of bias, GCI requests the Legislature to permit the RCA, as the expert body, to make these decisions.

Ms. Tindell addressed the issue of low costs, referencing discussion that GCI leases "loops" from ACS at \$19, whereas ACS costs are between \$33 and \$40. She remarked, "That is an apples to oranges comparison," explaining ACS reference to "loop costs as an accounting purpose" their loop costs consists of the "length of facilities from the switch to the home". She informed that GCI does not lease that entire facility, but rather the portion from "the neighborhood to the home." She stated that GCI provides its own "fiber" around the community and throughout the city and also provides its own "switch". She listed GCI costs at approximately \$33 for the "same comparison of what ACS is representing their costs to be."

Ms. Tindell furthered that depreciation is also an "apples to oranges comparison". She explained, "a rate based regulated company that's rates are set. The overwhelming determination of those rates is 'what percentage of the plant in the ground do they get to allocate to the consumer for the purpose of setting consumer prices.'" She characterized this as an allocation cost rather than a depreciation cost, which "is a totally separate phenomena than depreciation for tax purposes." She stated that depreciation for tax purposes does not affect "the price that a company gets to charge for consumers; it is simply a tax issue that determines the amount of taxes that company will pay that year. In contrast, she said depreciation for ratemaking purposes "directly gets plugged through to the consumer."

Ms. Tindell expressed that this bill would "deregulate local telephone companies with monopoly throughout their entire service area in many cases where there is not competition, for the purposes of depreciation." She informed this would allow the companies to "automatically increase the rates they charge, whether or not there's competition."

Ms. Tindell furthered that this bill would allow a company to deregulate in areas where no competition exists. She suggested the provisions are unclear as to "which direction the RCA is supposed to go."

Ms. Tindell spoke to the inconsistencies of the bill, referencing page 2, lines 6 - 13, a portion of Section 2, which adds new sections to AS 42.05, and reads as follows.

Sec. 42.05.433. Exemption from retail tariffs for telecommunications services in a competitive market. (a) A local exchange carrier may petition the commission for a determination that one or more of its markets is a competitive services area. The commission shall, within 90 days, grant or

reject the petition according to the standard set forth in this section. If the commission fails to act within 90 days after the submission of such a petition, the petition shall be deemed granted. A certification exempts the telecommunications utility from retail tariff filing requirements.

...

Ms. Tindell pointed out the origin and issuing authority of the aforementioned certification is not specified. She continued citing subsection (b) on lines 14 - 17, which reads as follows.

(b) A certification filed under (a) of this section is effective upon filing. The commission may deny a certification only upon a written finding and order that, based on a preponderance of the evidence, the competitive service area standard has not been met.

Ms. Tindell questioned the establishment of both a petition and certification and the 90-day effective date provision of the petition compared to the immediate effective date of a certification filing.

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Ms. Tindell referenced Section 1 and commented that "in order to get competition using [an existing] carrier's network for a rural area, there must be a finding that it will not affect universal service or rates to that rural area." She opined that it would be "difficult if not impossible" to meet that finding.

Ms. Tindell indicated other representatives of GCI were available to speak to the incompilance of this bill with federal law.

AT EASE 12:22 PM / 12:28 PM

Senator Taylor asked for an explanation of the differences between "bundled" and "unbundled".

Ms. Tindell informed of the separate issues of "bundled packages" and "unbundled elements". She explained that under commission regulation, a dominant carrier with monopoly power is not permitted to bundle its local services market with other offerings because the regulation presumes that this carrier has all the customers for the local service and that it would be unfair to provide that carrier with "a leg up" in attracting those customers to other

services for which competition exists. She qualified that the RCA granted provisions to allow the dominate carrier to request exemption.

Ms. Tindell then defined unbundled elements as "a notion of carrier to carrier costs", explaining this relates to a competitive carrier entering the market and leasing the existing carrier's network in order to provide service. Because the existing carrier has a "bottleneck facility" and has monopoly control over that facility, she stated that the U.S. Congress has ruled that the network facilities should be "broken down into its smallest elements possible" to allow a competitive carrier to lease only the elements necessary to provide service.

Senator Taylor thanked the witness for the explanation.

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**ADJOURNMENT**

Co-Chair Gary Wilken adjourned the meeting at 12:30 PM