HB

111

(File 3 of 5)

Docket R-03-3

Materials Submitted by the Regulatory Commission of Alaska to the House Judiciary Committee, regarding Implementation of Section 2, Chapter 93, SLA 2003

December 17, 2003

R-03-3
VOLUME 1 of 2

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STATE OF ALASKA

THE REGULATORY COMMISSION OF ALASKA

Before Commissioners: Dave Harbour, Chair
Kate Giard
Mark K. Johnson
James S. Strandberg
G. Nanette Thompson

In the Matter of the Commission Review of Rules and Regulations Governing Telecommunications Rates, Charges Between Competing Telecommunications Companies, and Competition in Telecommunications	R-03-3 ORDER NO. 1

ORDER ISSUING NOTICE OF INQUIRY, OPENING DOCKET TO CONSIDER AMENDING REGULATIONS AND TELECOMMUNICATIONS POLICIES, ESTABLISHING FILING AND HEARING SCHEDULE, AND APPOINTING HEARING EXAMINER

BY THE COMMISSION:

Summary

In response to recently enacted legislation, we open Docket R-03-3 to review and obtain comment on modifications to our telecommunications regulations.[1] We set a procedural schedule for initial and reply comments and set a hearing to address issues related to Docket R-03-3. We appoint Paul Olson as the hearing examiner in this proceeding.

Background

The legislature has enacted legislation requiring that we thoroughly review our rules and regulations governing telecommunications rates, charges between

[1] *See* CSHB 111(JUD) am. A copy of CSHB 111(JUD) am is attached as an appendix.

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competing telecommunications companies, and competition in telecommunications. The review must be guided by the following principles:

- the public shall be protected
- the rates charged to the public shall be fair
- the incumbent carrier may not be placed at an unfair competitive disadvantage
- businesses that provide local and long distance telecommunications services shall be treated as fairly as possible
- competition among telecommunications companies shall be encouraged
- the development of a modern telecommunications infrastructure in the state shall be encouraged
- it is desirable to promote competition and to take steps, if fair to the public, to encourage more, rather than fewer, businesses to enter and remain in the telecommunications business in the state.

The proposed regulations required by this legislation must include provisions to implement the following nine policies:

- there shall be fair payment by a user carrier for the use of another carrier's equipment and facilities, including existing and newly constructed equipment and facilities
- in determining whether a carrier is the dominant carrier for the purposes of setting rates, it is not relevant that the carrier in a competitive market is the incumbent carrier
- all telecommunications carriers may unilaterally reduce consumer rates, subject to state and federal antitrust laws
- a definition of "competitive service area" shall take into account whether actual competition exists in an area

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- any method of depreciation used by the commission shall consider the actual useful life of depreciated equipment and facilities
- when the commission approves a carrier's application for a certificate to provide competitive local exchange telecommunications service in an incumbent local exchange carrier's service area, in areas where the commission has determined there is competition among carriers, the incumbent local exchange carrier shall be subject to the same retail tariffing standards and regulations as the new carrier, but the incumbent local exchange carrier remains the carrier of last resort in the relevant area until the commission orders otherwise
- the use of fill factors shall consider the application of the fill factors in setting unbundled network element rates
- in areas where significant competition exists between carriers, competitors shall be allowed to increase rates under the same rules
- the commission may deny any rate increase to protect the public.

We open this docket in order to comply with the legislature's directives.

Discussion

As part of our regulatory review, the Legislature has specifically identified nine policies for which we must propose regulations. We seek comment on how to best implement each of the nine legislative policies identified above (that is, to the extent a particular policy requires further implementation). Commentors are encouraged to submit proposed regulations language as to each of the nine legislative policies and the rationale supporting each proposal. In recognition that the Legislature has asked us to address specific policies that are, in many cases, distinct from one another, commentors are urged to avoid proposed regulations language which unnecessarily combines or intertwines responses on the nine policies.

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To the extent that commentors believe that we should address other relevant issues pertaining to our rules governing telecommunications rates, charges between competing telecommunications companies, and competition in telecommunications, they are invited to submit comments on those issues along with proposed regulations language that is specific to those issues. Commentors should identify the specific policy, identify the corresponding regulations section, explain the policy change required and where, possible, provide regulations language revisions.

In making such submissions, commentors should understand that our efforts in this proceeding will be primarily focused on responding to the legislative policy mandates. Commentors should therefore recognize that an increased burden of persuasion will be necessary to convince us to take action regarding any additional relevant issues, including those pending in currently open dockets.

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The Legislature did not intend that our policy review should duplicate work already underway in pending regulations dockets.[2] We therefore urge commentors to avoid addressing issues already presented in the open dockets listed below

Docket	Issue	Relevant Regulation(s)
R-97-7	Directory Assistance	3 AAC 53.610-660
R-00-2	Access Charges Schedule	Article 700 of the Access Charge Manual
R-00-6	Changes in Customer Preference	3 AAC 52.333-336
R-01-1	Access Charges	3 AAC 48.440
R-01-2	Service Bundling	N/A
R-02-5	Uniform System of Accounts	3 AAC 48.277
R-02-6	Competitive Local Exchange Service	3 AAC 53.200-299

To the extent a commentor believes our review should address an issue or regulation already under review in one of the open dockets listed above, the commentor should clearly explain why our legislative mandate requires a reassessment of our ongoing review. If a reassessment is believed necessary, a summary of the participant's previous comments and a reference to those comments is requested and would assist us in evaluating the issues presented in this Order.

We recognize that our review and ultimate decisions in this docket may be affected by actions of the Federal Communications Commission (FCC) and Congress. Currently, the FCC is developing policies regarding interconnection and unbundled network elements as part of its *Triennial Review* process. Members of Congress have

[2]Section 2, *Review of Telecommunications Regulations*, at part (c), states that the "review required by (a) of this section does not apply to current open dockets pending review."

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indicated their intent to consider reforms to the federal universal service program and other telecommunications policies. To the extent parties believe that meeting the directives of the Legislature requires changes to federal laws and policies, such positions could be presented in this docket. We reiterate, however, that our efforts will primarily be focused on the legislative mandate and that an increased burden of persuasion will be necessary to convince us to act on any additional relevant issues.

Procedural Schedule

Comments in response to this Order are to be submitted in this docket and must be filed by 4 p.m., July 16, 2003. Reply comments must be filed by 4 p.m., August 13, 2003. We request that commentors include a diskette with their comments in either IBM compatible text (.txt) or Word (.doc) format, or in Adobe Acrobat (.pdf) format.

Since this is a rulemaking proceeding, commentors are not required to serve their comments on the other entities set out on the service list of this Order. We will post copies of all filed comments on our web site.

Hearing & Hearing Examiner

The Chair believes the appointment of a Hearing Examiner in this matter is appropriate.[3] The Hearing Examiner will have the powers and follow the procedures described in AS 42.05.171 and 3 AAC 48.165. Accordingly, the Chair appoints Paul Olson as the Hearing Examiner in this proceeding.

We will convene a public hearing to further evaluate the issues of Docket R-03-3. Public hearings will be held beginning September 2, 2003 through September 4, 2003, if necessary.

[3] *See* AS 42.04.070.

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A party may appear telephonically for the public hearing. Any parties wishing to appear telephonically must so advise us in writing by the deadline established in this Order and provide a telephone number where they may be reached for that appearance. We will bear the costs associated with the telephonic appearance of a party.

ORDER

THE COMMISSION FURTHER ORDERS:

1. Docket R-03-3 is opened to investigate the issues further identified in the body of this Order.

2. By 4 p.m., July 16, 2003, any interested person, including the Public Advocacy Staff or its successor, may file comments in response to this Order. Commentors are requested to include a diskette with their comments in either IBM compatible text (.txt) or Word (.doc) format, or in Adobe Acrobat (.pdf) format.

3. By 4 p.m., August 13, 2003, any interested person, including the Public Advocacy Staff or its successor, may file comments with the Commission in reply to those filed in response to Ordering Paragraph No. 2 of this Order. Commentors are requested to include a diskette of the reply comments in either IBM compatible text (.txt) or Word (.doc) format, or in Adobe Acrobat (.pdf) format.

4. Paul Olson is appointed to serve as a Hearing Examiner in this Docket.

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5. A public hearing[4] shall convene at 9:00 a.m., September 2, 2003,[5] in the East Hearing Room of the Commission's offices at 701 West Eighth Avenue, Suite 300, Anchorage, Alaska, and continuing thereafter, as necessary, through September 4, 2003.

DATED AND EFFECTIVE at Anchorage, Alaska, this 11th day of June, 2003.

BY DIRECTION OF THE COMMISSION

(S E A L)

[4]If you are a person with a disability who may need a special accommodation, auxiliary aid, or service or alternative communication format in order to participate in this hearing, please contact Grace Salazar at 1-907-263-2107 or TTY 1-907-276-4533 at least one week before the hearing to make the necessary arrangements.

[5]Any party wishing to appear telephonically at the hearing must advise us, in writing, by 4 p.m., August 27, 2003, and provide a telephone number where it may be reached for that appearance.

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NOTICE OF INQUIRY BY THE REGULATORY COMMISSION OF ALASKA

The Regulatory Commission of Alaska seeks comments on modifications to our telecommunications regulations. The legislature has enacted legislation requiring that we thoroughly review our rules and regulations governing telecommunications rates, charges between competing telecommunications companies, and competition in telecommunications.[1] The review must be guided by the following principles:

- the public shall be protected
- the rates charged to the public shall be fair
- the incumbent carrier may not be placed at an unfair competitive disadvantage
- businesses that provide local and long distance telecommunications services shall be treated as fairly as possible
- competition among telecommunications companies shall be encouraged
- the development of a modern telecommunications infrastructure in the state shall be encouraged
- it is desirable to promote competition and to take steps, if fair to the public, to encourage more, rather than fewer, businesses to enter and remain in the telecommunications business in the state.

The proposed regulations required by this legislation must include provisions to implement the following nine policies:

- there shall be fair payment by a user carrier for the use of another carrier's equipment and facilities, including existing and newly constructed equipment and facilities

[1] See CSHB 111(JUD) am.

- in determining whether a carrier is the dominant carrier for the purposes of setting rates, it is not relevant that the carrier in a competitive market is the incumbent carrier
- all telecommunications carriers may unilaterally reduce consumer rates, subject to state and federal antitrust laws
- a definition of "competitive service area" shall take into account whether actual competition exists in an area
- any method of depreciation used by the commission shall consider the actual useful life of depreciated equipment and facilities
- when the commission approves a carrier's application for a certificate to provide competitive local exchange telecommunications service in an incumbent local exchange carrier's service area, in areas where the commission has determined there is competition among carriers, the incumbent local exchange carrier shall be subject to the same retail tariffing standards and regulations as the new carrier, but the incumbent local exchange carrier remains the carrier of last resort in the relevant area until the commission orders otherwise
- the use of fill factors shall consider the application of the fill factors in setting unbundled network element rates
- in areas where significant competition exists between carriers, competitors shall be allowed to increase rates under the same rules
- the commission may deny any rate increase to protect the public.

We seek comment on how to best implement each of the nine legislative policies identified above (that is, to the extent a particular policy requires further implementation). Commentors are encouraged to submit proposed regulations

language as to each of the nine legislative policies and the rationale supporting each proposal. In recognition that the Legislature has asked us to address specific policies that are, in many cases, distinct from one another, commentors are urged to avoid proposed regulations language which unnecessarily combines or intertwines responses on the nine policies.

To the extent that commentors believe that we should address other relevant issues pertaining to our rules governing telecommunications rates, charges between competing telecommunications companies, and competition in telecommunications, they are invited to submit comments on those issues along with proposed regulations language that is specific to those issues.

In making such submissions, commentors should understand that our efforts in this proceeding will be primarily focused on responding to the legislative policy mandates. Commentors should therefore recognize that an increased burden of persuasion will be necessary to convince us to take action regarding any additional relevant issues, including those pending in currently open dockets.

The Legislature did not intend that our policy review should duplicate work already underway in pending regulations dockets.[2] We therefore urge commentors to avoid addressing issues already presented in the open dockets listed below

Docket	Issue	Relevant Regulation(s)
R-97-7	Directory Assistance	3 AAC 53.610-660
R-00-2	Access Charges Schedule	Article 700 of the Access Charge Manual

[2]CSHB 111(JUD) am, Section 2, *Review of Telecommunications Regulations*, at part (c), states that the "review required by (a) of this section does not apply to current open dockets pending review."

R-00-6	Changes in Customer Preference	3 AAC 52.333-336
R-01-1	Access Charges	3 AAC 48.440
R-01-2	Service Bundling	N/A
R-02-5	Uniform System of Accounts	3 AAC 48.277
R-02-6	Competitive Local Exchange Service	3 AAC 53.200-299

To the extent a commentor believes our review should address an issue or regulation already under review in one of the open dockets listed above, the commentor should clearly explain why our legislative mandate requires a reassessment of our ongoing review. If a reassessment is believed necessary, a summary of the participant's previous comments and a reference to those comments is requested and would assist us in evaluating the issues presented in this Order.

Any interested person may present comments relevant to this Notice by writing to the Regulatory Commission of Alaska, 701 West Eighth Avenue, Suite 300, Anchorage, Alaska 99501. Comments must be filed with the Commission by 4 p.m., July 16, 2003. Reply comments must be filed by 4 p.m., August 13, 2003. Commentors should reference Docket R-03-3 in their filings.[3] The Commission also requests that, if possible, each commenter file a diskette of the comments in IBM compatible text (.txt) format, MS Word (.doc) format or Adobe Acrobat (.pdf) format.

Since this is a rulemaking proceeding, commentors are not required to serve comments on the other entities set out on the service list of this Notice.

[3]If you are not interested in receiving future orders or notices concerning this subject matter, please e-mail rca@state.ak.us or notify our office by mail or at 1-907-276-6222, and we will take your name off our mailing list.

Interested persons may request copies of the comments filed in the proceeding from the Commission's Records and Filing Section at the address set out above. We will post copies of all filed comments on our web site.

Public hearings to receive oral comments in this proceeding will be held at 9:00 a.m., September 2, 2003 and continue, as necessary, through September 4, 2003.[4]

If you are a person with a disability who may need a special accommodation, auxiliary aid, or service or alternative communication format in order to participate in the process relevant to this Notice, please contact Grace Salazar at 1-907-263-2107 or TTY 1-907-276-4533 to make any necessary arrangements.

DATED at Anchorage, this 11th day of June, 2003.

REGULATORY COMMISSION OF ALASKA

Dave Harbour, Chair

[4]Any party wishing to appear telephonically at the hearing must advise us, in writing, by 4 p.m., August 27, 2003, and provide a telephone number where it may be reached for that appearance.

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STATE OF ALASKA

THE REGULATORY COMMISSION OF ALASKA

Before Commissioners: Mark K. Johnson, Chair
Kate Giard
Dave Harbour
James S. Strandberg
G. Nanette Thompson

In the Matter of the Consideration of Revision to the Regulations Governing the Competitive Local Exchange Market in Alaska	R-02-6 ORDER NO. 4
In the Matter of the Commission Review of Rules and Regulations Governing Telecommunications Rates, Charges Between Competing Telecommunications Companies, and Competition in Telecommunications	R-03-3 ORDER NO. 2

ORDER ISSUING PROPOSED REGULATIONS FOR COMMENT AND ESTABLISHING FILING SCHEDULE

BY THE COMMISSION:

Summary

We issue proposed regulations covering a wide scope of telecommunications policies for public comment. We require comments to be filed by January 13, 2004, with reply comments due February 12, 2004.

Background

We opened Docket R-03-3 to review our telecommunications regulations in response to recently enacted legislation.[1] We were directed to thoroughly review our rules and regulations governing telecommunications rates, charges between competing

[1] *See* ch. 93, SLA 2003, effective June 14, 2003.

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telecommunications companies, and telecommunications competition policies. We issued a Notice of Inquiry[2] to receive comments by July 16, 2003, and reply comments by August 13, 2003. So as not to duplicate work already underway in pending regulations dockets,[3] we urged commenters to avoid addressing issues already presented to us in other proceedings. We also scheduled a public hearing.

We received extensive comments and reply comments. We further reviewed the numerous comments received in Docket R-02-6 where many of the same issues were being addressed. We received numerous proposals from industry on how to revise our telecommunications regulations and implement the policies and principles of ch. 93, SLA 2003. Industry comment was extensive, but public comment on these matters was minimal.

We held public hearings on September 2, 3, and 4, 2003. On October 15, 2003, the Commission Staff (Staff) provided a lengthy and detailed report outlining the policy options presented to us in addition to recommendations regarding Dockets R-02-6, R-03-3, and R-01-2.[4] We found the bundling issues in Docket R-01-2 outside the scope of Docket R-03-3.

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[2]Order R-03-3(1), *Order Issuing Notice of Inquiry, Opening Docket to Consider Amending Regulations and Telecommunications Policies, Establishing Filing and Hearing Schedule, and Appointing Hearing Examiner*, issued June 11, 2003.

[3]Sec. 2 (c), ch. 93, SLA 2003.

[4]Docket R-01-2 is titled *In the Matter of Whether Interexchange Carriers Operating in the Anchorage Market Should be Allowed To Sell Interexchange and Local Services as a Bundle.*

We held public meetings on October 22, 29, and 31, 2003 to consider issues and to develop draft regulations for public notice in Dockets R-02-6 and R-03-3.

Discussion

To develop the attached proposed regulations, we balanced our existing statutory obligations, the policies and principles of ch. 93, SLA 2003, the public interest, and the conflicting advice and positions of the various entities that responded to our request for comment. We believe that our proposed regulations reasonably address and comply with the recent legislative intent of ch. 93, SLA 2003.

We issue the attached proposed regulations for public comment.[5] Given the scope and complexity of the issues raised, we will provide a longer than normal opportunity to provide comments.

Depreciation

We request that commenters on proposed 3 AAC 48.425 concerning depreciation also address the following questions:

a) Should the Commission place any form of threshold on the maximum annual change in depreciation expense that may occur as a result of using depreciation life and net salvage tables?

b) Should the Commission require any form of phase-in to depreciation expense changes allowed under the table approach? For example, should there be

[5]Sec. 2(a), ch. 93, SLA 2003, states, in part:

As part of this review, the commission shall hold public hearings and shall issue proposed regulations not later than November 15, 2003.

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provisions to amortize abrupt changes in depreciation expense or some other provisions to allow phase-in?

c) What time period between depreciation filings should we allow for a carrier that employs the depreciation table approach?

Consumer Reports

We request that commenters on proposed 3 AAC 53.235 concerning rate deregulation also address the following questions:

a) Is there a better method than that proposed for disseminating consumer complaint report information to the Commission and to the public?

b) What media (e.g., print, Internet, both) should be used to present consumer complaint information?

c) Should the reports be filed monthly or another cycle?

Interexchange Carrier of Last Resort Issues

We request that commenters on proposed 3 AAC 52.390 concerning interexchange carrier of last resort policies also address the following questions:

a) Should there be a threshold market percentage after which mandatory carrier of last resort sharing should occur?

b) If so, what threshold should be employed and how should carrier of last resort responsibilities change once the threshold is reached?

c) Should sharing of carrier of last resort responsibilities apply to existing facilities, new facilities, or both?

d) Should carrier of last resort responsibilities be assigned on a service area or some other basis?

e) Should carrier of last resort responsibilities be shared throughout a service area when parts of the service area remain under monopoly control?

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f) If carrier of last resort sharing is allowed, how often should the Commission reevaluate carrier of last resort assignments?

Eligible Telecommunications Carrier Issues

Through Docket R-03-3, the Rural Coalition[6] advanced a proposal asking that we implement specific policies concerning eligible telecommunications carriers (ETCs). Others argued that the Rural Coalition's proposal was inconsistent with federal requirements or that we should not act on the proposal through Docket R-03-3.

We concluded that we should not now propose draft ETC regulations. Our efforts in Docket R-03-3 must be primarily focused on responding to the mandates of ch. 93, SLA 2003. We were not persuaded to act on additional issues in this docket. Docket R-03-3 already covers a broad scope of issues.

The Federal Communications Commission (FCC) and the Universal Service Joint Board are currently in the process of revising federal policies that are likely to provide further guidance in this area. We choose to defer considering a state specific ETC policy until after national policies are clarified.

Interconnection Issues

We also received extensive comments on proposed regulation changes affecting the wholesale markets and unbundled network element issues. Commenters argued that the proposals we received were directly contrary to either the Telecommunications Act of 1996[7] or existing federal requirements.

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[6]The Rural Coalition is comprised of the following: Bristol Bay Telephone Cooperative, Inc.; Bush-Tell, Inc.; Copper Valley Telephone Cooperative, Inc.; Interior Telephone Company, Inc.; City of Ketchikan d/b/a Ketchikan Public Utilities; Matanuska Telephone Association, Inc.; Mukluk Telephone Company, Inc.; Nushagak Electric and Telephone Cooperative, Inc.; OTZ Telephone Cooperative, Inc.; Summit Telephone Company, Inc.; United-KUC, Inc.; and United Utilities, Inc.

[7]1996 Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) amending the Communications Act of 1934, 47 U.S.C. §§ 151 *et seq.*

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We do not believe interconnection pricing regulations are an appropriate part of this docket. The proposals filed are not fully consistent with federal mandates. Releasing a proposal simply stating that we would follow federal mandates quoting the provisions of ch. 93, SLA 2003 would not alter our current practice and may create confusion in light of the continually evolving nature of controlling federal law on this issue.

To respond to concerns that existing federal polices may be unreasonable, we opened Docket R-03-4[8] and requested comment on whether we should petition the FCC for relief from certain federal interconnection requirements.[9] We will review the comments filed in Docket R-03-4 and consider requesting exemption from federal requirements.

After the enactment of ch. 93, SLA 2003, the FCC released the Triennial Review Order[10] reducing unbundled network element (UNE) pricing obligations placed on incumbent local carriers except where such obligations were necessary and their absence would impair competitors.[11] Under the Triennial Review Order, the states were provided an opportunity to reach certain impairment decisions. We held a public

[8]Docket R-03-4 is titled *In the Matter of the Consideration of a Petition to the Federal Communications Commission Seeking Forbearance of the Pricing Standard for Establishing Unbundled Network Element Interconnection Rates between Incumbent Local Exchange Carriers and Certain Competitive Local Exchange Carriers.*

[9]Order R-03-4(1), *Order Seeking Comment on Whether to Petition for Waiver from the Requirement to Price Unbundled Network Elements on the Basis of Total Element Long Run Incremental Cost in Competitive Markets*, issued August 12, 2003.

[10]CC Docket No. 01-338, CC Docket No. 96-98, CC Docket No. 98-147, *Report and Order and Order on Remand and Further Notice of Proposed Rulemaking* (Triennial Review Order), FCC 03-36, released August 21, 2003.

[11]47 U.S.C. 251(d)(2)(A) and (B) for the federal requirements concerning "necessary" and "impair".

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meeting on November 12, 2003 to identify issues and plan to release an order soon explaining how we will meet our obligations under the Triennial Review Order.[12]

Rate Reductions

The legislature directed us to allow telecommunications carriers to unilaterally reduce consumer rates subject to state and federal antitrust laws.[13] We must read this policy directive in conjunction with existing statutory requirements that may also affect rate reductions.

We propose 3 AAC 48.315 allowing all telecommunications carriers to implement rate reductions after public notice and without our approval. Only in the situation where a rate reduction would violate an existing statutory requirement, would we investigate. The state and federal antitrust law concepts address the same policies and public interest considerations incorporated within our existing statutory requirements. Therefore, we do not mention them in the proposed regulations.

Other Issues

We did not provide proposed regulations on all of the issues suggested by the commenters in Docket R-03-3. We find that these "other issues" are not fully developed in our record. We may, in the future, explore these issues, but our goal in Docket R-03-3 was to concentrate our effort on tasks directly related to the mandate of

[12] *See* Docket R-03-7 titled *In the Matter of the New Requirements of 47 C.F.R. § 51 Related to the Federal Communication Commission Triennial Review Order on Interconnection Provisions and Policies.*

[13] Sec. 2 (e)(3), ch. 93, SLA 2003.

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ch. 93, SLA 2003. The attached proposed regulations achieve that goal.

Procedural Schedule

Comments in response to this Order and the attached draft regulations must be filed by 4 p.m., January 13, 2004. Reply comments must be filed by 4 p.m., February 12, 2004. We request that commenters include a diskette with their comments in either IBM compatible text (.txt) or MS Word (.doc) format, or in Adobe Acrobat (.pdf) format.

Since this is a rulemaking proceeding, commenters are not required to serve their comments on the other entities set out on the service list of this Order. We will post copies of all filed comments on our web site.

ORDER

THE COMMISSION FURTHER ORDERS:

1. The proposed regulations set out in Appendix A to this Order are issued for public comment.[14]

2. By 4 p.m., January 13, 2004, any interested person, may file comments in response to the proposed regulations attached as Appendix A to this Order. Commentors are requested to reference Dockets R-02-6/R-03-3 and include a diskette with their comments in either IBM compatible text (.txt) or MS Word (.doc) format, or in Adobe Acrobat (.pdf) format.

[14]If you are not interested in receiving future orders or notices concerning this subject matter, please e-mail rca@state.ak.us or notify our office by mail or at 1-907-276-6222 and we will take your name off our mailing list.

Regulatory Commission of Alaska
701 West Eighth Avenue, Suite 300
Anchorage, Alaska 99501
(907) 276-6222; TTY (907) 276-4533

3. By 4 p.m., February 12, 2004, any interested person, may file comments in reply to those filed in response to Ordering Paragraph No. 2 of this Order. Commentors are requested to include a diskette of the reply comments in either IBM compatible text (.txt) or MS Word (.doc) format, or in Adobe Acrobat (.pdf) format.

DATED AND EFFECTIVE at Anchorage, Alaska, this 14th day of November, 2003.

BY DIRECTION OF THE COMMISSION

(S E A L)

Regulatory Commission of Alaska
701 West Eighth Avenue, Suite 300
Anchorage, Alaska 99501
(907) 276-6222; TTY (907) 276-4533

Chapter 4[illegible], Practice and Procedure.

Article 2. Utility and Pipeline Tariffs.

Section

200. Scope of regulations
210. (Repealed)
220. Filing of tariff
230. Billing and contract forms
240. Delivery of tariff
250. Tariff on file for public inspection
260. Public notice of utility tariff inspection privilege
270. Advice letters
275. Supporting information
277. Uniform system of accounts
280. Notice and effective date
290. Response to notice
300. Waiver of statutory notice
310. Suspension and rejection of tariff filings
315. Telecommunications carrier rate reductions
320. Effective tariff controlling
330. Format of tariff sheets
340. Tariff sheet designation
350. Separate tariff for each utility
360. General arrangement and content of tariff
370. Content of rules and regulations
380. Content of rate schedules
390. Provisions of special contract
400. Adoption notice
410. Tariff of acquired utility or pipeline carrier
420. Uniform deposit practices
425. Depreciation
430. Jurisdictional separations
440. Rates for interexchange access
442. Delayed implementation of regulatory provisions relating to DEM weighting

3 AAC 48 is amended by adding a new section to read:

3 AAC 48.315. Telecommunications carrier rate reductions. (a) A telecommunications carrier may reduce a retail rate without approval of the commission after notice of a tariff filing submitted in accordance with applicable filing requirements and notice procedures.

(b) Notwithstanding (a) of this section, the commission will disapprove and require modification of a rate decrease that violates an existing statutory requirement, including those concerning undue discrimination and provisioning of just and reasonable rates. (Eff. _____/_____/_____, Register _____)

Authority: AS 42.05.141 AS 42.05.411 AS 42.05.431
AS 42.05.151 AS 42.05.421 AS 42.05.711
AS 42.05.381

3 AAC 48 is amended by adding a new section to read:

3 AAC 48.425. Depreciation. (a) A local exchange carrier may employ depreciation projection lives and net salvage levels from within the approved ranges developed by the commission for any or all of its property accounts for purposes of developing intrastate depreciation rates. Depreciation rates developed using the approved ranges must be submitted for commission approval.

(b) A local exchange carrier requesting a depreciation projection life or net salvage level not included in the approved ranges established in (a) of this section must obtain commission approval.

(c) The actual useful life of depreciated equipment and facilities must be considered in the development of depreciation rates.

(d) When proposing depreciation rates, a local exchange carrier shall have the burden of proof to show that its proposed depreciation or amortization expenses are just and reasonable, in accordance with AS 42.05.471, and in accordance with sound accounting and economic principles. (Eff. _____/_____/_____, Register _____)

Authority: AS 42.05.141 AS 42.05.411 AS 42.05.431
AS 42.05.151 AS 42.05.421 AS 42.05.471
AS 42.05.381

Chapter 52. Operation of Public Utilities.

Article 4. Criteria for Intrastate Interexchange Telephone Competition.

Section
350. Applicability, finding, purpose, and waiver
355. (Repealed)
358. Registration
360. Certificates of public convenience and necessity
361. (Repealed)
363. Determination of dominant status
365. Discontinuance, suspension, or abandonment of service
367. Online tariff of registered entities
370. Retail rates
375. Wholesale service and rates
376. Promotions
377. Detariffing of prepaid calling card services
380. Reporting, verification, and auditing requirements
385. Standards of service
390. Miscellaneous provisions
399. Definitions

3 AAC 52.363 is repealed and readopted to read:

3 AAC 52.363. Determination of dominant status. The commission will designate or change the designation of an interexchange carrier as dominant or nondominant under the following factors:

(1) any interexchange carrier with 60 percent or more of the statewide message telephone service market shall be considered a dominant carrier in the message telephone service market;

(2) any carrier with less than 60 percent of the statewide message telephone service market may be designated as a nondominant carrier in the message telephone service market;

(3) for all other services, an interexchange carrier holding a facilities monopoly for intrastate interexchange service shall be considered dominant for any retail service or group of services that employ those facilities;

(4) notwithstanding paragraphs (1) – (3), the commission may, upon petition or under its own motion, conduct an investigation to change the dominant or nondominant status of any carrier for a particular service and change the carrier's status accordingly based on that investigation; in performing the investigation allowed by this paragraph, the commission will determine whether an interexchange carrier has market power by taking into consideration the following:

(A) the carrier's market share;

(B) the number, size distribution, nature, and capabilities of competing carriers;

(C) the existence and nature of barriers to entry;

(D) the availability of reasonably substitutable service;

(E) the availability of competitive facilities alternative(s);

(F) the presence or absence of factors that restrain the exercise of market power, such as geographical rate averaging, rate caps, and similar safeguards; and

(G) any other factors the commission considers relevant to the issue, including the presence of material consumer complaints. (Eff. 3/16/91, Register 117; am _____/_____/_____, Register _____)

Authority:	**AS 42.05.141**	[AS 42.05.151(a)]	[AS 42.05.711(d)]
	[AS 42.05.141(a)]	AS 42.05.221	[AS 42.05.720(4)]
	AS 42.05.151	**AS 42.05.711**	

3 AAC 52.385(a) is amended to read:

3 AAC 52.385. Standards of service. (a) The application of 3 AAC 52.200 - 3 AAC 52.340 to nondominant carriers is waived except that a carrier that owns or controls interexchange facilities in the state and has more than 25 percent market share shall comply with **3 AAC 52.280, 3 AAC 52.320, and** 3 AAC 52.330.

(Eff. 3/16/91, Register 117; am 9/1/2002, Register 163, am _____/_____/_____, Register _____)

Authority:	AS 42.05.141	AS 42.05.221	AS 42.05.711
	AS 42.05.151	AS 42.05.241	AS 42.05.990

3 AAC 52.390(c) is amended to read:

3 AAC 52.390. Miscellaneous provisions.

(c) The incumbent carrier is [A DOMINANT CARRIER IS RESPONSIBLE FOR PROVIDING INTRASTATE INTEREXCHANGE TELEPHONE SERVICE AS] the carrier of last resort unless the commission changes carrier of last resort responsibilities under the procedure stated in this subsection. Pursuant to petition or under its own motion and after hearing, the commission will, at its discretion, reassign carrier of last resort responsibilities to one or more facilities-based intrastate interexchange carriers subject to commission jurisdiction. (Eff. 3/16/91, Register 117; am 7/8/93, Register 127; am 9/1/2002, Register 163; am 5/18/2003, Register 166; am _____/_____/_____, Register _____)

Authority:	AS 42.05.141	AS 42.05.221	AS 42.05.711
	AS 42.05.151	AS 42.05.241	AS 42.05.990

Chapter 53. Telecommunications.

Article 4. Local Exchange Competition.

Section
200. Applicability of local exchange competition provisions, purpose, and waiver
210. Local exchange telephone service: certificate of public convenience and necessity
220. Determination of dominant status
230. Discontinuance, suspension, or abandonment of service [BY NONDOMINANT CARRIER]
235. Rate deregulation
240. Retail rates
250. **(Repealed)** [WHOLESALE SERVICE AND RATES]
260. Repealed
290. Miscellaneous provisions
299. Definitions

3 AAC 53.200 is amended to read:

3 AAC 53.200. Applicability of local exchange competition provisions, purpose, and waiver. (a) The provisions of 3 AAC 53.200 - 3 AAC 53.299 apply to all local exchange carriers that furnish local exchange telephone service within **competitive** [THE ANCHORAGE] service **areas as recognized** [AREA AND ANY OTHER SERVICE AREA AS ORDERED] by the commission **in an order**.

(b) The purpose of 3 AAC 53.200 - 3 AAC 53.299 is to allow competition in the provision of local exchange telephone service to the extent possible while maintaining and promoting universal local exchange telephone service**, just and reasonable treatment of competitors and consumers, and a modern telecommunications infrastructure**.

(c) For good cause shown, the commission will, in its discretion, waive the application of all or any portion of 3 AAC 53.200 - 3 AAC 53.299 to a local exchange

carrier and establish appropriate criteria for that carrier. (Eff. 6/21/98, Register 146; am _____/_____/_____, Register _____)

Authority: AS 42.05.141 AS 42.05.221 AS 42.05.990
AS 42.05.151 AS 42.05.711

3 AAC 53.220 is repealed and readopted to read:

3 AAC 53.220. Determination of dominant status. (a) A local exchange carrier is dominant for the provision of retail service in a location if

(1) its market share in that location is 60 percent or more; and

2) no single local exchange eligible telecommunications carrier has obtained a market share of 20 percent or more at that location, as determined by the commission.

(b) For purposes of this section, market share is measured by the carrier's percentage of customer connections.

(c) Notwithstanding (a) of this section, a carrier holding a facilities monopoly for the provision of local exchange loops in a location is dominant with regard to the following services until the commission directs otherwise:

(1) line extension services;

(2) construction services;

(3) subdivision agreements;

(4) interexchange carrier access services;

(5) data services;

(6) private line services; and

(7) interconnection services not subject to review under federal rules.

(d) During the certification process for a competitor or during the eligible telecommunications carrier designation process for a competitor, the incumbent carrier may petition for review of its dominant status. If the commission finds the incumbent could face significant competition immediately upon entry of the certificated competitor or upon designation of the new eligible telecommunications carrier, the commission may classify the incumbent as nondominant for a service or a group of services.

(e) Notwithstanding any other provisions of this section, the commission may, after investigation, find a carrier to be dominant or nondominant in the provision of any service or category of service.

(f) In conducting a review of an incumbent's status as a dominant carrier in response to a petition filed under (d) of this section or pursuant to a review under (e) of this section, the commission will determine whether a local carrier has market power by taking into consideration the following factors:

(1) the carrier's market share;

(2) the number, size distribution, nature, and capabilities of competing carriers;

(3) the existence and nature of barriers to entry;

(4) the availability of reasonably substitutable service;

(5) the availability of competitive facilities alternative(s);

(6) the presence or absence of factors that restrain the exercise of market power, such as rate caps, and similar safeguards;

(7) the number of customers transferred to a competitor; and

(8) any other factors the commission considers relevant to the issue, including the presence of material consumer complaints.

(g) Until changed by the commission under (a) through (f) of this section, the incumbent carrier in any service area is a dominant carrier, and all other local exchange carriers in that service area are nondominant carriers. (Eff. 6/21/98, Register 146; am _____/_____/_____, Register _____)

Authority: AS 42.05.141 AS 42.05.221 AS 42.05.990
AS 42.05.151 AS 42.05.711

3 AAC 53.230 is repealed and readopted to read:

3 AAC 53.230. Discontinuance, suspension, or abandonment of service. (a) A local carrier with less than 10 percent market share in a community, as measured by customer connections served, may discontinue, suspend, or abandon a retail local exchange telephone service in that community after giving 30 days notice unless the commission finds that the public convenience and necessity require that carrier to continue service. A carrier seeking to discontinue, suspend, or abandon service under this section shall give the required notice, in writing, to

(1) the commission;

(2) the carrier's subscribers in the community where the carrier proposes to discontinue, suspend, or abandon service; and

(3) each local exchange carrier and interexchange carrier serving the community where the carrier proposes to discontinue, suspend, or abandon service.

(b) A carrier proposing to discontinue, suspend, or abandon service under (a) of this section must file a plan for the transfer of its customers to another carrier. This plan will be filed with the commission at the same time the carrier files its required notice under (a) of this section.

(c) The provisions of (a) of this section do not apply to an eligible telecommunications carrier.

(d) A carrier that does not meet the criteria of (a) of this section or a carrier that is an eligible telecommunications carrier may not discontinue, suspend, or abandon local exchange telephone service without commission approval under AS 42.05.261.

(Eff. _____/_____/_____, Register _____)

Authority: AS 42.05.141 AS 42.05.221 AS 42.05.990
AS 42.05.151 AS 42.05.711

3 AAC 53 is amended by adding a new section to read:

3 AAC 53.235. Rate deregulation. (a) The commission may allow rate deregulation of a retail service or group of services when the following conditions are satisfied:

(1) with few exceptions, customers in the area have access to at least two certificated, local exchange service competitors for the service(s) or have easy access to an effective substitute service;

(2) no carrier is considered dominant for the service(s);

(3) if monopoly facilities exist, all competitors have nondiscriminatory access to rights-of-way owned or controlled by the incumbent, network elements,

services, databases, and associated signaling necessary for provision of the service(s) at just and reasonable rates;

(4) two carriers each serve more than 30 percent of the relevant market;

(5) if any carriers in the market receive federal or state universal service high cost support for local exchange services or intrastate access services (excluding Lifeline/LinkUp) for the service(s), there must be adequate provisions for filing of the information necessary for the commission to insure appropriate use of universal service funds;

(6) the commission has not received a significant number of valid consumer complaints concerning the service(s) during the past two years;

(7) a carrier of last resort remains for the service(s);

(8) the service(s) are generally available throughout the area on a basic, unbundled basis at rates at or below rate caps set by the commission, if the commission considers rate caps to be necessary; and

(9) an adequate system exists for the prompt transfer of customers between carriers.

(b) Notwithstanding (a) of this section, rate deregulation or rate regulation of a retail service or group of services may occur if it is in the public interest. The commission may also regulate a retail service or group of services if the criteria of (a) or (c) of this section are no longer met.

(c) A carrier subject to rate deregulation under this section must

(1) file with the commission and post on an Internet website, an accurate tariff of rates and conditions of service, with any such changes, filed and posted at least 72 hours before the effective date;

(2) establish and periodically notify its customers of a consumer complaint process, including the right to contact the commission;

(3) maintain records of consumer customer complaints, including the nature of the complaint, how and if the complaint was resolved, and the time for resolution;

(4) file monthly with the commission a report of consumer complaints, including the information required by paragraph (3) of this subsection and the customer's name and contact information;

(5) notify customers 30 days in advance before implementing any change that would increase the customer's payment obligation;

(6) offer basic service on an unbundled basis at rates at or below rate caps if such caps are set by the commission, or at rates approved by the commission if no caps are in effect, with basic services being those defined by the Federal Communications Commission under 47 C.F.R. 54.101(a);

(7) comply with 3 AAC 53.230 concerning discontinuance, suspension, and abandonment of a rate deregulated service; and

(8) comply with all statutory requirements. (Eff. _____/_____/_____, Register _____)

Authority: AS 42.05.141 AS 42.05.151

3 AAC 53.250 is repealed:

3 AAC 53.250. Wholesale service and rates. Repealed. (Eff. 6/21/98, Register 146; repealed _____/_____/_____, Register _____)

3 AAC 53.290 (a), (c), and (f) are amended and a new subsection is amended to read:

3 AAC 53.290. Miscellaneous provisions. (a) **In competitive service areas,**

(1) the provisions of 3 AAC 48.275 [THE PROVISIONS OF 3 AAC 48.230, 3 AAC 48.275, 3 AAC 48.277, AND 3 AAC 48.430] do not apply to a nondominant carrier;

(2) the provisions of 3 AAC 48.230 do not apply to a nondominant carrier with less than 10 percent market share in a community, as measured by customer connections served; and

(3) the provisions of 3 AAC 48.277 and 3 AAC 48.430 apply to any carrier that meets one or more of the following:

(A) the carrier receives state universal service funds (excluding Lifeline);

(B) the carrier's costs are used to develop access charge rates based on an analysis of revenue requirement;

(C) the carrier's costs are used to develop intrastate subscriber line charges or rate caps;

(D) the carrier is required to provide wholesale services;

(E) the carrier is a carrier of last resort;

(F) the carrier is a dominant carrier for a service; or

(G) any other carrier designated by the commission for good cause shown.

(b) The provisions of 3 AAC 48.275(a) do not apply to the dominant carrier for rate decreases, new services, and repackaging of existing services.

(c) **The incumbent local exchange** [A DOMINANT] carrier **in a competitive service area** is responsible for providing local exchange telephone service in its service area as the carrier of last resort **unless and until the commission orders otherwise.**

(d) The provisions of 3 AAC 53.190 govern the reassignment of a subscriber's access line or lines to a different local exchange carrier.

(e) No implicit modification or waiver of any statutory or regulatory requirements is intended by 3 AAC 53.200 - 3 AAC 53.299 for either dominant or nondominant carriers. Absent specific modification or waiver, all statutory and regulatory requirements remain in effect for both dominant and nondominant carriers.

(f) A local exchange carrier **in a competitive service area** shall publish a public notice of all proposed tariff revisions in a local, general circulation newspaper no later than three days after filing it with the commission. The public notice must contain a general description of the filing that is accurate, written in plain English, and sufficient to alert consumers of tariff revisions that may affect either the rules or rates applicable to them. The notice must contain sentences containing the following information: the date the utility made (or will make) its filing with the commission; the date the revisions are expected to become effective; and a statement that both the proposed revisions and the utility's current tariff are available for review at the utility's office or which an address

and office hours are given. The notice must contain sentences similar to the following: "Any person may file comments on this tariff revision with the **Regulatory Commission of Alaska** [ALASKA PUBLIC UTILITIES COMMISSION] (address). To assure that the commission has sufficient time to consider the comments prior to the revisions taking effect, (utility name) suggests that your comments be filed no later than (a specific date, not a weekend or holiday, approximately 7-10 days prior to the filing's taking effect)."

(g) Where all necessary facilities and equipment are in place, a local exchange carrier shall complete the transfer of a customer to another local exchange carrier within seven working days of receiving a valid order for transfer of service.

(h) The provision of 3 AAC 48.270 requiring the filing of the estimated number of customers or shippers who will be affected by each separate schedule listed and the estimated annual revenues under both the existing and proposed rates does not apply to retail service offerings of a nondominant or a dominant carrier except when the carrier proposes to discontinue or increase the rates for a service. However, subsequent to submitting a tariff advice letter, a carrier must provide this information if requested by the commission. (Eff. 6/21/98, Register 146; am 11/11/2001, Register 160; am _____/_____/_____, Register _____)

Authority: AS 42.05.141 AS 42.05.221 AS 42.05.711
AS 42.05.151 AS 42.05.241 AS 42.05.990

3 AAC 53.299(1) is repealed, 3 AAC 53.299(2) – (3) are amended and new paragraphs are added to read:

3 AAC 53.299. Definitions. Unless the context indicates otherwise, in 3 AAC 53.200 - 3 AAC 53.299,

(1) **repealed;** _____/_____/_____, Register _____) ["ANCHORAGE SERVICE AREA" MEANS THE SERVICE AREA CERTIFICATED TO ATU TELECOMMUNICATIONS BY CERTIFICATE OF PUBLIC CONVENIENCE AND NECESSITY NO. 120 AS OF APRIL 8, 1998;]

(2) "commission" means the **Regulatory Commission of Alaska** [ALASKA PUBLIC UTILITIES COMMISSION];

(3) "dominant carrier" means a local exchange carrier **designated by the commission as a dominant carrier under 3 AAC 53.220** [DETERMINED BY THE COMMISSION TO HAVE MARKET POWER];

(4) "incumbent carrier" means the telephone utility, or its successor, certificated to provide local exchange telephone service within its service area as of February 8, 1996;

(5) "interexchange carrier" means a carrier certificated by the commission to provide intrastate interexchange telephone service;

(6) "local exchange carrier" means a carrier certificated to provide local exchange telephone service;

(7) "nondominant carrier" means a local exchange carrier other than a dominant carrier;

(8) "recorded authorization" means a voice communication that clearly grants the authority to transfer a customer's local exchange service from one local exchange carrier to another and that may be accurately retrieved for later review;

(9) "competitive service area" means the portion or portions of a certificated local exchange service area where multiple telecommunications providers are certificated to provide local exchange service and provide local exchange service throughout the area; however upon petition or its own motion, the commission may designate an additional area as a competitive service area based on the nature and extent of competition available;

(10) "customer connection" means any connection used to provide local exchange service, and shall include lines sold through local service resale, and shall exclude lines sold as unbundled network element loops; however, a line used to serve multiple customers or end-users shall be appropriatedly weighted based on its voice line equivalent; and

(11) "eligible telecommunications carrier" is a carrier that has been designated as an eligible telecommunications carrier by the commission under 47 U.S.C. 214(e) as that provision existed on January 1, 2003. (Eff. 6/21/98, Register 146; am _____/_____/_____, Register _____)

Authority: AS 42.05.141 AS 42.05.151 [AS 42.05.720]

4

NOTICE OF PROPOSED CHANGES IN THE REGULATIONS OF THE REGULATORY COMMISSION OF ALASKA

The Regulatory Commission of Alaska proposes, in Dockets R-02-6 and R-03-3 to adopt regulation changes in Title 3 of the Alaska Administrative Code, covering a wide scope of telecommunications policies.

The proposed regulation changes include new sections in 3 AAC 48; amendments in 3 AAC 52.350 - 3 AAC 52.399, and amendments, new sections and subsections and repeal of a section in 3 AAC 53.200 – 3 AAC 53.299. Issues and the proposed regulations addressing them include the following:

1) local exchange and interexchange pricing and policies in competitive markets; 3 AAC 52.385, 3 AAC 53.200, 3 AAC 53.290, 3 AAC 53.299;

2) carrier's obligation to provide service, including carrier of last resort policies and abandonment of service policies; 3 AAC 52.390, 3 AAC 53.230, 3 AAC 53.290;

3) when rate deregulation should occur and criteria for designation of a carrier as dominant for a service; 3 AAC 52.363, 3AAC 53.220, 3 AAC 53.235, 3 AAC 53.290;

4) when and under what conditions all telecommunications carriers may decrease or increase rates; 3 AAC 48. 315, 3 AAC 53.290;

5) local wholesale service provisions; repeal of 3 AAC 53.250 is proposed; and

6) depreciation criteria and approval requirements; 3 AAC 48.425.

A copy of the proposed regulation changes may be obtained from the Commission's Records & Filings Section at the address set out below or from the Commission's website at http://www.state.ak.us/rca under "Proposed Regulations". A copy of the Commission's Order proposing these regulation changes may also be obtained from the Commission's Record and Filings Section at the address set out below or viewed on our web site at http://www.state.ak.us/rca under *Issued Orders*.

Interested persons may comment on the proposed regulations including the potential costs to private persons of complying with the proposed changes by submitting written comments to the Regulatory Commission of Alaska at 701 West Eighth Avenue, Suite 300, Anchorage, Alaska 99501. The initial comments must be received no later than 4 p.m., on January 13, 2004, with reply comments due no later than 4 p.m. on February 12, 2004. In their comments, commenters should reference Dockets R-02-6 and R-03-3. The Commission also requests that, if possible, each commenter file a diskette of the comments in IBM compatible text (.txt) format, MS Word (.doc) format or Adobe Acrobat (.pdf) format. If you are a person with a disability who may need a special accommodation, auxiliary aid, or service or alternative communication format in order to participate in this process, please contact Grace Salazar at 1-907-276-6222 or TTY 1 907-276-8532, by 4 p.m., January 2, 2004, to ensure that any necessary accommodations can be provided.

Since this is a regulation proceeding, commentors are not required to serve their comments on the other entities set out on the service list of this

Notice. However, interested persons may request from the Commission copies of the comments filed in this proceeding.

After the public comment period ends, the Regulatory Commission of Alaska will either adopt these or other provisions dealing with the same subject, without further notice, or decide to take no action on them. The language of the final regulations may be different from that of the proposed regulations. You should comment during the time allowed if your interests could be affected.

Statutory Authority: AS 42.05.141; AS 42.05.151

Statutes Being Implemented, Interpreted, or Made Specific: AS 42.05.141; AS 42.05.151; AS 42.05.221; AS 42.05.241; AS 42.05.381; AS 42.05.411; AS 42.05.421; AS 42.05.431; AS 42.05.711; AS 42.05.990.

Fiscal Information: The proposed regulations are not expected to require an increased appropriation.

DATED at Anchorage, Alaska, this 14th day of November, 2003.

REGULATORY COMMISSION OF ALASKA

Mark K. Johnson
Chair

5

STATE OF ALASKA

THE ALASKA PUBLIC UTILITIES COMMISSION

Before Commissioners:

Mark K. Johnson, Chair
Kate Giard
Dave Harbour
James S. Strandberg
G. Nanette Thompson

In the Matter of the Commission Review of Rules and Regulations Governing Telecommunications Rates, Charges Between Competing Telecommunications Companies, and Competition in Telecommunications	)	R-03-03

COMMENTS OF ALASKA COMMUNICATIONS SYSTEMS

ACS of Anchorage, Inc. ("ACS-ANC"), ACS of Fairbanks, Inc. ("ACS-F"); ACS of Alaska, Inc. ("ACS-AK"), ACS of the Northland, Inc. ("ACS-N"), and ACS Long Distance, Inc. (ACS-LD), hereinafter collectively referred to as ACS, submit their initial Comments in response to the Notice of Inquiry ("NOI") issued in the above referenced docket.

Introduction

The Regulatory Commission of Alaska ("RCA" or "Commission") commenced R-03-3 by issuing an NOI on June 11, 2003. ACS expects to be an active contributor to this proceeding, as well the RCA's new rulemaking to

Alaska Communications Systems
600 Telephone Avenue, MS65
Anchorage, AK 99503
907. 297.3103 • Fax: 907. 297.3153

be commenced by a separate NOI in docket R-03-X.[1] In large measure, ACS' prior advocacy in docket R-01-2/R-02-6 will provide the foundation for ACS' participation in this "fast track" docket.

The Commission has urged "*...commentors to avoid addressing issues already presented* ..." in a list of rulemakings included in Order No. 1 in this proceeding.[2] ACS finds that reliance on the inputs, including certain proposed regulations, submitted in R-02-6 is essential. In the interest of economy, ACS will not repeat its earlier filings in their entirety, but incorporates them here by reference and will frequently refer to positions previously taken in R-02-6. In addition to these comments, ACS submits draft regulations attached as Exhibit A. Many of the provisions in these proposed regulations have been taken directly from ACS' earlier proposals made in R-02-6. Others are new and have been crafted in direct response to the NOI in this proceeding.

To augment its own comments, ACS has invited Alaska Pacific University Professor Dale Lehman to offer his insights on the role of regulation in competitive telecommunications markets. Professor Lehman's affidavit is attached as Exhibit B to these comments.

Alaska Communications Systems
600 Telephone Avenue, MS65
Anchorage, AK 99503
907. 297.3103 • Fax: 907. 297.3153

[1] *At its regularly scheduled Public Meeting held June 25, 2003, the RCA unanimously approved a new NOI to seek comment on whether to petition the FCC for forbearance in the application of certain TELRIC pricing standards. ACS had anticipated seeing the actual order in this matter prior to the filing deadline for the initial R-03-3 comments. However, to date, that order has not been released. Since its content and direction may viewed by the Commission as being relevant to this proceeding, ACS plans to offer limited comment on the new rulemaking based on the draft order that was circulated at the Public Meeting.*

[2] *R-03-3(1), p. 5 of 8.*

Background

The Alaska Legislature directed the Commission to undertake the instant inquiry as part of the decision to reauthorize the RCA for an additional four years.[3] The Legislature's decision to reauthorize the Commission was not one that was easily reached. During the course of legislative debate, Alaska lawmakers were made aware of numerous and substantial issues confronting this important regulatory body -- questions and concerns that could not be readily discounted. Of greatest consequence were the substantive issues associated with the regulation of telecommunications in Alaska and particularly in markets that have become demonstrably competitive.

As the RCA reauthorization process unfolded at the Legislature, interested participants had the opportunity to offer suggestions for policy changes and procedural improvements that were calculated to bring the RCA's decision-making up to date and in synch with the realities of competitive markets. In stark contrast to criticisms leveled during the Legislature's consideration of a 2002 "sunset" bill, the current Legislature expended substantial time and resources conducting hearings and evaluating options.[4]

Alaska Communications Systems
600 Telephone Avenue, M565
Anchorage, AK 99503
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[3] *See CSHB111.*

[4] *Extensive and, in some cases, multiple hearings were held by the House Labor & Commerce, Judiciary and Senate Finance Committees. This was in addition to a lengthy late night House floor Session that included consideration and debate of several substantive amendments to both CSHB111 and CSHB1^6.*

As one might expect, not everyone agreed on the best approach. The Chair of the RCA, for example, argued that to the extent remedial action was necessary, the Legislature should defer to the Commission itself to evaluate issues and find solutions.[5] Still others advocated no change whatsoever and urged a "clean bill". In the final analysis, the Legislature opted to extend the life of the RCA, but in doing so, it in no way closed the door on the significant issues that had been raised.

It is self-evident from the nine policy initiatives included in the reauthorization bill that the Legislature has mapped out a new direction for competitive telecommunications in Alaska. As the first order of business, the Legislature instructed the reauthorized RCA to conduct the inquiry that is the basis of this proceeding. With prescribed legislative principles as guideposts, the Commission has been directed to consider new proposed regulations that incorporate nine policy elements included in the reauthorization bill. The Commission and interested participants must complete this assignment by November 15, 2003.

Of equal importance, the Legislature did not simply discard the proposals that were made by interested local exchange and interexchange companies during the course of committee hearings. Those proposals remain alive and under active consideration as CSHB106. CSHB106 has already

[5] *RCA Chairman Dave Harbour's RCA memorandum to Chairman Tom Anderson, House Labor and Commerce Committee regarding response to proposed amendments to HB 111 dated April 15, 2003.*

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passed the Alaska House of Representatives and awaits further action in the Alaska Senate when the current Legislature reconvenes in January, 2004. As ACS sees it, the mission of the Commission, with inputs and recommendations from the public and the telecommunications industry, is to make further legislative action unnecessary. R-03-3 creates the potential for achieving that goal. The RCA forcefully urged the Legislature to hand these issues back to the Commission for resolution. ACS sincerely hopes that we are collectively up to the task.

Time for a Paradigm Shift

It is imperative that a new conceptual framework – a new paradigm – form the basis for Commission analysis and action in R-03-3. While reasonable people can always disagree, there seems to be little disagreement that the world of telecommunications has changed dramatically. The change is not theoretical. It is not prospective. In Alaska, the change has already occurred. The Telecommunications Act of 1996 set us all on a course of competition and deregulation with the caveat that universally available and affordable service remain a co-equal partner with competition. Without question, Alaska's regulators have enthusiastically and proactively embraced the cause of competition. As a result, irrevocable telecommunications competition is now a reality. Under any assessment, it is now time to turn our attention to the other goals of the Act.

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The question is no longer, should regulation be relaxed or eliminated. The question is not even "when" to do this. We clearly must advance to a deregulatory model and we need to do it now. The new paradigm must be comprehensive in its vision and include a transition to fairness for the ongoing availability and pricing of one carrier's facilities and services to a competitive carrier. Competition has already been "jumpstarted". This docket is not just about technical issues like retail pricing flexibility or the use of rational depreciation methodologies. It is about the way we think about competitive markets and a willingness to trust more in the efficacy of the "invisible hand", relying less on the imperfect interventions of the regulatory process.

Within the context of this new paradigm, ACS offers its comments in docket R-03-3.

Summary of ACS' Position

In this filing, ACS submits comments under several headings. However, the most substantive and specific recommendations will be given in response to the "nine policy initiatives" included in CSHB111. The following list briefly summarizes ACS' position relative to each of the nine policy initiatives.

1. **Payment by user carriers:** Payments currently authorized under interconnection agreements are not fair. The RCA has ample existing authority to make pricing changes that will be both TELRIC[6]-compliant

[6] *The FCC's pricing standard: Total Element Long Run Incremental Cost.*

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and render fair compensation to the providing carrier. Regardless of the pricing model chosen, "reasonably anticipated forward looking costs" should be used to determine unbundled network element ("UNE") rates. Pricing methodologies must include a fair assessment of depreciation rates, costs of capital and must comply with industry design standards as well as all state and local laws.

2. **Dominant Carrier Status:** CSHB111 requires an immediate change to the RCA regulations that declare the incumbent carrier to be the dominant carrier. In a competitive market, the incumbent lacks market power and must be declared non-dominant.

3. **Unilateral Rate Reductions:** Today's regulatory practice of reviewing all tariff filings, including rate reductions, and subjecting them to staff analysis/recommendations and an affirmative Commission approval process must be discontinued.

4. **Competitive Service Area - Actual Competition:** The definition of competitive service area should include the presence of actual competition of any type or form and the availability of a choice of provider to the majority of consumers in that market/community.

5. **Depreciation:** The determination of "actual plant lives" must include consideration of market dynamics and technological changes that have the tendency to shorten physical plant lives. To the extent that another governmental body has adopted industry accepted depreciation

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standards, they should be used a test of reasonableness for ratemaking purposes.

6. **Tariffing Standards for Incumbents and Competitors:** ACS proposes limited "notice tariff" filings for non-dominant carriers. Once significant (facilities-based) competition has evolved, all local companies should operate on a fully detariffed basis for retail and special access services. To the extent that tariffing continues in any form, filing requirements, support documentation and regulatory review standards must be exactly the same for both incumbents and competitors.

7. **Fill Factors:** Fill factors should represent a reasonable projection of actual total usage of the elements in question. Cost models used to price network elements must be designed to meet industry standards and comply with all state and local laws.

8. **Rate Increases – Significant Competition:** Significant competition is found in a market/community that has a facilities-based competitor capable of serving 75% of all consumers in the market/community. In these markets, all local providers should be allowed to offer retail and special access services on a detariffed basis. To the extent that tariffing continues in any form, filing requirements, support documentation and regulatory review standards must be exactly the same for both incumbents and competitors.

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9. **Rate Increases – Public Protection:** In markets that have been opened to competition, the RCA should, to the maximum extent possible, protect the public my allowing the free and unencumbered operation of market forces. Where concerns exist regarding residential ratepayers, the Commission might consider a basic residential service "safety net" approach.

The Seven Legislative Principles

The seven principles prescribed by the Legislature form the backdrop for the Commission's consideration of the nine policy initiatives. In that regard, ACS offers the following contextual comments.

1. **The public shall be protected.**

ACS believes that, in those markets deemed appropriate for competitive entry, the public is best protected by the free flow of market forces. Market forces – the economic energy released when providers are able to respond freely, rapidly and directly to the wants and needs of customers - provide the best source of incentives to meet the demands of consumers for high quality goods and services at affordable rates. Market forces also offer the best option for prompting efficiency and economy in the provision of desired services. Lastly, market forces are most likely to produce the financial incentives necessary to promptly bring new products, services and technologies to the consuming public.

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As the Commission applies this principle to its rulemaking, it must remember that public protection relies on a market structure that includes incentives for investment necessary to ensure a desired level of service quality as well as the health and viability of competition, itself.

To the extent that the Commission continues to be concerned about the effect of competition on those customers least able to effect the outcome, some version of a residential consumer "safety net" should be considered. In its response to the nine policy initiatives, ACS will address "safety net" considerations.

2. The rates charged to the public shall be fair.

Fair consumer rates are also the product of the free flow of market forces. "Fair rates" are not a function of regulated rates that were developed using a complex system of implicit subsidies calculated to produce a particular social objective. Instead, fair rates are the product of the free operation of the laws of supply and demand. Competition drives rates to cost. The elimination of implicit subsidies and the rebalancing of rates are a natural consequence of competition. Instead of trying to block this natural result, policy makers should encourage it. To the extent that the outputs of this process result in unintended or undesired consequences, government can monitor market performance and step back in to correct market failures that are detected. As already

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noted, the use of "safety nets" can also be considered as an added layer of protection for basic residential service.

3. **The incumbent may not be placed at an unfair competitive disadvantage.**

Incumbent Local Exchange Carriers ("ILECs") in Alaska have unquestionably been placed at an unfair competitive disadvantage. UNE prices, set by government-mandated arbitration at below-cost rates, render an unfair cost advantage to Competitive Local Exchange Carriers ("CLECs"). This cost advantage has resulted in unprecedented market share shift in Anchorage, Fairbanks and Juneau.[7] Even after positioning itself as one of the most cost-efficient ILECs in the nation, ACS cannot overcome the cost advantage awarded by regulators to its primary competitors. If left uncorrected, the logical extension of this cost advantage over time will allow CLECs to capture virtually 100% of the markets in which they operate.[8] The result will be a failure of the Telecommunications Act and a return to monopoly provision of local exchange services in Alaska.

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[7] *"Today we have a market share close to 45 percent in Anchorage, 21 percent in Fairbanks and 19 percent in Juno[Juneau].", GCI Senior Vice President of Legal, Regulatory, and Governmental Affairs, Dana Tindall's testimony at the hearing of the Communications Subcommittee of the Senate Committee on Commerce, Science and Transportation on the Future of Universal Service, April 2, 2003.*

[8] *See chart 1 of Exhibit B, page 8.*

As the Carrier of Last Resort ("CoLR"), ACS must invest and build infrastructure for its own use and for the use of its competitors. In this regard, the ILEC is subjected to yet another unfair competitive disadvantage. ACS must act as "banker" for its competitors by "fronting" the investment dollars necessary to create the infrastructure used by CLECs. The RCA has determined to amortize this investment over twenty years or more in establishing the rates to be paid by CLECs. In return, CLECs have no obligation to actually take service from the ILEC and are free to leave the ILEC's network at will. The result is that there is no guarantee that the "loan" made by the ILEC to the CLEC will ever be repaid. The ILEC is left assuming all of the risk.

In addition to these substantive disadvantages, ILECs are also subjected to procedural and structural inequities. The current unequal regulations that apply to "dominant" and "nondominant" carriers is exacerbated by the uneven interpretation of other regulations that purport to treat all carriers the same. The Commission has routinely granted waivers to CLECs that it declines to grant when the ILEC submits a similar request. CLECs are allowed to offer competitive plans to attract new customers. When the ILEC presents a similar plan, it is challenged and suspended. This uneven application of the regulatory process continues to leave the ILEC at a competitive disadvantage.

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The state regulator also chose to tilt the playing field by imposing artificial and unreasonable structural conditions only on ILECs. Anti-bundling prohibitions and rules that interfere with the efficient functioning of local exchange operations in concert with other affiliated business units are but two examples of how these structural impediments produce competitive disadvantages for ILECs alone.

4. Businesses that provide local and long distance telecommunications services shall be treated as fairly as possible

Local exchange and long distance companies are not currently being treated fairly. At this time, incumbent local and long distance providers are subjected to dominant carrier regulations and are designated as CoLR. This occurs regardless of whether incumbents hold market power and irrespective of the fact that competitors are active in the market and, in some instances, have captured significant market share.[9]

In addition the RCA imposes unequal rules on incumbents regarding bundling products and services, the need for structural separation from affiliates, joint use of facilities, and the shared use of

[9] *An estimate of GCI's local market share numbers is noted in Footnote 7. In addition, estimates of GCI's intrastate long distance market share place it at 45% relative to 42% held by AT&T Alascom.*

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staff resources. Competitive local and long distance companies (except for ACS' long distance affiliate) do not face similar restrictions.

At present, there is also unequal access to competitive networks. Under the Telecom Act, except where limited by the statutory "rural exemption", CLECs have a right to access an ILEC's network for purposes of resale. The Act does not give ILECs a similar right. The State is in a position to correct that imbalance. Reciprocity of competitive network access, whether required by the Act or not, should be mandated by state policy for both local and long distance services.

5. **Competition among telecommunications companies shall be *encouraged***

Competition should be encouraged within the overall purpose of the Telecommunications Act. The Commission should not lose sight of the fact that universal service is a co-equal goal with competition. As such, the statutory "rural exemption" must not be casually set aside. Public interest standards must be developed to ensure that the objectives of the "rural exemption" are achieved and maintained.

There is a need to challenge the assumption that competition will always be the best tool to achieve long-standing societal objectives. Competition - at least the version of it that has been introduced in Alaska – often takes undeserved credit for technological innovation that would have occurred regardless of the Telecom Act. And state-endorsed

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programs, such as those that brought long distance services to hundreds of rural Alaska villages, had absolutely nothing to do with the introduction of competition. To the extent that regulators have now adopted an overarching imperative to promote competition in every situation, caution is urged. Alaska's competition policy must be crafted in closer conformance with a longer-term view of the public interest.

For years, regulators have spun a complex web of implicit subsidies and held fast to the protection of universal service goals, rate integration and the concept of CoLR. We may find that these time-honored objectives are actually in conflict with the competitive model. As the Commission follows this legislative principle, it should take care to recognize that competition may put many desired outcomes at risk. The extension of competition into new, fragile markets must be an exercise in caution. Even where competitive entry seems viable and in the public interest, the apparent alignment of new market entrants and regulatory goals may only be a temporary phenomenon. It is much less clear that this alignment can be maintained once competition actually exists.

6. **The development of modern telecommunications infrastructure in the state shall be encouraged.**

This principle is so obvious that it almost does not need to be stated. Yet, current market structure rules and regulatory practices do not encourage infrastructure development, thus prompting the need for a

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legislative reminder. Current regulatory policies and decisions preclude ILECs from achieving a reasonable return on investment. This occurs when underpriced UNEs that give CLECs a cost advantage meet a competitive retail market that will not allow a shift of cost recovery to end users. The resultant "catch 22" leaves the ILEC in the position of not being able to generate the returns necessary to attract essential investment capital.

In a recent presentation before a Congressional subcommittee, ACS reminded national leaders that there is no "investor of last resort".[10] The equation is actually quite simple: A + B = C. (A) Absent a reasonable return history, capital markets will not view ILECs as a rational investment opportunity. (B) Without access to capital, investment is not possible. (C) Without investment, modern telecom infrastructure is only wishful thinking.

But, things get even worse. Below-cost UNE rates constrain ILEC cost recovery. Inadequate cost recovery will continue to inhibit direct ILEC infrastructure investment. Below-cost UNE rates also artificially signal CLECs to rely on a UNE strategy that slows down investment in new technology and competitive infrastructure. Hence incumbent carriers cannot invest because they lack the resources to do so and

[10] *Tom Meade, ACS Vice President of Revenue Requirements' testimony at the hearing of the Communications Subcommittee of the Senate Committee on Commerce, Science and Transportation on the Future of Universal Service, April 2, 2003.*

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competitive carriers will not invest because they lack economic incentive to do so. The bottom line is that the Commission must make near term and substantial changes to its regulatory policies to conform to this legislative principle.

7. It is desirable to promote competition and to take steps, if fair to the public, to encourage more, rather than fewer, businesses to enter and remain in the telecommunications business in the state

Promoting competition is appropriate in the context of the balance the Telecom Act seeks to achieve. Universal service must be a co-equal objective and the statutory "rural exemption" is a tool to protect universal service. The Commission should not forget that ILECs must also be encouraged to compete. Competition only exists if there are multiple carriers. The RCA's policies and decisions, to date, have mistaken promoting a competitor with promoting competition. In today's world, promoting a competitor is anti-competitive. In most markets in Alaska, competition would cease to exist if regulatory policies force ILECs to fail or to exit those markets. There are ample arguments supporting the notion that the Commission should ensure the financial health and viability of regulated entities. In the context of this docket, perhaps the most persuasive argument is that competition will not survive if ILECs do not survive.

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The Nine Legislative Policy Initiatives

1. **There shall be fair payment by a user carrier for the use of another carrier's equipment and facilities, including existing and newly constructed equipment and facilities.**

It is important to note that this policy initiative is written with mandatory language. "*There shall be fair payment by a user carrier....*" Payments that are less than an ILEC's reasonably anticipated forward-looking cost cannot be held to be "fair". The RCA's prior interpretation of TELRIC principles and the application of the RCA's "hypothetical carrier" standard do not produce fair payment by user carriers. Pricing standards and interpretations used by the Commission in the past, and anticipated to be used again in the arbitration of new interconnection agreements, are not mandated by federal law. The "hypothetical carrier" standard has no basis in federal law and diverges from the FCC's "hypothetical network" standard."

Beyond purely legal issues, it simply makes no sense to use pricing models that have been expressly discounted by the FCC. The disconnect is magnified when those models are populated with averaged cost data derived from non-representative Lower 48 markets and then used to forecast forward-looking costs in Alaska. Going forward, a fair

" *ACS's Response to GCI's Motion for Clarification Regarding the RCA's Efficient ILEC Standard, U-96-89, dated March 10, 2003.*

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payment for the use of the ILECs facilities cannot be derived from the models and inputs the RCA has elected to use in prior and current interconnection arbitrations. The Commission must reject the notion that because it has chosen to use a particular pricing approach in the past, it is obligated to continue to do so in the future.

While the RCA must comply with the FCC's TELRIC pricing standards, these rules leave the Commission ample discretion to modify its interconnection ratemaking policies and decisions. Neither the Telecom Act or FCC rules have predestined the outcomes that have been experienced in Alaska. No FCC UNE pricing "formula" exists. If states did not have discretion in setting UNE rates, the FCC would have simply produced a model, cranked in national default inputs and set the rates itself. The fact that these actions were delegated to the states makes it clear that, within broad federal guidelines, it is the state that exercises wide latitude in establishing UNE prices.

The United States Supreme Court validated the FCC's TELRIC pricing rules, including the "hypothetical network" standard, but it never endorsed a "hypothetical carrier" standard. Similarly, the U.S. Supreme Court said nothing about how to determine the forward-looking cost for labor and materials, appropriate depreciation rates, costs of capital, the need to adhere to state and local laws and industry design and construction criteria. Without question, the Commission could use a

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wide variety of models and inputs that would produce a range of TELRIC-compliant outcomes. ACS believes that, within that range, there are potential solutions that would produce fair compensation to the incumbent infrastructure provider.

Reasonably anticipated forward looking costs for provider network elements should be used to set prices to be paid by user carriers. The best evidence of "reasonably anticipated forward looking cost" is the provider carrier's most current cost adjusted for the future. Costs should be based on the most efficient technology actually deployed by the provider. If a technology has not been deployed, the likely reason is that the technology is not efficient. The RCA's UNE pricing policies should begin with a rebuttable presumption of ILEC efficiency. The provider carrier's cost of capital should be adjusted to reflect the increased risk that is confronted when operating in a competitive market. The provider carrier's depreciation expense should also be adjusted to reflect the increased rate of technological change and market dynamics that shorten physical plant lives in competitive markets. And the network design used to generate UNE prices should reflect all industry standards and construction criteria including adherence to state and local laws.

The ILEC's embedded cost is not a precluded consideration. Embedded cost is the "actual cost" of service. Unlike TELRIC rates, actual costs are auditable. While TELRIC clearly envisions forward

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looking costs, there is nothing in the Act or the FCC's rules to suggest that TELRIC should be a pure fiction or, worse yet, fantasy. The Act only states that interconnection rates will not be driven by historical costs or other rate base methodologies. However, embedded cost, adjusted to reflect "reasonably anticipated forward looking cost", provides a useful reference point in the Commission's analysis. Today's forward looking cost is tomorrow's embedded cost. As such, there is no reason to expect that in comparison, the numbers will be wildly different.

Included in the attached Exhibit A, ACS submits proposed regulatory language at 3 AAC 53.280 for Commission consideration as it advances policy initiative number 1 to the next phase of this proceeding.

2. **In determining whether a carrier is the dominant carrier for the purposes of setting rates, it is not relevant that the carrier in a competitive market is the incumbent carrier.**

This legislative policy initiative requires the immediate repeal of 3 AAC 53.220(b) – the RCA's regulation that declares the incumbent carrier is the dominant carrier.

The Commission must find that a carrier has "market power" before it can designate a carrier as "dominant". Market power exists only where a carrier has the ability to set market prices. The mere fact that a carrier changes its own rates (up or down) does not demonstrate market power unless other market participants consistently follow the price

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setter's lead. ACS-ANC, for example, implemented an interim rate increase. GCI opted not to follow that lead and generally held its Anchorage prices constant. This is a clear indication that ACS lacks market power in its inability to set the market price for telecommunications services in Anchorage. These same dynamics exist in the Fairbanks and Juneau markets. GCI sets prices independent of ACS.

Without market power, the ILEC is no longer the dominant carrier. There is no requirement that there be at least one dominant carrier in every market. For example, there are no longer any interstate IXC dominant carriers.[12] Absent empirical evidence to the contrary, once competition has been introduced in a given market and a majority of consumers have a choice of provider, the ILEC no longer holds market power and should not be regulated as a dominant carrier.

ACS proposes adoption of amended 3 AAC 53.220(a), (b), and (c) as reflected in its regulations proposal attached to these comments as Exhibit A.

3. All telecommunications carriers may unilaterally reduce consumer rates, subject to state and federal antitrust laws.

[12] *While not generally regulated as dominant, AT&T Alascom does have one tariff - Tariff 11, Common Carrier Services – that is subject to dominant carrier scrutiny at the FCC.*

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This legislative policy initiative requires modification of 3 AAC 53.240(a) and (b) – regulations regarding nondominant carrier rate changes and dominant carrier rate reductions.

The Legislature's language, with specific emphasis on the terms "all telecommunications carriers" and "unilaterally reduce consumer rates" makes it clear that retail rate reductions are no longer subject to any form of affirmative RCA approval process. Although this should have been the result under existing regulations language, the RCA has opted to ignore the term "without approval of the commission" found in current version of 3 AAC 53.240(a) and (b). The Commission continues to subject LEC and IXC tariff filings to formal staff analysis and action recommendations. This is followed by a formal Commission review and approval process, including a requirement that individual commissioners "sign off" on rate reduction tariffs before they are allowed to go into effect. Legislative policy initiative 3 requires that this process be discontinued.

ACS advocates full detariffing of retail rates where appropriate competitive market triggers have been met. In support of that position, ACS proposes regulations language at 3 AAC 53.220(e) in Exhibit A for retail detariffing where a CLEC offers facilities-based services[13] capable

[13] *The term "facilities-based services" denotes CLEC services provided on its own facilities or via unbundled network elements leased from another carrier.*

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of reaching 75% of the customers located the competitive market/community.[11] Even in advance of the trigger for full detariffing, ACS offers proposed language at 3 AAC 53.240(a) to implement this legislative initiative by way of "notice tariff" filings for all rate reductions.

4. **A definition of "competitive service area" shall take into account whether actual competition exists in an area.**

In response to this legislative policy initiative, ACS offers the following definition: "Competitive local market" or "competitive service area" means a certificated local exchange service area that has multiple local providers or CETCs in which the majority of customers has a choice of service providers. In serving areas that encompass multiple communities, the "competitive local market" determination will be community-specific.

This definition is codified as ACS' proposed regulation 3 AAC 53.299(6) found in the attached Exhibit A.

5. **Any method of depreciation used by the commission shall consider the actual useful life of depreciated equipment and facilities.**

The "actual useful life" of an asset is impacted by factors beyond

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[11] *In some instances, an ILEC's entire service area constitutes the competitive "community". Anchorage and Fairbanks are good examples of this. In other cases, such as ACS-AK and ACS-N, individual communities subsumed within a service area will become competitive over time. In such cases, ACS recommends a community-specific designation of competition for purposes of triggering the regulatory relief being proposed.*

those that determine useful physical life. Technological obsolescence and competitive market dynamics must be considered when determining "actual useful life." The FCC has indicated that state commissions have discretion in formulating depreciation policy for setting UNE prices and that accelerated depreciation may be more appropriate for competitive markets.[15] The RCA clearly has the same discretion under state statute for determining the depreciation rates to be applied to local and intrastate access rate setting.

During the course of legislative consideration of CSHB111, ACS proposed the use of IRS depreciation rates for RCA ratemaking purposes. ACS made this recommendation in the spirit of trying to find an administratively simple, yet substantively more appropriate way to set depreciation rates in regulated proceedings. To the extent that the IRS rates do not present the best option, ACS continues to support finding some government-sanctioned approach that might be used by the Commission as a test for reasonableness. ACS will continue to research this question and will provide an update with its Reply Comments to be filed in this docket.[16]

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[15] *Press release of the FCC , FCC Adopts New Rules for Network Unbundling Obligations of Incumbent Local Phone Carriers, February 20, 2003.*

[16] *One suggestion regarding the use of Securities and Exchange Commission depreciation rates has already surfaced. ACS will research this option and others and will report its results to the Commission on Reply.*

6. When the commission approves a carrier's application for a certificate to provide competitive local exchange telecommunications service in an incumbent local exchange carrier's service area, in areas where the commission has determined there is competition among carriers, the incumbent local exchange carrier shall be subject to the same retail tariffing standards and regulations as the new carrier, but the incumbent local exchange carrier remains the carrier of last resort in the relevant area until the commission orders otherwise.

Although ACS will comment specifically on this legislative policy initiative, it is important to mention that this item is directly related to initiatives 2 and 3, above. As already noted, current regulations that automatically impose different rules on ILECs and CLECs must be changed. This policy initiative also requires that tariffing regulations be written, interpreted and applied equally to both ILECs and CLECs. In response, ACS reiterates its support for "notice tariff" regulations found at 3 AAC 53.220(c), .230(c) and .240 in attached Exhibit A. As new competitive markets evolve into facilities-based competition, ACS proposes full retail and special access[17] detariffing for all competitors as

[17] *"Special Access" denotes those dedicated access services provided by local exchange companies directly to end-users. This is distinguished from "switched access" which is provisioned by LECs and paid for by IXCs.*

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described in draft regulation 3 AAC 53.220(e) and .230(d). To the extent that tariffing continues in any form, filing requirements, support documentation and regulatory review standards must be exactly the same for both incumbents and competitors.

This legislative initiative also declares that "...the incumbent local exchange carrier remains the carrier of last resort in the relevant area until the commission orders otherwise." In response to the Commission's directive to remain focused on the specific elements of this NOI, ACS will not raise the issue of shared "CoLR" at this time. ACS points out that this concept has been offered in R-02-6. ACS looks forward to Commission's thoughtful consideration of this important aspect of the competitive local market structure as it advances that other rulemaking.

7. The use of fill factors shall consider the application of the fill factors in setting unbundled network element rates.

Cable fill factors constitute an important local exchange design criterion and should represent a reasonable projection of actual total usage of the elements in question. Forward looking cost models that are used to develop UNE pricing must be structured to meet industry design standards and comply with applicable local and state laws. Contrary to past practice, the pricing models used by this Commission to set both

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UNE rates and retail rates must not deviate from established and accepted design standards, including fill factors.

Included in Exhibit A is proposed regulations language that ACS submits for Commission consideration as it advances policy initiative number 7 to the next phase of this proceeding.

8. **In areas where significant competition exists between carriers, competitors shall be allowed to increase rates under the same rules.**

"Significant competition" should be defined as any service area, or individual community within a service area where facilities-based competition exists and the CLEC is able to serve 75% or more of the customers via its own facilities or facilities it leases from another carrier. Once this market trigger is met, all LECs should be allowed to offer all retail and special access services on a detariffed basis.

ACS expects that its competitors will advocate a different response to this policy initiative. Instead of detariffing, GCI is likely to recommend that the existing rules be continued with the ILEC being subjected to the nondominant tariffing requirements that currently apply to CLECs. This is the wrong approach. If markets have truly achieved "significant competition" as the Alaska Legislature suggests, they should

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Anchorage, AK 99503
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be deregulated as promised by the federal Telecommunications Act of 1996, which brought competition to these markets.[18]

Alluding to the earlier reference to the "invisible hand", providers should be driven by consumer expectations. Pricing should be a function of supply and demand. Forcing ILECs to continue to pre-announce their marketing plans and be subjected to the vagaries of an arcane tariffing process – even as a nondominant carrier – only perpetuates the very concerns that motivated the Legislature to prompt the instant rulemaking. As long as there is a regulatory distinction between ILECs and CLECs, there will be a distinction in the results of regulation. The only way to truly level the playing field is to open the doors wide to free and unfettered competition. ACS' proposed 3 AAC 53.220(e) would achieve that goal.

In competitive service areas as described above, all LECs should be fully detariffed and should be allowed to raise rates without review or approval of the commission. The marketplace will be a swift and stern disciplinarian for companies that misjudge the willingness customers to accept such changes. If necessary, basic residential service consumers can be protected with a "safety net".

[18] *Former Sen. Larry Pressler (R – S.D.), author of S. 652, The Telecommunications Competition and Deregulation Act of 1995, stated that, "The Federal Courts have ruled that the FCC cannot deregulate. This bill solves that problem and makes deregulation legal and desireable." (emphasis added) Senate floor comments re S. 652, 15106 Congressional Record, June 7, 1995.*

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600 Telephone Avenue, MS65
Anchorage, AK 99503
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If the Commission does not accept the public interest value of market freedom, it is left with only one other choice. Proposed rate increases by either ILECs or CLECs must be governed by exactly the same rules, filing requirements and cost support obligations. All proposed rate increases must be subjected to exactly the same standards of review. To the extent that CLECs must change their accounting conventions and related systems in order to meet the equal filing standards test, the Commission must so order. The often-heard CLEC claim that "we do not use USOA"[19] will no longer constitute a valid defense to the new statutory standard. Absent implementing ACS' detariffing proposal, there is no other alternative that would comply with the Legislature's direction in this regard.

9. The commission may deny any rate increase to protect the public.

In markets that have been deemed appropriate for competitive entry, the commission should, to the maximum extent possible, protect the public by allowing market forces to operate freely. Deregulation/detariffing is the approach most likely to provide the public protection embodied in this legislative policy initiative. Where retail price changes approach the outer limits of reasonableness, the commission should defer to competitive alternatives to provide consumer choice

[19] *The FCC prescribed and RCA adopted Uniform System of Accounts.*

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600 Telephone Avenue, MS65
Anchorage, AK 99503
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unless collective pricing abuses become obvious. The commission should only intervene to block a rate change when there is clear and convincing evidence that a carrier is setting rates outside the zone of reasonableness or where implicit collusion is detected.

To the extent that the Commission remains concerned about those customers least likely to be able to protect themselves, a "safety net" approach for basic residential service might be appropriate. Safety net options are numerous and might include a cap or other limitation on the amount that basic residential service rates could be increased annually during a transition period. Other jurisdictions, such as Wisconsin, have implemented rate limitations tied to affordability standards (i.e. basic residential service rates that are not greater than 1% of the median income of the relevant market or community.) ACS recommends that if a "safety net" model is used, it should also include a "safe harbor" component that grants providers market and pricing freedom as long as the "safety net" guidelines are met.

In addition to the "safety net" concept, public protection includes establishing a market structure that ensures the ongoing presence of competition. Ongoing competition turns on the financial health of the infrastructure provider. The "new paradigm" must include incentives to maintain current infrastructure and to invest in maintenance, growth and future technologies. Given the long history of "social ratemaking" and

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600 Telephone Avenue, M565
Anchorage, AK 99503
907. 297.3103 • Fax: 907. 297.3153

the widespread existence of implicit subsidies, the Commission should refrain from intervening in pricing decisions until there has been ample opportunity for rate rebalancing to occur. Retail rates and access rates should be allowed to move toward cost. In conjunction with the "safety net" concept, where the Commission finds that cost-based retail prices pose a threat to universal service, it should address the difference between its prescribed affordability standards and actual cost of service with support from the Alaska Universal Service Fund ("AUSF"). Companies that consistently price below the AUSF trigger, however, should continue to operate on a detariffed basis and exercise retail pricing freedom.

Implications of R-03-X

As noted in the introduction to these comments, the RCA has decided to issue a separate NOI seeking comment on whether it should petition the FCC for forbearance regarding certain TELRIC pricing principles. To date, the order commencing this new proceeding has not been released. However, the Commission did discuss a draft order at its June 25, 2003 Public Meeting. ACS relies on the content and general direction of the draft order in submitting these comments.

ACS has not yet formed an opinion on the FCC petition that will be the subject of this new NOI. However, ACS is convinced that FCC forbearance, as

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600 Telephone Avenue, MS65
Anchorage, AK 99503
907. 297.3103 • Fax: 907. 297.3153

described in the draft order, is unnecessary to address the issues brought before the Alaska Legislature and subsequently referred to this Commission for resolution in this docket. As ACS has stated in these comments, the RCA has ample discretion under existing law and existing FCC rules to move forward with the policy changes ACS has proposed. No additional legal authority or FCC pronouncements are needed.

ACS is not suggesting that the Commission abandon its new NOI. However, there are extreme dangers in linking the new NOI with R-03-3. Those dangers include attaching a new schedule for an FCC proceeding to the later (post-November 15; 2003) stages of R-03-3. This will have the effect of further delaying the important and near-term relief that this docket promises and that the competitive markets in Alaska desperately need. More importantly, linking the FCC petition to R-03-3 sends an erroneous and potentially threatening signal. Whether deliberately or by inadvertence, the Commission may create a situation where parties are incented to argue federal preemption where no such preemption exists. In each and every instance noted in ACS's comments, the RCA today has the authority to reform its policies and practices in conformance with the legislative principles and the nine policy initiatives. Drawing a connection between this docket and the FCC petition will incorrectly cause some to believe that no UNE pricing changes are possible unless and until an FCC waiver has been secured. This conclusion is false and must be avoided.

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600 Telephone Avenue, MS65
Anchorage, AK 99503
907. 297.3103 • Fax: 907. 297.3153

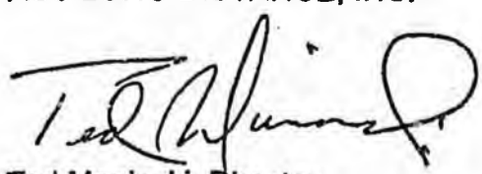
Again, ACS has not formed an opinion on the merits of the FCC forbearance petition, but looks forward to offering the Commission its opinion on the matter when the new docket is commenced. Like the many other important and related issues reserved for further consideration in R-02-6, the new NOI should be allowed to proceed on a normal rulemaking course. It should not be consolidated with or otherwise linked to the results expected to be produced in this proceeding.

Conclusion

ACS appreciates the opportunity to present these comments and looks forward to its further participation in this proceeding including the public hearing scheduled in this matter for September, 2003.

Respectfully submitted this 16th day of July, 2003,

ACS of ALASKA, INC.
ACS of ANCHORAGE, INC.
ACS of FAIRBANKS, INC.
ACS of the NORTHLAND, INC.
ACS LONG DISTANCE, INC.



Ted Moninski, Director
Regulatory Affairs/Carrier Relations

Alaska Communications Systems
600 Telephone Avenue, MS65
Anchorage, AK 99503
907.297.3103 • Fax: 907.297.3153

PROPOSED REGULATIONS

3 AAC 53.200. APPLICABILITY OF LOCAL EXCHANGE COMPETITION PROVISIONS, PURPOSE, AND WAIVER.

3 AAC 53.200(a) is amended[1] to read:

(a) The provisions of 3 AAC 53.200 - 3 AAC 53.299 apply to all local exchange carriers that furnish local exchange telephone service within [THE ANCHORAGE] **a competitive** service area **as defined by these regulations** [AND ANY OTHER SERVICE AREA AS ORDERED BY THE COMMISSION].

(b) The purpose of 3 AAC 53.200 - 3 AAC 53.299 is to allow competition in the provision of local exchange telephone service to the extent possible while maintaining and promoting universal local exchange telephone service.

3 AAC 53.200(c) is deleted: [(c) FOR GOOD CAUSE SHOWN, THE COMMISSION WILL, IN ITS DISCRETION, WAIVE THE APPLICATION OF ALL OR ANY PORTION OF 3 AAC 53.200 – 3 AAC 53.299 TO A LOCAL EXCHANGE CARRIER AND ESTABLISH APPROPRIATE CRITERIA FOR THAT CARRIER.] (Eff. 6/21/98, Register 146)

Authority: AS 42.05.141

AS 42.05.151

AS 42.05.221

AS 42.05.711

AS 42.05.990

3 AAC 53.210. LOCAL EXCHANGE TELEPHONE SERVICE: CERTIFICATE OF PUBLIC CONVENIENCE AND NECESSITY.

(a) An entity proposing to provide local exchange telephone service in competition with an existing local exchange carrier must file an application for a certificate of public convenience and necessity that includes

(1) the legal name and the name under which the applicant proposes to do business;

(2) the address of the principal national and Alaskan place of business;

(3) the name, title, and telephone number of the individual who is the liaison with the commission in regard to the application;

(4) the applicant's business structure (corporation, partnership, etc.), including proof of incorporation and name and address of registered agent, if applicable;

---

[1] *Changes to regulations are set out as follows: words being added are in boldface type and underlined; words being deleted are capitalized and enclosed in brackets. For new sections, etc., being added, the lead-in line identifies the material as new, and it is not underlined or in boldface type.*

EXHIBIT A

(5) proof of authority to do business in Alaska;

(6) a list of the owners of five percent or more of the applicant's equity;

(7) a list of persons or entities that are affiliated interests of the applicant;

(8) a list of all administrative and judicial proceedings that resulted in

(A) suspension, revocation, or denial of the authority, license, or certification of the applicant or its officers, directors, or affiliates to provide utility services;

(B) a reprimand, penalty, or conviction of an applicant or its officers, directors, or affiliates related to operations, gross misrepresentations, fraudulent transactions, or securities violations; or

(C) an adjudication of bankruptcy or a reorganization in bankruptcy of applicant or its officers, directors, or affiliates;

(9) a list of all cases and locations in which the applicant, its officers, directors, or affiliates, has abandoned service in violation of applicable statutes, regulations, or orders;

(10) a list of the names, titles, and responsibilities of key management now employed or to be employed by the applicant and resumes for each person;

(11) for existing businesses, copies of the most recent year's balance sheet and income statement or Federal Communications Commission Form M and, if available, Securities and Exchange Commission Form 10-K;

(12) for new businesses, copies of the most recent year's balance sheet and income statement for the owners of the business listed under (6) of this subsection;

(13) a list of all services proposed, together with an explanation of the applicant's technical ability to provide the proposed services;

(14) a description of the area within which the entity proposes to provide local exchange service;

(15) a description of all existing facilities that will be used to provide local exchange telephone service;

(16) a description of all agreements or negotiations with other utilities for joint use and interconnection of facilities;

(17) a tariff of rates and services; and

(18) a verification signed by the person authorized to sign on behalf of the applicant that all of the information provided in the application is true, accurate, and complete.

(b) The commission will give notice of an application for a certificate of public convenience and necessity to provide local exchange telephone service in accordance with 3 AAC 48.645(a).

EXHIBIT A

(c) The commission will issue a certificate of public convenience and necessity to an entity that proposes to provide local exchange telephone service under 3 AAC 53.200 - 3 AAC 53.299 and that is found by the commission to be fit, willing, and able to provide the proposed service.

(d) The commission will, in its discretion, place conditions on a certificate of public convenience and necessity that it considers appropriate, including a condition that the local exchange carrier post a bond to assure compliance with commission rules. (Eff. 6/21/98, Register 146)

Authority: AS 42.05.141

AS 42.05.151

AS 42.05.221

AS 42.05.241

AS 42.05.711

AS 42.05.990

3 AAC 53.220. DETERMINATION OF DOMINANT STATUS

3 AAC 53.220 is amended to read:

[(a) UPON PETITION OR ON ITS OWN MOTION, THE COMMISSION WILL, IN ITS DISCRETION, DETERMINE WHETHER A LOCAL EXCHANGE CARRIER HAS MARKET POWER IN ITS SERVICE AREA AND, AS APPROPRIATE, DESIGNATE OR CHANGE THE DESIGNATION OF THE LOCAL EXCHANGE CARRIER AS DOMINANT OR NONDOMINANT.]

(a) [UNTIL CHANGED UNDER (a) OF THIS SECTION,] **The** incumbent carrier in any service area is a dominant carrier **until such time as: (i) a Competitive Local Exchange Carrier ("CLEC"); or (ii) any other entity that has been designated as a Competitive Eligible Telecommunications Carrier ("CETC") commences to offer service in that service area. [**. AND A] **All CLECs entering a service area** [OTHER LOCAL EXCHANGE CARRIERS IN THAT SERVICE AREA] are nondominant carriers. (Eff. 6/21/98, Register 146)

(b) Upon commencement of CLEC or CETC service in a previously non-competitive service area, and in any manner that offers a majority of consumers in that service area a choice of providers, the incumbent carrier's status under this section is changed to nondominant.

(c) An ILEC that has its status changed to nondominant per (b) of this section will continue to function as Carrier of Last Resort.

(d) Nondominant carriers are free to increase or decrease retail rates. Except as noted in (e) of this section, nondominant carriers remain subject to "notice tariff" filing requirements as further described in 3 AAC 53.240.

EXHIBIT A

(e) In competitive markets as defined in 3 AAC 53.299(6), and where a CLEC or CETC offers facilities-based service, via its own facilities or the unbundled network elements of another LEC, capable of reaching 75% or more of the customers in that market, all retail and special access product and service offerings of all local service providers will be detariffed. Local service providers will post rates, terms and conditions for all retail product and service offerings on their Internet web pages and will make the same information available to consumers at the providers' primary places of business and any other business offices that are maintained.

Authority: AS 42.05.141

AS 42.05.151

AS 42.05.221

AS 42.05.711

AS 42.05.990

3 AAC 53.230. DISCONTINUANCE, SUSPENSION, OR ABANDONMENT OF SERVICE BY NONDOMINANT CARRIER

3 AAC 53.230 is amended to read:

(a) A nondominant carrier may discontinue, suspend, or abandon all of its local exchange telephone service at the end of the 30-day notice period required by (b) of this section unless the commission finds that continuation of the service is required for the public convenience and necessity.

(b) A nondominant carrier proposing to discontinue, suspend, or abandon local exchange telephone service shall provide at least 30 days' written notice to the commission, to its subscribers, and to every other local exchange telephone company and each interexchange carrier providing service to locations where the discontinuance, suspension, or abandonment is proposed. (Eff. 6/21/98, Register 146)

(c) A nondominant carrier required to make "notice tariff" filings per 3 AAC 53.220(c) and 3 AAC 53.240 may discontinue an individual retail product or service offering by making the appropriate "notice tariff" filing. The Commission will only intervene to limit such action where a party has made a clear demonstration that continuation of the product or service is required for the public convenience and necessity and is not otherwise available from another provider.

(d) A nondominant carrier operating in a competitive market described in 3 AAC 53.220(e) that has had its retail and special access product and service offerings detariffed will provide reasonable notice of intent to discontinue an individual retail product or service offering via its Internet web page. The Commission will only intervene to limit such action where a party has made a clear demonstration that continuation of the product or service is required for the public convenience and necessity and is not otherwise available from another provider.

EXHIBIT A

Authority: AS 42.05.141

AS 42.05.151

AS 42.05.221

AS 42.05.241

AS 42.05.711

AS 42.05.990

3 AAC 53.240. RETAIL RATES

3 AAC 53.240 is amended to read:

(a) Except as otherwise provided for in 3 AAC 53.220(e), [A]a nondominant carrier shall maintain a current tariff of retail and special access rates and all special contracts for retail and special access products and services [RATES] on file with the commission. A nondominant carrier may modify retail and special access rates and implement special contracts for retail and special access service by filing a "notice tariff" with the Commission. [WITHOUT APPROVAL OF THE COMMISSION] [A]After 7 [30] days' notice to the commission of a "notice tariff" filing, [SUBMITTED IN ACCORDANCE WITH 3 AAC 48.220, 3 AAC 48.240, 3 AAC 48.270 AND 3 AAC 48.290(F)] the tariff change will automatically go into effect without further affirmative approval action by the Commission. The Commission will only intervene to limit such "notice tariff" filings where a party has made a clear demonstration that the proposed tariff change results in below-cost pricing or is unreasonably discriminatory.

(b) [THE DOMINANT CARRIER SHALL MAINTAIN A CURRENT TARIFF OF RETAIL RATES AND ALL SPECIAL CONTRACTS FOR RETAIL RATES ON FILE WITH THE COMMISSION. THE DOMINANT CARRIER MAY REDUCE RETAIL RATES, OFFER NEW OR RE-PACKAGED SERVICES, AND IMPLEMENT SPECIAL CONTRACTS FOR RETAIL SERVICE WITHOUT APPROVAL OF THE COMMISION AFTER 30 DAYS' NOTICE TO THE COMMISSION OF A TARIFF FILING SUBMITTED IN ACCORDANCE WITH 3 AAC 48.220, 3 AAC 48.240, 3 AAC 48.270, AND 3 AAC 53.290(F). A TARIFF REVISION BY THE DOMINANT CARRIER TO INCREASE A RATE IS SUBJECT TO THE PROVISIONS OF 3 AAC 48.200 – 3 AAC 48.430.]

[(c) NOTWITHSTANDING (A) or (B) OF THIS SECTION, THE COMMISSION WILL DISAPPROVE AND REQUIRE MODIFICATION OF RATES THAT ARE NOT JUST AND REASONABLE OR THAT GRANT AN UNREASONABLE PREFERENCE OR ADVANTAGE TO ANY CUSTOMER OR SUBJECT A CUSTOMER TO AN UNREASONABLE PREJUDICE OR DISADVANTAGE.]

(Eff. 6/21/98, Register 146)

Authority: AS 42.05.141

AS 42.05.151

EXHIBIT A

AS 42.05.221

AS 42.05.241

AS 42.05.431

AS 42.05.711

AS 42.05.990

3 AAC 53.250. WHOLESALE SERVICE AND RATES.

3 AAC 53.250 is amended to read:

(a) A local exchange carrier shall offer all its services for resale to other carriers **at retail rates**. Services **may** [MUST] be offered for resale at wholesale rates **as specifically provided for in interconnection agreements or other commercially negotiated arrangements.** [TO THE EXTENT DETERMINED APPROPRIATE IN VIEW OF THE FACILITIES AND GENERAL SERVICE OFFERINGS OF THE LOCAL EXCHANGE CARRIER.] **A CLEC that has an established interconnection agreement with an incumbent provider is obligated to offer reciprocal services and unbundled network elements at rates, terms and conditions at least as favorable as those found in the interconnection agreement.**

(b) [THE COMMISSION WILL DISAPPROVE AND REQUIRE MODIFICATION OF WHOLESALE RATES THAT ARE NOT JUST AND REASONABLE OR THAT GRANT AN UNREASONABLE PREFEENCE OR ADVANTAGE TO ANY CUSTOMER OR SUBJECT A CUSTOMER TO AN UNREASONABLE PREJUDICE OR DISADVANGTAGE.] (Eff. 6/21/98, Register 146)

Authority: AS 42.05.141

AS 42.05.151

AS 42.05.221

AS 42.05.241

AS 42.05.431

AS 42.05.711

AS 42.05.990

3 AAC 53.260. CHANGES IN LOCAL EXCHANGE CARRIER

(Eff. 6/21/98, Register 146; repealed 11/11/2001, Register 160)

3 AAC 53.280 is added to read:

3 AAC 53.280. UNBUNDLED NETWORK ELEMENT PRICING

(a) Unbundled network element prices will be determined in conformance with the federal Telecommunications Act of 1996, the rules of the Federal Communications Commission adopted thereunder, and any other applicable state law.

(b) In addition to the requirements prescribed by (a) of this section, the following additional guidelines will apply to the pricing of unbundled network elements:

(1) In selecting a pricing model for unbundled network elements, the Commission will use the FCC's "hypothetical network standard" and will presume the existence of the most efficient technology actually deployed by the providing company.

(2) The Commission will ensure that the unbundled network element pricing model conforms to industry standard design and construction criteria and adheres to all applicable state and local laws.

(3) Unbundled network element prices will be based on the reasonably anticipated forward looking cost of the company providing the network elements.

(4) Reasonably anticipated forward looking costs, including but not limited to the cost of labor and materials, will be determined by using the providing company's current actual cost adjusted for future changes.

(5) In setting prices for unbundled network elements, the Commission will use fill factors that conform to industry standard design and construction criteria and adhere to all applicable state and local laws. Fill factors should reflect a reasonable projection of actual total usage of the elements in question.

(6) Unbundled network element pricing will include a depreciation component that is based on the actual plant lives of the providing company. Actual plant lives will reflect the impact of technological change and the effects of competition. It is presumed that plant lives in competitive markets will be shorter than the ranges prescribed by the FCC for interstate services. Accelerated depreciation in competitive markets is deemed reasonable.

(7) In evaluating the cost of capital component for unbundled network element pricing, the Commission will give consideration to the additional risks confronted by a providing company that operates in a competitive environment. It is presumed that application of a competitive risk premium will result in a higher cost of capital than prescribed by the FCC for interstate services.

3 AAC 53.290. MISCELLANEOUS PROVISIONS

3 AAC 53.290 is amended to read:

(a) The provisions of 3 AAC 48.230, 3 AAC 48.270, 3 AAC 48.275, 3 AAC 48.277, and 3 AAC 48.430 do not apply to a nondominant carrier that is required to make "notice tariff" filings per 3 AAC 53.220(c) and 3 AAC 53.240.

(b) [THE PROVISIONS OF 3 AAC 48.275 DO NOT APPLY TO THE DOMINANT CARRIER FOR RATE DECREASES, NEW SERVICES, AND REPACKAGING OF EXISTING SERVICES.]

(c) [A DOMINANT CARRIER IS RESPONSIBLE FOR PROVIDING LOCAL EXCHANGE TELEPHONE SERVICE IN ITS SERVICE AREA AS THE CARRIER OF LAST RESORT.]

(b) The provisions of 3 AAC 53.190 govern the reassignment of a subscriber's access line or lines to a different local exchange carrier.

(e) [NO IMPLICIT MODIFICATION OR WAIVER OF ANY STATUTORY OR REGULATOYR REQUIREMENTS IS INTENDED BY 3 AAC 53.200 – 3 AAC 53.299 FOR EITHER DOMINANT OR NONDOMINANT CARRIERS. ABSENT SPECIFIC MODIFICATION OR WAIVER, ALL STATUTORY AND REGULATORY REQUIREMENTS REMAIN IN EFFECT FOR BOTH DOMINANT AND NONDOMINANT CARRIERS.]

(c) A local exchange carrier **subject to 3 AAC 53.220(c) and 3 AAC 53.240 regarding "notice tariff" filings** shall publish a public notice of all proposed tariff revisions in a local, general circulation newspaper no later than three days after filing it with the commission. The public notice must contain a general description of the filing that is accurate, written in plain English, and sufficient to alert consumers of tariff revisions that may affect either the rules or rates applicable to them. The notice must contain sentences containing the following information: the date the utility made (or will make) its filing with the commission: the date the revisions are expected to become effective; and a statement that both the proposed revisions and the utility's current tariff are available for review at the utility's office for which an address and office hours are given. The notice must contain a sentence[S] similar to the following: "Any person may file comments on this tariff revision with the **Regulatory Commission of** Alaska [PUBLIC UTILITIES COMMISSION] (address). [To ASSURE THAT THE COMMISSION HAS SUFFICIENT TIME TO CONSIDER THE COMMENTS PRIOR TO THE REVISIONS TAKING EFFECT, (UTILITY NAME) SUGGESTS THAT YOUR COMMENTS BE FILED NO LATER THAN (A SPECIFIC DATE, NOT A WEEKEND OR HOLIDAY, APPROXIMATE 7-10 DAYS PRIOR TO THE FILING'S TAKING EFFECT)."]

(d) Where all necessary facilities and equipment are in place, a local exchange carrier shall complete the transfer of a customer to another local exchange carrier within seven working days of receiving a valid order for transfer of service.

(e) All local service providers in a competitive local market are free to bundle products and services. Bundles may include either a multiple of local exchange products and services or may combine local with non-local products and services including intrastate long distance services. To the extent that local and long distance bundling might conflict with the requirements of 3 AAC 52.370(a), the Commission expressly waives application of this regulation to bundled offers that include a long distance component.

(f) All local service providers in a competitive local market are free to structure their companies and business units in any manner not otherwise prohibited by federal, state and local laws. Structural separation of business units will not be required. Local service providers and their affiliates are free to jointly own and operate infrastructure, including

networks, switches and other facilities, that may used to provide local service as well as other services. All local service providers are free to exercise joint and common use of all resources, including staff resources, with other affiliated business units.

(Eff. 6/21/98, Register 146; am 11/11/2001, Register 160)

3 AAC 53.299 is amended to read:

3 AAC 53.299. DEFINITIONS

Unless the context indicates otherwise, in 3 AAC 53.200 - 3 AAC 53.299,

(1) ["ANCHORAGE SERVICE AREA" MEANS THE SERVICE AREA CERTIFICATED TO ATU TELECOMMUNICATIONS BY CERTIFICATE OF PUBLIC CONVENIENCE AND NECESSITY NO. 120 AS OF APRIL 8, 1998;]

(1) "commission" means the Regulatory Commission of Alaska [PUBLIC UTILITIES COMMISSION;]

(3) ["DOMINANT CARRIER" MEANS A LOCAL EXCHANGE CARRIER DETERMINED BY THE COMMISSION TO HAVE MARKET POWER;]

(2) "incumbent carrier" means the telephone utility, or its successor, certificated to provide local exchange telephone service within its service area as of February 8, 1996;

(3) "interexchange carrier" means a carrier certificated by the commission to provide intrastate interexchange telephone service;

(4) "local exchange carrier" means a carrier certificated to provide local exchange telephone service;

(5) "nondominant carrier" means a local exchange carrier providing service in a competitive local exchange market [OTHER THAN A DOMINANT CARRIER;]

(6) "competitive local exchange market" or "competitive local market" or "competitive service area" means a certificated local exchange service area that has multiple local providers or CETCs in which the majority of customers has a choice of service providers. In serving areas that encompass multiple communities, the "competitive local market" determination will be community-specific.

(7) "recorded authorization" means a voice communication that clearly grants the authority to transfer a customer's local exchange service from one local exchange carrier to another and that may be accurately retrieved for later review.

(Eff. 6/21/98, Register 146)

Authority: AS 42.05.141

AS 42.05.151

AS 42.05.720

EXHIBIT A

STATE OF ALASKA

THE ALASKA PUBLIC UTILITIES COMMISSION

Before Commissioners:

Mark K. Johnson, Chair
Kate Giard
Dave Harbour
James S. Strandberg
G. Nanette Thompson

In the Matter of the Commission Review of Rules and Regulations Governing Telecommunications Rates, Charges Between Competing Telecommunications Companies, and Competition in Telecommunications	)	R-03-03

AFFIDAVIT OF DALE E. LEHMAN
ON BEHALF OF
ALASKA COMMUNICATIONS SYSTEMS

I. BACKGROUND AND PURPOSE

1. My name is Dale E. Lehman. I am Director of the MBA Program in Telecommunications Management at Alaska Pacific University. My comments reflect my views and not that of my employer. I have previously held positions at Saint Mary's University, the University of Santa Clara, California State University at San Luis Obispo, Willamette University, the University of Colorado, Fort Lewis College, Bellcore, Villanova University, and Southwestern Bell Telephone Company. I have a B.A. in Economics from the State University of New York at Stony Brook and M.A. and Ph.D. degrees in Economics from the University of Rochester. I have numerous publications, primarily in the area of telecommunications economics. My complete vitae and list of prior testimony is provided in Attachment 1.

EXHIBIT B

2. The purpose of my affidavit is to provide guidance to the Regulatory Commission of Alaska (RCA) on appropriate modifications to the regulation of retail telecommunications services in the wake of the Telecommunications Act of 1996, its subsequent implementation, and the market evolution in Alaska. It becomes both appropriate and necessary for the RCA to change the way it regulates retail telecommunications services once the pro-competitive forces of the Act are in place. I will explain the theory of how and when retail service deregulation should accompany the development of competition. I will also explain how other states have been addressing issues of retail/wholesale regulation and deregulation.

II. The local telecommunications market in Alaska is more competitive than elsewhere.

3. The latest FCC data shows that 13% of the national end-user switched access lines are served by competitive local exchange carriers (CLECs).[1] State-level data is provided for most states except those where there are a small number of CLECs (including Alaska) to protect firm

[1] Local Telephone Competition: Status as of December 31, 2002. FCC, released June. 2003.

confidentiality. Among the states for which the FCC reports state-specific data, the average CLEC market share is 12.6%.[2] Alaska, for which public data is not available, has approximately a 24% statewide average CLEC market share, surpassed only by New York State (at 25%).[3] So, local competition in Alaska is robust – even more so if we look at the major urban market *within* the state. Table 1 compares CLEC entry data for the New York metro area and Anchorage. Note that the New York data is for December, 2001 and the Alaska data is for May, 2003[4]:

Table 1: Competition within New York and Alaska

Urban Area	CLEC share of lines	Average Local Revenue per Line[5]	Residential POTS price
New York metro	26%	$42.97	$25.07
Anchorage	49.5%	$37.45	$17.50

4. Table 1 reveals that the Anchorage market is more competitive than the market in New York City. The rest of the United States lags far behind New York and

[2] This average is unweighted by population. Most of the states for which data is withheld are smaller states. The 13% nationwide CLEC market share is a bit higher than this unweighted state-level average because it (1) counts states equally, while larger states generally have more extensive CLEC entry, but (2) it omits mostly smaller states (with less extensive CLEC entry). The net effect of (1) and (2) results in a slightly lower unweighted state average than the national average CLEC share of lines.

[3] The Alaska estimate is based on ACS data for December 31, 2002 of CLEC shares of 48.1%, 21.5% and 11.6% in Anchorage, Fairbanks, and Juneau, respectively, and total statewide switched lines of 466,880. CLEC shares have increased significantly since December, 2002 (to 49.5%, 21.9%, and 16.8%, respectively) but no comparable data for other states is yet available past that time.

[4] Data is for December 31, 2001 from the New York State Public Service Commission, www.dps.state.ny.us/telecom/bus_or_res_by_reg.htm. Alaska data for December 31, 2001 shows a CLEC share of 43.3% in Anchorage and much lower shares in Fairbanks and Juneau since competition had barely begun in those markets (it had not yet started in Juneau). The New York data probably did not change much from 2001 to 2003: the latest FCC data shows the overall CLEC share of the New York state market at 25%, up from 24% in 2001.

Alaska in terms of CLEC market entry, as does the rest of the world.[6] Retail competition is well-established in Alaska in markets where unbundling and interconnection policies are in effect. It is also evident that average revenues are higher in New York than Alaska, at least in the largest market. Local residential service is priced higher in New York: $25.07/month in New York City compared with around $17.50/month in Anchorage,[7] partially as a result of a decade of increased pricing flexibility accorded the dominant incumbent provider. So, Alaska is at least as competitive as New York State, and Anchorage is considerably more competitive than any urban area in New York, often considered the most competitive local markets in the country.[8] Retail (de)regulation needs to reflect this fact.

III. Economic theory clearly <u>requires</u> retail deregulation when wholesale unbundling and interconnection policies are in place.

5. Economic theory views competitive forces as better at achieving social welfare than regulatory processes, when competition is viable. Regulation has historically been seen as a *substitute* for competition – hence, as competition develops, regulation becomes both less necessary and less desirable. The Telecommunications Act of 1996 (the Telecom Act) embodies the goal to establish a "pro-competitive,

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[5] The New York State Public Service Commission reports the average revenue per line as the arithmetic average of residential and business revenues per line. I averaged the business and residential revenues per line provided by ACS to get a comparable figure. Both averages are for 2001.

[6] The OECD reports that only the United Kingdom has more local competition than the US (with 19.8% CLEC market share), *OECD Communications Outlook 2003*. Notably, the OECD reports that there were only 785 unbundled local loops used by CLECs (in May, 2002) in the whole country – the bulk of the local competition is through cable telephony.

[7] This data is from the FCC Reference Book on Prices and includes subscriber line charges, taxes, and universal service payments. The FCC reports the Anchorage rate as $15.23 – this was prior to the recent rate increase, so the above figure adjusts for that increase.

[8] Rochester is the urban market in New York State showing the highest CLEC share of lines: 28% in 2001. Notably, Frontier Communications is the largest CLEC in the Rochester market and is a subsidiary of the ILEC in the same market.

EXHIBIT B

deregulatory national policy framework" for local competition.[9] The FCC Interconnection Order 96-98 set out the requirements for unbundling, interconnection, and resale that form the basis for facilitating local exchange entry. That order was silent, however, on the role of retail rate regulation – because retail local rate regulation was in the state, not federal, jurisdiction. Thus, we find ourselves in a situation where local markets have been opened to competition by Federal law, in varying degrees, and the regulation of retail local rates under state law needs to be re-examined in that light. Alaska is at the forefront of facing these issues.

6. Little about the Telecom Act has been uncontroversial. Nothing has proven more contentious than the pricing of unbundled network elements (UNEs) and the FCC methodology established for this purpose (TELRIC: Total Element Long-Run Incremental Cost). Despite this continuing controversy, economic opinions about the relevance of retail regulation are strikingly uniform. Consider the following statements by the chief architect of the FCC's TELRIC methodology (Joseph Farrell was Chief Economist at the FCC when they issued the 96-98 Order detailing the TELRIC methodology) and Alfred Kahn, the most vocal opponent of the TELRIC methodology:

> *Smoothly functioning wholesale regulation...permits and indeed almost demands retail deregulation. If multiple providers can compete for a customer's business and promptly supply it at reasonable overall cost, even if they do so by leasing the incumbent's facilities, then it would seem that prompt deregulation of all charges to the provider's end-users will be appropriate...Indeed if regulators continue to regulate the incumbent's retail prices, and don't happen to replicate the solution that the incumbent and the customer find jointly most beneficial, it puts the incumbent at an artificial competitive disadvantage.*[10]

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[9] Joint Explanatory Statement at 1.

[10] Farrell, Joseph (1997) "Prospects for Deregulation in Telecommunications (revised version)," May 30. (available at http://www.fcc.gov/Bureaus/OPP/Speeches/jf050997.html).

and

> *What has yet to be generally remarked is that in telecommunications the obligations imposed on the ILECs by the Telecommunications Act and complementary state policies have come as close as conceivable to making the provision of telephone services at retail perfectly contestable and therefore regulation of the retail rates simply unnecessary. What these provisions do, at the extreme, is to reduce the sunk costs associated with entry into retailing close to zero....*
>
> *The implications of this new situation are, nevertheless, dramatic. What it means, specifically, is that the typical requirements in governing statutes or regulations for reclassifying the entire range of retail local telephone services as competitive will, as a matter of economics, be satisfied by these rules. In these circumstances, deregulation of the retail operations of the ILECs becomes not just possible but mandatory. Effective competition demands that they have the identical freedom to compete at that level as is now enjoyed by their competitors...*[11]

7. The theory is straightforward: suppose there is a single bottleneck facility (the local loop) for which regulators have guaranteed competitive access at a regulated price p. Assume all the other costs of local service are embodied in a per unit cost c_I for the incumbent and c_E for a competitive entrant. The competitive entrant can charge a price for local service as low as $p+c_E$. This becomes a ceiling on what the incumbent can then charge (assuming, for now, that the service is undifferentiated in quality). If the incumbent's cost for the non-bottleneck elements is lower than c_E, then the incumbent can offer the lower price. Where the incumbent's cost for non-bottleneck elements exceeds c_E, the entrant will have the lower price (and the incumbent will only supply the bottleneck input). Thus, consumer interests will be served without requiring any direct regulation of retail prices.[12]

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[11] Kahn, Alfred E. (1998) *Letting Go: Deregulating the Process of Deregulation*, Michigan State University Institute of Public Utilities.

[12] This analysis is further developed in Kolesar, Mark and Dennis L. Weisman (2003) "Accommodative Competitive Entry Policies and Telecommunications Regulation." *info*, volume 5, number 1, June 2003.

8. Presence of quality differences between incumbent and entrant services do not alter this basic argument. In fact, they strengthen the argument for retail deregulation. Retail pricing by the incumbent is constrained by the regulated price of the bottleneck input. If the incumbent's service is superior in quality, the incumbent will be able to charge a premium for that quality. Conversely, if the entrant's service is judged to be superior, the incumbent will have to discount their retail service to reflect this fact. The relative quality of the offerings is judged by the market and consumers will pay no more than the value they place on the service.[13]

9. Consumer welfare is enhanced by the fact that they have a *choice* of provider. Retail providers compete on both price and quality, and regulation of the incumbent's price and/or quality can only restrict the choices that consumers have – thereby reducing their welfare. The Act envisions choice – and deregulation – to eventually be expanded to wholesale markets as well. That is, once there is sufficient competition in the (formerly) bottleneck input, regulation of price and quality in this market is no longer efficient.

10. When is there sufficient competition in the retail market so as to make retail deregulation appropriate? As the above statements by Professors Farrell and Kahn indicate, the availability of UNEs should itself be enough to deregulate retail services of the incumbent. Added insurance can be provided by requiring that entry has occurred – that UNEs are available and being purchased by a competitive entrant. No market share threshold is required and none is advisable.

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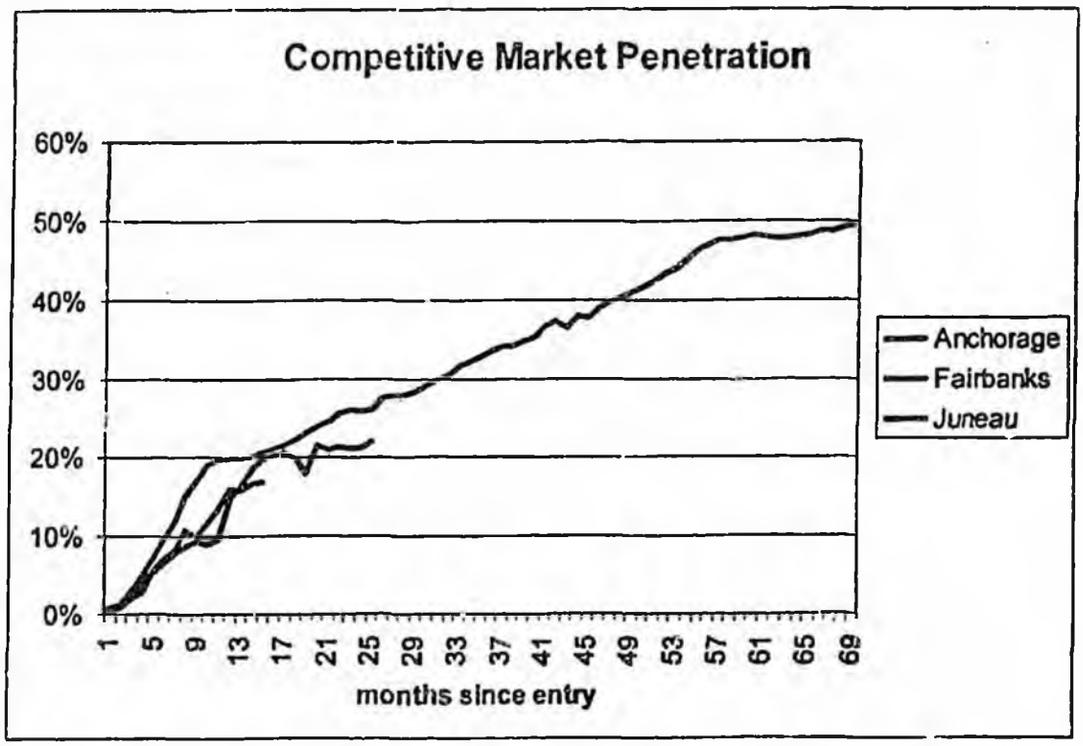
[13] This argument is enhanced by the fact that regulators do not solely set the price for the bottleneck facility – they also ensure it is equal in quality for the entrant as for the incumbent.

11. This point is underscored by looking at the entry statistics for markets in Alaska. Chart 1 shows the monthly market shares for CLECs in the Anchorage, Fairbanks, and Juneau markets upon initial market entry:[14]

Chart 1: CLEC Market Share as a Function of Months since Entry



12. CLEC market entry has been rapid in each case. It is imperative that all retail providers have the same ability to compete once entry has occurred. The choice of any market share threshold would be arbitrary and could only serve to *guarantee* a minimum market share for the entrant. Guarantees are not consistent with competition. If the incumbent provider is able to change the above trends through retail flexibility, then it is consumers that benefit as a result. Competition means that the evolution of

[14] The data series begin in September, 1997 for Anchorage, July, 2001 for Fairbanks, and March, 2002 for Juneau. These are the first months for which entry is reported in each market.

market shares results from the relative ability of competitors to satisfy consumer demands, not due to regulatory fiat.

IV. Failure to deregulate retail services threatens competition and will reduce consumer welfare.

13. Continued regulation of an incumbent provider, after UNE rates have been established and are being used, will result in a managed market rather than a competitive market. Competition is a dynamic process. Firms win and lose, enter and go out of business, and reorganize/restructure to improve efficiencies. Stable market shares are *not* a characteristic of competitive markets.[15] Imposing greater restrictions on an incumbent provider than on a competitive entrant unfairly advantages the competitor. Consumer choices are more limited than they should be, and competition is more muted than it could be. Regulators must be willing to trust the competitive forces they have put into place, and this means permitting pricing, bundling, promotions, and quality levels to be determined by competition.

14. Continued regulation of incumbent retail services runs the risk of leading to a single provider – the entrant – as survivor. Handicapping the incumbent can threaten their viability. If only the entrant can survive, then competition will have been transient. One monopoly will have been replaced by another monopoly. Consumer choice is served by permitting all providers to freely compete at the retail level (assuming either that there is no bottleneck or that it has been neutralized through the

[15] A case in point is the airline industry. Regulation produced stable market shares for 40 years; market shares have been volatile since deregulation (see Breyer, *Regulation and Its Reform*, MIT Press, 1984). Regulation based on market shares entailed significant welfare losses and we should expect the losses in telecommunications markets to be even greater, primarily due to the higher degree of technological innovation in telecommunications.

provision of UNEs). Only then can we be assured that providers' survival will depend on their ability to satisfy consumers and not on their ability to obtain preferential regulatory treatment.

15. There are other significant costs to continued retail regulation. Regulation is a costly process – both to firms (regulated and unregulated) and to regulators. These costs can be substantial. Rate cases, interventions in rate cases, delay of new offerings, and time and money spent in detailed contentious proceedings are a drain on society's resources. These costs may be justified when there is a corresponding benefit. When retail regulation becomes superfluous, however, there is no benefit to offset these costs.

16. The RCA still has authority to receive consumer complaints and to protect the public. Deregulation of retail services (upon the use of UNEs by competitors) shifts the primary responsibility to the market where it belongs, leaving the RCA residual power to intervene when conditions warrant. In a competitive market, such intervention should be carefully constructed to be consistent with competition and not premised on the existence of a single monopoly provider.

V. Other states, with less developed competition than Alaska, are relaxing retail regulation in accordance with theoretical guidance. Alaska should be in the lead in doing so.

17. A number of states have moved in the direction of deregulation of retail services. Table 3 shows some recent developments.

Table 3: State Deregulatory Developments[16]

State	Year	Business Services	Residential Services	Residential Flat-rate Price[17]	CLEC market share
NJ	2002	Full pricing flexibility for 4+ lines; max. of 10% annual increase for 2-4 lines	Capped at current levels	$14.68	10%
MA	2003	Full pricing flexibility	Rebalanced: $2.44/month increase; found that residential rates are $6/mo below cost	$24.16	17%
NY	2002	Full pricing flexibility	Max. increase of $2-$3/year; overall limit of 3% annual increase in total company revenues	$19.02 - $29.09	25%
RI	2003	Full pricing flexibility	Max. annual increase of $1/month for 2-3 years; max. annual price changes of 5-15% for other services	$24.68	22%

[16] Sources for these state decisions are as follows:

- New Jersey Board Of Public Utilities (2002) Board Meeting in Docket No. T001020095 – In the Matter of the Application of Verizon-New Jersey, Inc. for Approval (i) of a New Plan for an Alternative Form of Regulation and (ii) to Reclassify Multi-Line Rate Regulated Business Services as Competitive Services.
- Massachusetts Department of Telecommunications and Energy (2003) DTE 01-31-Phase II, Investigation by the Department of Telecommunications and Energy on its own Motion into the Appropriate Regulatory Plan to succeed Price Cap Regulation for Verizon New England, Inc. d/b/a Verizon Massachusetts' intrastate retail telecommunications services in the Commonwealth of Massachusetts, April 11.
- New York Public Service Commission (2002) Order Instituting Verizon Incentive Plan, Cases 00-C-1945 and 98-C-1357, February 27.
- Rhode Island(2003): Verizon Rhode Island Alternative Regulation Plan, Docket No. 3445, Order No. 17417, March 31.

[17] The residential flat-rate monthly prices are those reported in the Reference Book of Rates, Price Indices, and Household Expenditures for Telephone Service, and refer to urban prices in selected cities in each state. Alaska's reported rate for Anchorage is $15.23 and includes, according to the FCC document, subscriber line charges, taxes, and universal service charges. This data does not appear to include the latest rate increase in Alaska which would put the current rate close to $17.50.

18. Recall that Alaska has more competition (except possibly for NY). It is also important to note that all of the above states are states in which the incumbent RBOC has been granted section 271 authority to offer inter-LATA long-distance service. This is a significant revenue opportunity for the incumbent provider that can offset some of the competitive losses that have occurred. All of the above states have also had price cap regulation, rather than rate-of-return regulation in place for several years. This means that the incumbent provider has had significant pricing flexibility prior to these recent decisions. Finally, residential service prices in Alaska appear to be on the low end of those in these other states (except for New Jersey).

19. States continue to modify their retail regulatory regimes as the impacts of growing retail competition are felt. North Carolina, for example, recently passed legislation that removes requirements for local exchange carriers to seek commission approval for any promotion or bundled service offering for residential or business customers (only one days notice will be required).[18] It is clear that such efforts will increase as competition continues to evolve. It is also clear that Alaska cannot afford to wait until other states act – competition is more developed here than elsewhere. Availability of UNEs essentially removes the incumbent's ability to raise prices above competitive levels. So, retail price regulation is no longer necessary or desirable.

VI. Carrier-of-last-resort (COLR) policy and exit policy (the other side of the COLR coin) must also be consistent with the establishment of retail competition.

20. Deregulation of retail services (upon facilities-based entry) may raise an additional regulatory concern. What happens if either the incumbent provider wishes to

discontinue service for a customer or group of customers, or no provider is willing to provide service to a new location? In the past, this "carrier-of-last-resort" (COLR) responsibility has resided with the "dominant" or incumbent provider. In a competitive market, COLR cannot rest with one provider that is trying to compete with providers that do not have these costly obligations. The COLR responsibility requires a competitively neutral funding mechanism.

21. First, it is worthwhile to consider two other industries that have faced similar "exit" issues (under what conditions may the incumbent exit a particular market?). The railroad industry was long regulated to continue service even on unprofitable routes. The industry was practically driven to bankruptcy, largely due to such exit restrictions. The Staggers Act in 1980 finally permitted exit from unprofitably routes (and deregulated most other practices of railroads) and the industry has finally stabilized. Consider the following portrayal of the regulation era:

> *"Much of railroading's failure to keep pace with changing economic circumstances has been laid at the door of the federal regulatory regime. Railroads had been the economy's most regulated industry since passage of the Act to Regulate Commerce in 1887, which established the ICC, America's first independent regulatory agency. At one point there were said to be more than a trillion railroad rates on file with the ICC, and each one had to be "just and reasonable" or it was unlawful. To change a rate, discontinue a service, or issue securities, a railroad had to seek permission from the ICC in adversary proceedings, where other parties (including other railroads) could invoke a huge body of law and precedents in an attempt to stop almost any market initiative.*[19]

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[18] Telecommunications Reports, June 15, 2003, page 39. According to the report, several CLECs asked the governor to veto the legislation (which he did not), arguing that it effectively would deregulate basic telecommunications services simply by bundling them with unregulated services.

[19] A good review of the regulatory experience of railroads can be found in Gallamore, "Regulation and Innovation: Lessons from the Railroad Industry," chapter 15 in Gomez-Ibanez, Tye, and Winston, editors, *Essays in Transportation Economics and Policy: A Handbook in Honor of John R. Meyer*, The Brookings Institution, 1999, pages 499-500.

22. The degree of regulatory oversight may have been (arguably) greater than for incumbent local telephone providers but the industry was slow-moving compared with the speed of light present in telecommunications. Both industries share competitive inter-modal pressures (highways for railroads, CATV and wireless for local wireline). Freedom of exit was necessary for the survival of railroads. Of course, this left many communities without railroad service – a result that we consider unacceptable for telecommunications.

23. Airline service is considered a necessity for many communities, particularly in Alaska. As a result, when the airline industry was deregulated in 1978, the Essential Air Service (EAS) program was established. Any community with scheduled air service upon passage of the Airline Deregulation Act was considered to be an EAS-eligible community. A carrier with sole service to such a community must give 90 days notice to exit from serving that community. First, a new carrier willing to service the community without subsidies is sought. If none comes forth, an RFP is issues to find a carrier. The incumbent carrier must continue to provide service during this time, but is compensated for its excess costs beyond the 90 day time limit until a new carrier is found. The program provides subsidies for continued service as a result of the RFP.[20] This is a competitively neutral way to provide COLR responsibilities and provides an incentive to reduce costs by having competitive bidding for the servicing of these otherwise unprofitable routes.

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[20] Details on the EAS can be found at www.ostpxweb.gov/aviation/rural/easfaqs.htm. Currently 26 Alaskan communities, and 78 communities outside Alaska, receive EAS subsidies.

24. Deregulation of retail services in competitive areas entails the possibility that some customers would lose service or, equivalently, that some customers would fail to get service. In order to ensure that all customers receive service, a competitively neutral mechanism is required.

25. The essential features of such a mechanism are that: (1) It cannot impose the costs of COLR responsibility on a single competitor in the market; (2) It can require that a single provider provide service, but must then establish a revenue source with which to compensate such a provider for any revenue shortfall associated with serving that customer or set of customers; and (3) As new facilities are constructed by multiple providers in a market, there needs to be equivalent and symmetric access to these facilities and interconnection with these facilities for all competitors.

26. Australia has experimented with a system of portable subsidies for Universal Service Obligations (USO).[21] They used two pilot study areas where a (theoretically) portable subsidy would be available for provision of universal service. Notably, no competitors emerged wishing to provide service. Australia also used a franchise bidding model (a single provider model – with competitive bidding for the subsidy required to serve high cost areas) with somewhat more success, but they are still searching for a solution to COLR in a competitive market. The Alaska Universal Service Fund (AUSF) can play the role of a competitively neutral COLR funding mechanism. It can provide funding required when no provider wishes to voluntarily provide service to an existing or new customer.

[21] In particular, see Finding 2.3 in http://www.telinquiry.gov.au/rti-report/chpt2.doc.

VII. What follows is a practical proposal to deregulate retail markets, promote competition, and protect consumers' interests.

27. Market Definition: the market would be defined at a wire center or community basis. Since the bottleneck UNE (if there is one) is the local loop, leasing a UNE loop implies the ability to provide service throughout a wire center (since the loops all terminate at the wire center and either the switching and transport UNEs are used at that point, or collocation and other switching/transport services are being employed to service the customer's traffic). For communities that do not have their own wire center, the use of UNEs to serve a customer within that community, implies the ability to serve others in that community (the same transport and switching arrangements can be employed).

28. Trigger for Retail Deregulation: Facilities-based entry into a market. This can either be lines served totally over competitive facilities or use of UNEs (with or without the use of one's own physical facilities). Immediately upon such entry, the retail market would be deregulated.

29. Terms of Deregulation: Retail services would be de-tariffed. There would be no restrictions on bundling or promotional offerings. Only official notice of new prices/services would be required (e.g., one days notice). Privately negotiated retail contracts would be permitted for all providers in a competitive service area with no tariffing requirements. Nothing in this section would remove the obligation to provide UNEs, or to resell standard retail services at wholesale discounts.

30. Safeguards: The availability of UNEs makes the local market contestable and should be sufficient to constrain the pricing behavior of an ILEC. If the

Commission has remaining concerns about potential rate increases, a few safeguards can be employed. Given the intense competitive pressure for business customers, all business services/rates should be completely deregulated. Residential POTS rate increases could be limited, for example, to a maximum yearly dollar increase, a maximum percentage increase, or benchmarked against some measure of nationally averaged rates.

31. Carrier-of-Last Resort: UNEs would still be available to serve all existing customers in competitive service areas. COLR issues arise if either no carrier appears willing to serve the customer at existing wholesale and retail rates, or a new customer requires service for which no voluntary supplier appears. In either case, the AUSF could be used to compensate whatever carrier bears the COLR responsibility. The COLR in such cases could be open to competition pressure to ensure that it is provided at minimum cost.

32. This completes my affidavit.

DATED this 16th day of July, 2003, at Anchorage, Alaska.

Dale E. Lehman

Subscribed and sworn to or affirmed before me on this 16th day of July, 2003, at Anchorage, Alaska.

Notary Public in and For Alaska
My Commission Expires: April 13 2006

Curriculum Vitae

DALE EDWARD LEHMAN

July, 2003

PERSONAL INFORMATION

Address:

Office: Director of the MBA Program in Telecommunications Management
Business Administration
Alaska Pacific University
4101 University Drive
Anchorage, AK 99508
(907) 564-8271
E-Mail: dlehman@alaskapacific.edu
Current Semester Web Site: http://polar.alaskapacific.edu/dlehman

Home: 11840 Coughlan Way
Anchorage, AK 99516
(907) 349-1006

Birthdate: May 6, 1951
Brooklyn, New York

EDUCATION

State University of New York at Stony Brook, B.A., cum laude (Economics), 1972, New York State Regents Scholarship 1968-1972, Summer Intern, Suffolk County Human Rights Commission, 1971.

University of Rochester, M.A. 1975, Ph.D. 1981
University Fellowship, 1972-1975
Ph.D. Dissertation: "Technology and Optimal Exhaustible Resource Depletion," supervised by Hersh Shefrin.

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ATTACHMENT 1

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"Price Rigidities in Communications Networks," presented at the Rutgers University Conference on Public Utility Regulation, May 1996.

"Internet Information Services" at the 2nd Annual Aspen Internet Festival, October 1995.

"Electronic Commerce" presentation at Society and the Future of Computing, USACM, June 1995.

"The Future of Document Delivery" workshop for the Association of College Research Libraries, Pittsburgh, March 1995. Also, keynote address for the Colorado Interlibrary Loan Association, June, 1995.

"Telephone Pools and Economic Incentives," Rutgers University Conference on Public Utility Regulations, Newport, May, 1995.

"Rural Telecommunications Issues," presented at the National Association of State Utility Consumer Advocates, June 1994, Santa Fe.

"Avoiding Trickle-Down Infrastructures" presented at the 1993 International Communication Association Conference.

"Local Exchange Competition and the Information Infrastructure," workshop for the Public Utilities Research Center, University of Florida, 1992.

"Access Charges for Private Networks Interconnecting with Public Networks," presented at Columbia Institute for Tele-information, 1991, and the Tele- communications Policy Research Conference, 1992.

"The Gateway meets Deregulation: In Search of a Policy, "Telecommunications Costing and Pricing Workshop, Public Utilities Research Center, University of Florida, 1991.

"Option Value and Telecommunications Demand," with D. Weisman and D. Kridel, presented at the Bellcore - Bell Canada Demand Modeling Conference, 1990.

Participation on the Telecommunications Technology and Usage Projection Panel, sponsored by US West and the University of Colorado Center for Economic Analysis, 1989.

"Mass Market Information Services: The Getaway Meets Deregulation," presentation at the First Annual International Telecommunications Symposium, "International Telecommunications Futures," University of Nebraska, 1989.

"A View From Inside the Outside: A Look at How Telecommunications Will Change the Future of Libraries, *Colorado Libraries*, 15, 1, 19-22,1989.

"Mass Market Information Services," presented at the Kennedy School of

Government Telecommunications Policy Series, and at the 1988 International Telecommunications Society Conference.

"The External Costs of Bypass," with D.L. Weisman, presented at the TS Cost Recovery Conference, Bellcore, Seattle, July, 1986.

"Asymmetric Pricing and Arbitrage," with A.C. Larson, presented at the 6th International Conference on Forecasting and Analysis for Business Planning in the Information Age, Tokyo, December, 1986.

"A General Theory of Point-to-Point Long Distance Demand," with A.C. Larson and D.L. Weisman, presented at the 1984 Bell Communications Research Conference and at the Telecommunications Demand Modeling Conference in New Orleans, October, 1985.

"Instrument Dependent Randomness," with M.G. Bradley, Discussion Paper No. 169, University of Colorado, Boulder, 1983. Paper presented at the 1983 Econometrics Society Winter Meetings.

Reader Response, *Natural Resources Journal*, 22, 275-276, 1982.

"Doomsday Reconsidered," presented to the Econometrics Society European Meetings, Geneva, Switzerland, 1978.

"Exhaustible Resource Depletion Under Uncertainty," Working Paper #77-1, Saint Mary's University, 1977 - also presented at the Western Economics Association Meetings, June 1977 and in the William Bennett Munro Memorial Seminar and Lecture Series, California Institute of Technology, 1977.

EXPERIENCE

2002 Director, MBATM Program. Alaska Pacific University

1985 - present Associate Professor Economics, Fort Lewis College, Durango, Colorado (on leave 1986-88, 1989-91, 1996-1997, 2002).

1996- 1997 Senior Economist, Southwestern Bell Telephone Company

1989 - 1991 Visiting Associate Professor of Economics, Villanova University.

1986 - 1988 Member of Technical Staff, Bell Communications Research. - Responsible foreconomic analysis of strategic planning and public policy issues associated with local telephone pricing and information services market development.

1983 - 1985 Assistant Professor of Economics, Fort Lewis College.

1982 Visiting Assistant Professor, The Economics Institute, University of Colorado, Boulder.

1981 - 1983 Assistant Professor of Economics, University of Colorado.

1980 - 1981 Visiting Professor of Economics, Williamette University, Salem, Oregon.

1979 - 1980 Lecturer in Economics, California Polytechnic State University, San Luis Obispo, California.

1977 - 1979 Assistant Professor of Economics, University of Santa Clara

1976 - 1977 Lecturer in Economics, Saint Mary's University, Halifax, Nova Scotia, Canada.

1975 - 1976 Lecturer, Nazareth College of Rochester (part time).

Fall - 1975 Taught Introductory Economics at the Attica Correctional Facility Inmate Education Program, Genesee Community College.

1974 - 1975 Assistant Lecturer, University of Rochester, (part time)

OTHER EXPERIENCE

1994 - 1996 Faculty representative to the State Board of Agriculture (governing body for Fort Lewis College and Colorado State University System).

1989 - 1992 Principal, TELA Group (with Brian Savin, Peter Temin, Joseph Weber)

Technical Reviewer for environmental cost and benefit valuation studies, Bonneville Power Administration, 1985 - 1986.

Principal Investigator for Energy and Resource Consultants, Inc. on "A Review and Analysis of Alternative Methods for Valuing Damage to Natural Resources," prepared for the American Petroleum Institute, 1985. Acid Rain Deposition Contract. Energy and Resource Consultants, Inc., 1983-1984, contributing consultant.

"Regulatory Impact Analysis: "Cope Project," for Abt Associates Incorporated, 1981, contributing consultant.

TESTIMONY

Illinois Commerce Commission Nos. 96-0146 through 96-0155 joint petition for suspension of rural carriers of Section 251(b) and (c) of the Federal Telecommunications Act of 1996, on behalf of 10 rural telephone companies.

Kansas Corporation Commission. Docket Number 97-AT&T-290-ARB in SWBT-AT&T arbitration, on behalf of Southwestern Bell Telephone Company, January 1997.

Arkansas Public Service Commission, Docket Number 96-395-U in SWBT-AT&T arbitration, on behalf of Southwestern Bell Telephone Company, January 1997.

Kansas Corporation Commission. Docket Number 97-SCCC-149-GIT regarding cost model methodology on behalf of Southwestern Bell Telephone Company, March 1997.

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Oklahoma Corporation Commission, Cause No. PUD 97000213, Direct Testimony on behalf of Southwestern Bell Telephone Company regarding cost and price methodologies, September 1997.

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Oklahoma Corporation Commission, Cause Nos. PUD 97000213 and 97000442, Rebuttal testimony on behalf of Southwestern Bell Telephone Company regarding cost and price methodologies for UNEs, March 1998.

Colorado Public Utilities Commission, Docket No. 97A-540T, rebuttal testimony on behalf of US WEST Communications regarding alternative regulation, May 1998.

Kansas Corporation Commission, Docket No. 97-SWBT0411-GIT, rebuttal testimony on behalf of Southwestern Bell Telephone Company regarding interLATA entry, June 1998.

Public Utility Commission of Texas, Docket No. 19461, direct testimony on behalf of Southwestern Bell Telephone Company regarding stand-alone cost and pricing of National Listing Service, December 1998.

Arkansas Public Service Commission, Docket No. 99-015-U, rebuttal testimony on behalf of Southwestern Bell Telephone Company regarding unbundled network element costs, March, 1999.

Kansas Corporation Commission, Docket No. 99-GIMT-326-GIT, rebuttal testimony on behalf of Southwestern Bell Telephone Company regarding revision of the Kansas Universal Service Fund, May 1999.

Colorado Oil and Gas Commission, Docket Nos. 0004-AW-05 and -06, testimony on behalf of the San Juan Citizens Alliance concerning economic methodology for determining the impacts of coalbed methane gas drilling, June 2000.

Public Utilities Commission of Nevada, Docket Nos. 99-12033 & 00-4001, testimony on behalf of Nevada Bell regarding nonrecurring charges for unbundled network elements (UNEs), September 2000.

California Public Utilities Commission, Reply Declaration on behalf of SBC in the California state 271 proceeding, September 2001.

Federal Communications Commission, Affidavit on behalf of SBC in the Missouri/Arkansas 271 proceeding, October 2001.

Colorado Public Utilities Commission, testimony on behalf of Qwest regarding regulation of prices in the operator services industry, November 2001.

Federal Communications Commission, Declaration and Reply Declaration on behalf of SBC in the California 271 proceeding, September, 2002, WC Docket No. 02-306.

STATE OF ALASKA

THE REGULATORY COMMISSION OF ALASKA

Before Commissioners:

Mark K. Johnson, Chair
Kate Giard
Dave Harbour
James S. Strandberg
G. Nanette Thompson

In the Matter of the Commission Review of Rules and Regulations Governing Telecommunications Rates, Charges Between Competing Telecommunications Companies, and Competition in Telecommunications	)	Docket No. R-03-3

COMMENTS OF AT&T ALASCOM

The legislation that prompted the opening of this docket requires a thorough review of telecommunications rules and regulations governing rates, charges between competing telecommunications companies, and competition in telecommunications in general. The Legislature outlined seven Guiding Principles and nine Policies for the review, as set forth in Order No. R-03-3(1). AT&T Alascom's comments will focus on how those Guiding Principles and Policies can be applied to promote consumer benefits as well as fair and equal treatment of competitors in Alaska's interexchange market.

BACKGROUND

There is little doubt in 2003 that interexchange competition in Alaska is highly competitive. It was not always this way, however. A rudimentary version of the modern network AT&T Alascom operates today provided the first long distance telecommunications

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in Alaska. The network began when the United States military strung wires between strategic locations during World War II. The network remained in operation after the war, serving civilian communities throughout Alaska. Over the years, the network was expanded and upgraded. In 1969, the military sold the network to RCA, and RCA Alascom was granted the first certification of public convenience and necessity to serve as a statewide long distance carrier. In 1973, Alascom moved to offer the first satellite telephone service in Alaska via the Canadian ANIKII satellite. The system was the first functional domestic satellite system in the nation, and in 1982, Alascom launched its own satellite – Aurora I – the only satellite of its kind, and devoted exclusively to use by a single state – Alaska.

As the only long distance carrier in Alaska, Alascom was initially regulated as monopoly with statewide averaged rates and a guaranteed rate of return. Its rates were set at levels that provided enough revenue to install and maintain facilities even in low-density, high-cost areas that, on their own, did not generate revenues sufficient to cover the cost of service.

In 1991, Alascom's world changed when intrastate long distance competition was initiated. New regulations were adopted to ensure that Alascom did not misuse its power as the incumbent monopoly to stifle competition before it could develop. The same regulations granted new long-distance competitors broad and significant freedoms not available to Alascom. Competition grew and, in 1995 when AT&T bought Alascom, the market was already highly competitive. However, AT&T bought a company regulated as though it were still a monopoly, a problem that persists eight years later.

As a result of intense competition from GCI, ACS-LD, MTA-D and others, AT&T Alascom now has a statewide market share of well under 50%, and its principal competitor,

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GCI, is the largest telecommunications carrier in the state. Nevertheless, AT&T Alascom is still regulated as the Dominant Carrier under 3 AAC 52.363(b).[1] In contrast, when AT&T (AT&T Alascom's parent company) fell below a 60% market share in the Lower 48 back in 1995, the FCC deemed the long distance market to be sufficiently competitive and ceased regulating AT&T as the "Dominant Carrier".[2]

Many of the regulations that restrict AT&T Alascom today are vestiges of the old monopolistic environment. In this highly competitive marketplace, however, they do not serve as an incentive for investment – they only add cost and are no longer necessary and provide a disincentive for investment in new facilities.

AT&T ALASCOM'S PROPOSED REFORMS

The interexchange market in Alaska requires (1) elimination of discriminatory treatment between competitors, (2) the creation of incentives for investment, and (3) provisions for the sharing of Carrier of Last Resort responsibility. These three goals are explicitly endorsed in the new legislation.

Elimination Of Discriminatory Treatment Between Competitors

Of particular concern to AT&T Alascom is its designation as the "Dominant Carrier." The additional regulation resulting from this designation adds substantially to AT&T Alascom's costs for tracking, journalization, and reporting. (AT&T Alascom estimates the costs to be between $5 - 7 million annually.) These increased costs, along with

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[1] AT&T Alascom is also the Carrier of Last Resort (COLR), which requires that it provide service to all communities served by a local exchange carrier with 25 or more year-round residents. Dominant status and COLR obligations are distinct but related. *See* 52.390(c).

[2] Only one of AT&T Alascom's interstate tariffs remains "Dominant" – its interstate wholesale carrier-to-carrier tariff, Tariff 11. The dominant status of Tariff 11 is the subject of a current docket at the FCC. *See* Federal Communications Commission, CC Docket No. 46.

the inability to compete effectively because of discriminatory regulations, combine to limit AT&T Alascom's ability to attract capital and invest in the network.[3] Relieving some of the regulatory requirements associated with Dominance, thereby equalizing the burdens borne by all competitors, would improve AT&T Alascom's ability to provide high quality service to Alaska consumers and to compete effectively in the long distance market.

AT&T Alascom supports the FCC's decision to relieve AT&T from the burdens of Dominance. In Alaska, AT&T Alascom endorses application of non-dominant regulations to all interexchange carriers. The "Dominant" regulations that may have been appropriate in 1991, when competition was just getting underway, are outdated in today's fully competitive market. The specific relief AT&T Alascom requests is elimination of (1) the requirement to file an annual report, which requires the separate journalization of costs and revenues; (2) daily Outage Reports and quarterly Network Performance Reports; and (3) the more stringent tariff filing requirements imposed only on a Dominant Carrier by 3 AAC 52.375.

Annual Report. The annual report AT&T Alascom must file requires costly billing-system development on every new offer (in all of AT&T's numerous billing systems), occasional re-programming on existing offers, and an intense three-month effort to produce the 78-page annual report, which consumes the energies and attention of several groups within AT&T. No other interexchange carrier in Alaska is required to file this report.

Daily 25% Outage Report and Quarterly Network Performance Reports: These two network reports require AT&T Alascom to maintain entire computer systems for recording and reporting that do not exist anywhere else in the entire AT&T network. Significant labor is

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[3] AT&T Alascom operates in a miniature financial market within AT&T. In order to obtain capital for investment, it is important that AT&T Alascom be able to provide a reasonable return to AT&T stockholders.

also required to produce the reports. No other Alaskan interexchange carrier is required to file these reports.

More Stringent Tariff Filing Requirements. The tariff filing rules require that the Dominant carrier file all rate increases (or anything that might appear to be a rate increase) under a 45-day notice period with cost justification. All other carriers file on a 30-day notice period for similar filings, with no cost justification required.

Relief from these regulatory burdens would benefit Alaska consumers by ensuring a healthy competitive environment with equal regulatory requirements for all players, reducing regulatory cost, and increasing competitive flexibility. After 12 years of competition and the loss of 50% of AT&T Alascom's share of the market to its competitors, theses minor reforms are long overdue.

In previous dockets examining regulatory reform, the Commission separately examined each of AT&T Alascom's various interexchange services – Retail Switched Service, Private Line Service, and Wholesale. There was no debate that the Retail Switched market is highly competitive. Retail Switched rates are geographically averaged, which prevents any carrier from charging more for the same service to a caller in Deadhorse than it charges to a caller in Anchorage. Therefore, rates are competitive and consumers are protected, even in high-cost rural areas where AT&T Alascom's competitors have chosen not to install their own facilities. Given the intense competition for urban customers, combined with geographic averaging, AT&T Alascom has no market power to raise rates in this market.

The Private Line and Wholesale markets seemed to be of more concern to the Commission, despite the fact that consumers in these markets have facilities-based choices

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As reflected in its 2002 annual report, AT&T Alascom experienced an intrastate loss of $26 million.

nearly everywhere in the state, and in spite of AT&T Alascom's commitment not to raise these rates. AT&T Alascom has no desire to increase its wholesale or private line rates or to harm its consumers in any way. The commitment AT&T Alascom made in Docket R-98-1 still holds: AT&T Alascom will cap its private line and wholesale rates in any of the locations it serves where there is no facilities-based competitor. This commitment protects the consumer while allowing AT&T Alascom to divert the millions of dollars in extra costs associated with being the "Dominant Carrier" to more efficient uses, such as network investment. Real benefit to Alaska consumers will be the result.

Creation Of Incentives For Investment

AT&T Alascom has supported, and continues to support, the creation of a new Universal Service Fund for the purpose of creating incentives for investment in facilities-based interexchange operations. The RCA has the authority to create a universal service fund to support interexchange "long distance" services in Alaska under AS 42.05.840:

> The commission may establish a universal service fund or other mechanism to be used to ensure the provision of long distance telephone service at reasonable rates throughout the state, and to otherwise preserve universal service.

The Commission exercised this authority when it created the existing Alaska Universal Service Fund for the purpose of supporting local exchange operations. AT&T Alascom believes that it is time to do the same for high-cost interexchange facilities, which must be constructed, operated and maintained in the same low-density, high-cost areas in which the rural LECs operate. Last year, Alaska's LECs received over $75 million in federal

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USF funds to support the high costs of serving rural Alaska. Facilities-based IXCs received zero support for rural MTS service.[4]

AT&T Alascom bears the significant burden of serving high-cost, low-density rural areas of Alaska. Services to these areas used to be subsidized by geographic rate averaging, which allowed excess revenues generated on high-density, low-cost routes to cover the higher costs of serving low-density rural areas. Intense competition has, however, eliminated these margins. A replacement for this implicit subsidy is badly needed.

In Docket R-98-1, AT&T Alascom proposed the development of a competitively-neutral, explicit subsidy mechanism designed to partially compensate all facilities-based IXCs for shortfalls in providing basic voice service in the most rural locations served by satellite. The mechanism AT&T Alascom proposed could be funded through a per-minute surcharge on all interexchange telephone users in the state. The fund could be administered by the Alaska Universal Service Administrative Company (AUSAC), which administers the existing Alaska Universal Service Fund. The proceeds could be distributed to the various facilities-based IXCs operating in rural locations based on their market share of billed minutes in those areas. The purpose of the support mechanism would be to levelize the burden of serving the Bush, help compensate carriers willing to serve the Bush for the high costs they incur, create incentives to further facilities-based entry where appropriate, and provide incentives to modernize and upgrade Bush facilities. When initially proposed in 2000, AT&T Alascom's revenue shortfall in these rural areas (designated as Category 3 in its

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1130 WEST SIXTH AVENUE
ANCHORAGE, ALASKA
99501-5914
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[4] Federal Subsidies were available, however, for certain long distance services to rural schools, libraries and health care providers.

wholesale tariff) was estimated to be in the range of $7.3 million, or approximately $0.1883 per minute. *See* Affidavit of Mark Vasconi, attached as Exhibit A.

Consumer demands for services change rapidly and the costs to deploy new technology are high. AT&T Alascom cannot deploy new facilities without a reasonable opportunity to recover its costs and earn a return. The proposed fund would make investment in rural Alaska more feasible in today's competitive market. A competitively-neutral, explicit rural subsidy for all facilities-based LXCs would be the best way to ensure that long distance service is maintained at a level reasonably comparable to urban Alaska.[5]

Sharing of Carrier of Last Resort Responsibilities

AT&T Alascom, as the Carrier of Last Resort, is required to provide service to every community served by a local exchange carrier with 25 or more year-round residents. AT&T Alascom has no wish to abandon its COLR responsibilities, but it believes that there are instances in which the sharing of COLR responsibilities could be warranted. In line with the Guiding Principles established by the Legislature, sharing of COLR furthers fair and equal treatment of competitors and ensures that the incumbent is not placed at a competitive disadvantage. Therefore, the sharing of COLR in appropriate circumstances should be considered in the review of interexchange regulations and competition in this docket.

THE LEGISLATURE'S "GUIDING PRINCIPLES" AND "POLICIES" SUPPORT AT&T ALASCOM'S PROPOSALS

The seven Guiding Principles established by the Legislature all support AT&T Alascom's proposals:

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[5] Unlike the "CMEC" ACS has proposed, the long distance support fund AT&T Alascom advocates would be available on a nondiscriminatory basis to support all facilities-based rural carriers, not just AT&T Alascom.

(1) The public shall be protected.

(2) The rates charged to the public shall be fair,

(3) The incumbent carrier may not be placed at an unfair competitive disadvantage,

(4) Businesses that provide local and long distance telecommunications services shall be treated as fairly as possible,

(5) Competition among telecommunications companies shall be encouraged,

(6) The development of a modern telecommunications infrastructure in the state shall be encouraged,

(7) It is desirable to promote competition and to take steps, if fair to the public, to encourage more, rather than fewer, businesses to enter and remain in the telecommunications business in the state.

Two of these Guiding Principles are particularly relevant to AT&T Alascom's anachronistic regulation as the Dominant Carrier. Guiding Principle Three states that "the incumbent carrier may not be placed at an unfair competitive disadvantage," and Guiding Principle Four states that "businesses that provide local and long distance telecommunications services shall be treated as fairly as possible." Neither of these principles is consistent with the current regulations. AT&T Alascom's proposal to eliminate regulation of any interexchange carrier in today's market as "Dominant" would accomplish both of these goals.

Guiding Principle Six is particularly relevant to AT&T Alascom's proposal to establish an intrastate interexchange Universal Service Fund. It says that "the development of a modern telecommunications infrastructure in the state shall be encouraged." The only way to encourage investment effectively in high-cost, low-density areas of Alaska is to create a competitively-neutral funding mechanism that will compensate carriers for maintaining and improving their networks in those areas.

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1130 WEST SIXTH AVENUE
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99501-5914
(907) 276-4331
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All of the Policies established by the Legislature are also consistent with AT&T Alascom's proposals, but two are especially pertinent: (2) In determining whether a carrier is the dominant carrier for the purposes of setting rates, it is not relevant that the carrier in a competitive market is the incumbent carrier; and (8) In areas where significant competition exists between carriers, competitors shall be allowed to increase rates under the same rules.

AT&T Alascom is designated as a Dominant Carrier today for the sole reason that it was the incumbent carrier back in 1991. Under current market conditions there is no way that AT&T Alascom would be found to be dominant in the market. The designation imposes unequal burdens with no commensurate benefits. Regulation 3 AAC 52.363(b) directly conflicts with this legislative policy and must be repealed.

Policy Eight states that "in areas where significant competition exists between carriers, competitors shall be allowed to increase rates under the same rules." As the Dominant carrier, AT&T Alascom is prohibited from raising its rates under the same rules as its competitors. In order to increase its rates, it must provide cost justification, and must file under a 45-, rather than a 30-day notice requirement. As a practical matter, the highly competitive market, combined with geographic rate averaging, prohibit increasing rates above competitive levels. However, it is important that AT&T Alascom have the same flexibility to adjust its rates up and down as necessary, constrained (as its competitors are) by competitive pressures.

Specific to AT&T Alascom being regulated as the Carrier of Last Resort, two Guiding Principles are particularly relevant. First, Guiding Principle Three states that "the incumbent carrier may not be placed at an unfair competitive disadvantage." There is little question that the higher cost of servicing high-cost, low-density rural locations disadvantages

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99501-5914
(907) 276-4331
FAX (907) 277-8235

AT&T Alascom relative to its competitors. Permissive sharing of this responsibility is warranted. Guiding Principle Four also supports sharing of COLR responsibilities, stating that "businesses that provide local and long distance telecommunications services shall be treated as fairly as possible." Sharing of COLR responsibilities would be a fairer method of spreading the burden of providing high-cost service to the Bush.

CONCLUSION

To further the goals established by the legislature, AT&T Alascom urges the Commission to eliminate discriminatory treatment of interexchange carriers, not through increasing regulation on non-dominant carriers, but through reduction of regulation on AT&T Alascom, which is designated as Dominant only because it was the incumbent carrier back in 1991. AT&T Alascom also encourages the Commission to create incentives for investment in rural Alaska through a Universal Service Fund that helps defray the high cost of installing and operating long distance facilities in areas that need service but generate insufficient revenues. Together, these changes would facilitate increased competition and encourage needed investment in the infrastructure to support interexchange telecommunications in Alaska in the future.

Dated: July 16, 2003

ASHBURN & MASON
Attorneys for AT&T Alascom

By _____
A. William Saupe

ASHBURN & MASON
LAWYERS
A PROFESSIONAL CORPORATION
SUITE 100
1130 WEST SIXTH AVENUE
ANCHORAGE, ALASKA
99501-5914
(907) 276-4331
FAX (907) 277-8235

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STATE OF ALASKA

REGULATORY COMMISSION OF ALASKA

Before Commissioners:

G. Nanette Thompson, Chair
Burnell Smith
Patricia DeMarco
Wilfred K. Abbott
James S. Strandberg

In the Matter of the Consideration of the Reform of Intrastate Intercexchange Telecommunications Market Structure and Regulation in Alaska.

Docket No. R-98-1

AFFIDAVIT OF MARK VASCONI

STATE OF ALASKA)
) ss:
THIRD JUDICIAL DISTRICT)

Mark Vasconi, being first duly sworn upon oath, deposes and states:

1. My name is Mark Vasconi. My business address is 210 East Bluff Drive, MPB Room 385, Anchorage, Alaska 99501. I am employed by AT&T Alascom as the Director of Regulatory Affairs. I have held this position since August 1996. In this position, I am responsible for developing and implementing AT&T Alascom's regulatory policies regarding long distance service and local service. I am also responsible for developing and representing AT&T Alascom's positions in various legislative forums at the state level.

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ANCHORAGE, ALASKA
99501-3814
(907) 276-4331

25. Exhibit MJV-4 depicts the percentage of access lines in locations where competing facilities do not exist. Approximately 91 percent of the access lines in Alaska are in locations served by competing facilities. The remaining nine percent of the lines (approximately 36,000) are distributed among 153 Bush locations (out of a total of approximately 243 communities in the entire state).[7] These Bush villages are served exclusively by AT&T Alascom facilities. Most are served by satellite and some are served by microwave. The overwhelming majority of consumers in the state are served by facilities-based competitors.

AT&T ALASCOM'S SUBSIDY PROPOSAL

26. Because competition in urban locations has driven rates down and reduced market share, AT&T Alascom proposed the development of two separate, competitively-neutral, explicit subsidies. The first subsidy would compensate AT&T Alascom for shortfalls in providing basic voice service in Category 3 locations served by satellite. The second would allow AT&T Alascom to offer end users in Category 3 dial-up access to the Internet at rates for unlimited service comparable to those found in urban Alaska. In other

[7]Even in the 153 locations where facilities-based competition does not exist, there are approximately 60 locations where GCI has established V-Sat service for schools and libraries under the Federal Universal Service Fund program. In these 60 locations, while GCI is not directly providing facilities-based service to most customers, it is using V-Sat to provide service to one of the biggest customers in any Bush village, namely the school. While this form of competition does not typically compete for voice traffic, it does represent a limited form of facilities-based competition which directly impacts AT&T Alascom's ability to recover costs incurred in serving Bush villages.

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99501-3914
(907) 276-4331

Exhibit A

words, in the plan AT&T Alascom proposes, customers could connect with the Internet via a local call.

27. As explained in AT&T Alascom's written comments, the basic service subsidy should be collected directly from all long distance telephone users in the state in the form of a per-minute surcharge on their long distance bills administered via the Alaska Universal Service Administrative Company ("AUSAC"). The proceeds of the fund could then be distributed to the various facilities-based IXCs operating in Category 3 on the basis of their market share of Category 3 billed minutes. The purpose of this support mechanism would be to levelize the burden of serving the Bush, help compensate carriers willing to serve the Bush for the high costs they incur, create incentives to further facilities-based entry where appropriate, and provide incentives to modernize and upgrade Bush facilities.

THE SIZE OF THE BASIC SERVICE SUBSIDY

28. The size of a basic service subsidy on a per minute of usage ("MOU") basis is driven by the difference in the average rate per minute and the average cost per minute in Category 3. Exhibit MJV-5 is a worksheet that examines the relationship between these two items. MJV-5 shows that the basic revenue shortfall in Category 3 is approximately $0.1883 per minute. Multiplying this amount by the total number of Category 3 minutes results in an annual shortfall of $7.3 million.

29. This analysis uses per-minute cost estimates developed in GCI's forward-looking wholesale cost analysis filed in Docket U-98-26. GCI has recently developed

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36 WEST SIXTH AVENUE
ANCHORAGE, ALASKA
99501-3814
(907) 276-4331

a Bush network to serve 50 locations in Category 3, using modern satellite technologies (*i.e.*, DAMA). The fiber optic network GCI uses to link Anchorage, Fairbanks and Juneau is only about one year old. Both of these major network deployments are representative of the technologies that a new entrant would deploy to serve Bush Alaska. Moreover, the costs GCI incurred to construct its network, reflected in its cost studies, are representative of the costs that a competitor using new technology has incurred to deploy modern facilities in the Bush and are the costs against which AT&T Alascom must compete.

30. The analysis in MJV-5 starts by determining the average cost per minute of serving Category 3. This per-minute cost is developed by summing GCI's network cost of $0.2517 per minute with an average statewide access cost of $0.1332 per minute and a marketing cost of $0.029 per minute. This sums to an average cost per minute of $0.4139 to serve Category 3 locations. Next, a net margin is developed by subtracting the average cost per minute from the average statewide revenue per minute of $0.2256. This produces a net margin of negative $0.1883 per minute in serving Category 3. The actual total margin is then estimated by multiplying negative $0.1883 per minute by 3,213,017 minutes, which is the number of billed minutes in Category 3 for September 1999. The analysis here assumes that DAMA technology has been deployed in all earth stations. The resulting shortfall for September 1999 is $605,011. Assuming that September is approximately one-twelfth of the year, the total shortfall in serving Category 3 is approximately $7.3 million. This shortfall is the amount that would have to be collected by the proposed subsidy mechanism.

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(907) 278-4331

Exhibit A

31. If a similar analysis is performed on a statewide basis, it is obvious that geographic rate averaging alone is not sufficient to offset the Category 3 shortfall. The average cost per minute on a statewide basis is $0.2371. With average statewide revenue per minute of $0.2256, this produces a $0.0115 per minute deficit. Multiplying this deficit by AT&T Alascom's total minutes for 1999 based on September data produces an annual shortfall of $2 million. Without the $7.3 million Category 3 deficit, the overall result would be positive by $5.2 million.

INTERNET SUBSIDY

32. In response to the mounting pressure on policy makers to bridge what some refer to as the "Digital Divide," AT&T Alascom has estimated how much it might cost to make dial-up Internet access available to residential and business in the state's smaller, more rural communities. AT&T Alascom has developed a conceptual procedure for subsidizing the service to make it available at rates reasonably comparable to those presently charged in Anchorage. The subsidy estimated here is a first approximation only, built on a number of assumptions that may or may not be realistic for any particular location.

33. In order to size the subsidy, AT&T Alascom estimates that an annual subsidy by approximately $1.7 million would be needed. The subsidy was sized to include those 164 communities that are in Category 3 and are dependent upon satellite technology for long distance telecommunications services. These 164 communities were chosen because they are the most remote and probably the least likely to have local dial-up capabilities. Hub

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LAWYERS
PROFESSIONAL CORPORATION
SUITE 100
36 WEST SIXTH AVENUE
ANCHORAGE, ALASKA
99501-5814
(907) 276-4331

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STATE OF ALASKA

THE REGULATORY COMMISSION OF ALASKA

Before Commissioners:	Mark Johnson, Chair Dave Harbour Kate Giard James S. Strandberg G. Nanette Thompson
In the Matter of the Commission Review of Rules and Regulations Governing Telecommunications Rates, Charges Between Competing Telecommunications Companies, and Competition in Telecommunications	R-03-03

COMMENTS OF GCI

Introduction

On June 11, 2003, the Commission issued a Notice of Inquiry in this matter to consider proposed regulations as required by recently passed legislation, CSHB 111(JUD)am ("HB 111"). GCI Communication Corp. d/b/a General Communication, Inc., and d/b/a GCI (GCI) submits these initial comments in response to the Notice of Inquiry.

Discussion

A. Background and Overview

As the Commission is well aware, the Legislature's consideration of HB 111, the bill to extend the life of the Commission, was accompanied by significant controversy. Although HB111 as introduced by the Governor was a simple bill

GCI Communication Corp.
2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

that did nothing more than extend the life of the Commission by 4 years, the bill soon garnered numerous controversial provisions that would have directly changed the Commission's regulation of local exchange carriers, particularly in markets experiencing any degree of competition.

Ultimately, however, none of the provisions that directly affect the Commission's regulation of local exchange carriers were adopted.[1] Instead, as passed and signed into law, HB 111 specifically states that "the legislature does not take a position on the propriety of existing commission rulings or regulations." (HB 111, § 2). The Legislature required the Commission to review its rules and regulations governing telecommunication rates, charges between competing telecommunication companies, and competition in telecommunications. To guide the Commission's consideration, the Legislature adopted seven principles.

The principles adopted by the Legislature can be grouped into several related subjects. Two of the principles specifically promote competition, stating that competition shall be "encouraged" and "promote[d]". Two principles also evidence a clear desire to protect the public and ensure fair rates to the public. Another theme is that all providers of telecommunications service should be treated fairly, with incumbent carriers not placed at an unfair competitive

[1] It is clear that if the Legislature had adopted the proposed provisions that directly affect the determination of unbundled network element pricing or other matters that are subject to negotiation and arbitration under the Telecommunications Act of 1996, such provisions would have been unlawful. In Illinois, the State Legislature adopted provisions promoted by ILECs regarding the determination of UNE rates, and the legislation was almost immediately ruled invalid in Federal District Court. See *Voices for Choices v. Illinois Bell Telephone Company*, Case 03-C-3290, Memorandum Opinion (June 9, 2003)

GCI Communication Corp.
2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

disadvantage. Finally, one principle encourages development of a modern telecommunications infrastructure.

The Legislature further required that the Commission propose regulations to implement 9 specific policies. The policies are, in most instances, supported by or related to the 7 principles discussed above. Several relate directly to the rates charged to consumers, several relate to the scope of regulation of the ILEC[2] and CLEC[3] in competitive areas, and two relate to the payments by one carrier for the use of another carrier's facilities. These policies, and proposed regulations to address the policies, are discussed below.

B. Discussion of Policies

1. Policy #1: "There shall be fair payment by a user carrier for use of another carrier's equipment and facilities, including existing and newly constructed equipment and facilities."

Policy #1 seems to address the issue of the methodology for determining compensation for the leasing of Unbundled Network Elements (UNEs).[4] Pursuant to the Telecommunications Act, the price for UNEs must be "just and reasonable" based on specified criteria. 47 USC §252(d)(1). The regulations of the FCC adopted pursuant to the "just and reasonable" requirement

[2] "ILEC" is incumbent local exchange carrier.

[3] "CLEC" is competitive local exchange carrier.

[4] A broad reading of the policy would require a review of many other topics, such as regulations regarding access charges and joint use of poles. Given the focus of the legislative proceedings and the reference in the legislation to "charges between competing telecommunications companies", GCI believes that the intent was directed at UNE prices.

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2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

of the Act specify that UNE prices must be determined bases on the Total Element Long Run Incremental Cost of providing the unbundled element, 47 CFR §51.505, and the United States Supreme Court specifically upheld the FCC's adoption of TELRIC as a just and reasonable rate for UNEs. *Verizon v. FCC*, 535 U.S. ___ (2002). States are required to follow TELRIC pricing standards in setting UNE rates, and neither the State commission nor the State Legislature can require deviation from the TELRIC rules. *AT&T Corp. v. Iowa Utilities Board*, 525 U.S. 366, 385 (1999); *Voices for Choices*, slip op. at 10-12. Thus, the just and reasonable rate determined by the FCC which, under the law of the land, must be followed by state commissions is, as a matter of law, the fair rate for payment for use of another carrier's facilities.

However, even though it is abundantly clear that federal law mandates that UNE rates be established based on TELRIC, GCI believes that it is important to explore and understand the underlying reasons that rates based on TELRIC are, in fact, fair, just and reasonable. The underlying reasons are set out in significant part in the order of the FCC adopting the TELRIC standard. First Report and Order, CC Docket Nos. 96-98 and 95-185 (Rel. Aug 8, 1996) (hereinafter, "*First Report and Order*"). Prior to adopting that Order—the first major order implementing the major competitive provisions of the Act—the FCC received exhaustive comment from all segments of the telecommunications industry,

GCI Communication Corp.
2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

including lengthy arguments regarding both the legal and economic underpinning of a "just and reasonable" methodology for setting UNE rates.

The FCC recognized early in its order that the goal of Congress and the Act was to set UNE prices in a manner that promotes competition but does not favor either the incumbent or the new entrant over the other. *First Report and Order*, ¶618. TELRIC is the methodology that best furthers the goals of the Act. *First Report and Order*, ¶620 TELRIC was selected for all of the following reasons:

- In competitive markets, firms take action based not on embedded costs, but on the relationship between market-determined prices and forward looking costs. *First Report and Order*, ¶ 620.

- TELRIC provides the proper incentive for investment. New entrants should make decisions whether to purchase unbundled elements or to build their own facilities based on the relative economic cost of those options; new entrants' investment decisions would be distorted if the price of unbundled elements were based on embedded costs. *First Report and Order*, ¶¶620, 673.

- Forward looking costs encourage efficient levels of investment and entry. *First Report and Order*, ¶ 620, 672-673, 705. Prices based on forward looking long run incremental costs (LRIC) give appropriate price signals to producers and consumers and ensure efficient entry and utilization of the telecommunications infrastructure. *First Report and Order*, ¶630.

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2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

- A forward looking cost methodology best replicates, to the extent possible, the conditions of a competitive market. In addition, it reduces the ability of an incumbent LEC to engage in anti-competitive behavior. Availability of UNEs at TELRIC enables consumers to reap the benefits of the competition. *First Report and Order*, ¶679.

- TELRIC is fair to all firms in the industry. *First Report and Order*, ¶679.

- Investment decisions would be distorted if the price of UNEs were based on embedded costs. *First Report and Order*, ¶620.

- An embedded cost methodology would be pro-competitor, in favor of the incumbent, rather than pro-competition. *First Report and Order*, ¶705.

The theory that rejects embedded cost as the basis for competitive decisions, including investment decisions, is perhaps confusing to anyone without training in economics. However, the theory—and the reality of the theory—is in many ways quite simple. Take the example of a computer. For many years, the price of computers has gone down at the same time that the capabilities have gone up. A computer purchased three years ago for $1000—even if it has remained in its box, unopened and untouched—is no longer worth $1000. A buyer that needed to invest in a computer would not be willing to pay the embedded cost for that computer, the buyer would pay the forward looking cost, the amount it could be

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2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

purchased for today. The seller, if rational, would not ask $1000 because he would know no buyer would be willing to pay that amount. The fair price for the computer would be the price at which a new computer with the same capabilities could be purchased today. The telecommunications network is no different. New technologies and new types of equipment have been developed, and the results of TELRIC studies nationwide demonstrate that the existing telephone network could be replicated for less than the embedded cost.[5]

Both theory and facts also demonstrate that TELRIC pricing is consistent with the legislative principle of encouraging investment in telecommunications infrastructure. The theory is discussed above. The U. S. Supreme Court documented the fact that significant investment in infrastructure had resulted from TELRIC pricing. *Verizon* at 45-46 (slip opinion).

Furthermore, the experience in Alaska also demonstrates that UNE rates are providing GCI with a strong incentive to invest in its own local exchange facilities. GCI has invested over $6 million dollars in order to provide the equivalent of UNE loops over its cable television facilities, and just last week GCI began service to its first retail, non-test customer using those facilities. If the existing UNE rates were too low, GCI would continue to rely solely on UNEs

[5] UNE rates reflecting decision by state commissions nationwide can be found at http://www.cad.state.wy.us/Une%20Page.htm GCI has provided evidence in pending arbitrations that the nationwide UNE rates are consistently below the embedded cost of the facilities.

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2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

rather than investing in its own loop plant. GCI's investments demonstrate that, if anything, the existing UNE loop rates are too high.

Use of TELRIC for UNE pricing is also supported by the other Legislative principles in HB 111. Those principles state that competition should be encouraged and that more entrants into the telecommunications business should be encouraged. TELRIC pricing, as explained, gives proper incentives for new entrants, it allows new businesses to enter the market without building a fully-redundant system, and it encourages investment where better, more efficient facilities are available. In all these ways, TELRIC pricing is consistent not only with federal law and Policy #1 but also with the principles set out in HB 111.

To implement proposed policy #1, GCI suggests adoption of a new regulation to read as follows:

Determination of Rates for Unbundled Network Elements: Rates for unbundled network elements shall be determined by the Commission based on the Total Element Long Run Incremental Cost methodology, as defined by 47 CFR 51.505.

2. Policy #2. "In determining whether a carrier is the dominant carrier for the purposes of setting consumer rates, it is not relevant that the carrier in a competitive market is the incumbent carrier."

Telecommunication regulation in markets where competition is introduced has historically been based, at least in part, on a distinction between carriers as "dominant" and "non-dominant." The FCC has long relied on the

GCI Communication Corp.
2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

dominant/non-dominant distinction in regulation of the interstate long distance market, and a similar approach was adopted by the Alaska Public Utilities Commission (APUC) in 1991 when competition was introduced in the long distance market and then again in 1997 when competition was introduced into the local exchange market. Re: Regulations Governing the Market Structure for Intrastate Telecommunications Service, 10 APUC 407 (1990); Order R-97-9(2), dated May 4, 1998.

In the Commission's regulations, the dominant carrier is defined as a carrier with market power. 3 AAC 52.999(2) for interexchange service and 3 AAC 53.999(3) for local service. The regulations includes provisions for determining which carriers have market power and the regulations state that, until changed, the incumbent carrier will be treated as the dominant carrier and other carriers will be treated as non-dominant. 3 AAC 52.363 for interexchange service and 3 AAC 53.220 for local service.

The rationale for dominant/non-dominant regulation, based on market power, has been clearly set out in FCC decisions. Between 1979 and 1985, the Commission conducted the *Competitive Carrier* proceeding, in which it examined how its regulations should be adapted to reflect and promote increasing competition in telecommunications markets.[6] The FCC defines market power as the ability to control prices; this ability to control prices was explained as both the

[6] The Competitive Carrier proceeding is CC Docket No. 79-252, Policy and Rules Concerning Rules for Competitive Carrier Services and Facilities Authorizations Therefor.

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2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

ability to raise prices by restricting output and the ability to raise and maintain prices above the competitive level without driving away so many customers as to make the increase profitable. *Competitive Carrier First Report and Order*, FCC 80-629, ¶¶ 56; *Competitive Carrier Fourth Report and Order*, FCC 83-481, ¶¶ 7-8.[7] The latter explanation is particularly helpful in understanding why it is appropriate to regulate carriers differently depending on whether or not they possess market power. If a firm cannot raise and maintain prices above the competitive level without driving away customers and losing so many customers that the increase is unprofitable, then the firm has no incentive to increase rates above the competitive level; even if it does raise rates above the competitive level, it quickly learns that the increase is not profitable and must eliminate the increase. Thus, there is no need for regulation of the prices of such a firm.[8] If, on the other hand, the firm can profitably raise and maintain prices above competitive levels, then the traditional rationale for rate regulation of that firm remains.[9] In summary, a carrier "with market power is able to engage in conduct that may be anti-competitive or otherwise inconsistent with the public interest" and thus should be

[7] The ability to control price could also entail setting price below competitive costs to forestall entry by new competitors or to eliminate existing competitors. (Competitive Carrier First Report and Order, ¶56)

[8] As stated by the FCC, "Because [non-dominant] carriers lack the market power to chare rates or impose conditions of service that would contravene the Act, we would consider their tariff filings to be presumptively lawful." Competitive Carrier First Report and Order, FCC 80-269, ¶ 16

[9] "We therefore proposed to continue to regulate these [dominant] carriers essentially as we do today so that the Commission could ensure that they did not exploit their market power to the detriment of the public." Id. ¶ 15

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2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

regulated more extensively to protect the public interest than a carrier without market power. (*Competitive Carrier First Report and Order*, ¶56)

Much more recently, and partially in response to the Telecommunications Act of 1996, the FCC again considered and applied dominant/non-dominant regulation, based on market power. *Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area and Policy and Rules Concerning the Interstate, Interexchange Marketplace, CC Docket No. 96-149 and 96-6,* Second Report and Order in CC Docket No. 96-149 and Third Report and Order in CC Docket No. 96-61 (April 18, 1997). That Order relied extensively on the *Competitive Carrier* proceeding and also on the 1992 Department of Justice/Federal Trade Commission Merger Guidelines, 4 Trade Reg.Rep. ¶13,104 (available at http://www.usdoj.gov/atr/public/guidelines/horiz_book/hmgl.html

Policy #2 does not in any way repudiate the rationale for differentiation among carriers as "dominant" and "non-dominant". To the contrary, the policy presumes that determination of whether a carrier is dominant is a relevant regulatory consideration, consistent with the rationale that if a carrier has market power then it needs to be regulated as to rates. The only thing the policy does is state that, in making a determination regarding dominance, it is not relevant whether a carrier is the incumbent carrier.

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2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

To implement Policy #2, the existing regulations defining the dominant carrier as the carrier with market power should be retained, and the regulations stating that, until changed, the incumbent carrier will be treated as the dominant carrier should be repealed.

Given the clear rationale for continuing differential regulation of dominant and non-dominant carriers based on market power, but elimination of the regulation initially defining the incumbent carrier as dominant, it will be necessary for the Commission to evaluate and designate, as appropriate, a dominant carrier in all newly competitive markets. This task will need to be done expeditiously at the same time that the Commission issues a certificate to a competitive provider for the first time in a service area. In order to accomplish that task expeditiously, it may be desirable to develop, in these regulations, the methodology that will be followed in the market power analysis.[10] The FCC has addressed this matter in detail and the FCC's analysis can be adopted by this Commission.

Factors that have been considered by the FCC in determining whether a carrier has market power include market share; the number and size distribution of competing firms; the existence and nature of barriers to entry; the availability of substitutable service; and control of bottleneck or essential facilities. *Competitive*

[10] When the Commission adopted dominant/non-dominant regulations for the competitive interexchange market, the Commission specifically declined to further define "market power" or establish a specific market power analysis. 10 APUC at 414.

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2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

Carrier First Report and Order, ¶56-59. For the purposes of the analysis, the FCC first determines the "relevant product market" and "relevant geographic market" under consideration. *Competitive Carrier Fourth Report and Order*, ¶¶13, 25. The "relevant product market" analysis is necessary because a carrier may have, for example, market power in one business segment—provision of unbundled loops—but not have market power is a related business segment—provision of retail phone service. The relevant geographic market analysis is necessary because a carrier may, again for example, have market power as to a single product or service in one geographic area but not in another. (See Policy #4, addressing related concepts.)

GCI suggests that, in order to implement Policy #2, the regulations that define the incumbent carrier, until changed, as the dominant carrier (3 AAC 52.363(b), for interexchange service, and 3 AAC 53.220(b), for local service) should be repealed and the following regulations should be adopted the following new subsections to 3 AAC 53.220:

(b) When the Commission grants a certificate of public convenience and necessity to provide local exchange telephone service, the Commission shall determine whether or not the carrier should be classified as dominant or non-dominant. When the Commission grants the first certificate of public convenience and necessity for the provision of competitive local exchange service in a service area, the Commission shall also determine whether the incumbent carrier should be classified as dominant or non-dominant.

(c) Within 180 days after the adoption of this regulation, the Commission will determine whether or not the status of any carrier previously designated as dominant should be changed. Until the status is changed, any such carrier will continue to be treated as dominant.

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2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

(d) In its determination of whether or not a carrier has market power, the Commission shall determine the relevant product market and the relevant geographic market and shall consider the following factors in the relevant product and geographic market: the market share of the carrier; the number and size distribution of competing firms; the existence and nature of barriers to entry; the availability of reasonably substitutable service; and whether the carrier controls any bottleneck or essential facilities. Control of bottleneck facilities, defined as sufficient control over some essential commodity or facility to be able to impede new entrants, constitutes prima facie evidence of market power.

For the interexchange market, the Commission should adopt the following new subsections to 3 AAC 52.363[11]:

(b) When the Commission grants a certificate of public convenience and necessity to provide intrastate interexchange service, the Commission shall determine whether or not the carrier should be classified as dominant or non-dominant.

(c) Within 180 days after the adoption of this regulation, the Commission will determine whether or not the status of any carrier previously designated as dominant should be changed. Until the status is changed, any such carrier will continue to be treated as dominant.

(d) In its determination of whether or not a carrier has market power, the Commission shall determine the relevant product market and the relevant geographic market and shall consider the following factors in the relevant product and geographic market: the market share of the carrier; the number and size distribution of competing firms; the existence and nature of barriers to entry; the availability of reasonably substitutable service; and whether the carrier controls any bottleneck or essential facilities. Control of bottleneck facilities, defined as sufficient control over some essential commodity or facility to be able to impede new entrants, constitutes prima facie evidence of market power.

3. Policy #3: "All telecommunications carriers may unilaterally reduce consumer rates, subject to state and federal antitrust laws."

[11] The changes for the interexchange market are somewhat different because numerous competitors already exist throughout the interexchange market, whereas most local markets still remain as monopolies.

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2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

This policy indicates that the Legislature is inclined to the view that reductions in consumer rates generally benefit consumers and that in most cases the Commission need not subject requests to reduce rates to significant scrutiny. At the same time, the policy recognizes that the most significant issues that could be implicated by a rate reduction involve antitrust concerns.

GCI also believes that it is important to note certain things that this policy does not address. Most specifically, it does not address terms and conditions that a utility might attempt to include with a rate reductions. The policy does not in any way limit the Commission's authority to address any such terms and conditions that might be unduly discriminatory and otherwise unreasonable. GCI thus believes that the policy is directed solely at simple reductions in existing rates and not at new service packages or repackaging of existing services.

GCI suggests that implementation of Policy #3 requires amendment of several existing regulation and addition of a new regulation. The existing regulations on revision of rates in competitive local exchange and long distance markets should be rewritten as follows:

3 AAC 53.240(c) Notwithstanding (a) or (b), the commission will disapprove and require modification of a reduction in an existing rate if the reduction conflicts with principles of state or federal antitrust law, and the commission will disapprove and require modification of any other rates that are not just and reasonable or that grant an unreasonable preference or advantage to any customer or subject a customer to an unreasonable preference or disadvantage.

GCI Communication Corp.
2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

Additionally, a new subsection should also be added to 3 AAC 48.275 to address rate reductions in non-competitive markets.

3 AAC 48.275 **Supporting Information.** (a) Except as provided in (b) and (c) of this section...

(c) Subsection (a) of this section does not apply to a request to reduce an existing rate. Such a request shall become effective without approval of the Commission at the conclusion of the 45 day notice period. Notwithstanding the foregoing, the commission will disapprove and require modification of a reduction in an existing rate if the reduction conflicts with principles of state or federal antitrust law.

4. Policy #4: "A definition of 'competitive service area' shall take into account whether actual competition exists in an area."

The correct interpretation of this policy requires a careful examination of the legislative history of the HB 111. In various forms, amendments to the HB 111 were proposed that would have had the effect of deregulating the incumbent's retail rates even in areas where the incumbent faced no competition. In the initial form, a proposed amendment to HB 111 stated that upon approval of a CLECs application to provide service in any portion of an incumbent's service area, the incumbent could not be regulated as a dominant carrier if its statewide market share of access lines was less than 60 percent. Subsequently, HB 111 included provisions that provided broad exemptions from regulation in a "competitive service area", defined as "the service area served by a local exchange carrier in which at least 50 percent of all retail customers have a choice of facilities based provider" in one version (CSHB 111, Work Draft 23-GH1049\Z) and as "the

GCI Communication Corp.
2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

service area served by a local exchange carrier under a certificate of public convenience and necessity in which at least 50 percent of all retail customers have a choice of facilities-based providers" (CSHB 111 (JUD), Work Draft 23-GH1049\C).

These various proposals were opposed because of the fact that they would have deregulated retail rates even in areas that did not have any actual competition. In the original version, the retail rates of ILECs would have been deregulated throughout their service area as soon as an CLEC application was approved, since no ILEC has a statewide market share of over 60%. In later versions, ILECs would have been broadly deregulated throughout their service areas based on the existence of competition in only a portion of the service area. For example, Matanuska Telephone Association would have obtained retail deregulation even in Healy, Tyonek and Cantwell based on facilities-based competition that existed only in Eagle River/Chugiak.

These various proposals ultimately failed to pass. Instead, the proposed policy endorses the opposite position, that a given area should be defined as a "competitive service area" only if actual competition exists in that specific area.

To address this policy, GCI suggests that the following regulation be proposed as a definition in 3 AAC 53.299:

"competitive service area" means the portion or portions of the service area served by a local exchange carrier under a certificate of public convenience and necessity in which retail customers have a choice of facilities-based providers."

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2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

5. Policy #5: "Any method of depreciation used by the commission shall consider the actual useful life of depreciated equipment and facilities."

As with Policy #4, a review of the legislative history of HB 111 provides useful insight into the appropriate interpretation of this policy. Various versions of HB 111 included provisions that required the Commission to accept, for ratemaking purposes, depreciation rates proposed by a LEC so long as the underlying service lives were no shorter than the lives permitted by the U.S. Internal Revenue Service (IRS). These provisions were opposed on the ground that the lives allowed by the IRS are not related to the actual useful life of telephone plant.

Once again, the proposed legislative policy represents a repudiation of the provisions that had been proposed in HB 111. The policy requires that rates be based on actual useful lives.

Furthermore, the policy goes further and requires the Commission to consider the actual, historically experienced service lives of equipment when setting new depreciation rates. The requirement that historical experience must be considered is demonstrated by the phrase "actual useful life of depreciated equipment and facilities." (emphasis added). This wording requires consideration of the actual life of partially depreciated equipment still in service and fully depreciated equipment recently removed from service.

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2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

The policy does not require that depreciation rates be established based solely on the historical experience. However, that experience must be considered and given appropriate weight. The policy is a repudiation of recent proposals in which certain LECs have claimed that historical experience is irrelevant in setting depreciation rates for the future.

In order to implement this proposed policy, GCI suggests the following regulation:

A telecommunications carrier proposing to establish depreciation rates for any purpose shall include in its proposal an analysis of the actual service life of equipment and facilities in service and of any equipment and facilities retired in the previous 4 years. In establishing depreciation rates for a carrier, the Commission will consider the actual service life of equipment and facilities either in service or retired in the previous 4 years, including the analysis submitted by the carrier and any similar analysis submitted by any other party.

6. Policies #6, #8, and #9: When the commission approves a carrier's application for a certificate to provide competitive local exchange telecommunications service in an incumbent local exchange carrier's service area, in areas where the commission has determined there is competition among carriers, the incumbent local exchange carrier shall be subject to the same retail tariff standards and regulations as the new carrier, but the incumbent local exchange carrier remains the carrier of last resort in the relevant area until the commission orders otherwise"; "in areas where significant competition exists between carriers, competitors shall be allowed to increase rates under the same rules"; and "the commission may deny any rate increase to protect the public."

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2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

These three policies all relate to the regulation of rates in markets with local exchange competition. As such, these policies overlap significantly the issues that have been addressed in Docket R-02-6. GCI will attempt to avoid repetition of comments already made in that Docket.

Policy #6 and Policy #8 address very similar topics and are somewhat inconsistent. Policy #6 states that incumbents and new competitors should be "subject to the same retail tariffing standards and regulations" "in areas where the commission has determined there is competition." Policy #8 states that incumbents and new competitors "shall be allowed to increase rates under the same rules" "in areas where significant competition exists." (Emphasis added) Thus, on first reading, there seems to be an inconsistency between the two policies because Policy #6 seems to establish the same standards for ILECs and CLECs for all retail rate changes (including increases) as soon as an area become competitive, while Policy #8 seems to indicate that the same standard for rate increases should not be available to ILECs until "significant" competition exists.

There are at least two ways that this potential inconsistency could be resolved. The first would be to interpret Policy #6 so that the requirement would not apply until significant competition is found to exist. That interpretation would eliminate the inconsistency between the two policies. However, that interpretation would also render Policy #8 meaningless and redundant. This would run counter

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2550 Denali Street, Suite 1000
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to the rule of statutory construction that a statute should be read and interpreted to give meaning to all provisions of the statute.

The second approach would be to interpret Policy #6 not to apply to rate increases. This interpretation would not only resolve the inconsistency between Policy #6 and Policy #8 but would also give each of those two policies separate, independent meaning. For these reasons, GCI believes that is the most logical and defensible interpretation of the two policies.

However, GCI also believes that Policy #8 evidences legislative intent that ILECs and CLECs be subject to the same rules for rate increases at an earlier stage of competition than is now the case. In order to accomplish that result, GCI believes that a "bright-line" definition of "significant" competition should be established so that an ILEC is subject to the same rules for increases as the CLEC as soon as that bright line is passed. GCI suggests that the bright line be established as soon as an ILEC's market share falls below 80%. For this purpose, and as further explained in Docket R-02-6, the market share of the ILEC should include lines served by another carrier through total service resale.[12]

Policy #6 is also limited to "areas where the commission has determined that there is competition among carriers". GCI believes that this portion of Policy #6 relates to the definition of Policy #4, defining "competitive service area." Taken together, the polices provide that the rate flexibility granted to ILECs

[12] Stated differently, the bright line would be passed when CLECs collectively serve more than 20% of the access lines entirely on their own facilities or on leased UNE loops.

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should be allowed only in the areas meeting the definition of "competitive service area."

In order to implement these policies, 3 AAC 53.240, which now governs changes in retail rates in competitive local markets, needs to be amended. Combined with the amendments previously discussed regarding Policy #3 (rate reductions) and incorporating the definition of "competitive service area", GCI suggests that 3 AAC 53.240(b) be amended to read as follows and that subsections (c) and (d) should be added as follows:

(b) The dominant carrier shall maintain a current tariff of retail rates and all special contracts for retail rates on file with the commission. The dominant carrier may reduce retail rates, offer new or re-packaged services, and implement special contracts for retail service in a competitive service area without approval of the commission after 30 days notice to the commission of a tariff filing submitted in accordance with 3 AAC 48.220, 3 AAC 48.240, 3 AAC 48.270, and 3 AAC 53.200(f). A tariff revision by the dominant carrier to increase a rate is subject to the provisions of 3 AAC 48.200—3 AAC 48.430.

(c) Notwithstanding (a) or (b), the commission will disapprove and require modification of a reduction in an existing rate if the reduction conflicts with principles of state or federal antitrust law, and the commission will disapprove and require modification of any other rates that are not just and reasonable or that grant an unreasonable preference or advantage to any customer or subject a customer to an unreasonable preference or disadvantage.

(d) Notwithstanding (b) of this section, a dominant carrier that serves less than 80% of the access lines in a competitive area shall also be allowed to increase rates for retail service without approval of the commission after 30 days notice to the commission of a tariff filing submitted in accordance with 3 AAC 48.220, 3 AAC 48.240, 3 AAC 48.270, and 3 AAC 53.200(f). For the purposes of this subsection, the access lines of the dominant carrier shall include lines served by another carrier using total service resale of the dominant carriers service.

7. Proposed Legislative Policy #7: "The use of fill factors shall consider the application of fill factors in setting unbundled network element rates."

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As was discussed above, this Commission is required to follow federal law in setting rates for unbundled network elements, and any state legislation that required the use of any methodology inconsistent with federal law would be unlawful. Fortunately, Policy #7 is consistent with applicable Federal law and regulation concerning UNE pricing and has been so implemented by Commission Order in the past. *See* RCA Order U-99-141/142/143(9)-(8/24/00), adopting Arbitration Decision On Model Inputs, dated July 17, 2000, in its 'Fill Factor' section, pages 17-20.

A fill factor is the ratio of the amount of used capacity to total available capacity of a given telecommunications network component. According to the FCC, the purpose of fill factors in modeling or analyzing forward-looking costs is to identify sufficient capacity to fulfill current demand as well as sufficient excess capacity to accommodate certain administrative spare, including short-term growth. *See e.g.* Tenth Report and Order, *In Re: Forward-Looking Mechanism for High Cost Support for Non-Rural LECs*, CC Docket No. 97-160, FCC 99-304, November 2, 1999, at paras.186-208. The Commission has recognized and applied this principle, consistent with such Federal interpretation, by adopting the FCC's conclusion that target fill factors generally should reflect current demand and that the actual fill achieved, after taking into account the fixed nature of cable sizes, would adequately provide sufficient excess capacity for administrative functions such as inoperative components and short-term growth. *See*

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Anchorage, AK 99503
(907) 265-5600

Arbitration Decision On Model Inputs, cited above, at pages 17-20. So long as the "use" or "consideration" of fill factors by this Commission continues to be consistent with Federally mandated TELRIC principles for UNEs, it is consistent with applicable Federal law. *See* 47 CFR 51.505(b)(1).

Given the fact that Policy #7, like Policy #1, concerns the calculation of UNE rates, GCI suggests that the regulation to implement Policy #7 should be incorporated into the proposed regulation for Policy #1:

Determination of Rates for Unbundled Network Elements: Rates for unbundled network elements shall be determined by the Commission based on the Total Element Long Run Incremental Cost methodology, as defined by 47 CFR 51.505. The models and analyses used to determine unbundled network element rates and charges shall reflect network components that are sized, using fill factors consistent with an efficiently-operating firm, for the current level of demand with sufficient excess capacity to accommodate administrative spare, inoperative components, and short-term growth; these fill factors may or may not correspond to those that are found at present in the existing network.

Additionally, the following should be added to a definition section of the proposed regulations:

"Fill Factor" A fill factor is the ratio of the amount of used capacity to total available capacity of a given telecommunications network component.

Summary and Conclusion

This proceeding provides the Commission with an opportunity to review the rules applicable to competitive markets and to develop new rules for those markets. Consistent with the legislative principles, the new regulations must promote competition, protect the public, and be fair among competing carriers.

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GCI believes that these principles, and the legislative policies, are fully consistent with the pro-competitive principles of the Telecommunications Act of 1996. GCI also believes that its proposals herein address the legislative policies consistent with the legislative principles and federal law. GCI looks forward to working with the Commission and other parties to further refine the regulations necessary to comply with HB 111.

DATED at Anchorage, Alaska this 16th day of [month], 2003.

GENERAL COMMUNICATION, INC.

BY: _____
James R. Jackson
Its: Regulatory Attorney

VERIFICATION

I, James R. Jackson, verify that I believe the statements contained in this pleading are true and accurate.

_____
James R. Jackson

SUBSCRIBED AND SWORN to before me this 16th day July, 2003.

CAROL S. CHAMBERS NOTARY PUBLIC STATE OF ALASKA My Commission Expires:

Carol Chambers
Notary Public in and for Alaska
My commission expires: 4-2-05

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2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

8

STATE OF ALASKA

THE REGULATORY COMMISSION OF ALASKA

Before Commissioners:

Mark K. Johnson, Chair
Kate Giard
Dave Harbour
James S. Strandberg
G. Nanette Thompson

03 JUL 15 AM 9:00

RCA

In the Matter of the Commission Review of Rules And Regulations Governing Telecommunications Rates, Charges Between Competing Telecommunications Companies, and Competition In Telecommunications	))))))	R-03-3

Comments of the Alaska Telephone Association
Concerning the Notice of Inquiry to Consider Amending Regulations and Telecommunications Policies

The Alaska Telephone Association ("ATA") welcomes this opportunity to offer comments regarding the review of the Commission's rules and regulations governing competition in the local telecommunications marketplace.

The members of the Alaska Telephone Association[1] are all rural incumbent local exchange carriers with a history of providing high quality, affordable telephone service to Alaskans in high cost, rural and remote communities. Many of the issues raised in this Notice of Inquiry ("NOI") are crucial to the companies' ability to continue to offer such service to their respective customers.

[1] Alaska Power & Telephone Company,; Arctic Slope Telephone Association Cooperative; Bristol Bay Telephone Cooperative, Inc; Bush-Tell, Inc; Copper Valley Telephone Cooperative, Inc; Cordova Telephone Cooperative; KPU Telecommunications; Matanuska Telephone Association; Nushagak Electric & Telephone Cooperative, Inc; OTZ Telephone Cooperative; Summit Telephone Company, Inc; TelAlaska, Inc; United Utilities, Inc; and Yukon Telephone Company, Inc.

Rather than address all of the nine identified legislative policies, ATA will focus its attention and that of the Commission on those items that most directly impact the customers served by ATA members. In no way is this focus intended to convey a lack of interest in the other specifically identified policies. ATA certainly reserves the opportunity to address those issues or the comments of other parties in regard to those issues in the reply phase of this proceeding.

During the Legislature's consideration of the issues that prompted this NOI, ATA offered testimony advocating regulatory parity among service providers in a competitive environment. The Legislature addressed ATA's concern with the stated principle that "the incumbent carrier may not be placed at an unfair competitive disadvantage."[2]

Every ATA member provided high quality, affordable service to rural, high cost Alaskan communities prior to the Telecom Act of 1996. With the sweeping change in the legal and regulatory environment introduced by the Act, the perpetuation of such service by the same providers has been jeopardized. From a state policy-maker's perspective, it is crucial that all customers continue to receive high quality, affordable service. A change in the legal and regulatory arena should not diminish the service to which Alaskans are accustomed and, by law, entitled. With that purpose in mind, the incentive of the incumbent provider to serve and invest must be maintained.

When measured by number of customers and compared to incumbent local providers nationally, each member of ATA ranges in size from small to miniscule. However the areas served by most of these companies are extraordinary. In issuing their

[2] *See* House Bill 111, p. 2.

decisions, it is important for regulators to recognize the fragile circumstance by which rural customers receive affordable service.

Our focus on parity in a competitive area directs our attention to "a definition of 'competitive service area' shall take into account whether actual competition exists in an area" and

when the commission approves a carrier's application for a certificate to provide competitive local exchange telecommunications service in an incumbent local exchange carrier's service area, in areas where the commission has determined there is competition among carriers, the incumbent local exchange carrier shall be subject to the same retail tariffing standards and regulations as the new carrier, but the incumbent local exchange carrier remains the carrier of last resort in the relevant area until the commission orders otherwise.[3]

The perspective that, with the advent of competition for its customers, a small rural provider would be held to a more restrictive and costly regulatory regimen than a new entrant, is immediately threatening to infrastructure investment. Owners, boards of directors, and co-op members have struggled with decisions of whether to invest in an environment in which they might be held to a higher "dominant carrier" threshold than that required of a new, perhaps far more affluent, entrant. The Commission has an opportunity in addressing these policies to allay the incumbents' concerns regarding, not a competitive environment, but an unfair competitive environment. We believe the prerequisite of parity in a competitive arena is not only a logical and necessary component of competition, but a key element in insuring the continuation of affordable, high quality telecommunications service for rural Alaskans.

[3] *See* R-03-3(1), pp. 2-3.

The ATA looks forward to further participation in this NOI.

Respectfully submitted,

July 16, 2003

By: _____
James Rowe
Its: Executive Director

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STATE OF ALASKA

THE REGULATORY COMMISSION OF ALASKA

Before Commissioners: Mark K. Johnson, Chair
Dave Harbour
Kate Giard
James S. Strandberg
G. Nanette Thompson

In the Matter of the Commission Review of Rules and Regulations Governing Telecommunications Rates, Charges Between Competing Telecommunications Companies, and Competition in Telecommunications	))))))	R-03-3

THE RURAL COALITION'S COMMENTS AND PROPOSED REGULATIONS

The Rural Coalition submits the following comments and proposed rules in response to the Notice of Inquiry ("Notice") of the Regulatory Commission of Alaska ("Commission" or "RCA") dated June 11, 2003, regarding the review of the regulations governing telecommunications rates, charges between competing telecommunications companies, and competition in telecommunications.

I. Introduction

The Rural Coalition has a strong interest in local competition rules as applied to rural and remote regions in Alaska, an area currently inadequately addressed by the Commission's rules. The Legislature has directed the Commission to propose

DORSEY & WHITNEY LLP
1031 WEST 4th Avenue
Suite 600
Anchorage, AK 99501
(907) 276-4557

regulations covering nine specific policies ("Policies").[1] The Rural Coalition welcomes this review and has prepared proposed rules addressing several of the Legislature's Policies – specifically those related to local exchange competition and parity of obligations among competing carriers. These proposed regulations are attached as Exhibit A.

The Rural Coalition also believes that it is necessary to complete a comprehensive reworking of the Commission's rules governing local competition and the regulation of rural incumbent local exchange carriers in order to implement the Legislature's mandates. The current local competition rules were originally adopted on an interim basis and have outlived their useful life. **Section II** describes the history of the current rules and why they no longer adequately serve to regulate competition, particularly in rural areas. **Section III** discusses the principles that must guide the review and revision of the Commission's rules and explains how the Rural Coalition's proposed rules[2] advance the Legislature's Policies.

II. History of current local competition rules

The existing local competition regulations, 3 AAC 53.200-53.299, were enacted on an interim basis as a stop-gap measure to inject some order and predictability into the

[1] *See* House Bill No. 111, 23rd Legislature of the State of Alaska – First Session (2003) (as amended), attached as an appendix to RCA Order No. R-03-3(1).

[2] Where referenced herein, the Rural Coalition's proposed rules (many of which share numbering with the existing rules) will be underlined. The Commission's current rules will be cited without underlining.

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Anchorage local exchange market where, in the absence of rules, the developing competition was proceeding in a muddled and disorganized manner. The regulations were borrowed from Alaska's rules governing intrastate interexchange competition[3] without being tailored to local exchange service and were never intended to govern local competition for any lengthy period of time.

The Commission's long-term goal was to develop appropriate local exchange competition regulations through Docket No. U-97-12. For whatever reason, the development of substantive regulations for local exchange competition did not take place, leaving the interim regulations adopted at 3 AAC 53.200 *et seq.* as the only regulations governing local competition.

Not only do the existing regulations say very little about local exchange competition generally, but they do not address how competition is actually evolving in rural Alaska. These regulations, much like the Telecommunications Act of 1996, presume that local competition will be achieved through a competitive local exchange carrier's ("CLEC") use of an incumbent local exchange carrier's ("ILEC") unbundled network elements ("UNEs"). This is evident by the regulations' focus on concepts such as "dominance" and "resale through wholesale rates." *See* 3 AAC 53.220 and 3 AAC 53.250. These concepts are only directly relevant where one carrier relies on another carrier to carry its traffic. This is not the case in rural Alaska.

[3] *Compare* 3 AAC 53. 200-53.299 (Local Exchange Competition) *with* 3 AAC 52.350-399 (Criteria for Intrastate Interexchange Telephone Competition).

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(907) 276-4557

Local competition in the most rural parts of Alaska is highly unlikely to take place through a CLEC's use of and reliance on an ILEC's network. Rather, local competition will almost certainly develop through a competitor's construction of a stand-alone wireless network. This is the result of several factors:

- Constructing a wireless network is less expensive than constructing a wireline network.
- Constructing a stand-alone wireless network avoids the regulatory requirement of seeking to terminate a rural exemption and negotiating and arbitrating an interconnection agreement as a prerequisite to providing competitive local exchange service.[4]
- Constructing a stand-alone wireless network allows the wireless provider to compete with the ILEC without making its network available to other competitors.[5]

Another likely vehicle for local competition is cable modems. The reasons are the same as those identified for wireless carriers. The only difference is that, while the cost of constructing a cable network may be comparable to the cost of constructing a

[4] A CLEC that relies on an ILEC's network to provide service may only do so after successfully terminating a rural telephone company's rural exemption and negotiating (and arbitrating, if necessary) an interconnection agreement. These requirements do not apply where a competitor builds its own network.

[5] A competitor that relies on the ILEC's network to provide service must make its interconnection agreement available to other competitors for their use under the "pick and choose" rules of the Telecommunications Act of 1996. If a company builds a stand-alone wireless network, there is no obligation to make that network available for use by other competitors.

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wireline network, the cable provider is already recovering costs through unregulated cable television charges, making the incremental cost of providing telephone service using the network lower.

As a result, local exchange competition in Alaska's most rural areas has been, and will almost certainly continue to be, through stand-alone networks and not through the ILEC's network. The Commission's local competition rules must be substantially revised to match this reality.

There are two additional reasons why new Alaska regulations must be developed to address local exchange competition in rural areas. The first reason is to identify when competition actually begins. In rural Alaska, competition is triggered not only by the certification of a CLEC in an area served by a rural telephone company, but also by designation of a second Eligible Telecommunications Carrier ("ETC"). In either case, regulatory reforms must take place prior to the onset of competition to ensure that the incumbent carrier is not placed at an unfair competitive disadvantage and that a modern telecommunications infrastructure is promoted.[6] Alaska's current local competition rules do not recognize or even contemplate that the designation of a second ETC in any area served by a rural telephone company is a competitive trigger.

The second reason that the local competition rules must be revised is time. When a wireless provider builds a network and obtains ETC designation, there is currently no

[6] *See* House Bill No. 111, p. 2 ("[T]he commission shall be guided by following principles: . . . the incumbent carrier may not be placed at an unfair competitive disadvantage . . . [and] the development of a modern telecommunications infrastructure in the state shall be encouraged").

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Suite 600
Anchorage, AK 99501
(907) 276-4557

time to identify and implement the appropriate prerequisites to competition. In the absence of Alaska regulations governing local competition in rural areas, the Commission may lack the time to put into place processes to ensure that the principles set forth in House Bill No. 111 are achieved. For these reasons, the existing local competition regulations must be substantially revised and amended.

III. Rural Coalition's proposed rules

The Rural Coalition has prepared proposed rules to address the major gaps in the Commission's existing local competition regulations. If implemented, the Rural Coalition's proposed rules will ensure that competition in rural Alaska (where it is appropriate) is implemented fairly and does not undermine the goals of universal service or the principles established by the Legislature.

The proposed rules include: (1) a modification of the existing Commission rules relating to local exchange competition (submitted as redlined rules, 3 AAC §§ 53.200 - 53.299, at Section I of Exhibit A); and (2) new rules relating to (i) ETC designation in areas served by rural telephone companies, (ii) the conditions necessary to ensure designating an additional ETC in a rural service area is in the public interest, and (iii) the changes in rate structure (*e.g.*, rate deaveraging and removal of implicit subsidies) that an incumbent local exchange carrier must be permitted to put in place prior to the creation of a competitive marketplace (submitted as new regulation, 3 AAC 53.360, at Section II of Exhibit A).

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Suite 600
Anchorage, AK 99501
(907) 276-4557

These proposed rules address the Policies established by the Legislature in House Bill No. 111, and specifically Policies 4, 6 and 8:

> Policy No. 4. A definition of "competitive service area" shall take into account whether actual competition exists in an area.

The Rural Coalition's proposed rules implement this directive by defining the term "competitive service area" and establishing the existence of a "competitive service area" as the trigger for the application of local competition rules. *See* Proposed Rules 3 AAC §§ 53.220, 53.299. This approach significantly alters the scope of the Commission's current local competition rules, which only apply in the Anchorage service area in the absence of a Commission order. *See* 3 AAC § 53.200(a).

Among the categories of competitive service areas are "[a]ny service areas where multiple carriers have been designated as eligible telecommunications carriers". *See* Proposed Rule 3 AAC 53.220(3). The Rural Coalition has also established rules relating to multiple ETC designations, and specifically the considerations required to ensure such designation is in the public interest and otherwise in accordance with the law (Proposed Rules 3 AAC § 53.360(b)), application requirements and Commission procedures (Proposed Rule 3 AAC § 53.360(c)), conditions precedent for a carrier to achieve ETC status (Proposed Rule 3 AAC § 53.360(c)(6), (e)), and annual recertification requirements (Proposed Rule 3 AAC § 53.360(d)).

> Policy No. 6. When the commission approves a carrier's application for a certificate to provide competitive local exchange telecommunications service in an incumbent local exchange carrier's service area, in areas where the commission has determined there is competition among carriers, the incumbent local exchange carrier shall be subject to the same retail tariffing standards and regulations as the new

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1031 WEST 4th Avenue
Suite 600
Anchorage, AK 99501
(907) 276-4557

carrier, but the incumbent local exchange carrier remains the carrier of last resort in the relevant area until the commission orders otherwise.

The Rural Coalition's proposed rules implement this policy by establishing parity of regulation between competing carriers. *See, e.g.*, Proposed Rules 3 AAC §§ 53.200 – 53.299. 53.360 (c)(6), (d), and (e). Specifically, the Rural Coalition has eliminated the "dominant/non-dominant" distinction in competitive service areas so that all competing carriers, incumbent and competitors alike, are subject to a level regulatory playing field.

The Rural Coalition has also established a process by which an ILEC can modify its rate structure (to deaverage its rates and eliminate implicit subsidies) prior to the onset of competition to ameliorate the possibility of competitors engaging in cream-skimming[7] or other inequitable conduct. *See* Proposed Rule 3 AAC 53.360(e). This type of restructuring is also required for parity in retail tariffing standards as contemplated by Policy No. 6.[8]

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[7] ETC applicants often rely on the redefinition of rural service areas and the disaggregation of universal service zones as a remedy to the threat of cream skimming. *See, e.g., In the Matter of the Application of Dobson Cellular Systems, Inc. for Designation as a Carrier Eligible to Receive Federal Universal Service Support under the Telecommunications Act of 1996 and Petition for Redefinition of Certain Rural Service Areas*, Docket No. U-03-48 (dated July 11, 2003), ¶ 41. However, the disaggregation of universal service zones is not a cure-all for cream skimming, and, in fact, is only the first step in a multi-step process, which must also include the deaveraging of rates and the elimination of implicit subsidies as described in the Rural Coalition's proposed rules.

[8] It is important to note that these rules, while necessary to ensure parity, may ultimately impact rural consumer rates. Once the required ILEC restructuring is completed and competition begins, the Commission may need to monitor consumer rates and determine if the Alaska Universal Service Fund needs to be expanded to keep rates affordable for all consumers in the competitive marketplace.

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(907) 276-4557

Policy No. 8. In areas where significant competition exists between carriers, competitors shall be allowed to increase rates under the same rules.

Similar to Policy No. 6, this Policy demands parity (here, for upward rate adjustments) in competitive service areas. The Rural Coalition's proposed rules implement this policy (*see, e.g.*, 3 AAC § 53.240) and allow any competitor to petition the Commission if unforeseen or residual disparities continue to exist once the new local competition rules are in place. *See* Proposed Rule 3 AAC § 53.290(d).

In sum, the Rural Coalition believes that its proposed rules provide a much needed starting point to address the Legislature's mandate and to reformulate the Commission's local competition rules in an equitable and workable manner that takes into account the reality of how competition (where appropriate) is likely to develop in rural Alaska. The Rural Coalition reserves the right to further clarify its position and the scope of its proposed rules (including adding to the list of those regulations that need to be modified or added) as this investigation proceeds.

IV. Conclusion

For all the foregoing reasons, the Rural Coalition respectfully requests that the Commission adopt the regulations proposed herein.

Dated this 16th day of July, 2003.

DORSEY & WHITNEY LLP
Attorneys for the Rural Coalition

By: Heather H. Grahame
Heather H. Grahame

DORSEY & WHITNEY LLP
1031 WEST 4th Avenue
Suite 600
Anchorage, AK 99501
(907) 276-4557

EXHIBIT A
THE RURAL COALITION'S PROPOSED RULES[1]

I. MODIFICATION OF EXISTING LOCAL EXCHANGE COMPETITION RULES, 3 AAC 53.200 – 53.299

3 AAC 53.200. APPLICABILITY OF LOCAL EXCHANGE COMPETITION PROVISIONS, PURPOSE, AND WAIVER

(a) The provisions of 3 AAC 53.200 - 3 AAC 53.299 apply to all local exchange carriers that furnish local exchange telephone service within ~~the Anchorage~~a competitive service area ~~and any other service area as ordered by the Commission.~~.

(b) The purpose of 3 AAC 53.200 - 3 AAC 53.299 is to allow competition in the provision of local exchange telephone service to the extent possible while maintaining and promoting universal local exchange telephone service; to promote the maintenance and continued development of a modern telecommunications infrastructure; and to ensure that no carrier (including the incumbent carrier) is placed at an unfair competitive disadvantage.

(c) For good cause shown, the commission will, in its discretion, waive the application of all or any portion of 3 AAC 53.200 - 3 AAC 53.299 to a local exchange carrier and establish appropriate criteria for that carrier.

(d) If any conflict or discrepancy arises or is discovered between the application of these local exchange competition rules and other rules or regulations of the commission, these local exchange competition rules will control.

3 AAC 53.210. LOCAL EXCHANGE TELEPHONE SERVICE: CERTIFICATE OF PUBLIC CONVENIENCE AND NECESSITY

(a) Unless otherwise exempt by state or federal law, ~~A~~an entity proposing to provide local exchange telephone service in competition with an existing local exchange carrier must file an application for a certificate of public convenience and necessity that includes

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[1] Amendments are delineated by underlining, deletions by ~~strikethrough~~.

(1) the legal name and the name under which the applicant proposes to do business;

(2) the address of the principal national and Alaskan place of business;

(3) the name, title, and telephone number of the individual who is the liaison with the commission in regard to the application;

(4) the applicant's business structure (corporation, partnership, etc.), including proof of incorporation and name and address of registered agent, if applicable;

(5) proof of authority to do business in Alaska;

(6) a list of the owners of five percent or more of the applicant's equity;

(7) a list of persons or entities that are affiliated interests of the applicant;

(8) a list of all administrative and judicial proceedings that resulted in

(A) suspension, revocation, or denial of the authority, license, or certification of the applicant or its officers, directors, or affiliates to provide utility services;

(B) a reprimand, penalty, or conviction of an applicant or its officers, directors, or affiliates related to operations, gross misrepresentations, fraudulent transactions, or securities violations; or

(C) an adjudication of bankruptcy or a reorganization in bankruptcy of applicant or its officers, directors, or affiliates;

(9) a list of all cases and locations in which the applicant, its officers, directors, or affiliates, has abandoned service in violation of applicable statutes, regulations, or orders;

(10) a list of the names, titles, and responsibilities of key management now employed or to be employed by the applicant and resumes for each person;

(11) for existing businesses, copies of the most recent year's balance sheet and income statement or Federal Communications Commission Form M and, if available, Securities and Exchange Commission Form 10-K;

(12) for new businesses, copies of the most recent year's balance sheet and income statement for the owners of the business listed under (6) of this subsection;

(13) a list of all services proposed, together with an explanation of the applicant's technical ability to provide the proposed services;

(14) a description of the area within which the entity proposes to provide local exchange service;

(15) a description of all existing facilities that will be used to provide local exchange telephone service;

(16) a description of all agreements or negotiations with other utilities for joint use and interconnection of facilities;

(17) a tariff of rates and services; and

(18) a verification signed by the person authorized to sign on behalf of the applicant that all of the information provided in the application is true, accurate, and complete.

(b) The commission will give notice of an application for a certificate of public convenience and necessity to provide local exchange telephone service in accordance with 3 AAC 48.645(a).

(c) The commission will issue a certificate of public convenience and necessity to an entity that proposes to provide local exchange telephone service under 3 AAC 53.200 - 3 AAC 53.299 and that is found by the commission to be fit, willing, and able to provide the proposed service.

(d) The commission will, in its discretion, place conditions on a certificate of public convenience and necessity that it considers appropriate, including a condition that the local exchange carrier post a bond to assure compliance with commission rules.

3 AAC 53.220. DETERMINATION OF ~~DOMINANT STATUS~~A COMPETITIVE SERVICE AREA

(a) ~~Upon petition or on its own motion, the commission will, in its discretion, determine whether a local exchange carrier has market power in its service area and, as appropriate, designate or change the designation of the local exchange carrier as dominant or nondominant.~~

~~(b) Until changed under (a) of this section, the incumbent carrier in any service area is a dominant carrier, and all other local exchange carriers in that service area are nondominant carriers.~~ The following service areas are competitive service areas:

(1) The Anchorage service area;

(2) Any service area where multiple carriers are certificated to provide local exchange service and are actually providing local exchange service;

(3) Any service area or study area where multiple carriers have been designated eligible telecommunications carriers;

(4) Any service area where the rural exemption has been lifted; and

(5) Any other service area determined to be a competitive service area by the commission.

(b) When making a determination under (a)(5) of this section, the commission shall consider the following:

(1) Whether actual competition exists in a service area;

(2) Whether provision of service is a natural monopoly; and

(3) Whether monopoly or competitive provision of service is in the public interest.

3 AAC 53.230. DISCONTINUANCE, SUSPENSION, OR ABANDONMENT OF SERVICE ~~BY NONDOMINANT CARRIER~~

(a) A ~~nondominant~~ local exchange carrier in a competitive service area may discontinue, suspend, or abandon local exchange telephone service at the end of the 30-day notice period required by (b) of this section unless the commission finds that continuation of the service is required for the public convenience and necessity or is otherwise required by law.

(b) A ~~nondominant~~ local exchange carrier in a competitive service area proposing to discontinue, suspend, or abandon local exchange telephone service shall provide at least 30 days' written notice to the commission, to its subscribers, and to every other local exchange telephone company and each interexchange carrier providing service to locations where the discontinuance, suspension, or abandonment is proposed.

3 AAC 53.240. RETAIL RATES

(a) Unless otherwise exempt by state or federal law, a ~~A nondominant~~ local exchange carrier in a competitive service area shall maintain a current tariff of retail rates and all special contracts for retail rates on file with the commission. A ~~nondominant~~ carrier may modify retail rates and implement special contracts for retail service without approval of the commission after 30 days' notice to the commission of a tariff filing submitted in accordance with 3 AAC 48.220, 3 AAC 48.240, 3 AAC 48.270, and 3 AAC 53.290(f).

~~(b) The dominant carrier shall maintain a current tariff of retail rates and all special contracts for retail rates on file with the commission. The dominant carrier may reduce retail rates, offer new or re-packaged services, and implement special contracts for retail service without approval of the commission after 30 days' notice to the commission of a tariff filing submitted in accordance with 3 AAC 48.220, 3 AAC 48.240, 3 AAC 48.270, and 3 AAC 53.290(f). A tariff revision by the dominant carrier to increase a rate is subject to the provisions of 3 AAC 48.200 - 3 AAC 48.430.~~

(be) Notwithstanding (a) ~~or (b)~~ of this section, the commission will disapprove and require modification of rates and conditions that are not just and reasonable or that grant an unreasonable preference or advantage to any customer or carrier or subject a customer or carrier to an unreasonable prejudice or disadvantage.

3 AAC 53.250. WHOLESALE SERVICE AND RATES

(a) A local exchange carrier shall offer all its services for resale to other carriers. Services must be offered for resale at wholesale rates to the extent determined appropriate in view of the facilities and general service offerings of the local exchange carrier.

(b) The commission will disapprove and require modification of wholesale rates that are not just and reasonable or that grant an unreasonable preference or advantage to any customer or subject a customer to an unreasonable prejudice or disadvantage.

(c) The requirements of (a) of this section do not apply to an incumbent local exchange carrier operating under the rural exemption.

3 AAC 53.290. MISCELLANEOUS PROVISIONS

(a) The provisions of 3 AAC 48.230 and 3 AAC 48.275 do not apply to a local exchange carrier in a competitive service area. The provisions of 3 AAC 48.277, and 3 AAC 48.430 likewise do not apply to a ~~nondominant~~ local exchange carrier in a competitive service area unless the carrier participates in the state access charge pool.

~~(b) The provisions of 3 AAC 48.275(a) do not apply to the dominant carrier for rate decreases, new services, and repackaging of existing services.~~

(bc) ~~A dominant~~ The incumbent local exchange carrier in a competitive service area ~~is~~ remains responsible for providing local exchange telephone service in its service area as the carrier of last resort.

(cd) The provisions of 3 AAC 53.190 govern the reassignment of a subscriber's access line or lines to a different local exchange carrier.

(de) No implicit modification or waiver of any statutory or regulatory requirements is intended by 3 AAC 53.200 - 3 AAC 53.299. However, in a competitive service area no carrier shall be subject to regulatory requirements that will place the carrier at an unfair competitive disadvantage. All carriers in a competitive service area will be subject to the same or substantively similar regulatory requirements, including the requirement of 3 AAC 52.200 – 52.340. A carrier may petition the commission for a waiver or modification of any regulatory requirement that violates this section. ~~for either dominant or nondominant carriers. Absent specific modification or waiver, all statutory and regulatory requirements remain in effect for both dominant and nondominant carriers.~~

(ef) A local exchange carrier in a competitive service area shall publish a public notice of all proposed tariff revisions in a local, general circulation newspaper no later than three days after filing it with the commission. The public notice must contain a general description of the filing that is accurate, written in plain English, and sufficient to alert consumers of tariff revisions that may affect either the rules or rates applicable to them. The notice must contain sentences containing the following information: the date the utility made (or will make) its filing with the commission; the date the revisions are expected to become effective; and a statement that both the proposed revisions and the utility's current tariff are available for review at the utility's office or which an address and office hours are given. The notice must contain sentences similar to the following: "Any person may file comments on this tariff revision with the ~~Alaska Public Utilities Commission~~ Regulatory Commission of Alaska (address). To assure that the commission has sufficient time to consider the comments prior to the revisions taking effect, (utility name) suggests that your comments be filed no later than (a specific date, not a weekend or holiday, approximately 7-10 days prior to the filing's taking effect)."

(fg) Where all necessary facilities and equipment are in place, a local exchange carrier shall complete the transfer of a customer to another local exchange carrier within seven working days of receiving a valid order for transfer of service.

3 AAC 53.299. DEFINITIONS

Unless the context indicates otherwise, in 3 AAC 53.200 - 3 AAC 53.299,

(1) "Anchorage service area" means the service area certificated to ATU Telecommunications by certificate of public convenience and necessity No. 120 as of April 8, 1998;

(2) "commission" means the ~~Alaska Public Utilities Commission~~Regulatory Commission of Alaska;

~~(3) "dominant carrier" means a local exchange carrier determined by the commission to have market power;~~

(3) "competitive service area" has the meaning given to it in 3 AAC 53.220;

(4) "incumbent carrier" means the telephone utility, or its successor, certificated to provide local exchange telephone service within its service area as of February 8, 1996;

(5) "interexchange carrier" means a carrier certificated by the commission to provide intrastate interexchange telephone service;

(6) "local exchange carrier" means a carrier certificated to provide local exchange telephone service;

~~(7) "nondominant carrier" means a local exchange carrier other than a dominant carrier;~~

(78) "recorded authorization" means a voice communication that clearly grants the authority to transfer a customer's local exchange service from one local exchange carrier to another and that may be accurately retrieved for later review.

II. NEW UNIVERSAL SERVICE FUND REGULATIONS

3 AAC Section 53.360. ELIGIBLE TELECOMMUNICATIONS CARRIER DESIGNATION

(a) Purpose

The purpose of these rules is to establish regulations concerning the designation of an eligible telecommunications carriers ("ETC"), as defined at 3 AAC 53.399(3), in rural and non-rural areas and to define certain obligations that attach to such designation.

(b) ETC designation

(1) Non-rural service area

(A) To be eligible to receive universal service support in non-rural areas, a carrier must provide federally supported services pursuant to 47 C.F.R. § 54.101 throughout the area for which the carrier seeks to be designated as an ETC;

(B) The commission shall designate a requesting carrier an ETC in a non-rural service area if it determines that the carrier: offers the services described in (1)(A) of this section either using its own facilities or a combination of its own facilities and resale of another carrier's services; and advertises the availability of and charges for such services using media of general distribution.

(2) Area served by a rural telephone company

In addition to the requirements and determinations of part (1) of this section, where a carrier seeks designation in an area served by a rural telephone company, the commission shall determine whether or not such designation is in the public interest. In making this determination, the commission shall consider the following:

(A) Whether the applicant has adequately demonstrated a concrete intent to serve the entire service area within a reasonably short period of time after ETC designation;

(B) Whether the applicant has adequately demonstrated it will provide the required services at affordable rates;

(C) Whether the applicant has adequately demonstrated it has the financial wherewithal to provide supported services throughout the service area;

(D) Whether the applicant has adequately demonstrated it is capable of and committed to maintaining an adequate level of service quality;

(E) Whether the applicant has adequately demonstrated it will provide those benefits that it promises in its application;

(F) Whether designating the applicant as an ETC will harm consumers through inadequate service quality, unacceptable "dead spots," disincentives for investment, or otherwise;

(G) How the applicant intends to use any universal service funding;

(H) Whether the applicant will bring sufficient incremental benefits to consumers to warrant providing universal service support to a carrier other than the rural local exchange carrier;

(I) Whether designating the applicant as an ETC will further the efficiency, availability and affordability of universal telecommunications service in accordance with AS 42.05.145;

(J) If the incumbent local exchange carrier provides preliminary analyses or other data or information regarding the deaveraging of rates or the removal of implicit subsidies upon designation of an additional ETC in accordance with 3 AAC 53.360(e), what impact such deaveraging of rates or removal of implicit subsidies will have on consumers and the state universal service fund; and

(K) Any other relevant evidence, data, or information of potential benefits or harms resulting from the applicant's ETC designation.

(c) Application requirements and commission processing of applications

(1) Time of application

At any time, a carrier may seek commission approval to be designated an ETC for a requested service area.

(2) Notice of application

The commission will give reasonable public notice of an ETC application in accordance with the commission's rules of Practice and Procedure.

(3) Contents of application

(A) An application seeking designation as an ETC shall be verified and shall contain the following information:

(i) A statement identifying the decision(s) of this commission and/or the Federal Communications Commission authorizing the applicant to provide telecommunications service;

(ii) A statement which describes with particularity the service area for which the applicant seeks designation as an ETC. Such statement shall be accompanied by a map displaying the service area and a township and range description of the service area and shall identify where within the identified service area, if at all, the applicant currently provides local exchange service.

(iii) A statement of facts (not in the form of conclusory statements) and supporting data and information relied upon by the applicant to demonstrate that it meets the requirements of 47 C.F.R. § 54.201(d);

(iv) A description of the system that will be used to provide service;

(v) An affirmative statement that the applicant will offer the services that are supported by the Federal universal service support mechanism under 47 U.S.C. § 254(c), throughout the identified service area;

(vi) An affirmative statement that the applicant is a common carrier;

(vii) A statement detailing the method the applicant will use to advertise the availability of its supported services and the charges therefore using media of general distribution pursuant to section 47 U.S.C. § 214(e)(1)(B). Such a statement should include a copy of the text of the advertisement. The commission establishes as guidelines to meet this requirement, that an ETC advertise in publications targeted to the general residential market and that an ETC place an advertisement in the telephone directory within the ETC's service area. Such advertisements should at a minimum

indicate that the carrier will offer basic local exchange service to all who request such service within the service area. In addition, the carrier's service area map, including dates by which service is expected to be available in various areas, shall be posted on a website available to the public.;

(viii) An explanation of the agreements the carrier has with long distance carriers for origination and termination of long distance calls and equal access to long distance carriers;

(ix) An affirmative statement that the applicant will make available Lifeline and Link-Up services to all qualifying low-income consumers and toll limitation services in accordance with applicable Federal rules;

(x) An explanation of the level of "local usage" that the carrier will provide to comply with 47 C.F.R. § 54.101(a)(2);

(xi) An affirmative statement that all universal service funds provided will be used only for the provision, maintenance, and upgrade of facilities and services for which the support is intended. Such a statement should include a description of the carriers plans to extend or improve its network that would be accomplished through receipt of universal service funds and any plans to use the funds to reduce customer rates;

(xii) An explanation of how the carrier will identify and request support only for eligible customers within the service area; and

(xiii) Any other information which the applicant wants the commission to consider in connection with the commission's review of its application.

(B) In addition to the information identified in (A) of this section, if the applicant is seeking ETC designation in a rural service area, the application must also contain the following information:

(i) A statement of facts (not in the form of conclusory statements) and supporting data and information relied upon by the applicant to demonstrate that its designation as an ETC will serve the public interest;

(ii) A description of any unserved or underserved area(s) which the applicant will serve. Such showing will be

accompanied by a map displaying the unserved or underserved area(s), an estimate of the number of customers in the unserved or underserved area(s), a build-out plan demonstrating how the unserved or underserved area(s) will be served, and a proposed date by which such service will be provided;

(iii) A description of any customer service complaints, administrative complaints, judicial complaints, or other legal or enforcement actions received by or instituted against the applicant with respect to its current telecommunications operations and service offerings within or outside of the service area covered by the application that are currently pending or were received or resolved within the 12 months prior to the date of application;

(iv) If the applicant claims to provide new or advanced services, a detailed description of such services and a deployment schedule demonstrating when these services will be made available at a reasonable cost to consumers;

(v) A filing consistent with (6)(A) and (B) of this section where applicable; and

(vi) Any other evidence, data, or information requested by the commission or otherwise necessary to credibly demonstrate that the benefits claimed by the applicant will be made available to all requesting customers in the service area upon ETC designation or within a reasonably short period of time thereafter.

(4) Objections

Within 30 days of a Notice of Application any person may file an objection with the commission. Such objection must include a brief statement explaining the grounds for the objection.

(5) Commission process

(A) An application considered under this section may be considered administratively unless the commission receives an objection within 30 days of the Notice of Application;

(i) *Sufficiency*. The commission shall examine the application for sufficiency. If material deficiencies are

determined to exist, the applicant shall be notified and shall be given a reasonable opportunity to supplement the application.

(ii) *Comments.* Within 30 days after the Notice of Application all interested persons may file comments with the commission. The commission shall consider these comments when making its decision on whether or not to approve the application.

(iii) *Additional proceedings.* If at any time the commission determines that additional proceedings would be beneficial, it may order any such proceedings, including a hearing in accordance with (B) of this section.

(iv) *Effective date.* The earliest effective date for an administrative approval of the application will be no less than 60 days after the filing of a sufficient application.

(B) If the commission receives an objection to the ETC application within 30 days of the Notice of Application, or upon the commission's own motion, the application may be docketed for hearing pursuant to the commission's rules of Practice and Procedure.

(i) *Intervention.* All interested parties may be invited to intervene in accordance with 3 AAC 48.110. Where an ETC application is for a rural service area, the incumbent local exchange carrier in that service area shall be permitted to intervene.

(ii) *Discovery.* Parties to the proceeding shall be provided a reasonable opportunity to conduct discovery.

(iii) *Hearing and burden of proof.* A hearing on the merits may be held in accordance with the commission's rules of Practice and Procedure. The burden of proof at the proceeding will be borne by the applicant. To meet its burden an applicant must credibly demonstrate its capability and commitment to provide the services required of an ETC throughout the service area for which it seeks ETC status, and, in rural study areas, credibly demonstrate that its designation as an ETC is in the public interest.

(iv) *Effective date.* The earliest effective date for an approval of the application will be no less than 120 days after the filing of a sufficient application.

(6) Conditions and compliance filing

(A) As part of its ETC application, a CMRS provider shall file the following items:

(i) A tariff containing a detailed description of its Basic Universal Service offering, which shall include at least one package which includes both unlimited local usage or the minimum level of local usage set by the FCC. The Basic Universal Service offering must contain the services required under 47 C.F.R. § 54.101(a), must identify any additional services that may be added to the Basic Universal Service offering; must contain the prices for the Basic Universal Service offering; and must identify all areas where the Basic Universal Service offering is available;

(ii) A plan for advertising its universal service offering(s) throughout its proposed service area;

(iii) A proposed customer service agreement for Commission review and analysis, with and against existing Commission service quality standards, including: The terms and conditions of service such as credit for interrupted services and a process for resolving customer complaints; and service quality standards such as compliance with the State Telecommunications Modernization Plan (where technically feasible), and a minimum call completion rate;

(iv) A proposed build-out plan with firm dates by which the carrier commits to complete its network in order to provide service throughout the entire service area. If the build-out plan does not result in coverage throughout the entire service area within a reasonable period of time, the Commission will not grant final ETC designation;

(v) An affirmative statement that the carrier will abide by the terms and conditions of its filings set forth under (i)-(iv) of this section and that it acknowledges the Commission may revoke the carrier's ETC designation if it does not.

(B) . At any time prior to granting ETC designation, the Commission, in its discretion, may require any other condition or compliance filing that it determines is necessary to preserve the public interest. All parties to the carrier's ETC application proceeding may comment on the conditions and compliance filings that are required by this section under a schedule established by the Commission.

(C) Final approval of a carrier's request for ETC designation is conditioned upon Commission review and approval of the filings required under (A) and (B) of this section.

(d) Annual ETC recertification

The commission shall require each ETC to file an annual certification that the carrier is using the universal service funding that it receives only for its intended purpose.

(1) A recertification filing shall consist of the information that the commission deems necessary to determine that each ETC uses its universal service support only for the provision, maintenance, and upgrading of its facilities and services and that such use is otherwise in accordance with the law. With the exception of any information required under (2) of this section, the recertification filing requirements shall be substantially the same for all ETCs.

(2) At its discretion, the commission may require an ETC to include additional information in its recertification filing to verify that the ETC is in compliance with the specific conditions established under 3 AAC 53.360(c)(6) and that its ETC designation is still in the public interest.

(e) Actions of an incumbent local exchange carrier in a competitive service area

(1) Before the commission designates a second ETC in an area served by a rural telephone company or determines that a service area is a competitive service area as defined by 3 AAC 53.220, the incumbent local exchange carrier shall be afforded a reasonable opportunity to effect the following changes:

(A) The incumbent local exchange carrier may revise its rates to reflect the underlying costs of providing telecommunications services by deaveraging rates throughout its service area. The incumbent local exchange carrier may decide the manner in which its rates are deaveraged subject to commission approval;

(B) The incumbent local exchange carrier may remove any implicit subsidies; and

(C) The incumbent local exchange carrier may revise its tariff in accordance with the commission's rules on local exchange competition, 3 AAC 53.200 - 53.299, to remove requirements that would place the carrier at an unfair competitive disadvantage.

(2) In support of the changes described in (1)(A) and (B) of this section, the incumbent local exchange carrier shall file cost studies with the commission demonstrating that its revised rates recover embedded costs, that no implicit subsidies remain, and that no cross-subsidization is occurring. These cost studies will be fully-distributed and shall include:

(A) Normalized expense and demand levels based on a local revenue requirement that has been filed with the commission within two years of the date of the cost study;

(B) Cost categories that include, at a minimum, "residential", "business", "custom calling features", "special access", "directory advertising", "nonrecurring charges", and "other";

(C) A rationale for the allocation of joint costs to services and for allocating common costs among services;

(3) The incumbent local exchange carrier will complete the analysis described in (2) of this section within 60 days of the application of a second ETC in its service area if the analysis is based on an approved revenue requirement or 120 days if the analysis requires that normalized expense and demand also be determined.

(4) The commission shall issue an order accepting or modifying the rates proposed by the incumbent local exchange carrier within 45 days of a complete filing in accordance with (1) - (3) of this section, unless the carrier, for cause, develops cost-based rates below the level of its universal service fund disaggregation zones, in which case the commission shall issue its order within 90 days.

(5) To the extent that the rate modifications described in this section create affordability concerns with regard to a customer or class of customers, the commission will also resolve this issue before it designates a second ETC in an area served by a rural telephone company or determines that a service area is a competitive service area.

3 AAC 53.399. DEFINITIONS

* * *

(*) "service area" means a geographic area established by the commission for the purpose of determining universal service and support mechanisms. In the case of an area served by a rural telephone company, "service area" means such company's "study area" unless and until a different service area is established for such company in accordance with state and federal law.

10

STATE OF ALASKA

THE REGULATORY COMMISSION OF ALASKA

Before Commissioners: Mark Johnson, Chair
Dave Harbour
Kate Giard
James S. Strandberg
G. Nanette Thompson

In the Matter of the Commission Review of Rules and Regulations Governing Telecommunications Rates, Charges Between Competing Telecommunications Companies, and Competition in Telecommunications	)	R-03-03

REPLY COMMENTS OF GCI

Introduction

On June 16, 2003, initial comments were submitted in this matter by ACS[1], AT&T Alascom[2], ATA[3], the Rural Coalition, and GCI[4]. GCI submits these comments in reply to the comments of ACS, AT&T Alascom, ATA, and the Rural Coalition.

Discussion

I. Reply to ACS.

[1] "ACS" includes ACS of Anchorage, Inc., ACS of Fairbanks, Inc., ACS of Alaska, Inc., ACS of the Northland, Inc., and ACS Long Distance, Inc.

[2] "AT&T Alascom" is Alascom, Inc.

[3] "ATA" is the Alaska Telephone Association.

[4] "GCI" is GCI Communication Corp. d/b/a General Communication, Inc., and d/b/a GCI.

GCI Communication Corp.
2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

A. General.

The comments of ACS echo its familiar themes: UNE rates are too low, competition is unfair, and markets should be instantly deregulated as soon as competition is authorized. GCI will address each of ACS' specific contentions and proposals below. While—as set forth in its initial comments--GCI agrees that in many instances regulation of ACS should be relaxed in competitive markets, ACS' proposals go too far, too fast.

As a general matter, GCI believes that ACS consistently misinterprets the intent of the Legislature. ACS generally interprets the provisions of HB 111 as endorsing the proposals that it put forth during the past legislative session and as mandating that the Commission adopt regulations that reverse course on previous decisions. In doing so, ACS ignores the specific statutory provision stating that "the legislature does not take a position on the propriety of existing commission rulings or regulations." (Section 2(d) of HB 111).

Additionally, in many instances the specific principles set forth by the Legislature in HB 111 are completely contrary to ACS' positions. In these instances, ACS simply ignores the specific language of the legislation. For example, Principle 5 simply states that "competition among telecommunications companies shall be encouraged." ACS stands that principle on its head and argues that the principle really means that "the 'rural exemption' must not be casually set

GCI Communication Corp.
2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

aside" and that "competition may put many desired outcomes at risk." (ACS Comments, p 14, 15)

The point of this general discussion thus far is that the Commission should not be under any misconception that it is compelled to adopt the proposals of ACS and it should not feel bullied by ACS' threat to obtain the relief it seeks from the legislature, through CSHB 106, if it does not get such relief in this proceeding.[5] Instead, the Commission should simply evaluate all of the proposals based on their substantive merits and consistency with the actual requirements of HB 111.

Another general matter that must be addressed concerns ACS' overall financial condition and the effects that competition has had on ACS. In its comments ACS makes a number of implicit allegations that current competitive policies must be changed because they threaten ACS' financial viability. ACS states, for example, that "in the context of this docket, perhaps the most persuasive argument is that competition will not survive if ILECs do not survive" (ACS Comments, p. 17); "ongoing competition turns on the financial health of the infrastructure provider" (ACS Comments, p. 31); and, "current policies could result to a return to a monopoly when CLECs gain 100% market share." (ACS comments, p. 11). These ACS comments are consistent with more specific

[5] See ACS Comments, p. 4-5. As indicated in GCI's initial comments, many of the provisions of CSHB 106 are clearly preempted by federal law.

GCI Communication Corp.
2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

allegations that ACS has made in other contexts that competition threatens its ongoing financial viability.

GCI has engaged an expert who is thoroughly familiar with Alaskan telecommunications and with corporate finance to evaluate these claims. The affidavit of Gregory F. Chapados is attached. Mr. Chappados' qualifications are of the highest order. Born and raised in Fairbanks and educated at Harvard, Mr. Capados served as Chief of Staff for Senator Ted Stevens and was actively involved in telecommunications policy at the time. Mr. Chapados also served as the principal advisor to President Bush (Senior) on telecommunications policy, holding the office of Assistant Secretary of Commerce for Communication and Administration and Administrator of the National Telecommunications and Information Administration. Since leaving public service Mr. Chapados was senior vice president of Crown Media, Inc., and is now a Managing Directory of an investment banker based in Dallas, Texas.

As is clearly set forth in Mr. Chapados affidavit, ACS' financial condition has steadily improved over the past several years and ACS has not been significantly harmed by competition. ACS has actually become dramatically more efficient as a result of competition, as one would expect. Furthermore, ACS just announced a major new financing package. In sum, Mr. Chapados affidavit demonstrates that ACS' claims of financial ruin are clearly no more than "crying wolf."

GCI Communication Corp.
2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

Mr. Chappados also addresses another claim often made by ACS, that it cannot afford to invest in telecommunications facilities. (See ACS Comments, p. 15-17.) As Mr. Chappados sets out, ACS continues to invest significantly in telecommunications facilities in Alaska. ACS continues to maintain large cash reserves that are available for investment.

Thus, the second point of this general discussion is that the Commission should not be under any misconception that it needs to change existing policies in order to save ACS from financial ruin. ACS remains a viable company and, to the extent it has suffered harm, most of that harm has been self-inflicted.

GCI now turns to the various specific proposals set forth in ACS' comments.

B. Policies #2 and #7, UNE Rates and Fill Factors.

1. ACS' Suggestions on How to Set UNE Rates Are Misguided and, If Adopted, Would Violate FCC Pricing Rules.

In its comments, ACS claims that the RCA has not properly implemented the FCC's TELRIC principles in the past, and, therefore, has not set fair UNE rates in prior arbitrations. Based on this premise, ACS offers various suggestions to the Commission on how it should implement TELRIC in the future to set UNE rates that, at least in ACS' view, would be fairer. GCI disagrees both with ACS' premise and its suggested changes. Collectively, the changes proposed by ACS would gut the FCC's TELRIC construct, for instance, by imposing "applicable state laws" and "industry standards" that may or may not be consistent

GCI Communication Corp.
2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

with TELRIC, and by allowing ACS to recover its uneconomic embedded costs through UNE rates in direct contradiction to the FCC's requirement that such embedded costs not be considered.

ACS begins its TELRIC discussion by claiming that the RCA's "prior interpretation of TELRIC principles and the application of the RCA's "hypothetical carrier" standard do not produce fair payment by user carriers." ACS Comments, p. 18. ACS argues that the RCA's past UNE rate decisions are flawed because of the Commission's reliance on a "hypothetical carrier" standard rather than a "hypothetical network" standard. Apart from a difference in terminology, GCI fails to understand what prior error ACS is trying to correct. The FCC's Rule 51.505(b)(1)[6] requires state commissions to set UNE rates based "on the most efficient telecommunications technology currently available and the lowest cost network configuration given the existing location of the incumbent LEC's wire centers." This rule is the heart of the FCC's TELRIC pricing standard. It is unimportant whether one semantically refers to the efficiency standard that underlies the FCC's rule either as a "hypothetical network" or a "hypothetical carrier" standard. What is important, however, is that the RCA follow and implement the FCC's rule.

In Order U-96-89(30), the RCA recently granted GCI's motion for clarification in the Anchorage arbitration confirming that the Commission intends

[6] 47 C.F.R. § 51.505(b)(1).

GCI Communication Corp.
2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

to follow (as indeed the Commission must in accordance with the Supreme Court's decision in *Verizon Communications, Inc. v. FCC*, 122 S.Ct. 1646 (2002)), and implement the FCC's standard as promulgated in Rule 51.505(b)(1).[7] With this clarification, nothing further remains for the Commission to correct or do on this subject.

Next, ACS claims that "it simply makes no sense to use pricing models that have been expressly discounted by the FCC" to set UNE rates. ACS Comments, p. 18. This comment implies that the RCA's use of a modified version of the FCC Synthesis Model to set UNE rates has been improper and that the Commission should no longer use the modified FCC's proxy model in the future to generate UNE rates. To be clear, the FCC has not prohibited state commissions from using a modified version of the Synthesis Model to develop TELRIC-compliant UNE rates. The FCC developed its Synthesis Model for the purpose of determining federal universal service support and in that context relied on nation-wide default cost values rather than company-specific cost inputs to determine universal service funding for non-rural carriers. Additionally, the FCC made certain assignments of cost that were immaterial for universal service funding purposes but are inappropriate for generating UNE rates. Thus, the FCC

GCI Communication Corp.
2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

7 Order U-96-89(30) at 9 (April 14, 2003).

cautioned that its Synthesis Model, unmodified, "may not be appropriate for other purposes, such as determining prices for UNEs."[8]

In March 2000, in the context of the ACS-GCI arbitration proceedings for Juneau, Fairbanks, and the Glacier State Study Area in Consolidated Docket U-99-141/U-99-142/U-99-143, the Commission hired an independent consultant, Ben Johnson Associates, Inc., to assist the Commission in its review of the parties' competing contentions regarding the selection of an appropriate model to set UNE rates.[9] Ultimately, Ben Johnson issued a report recommending that the FCC's Synthesis Model be modified and used because it is a neutral platform capable of generating TELRIC-compliant UNE rates. The Commission selected the FCC Synthesis Model based on Mr. Johnson's recommendation. The parties, thereafter, worked together and agreed on a method to modify the FCC Synthesis Model platform making it capable of generating individual UNE rates. Moreover, although the FCC's default values were used as a starting point in the Juneau-Fairbanks-Glacier State arbitrations, either party was free to propose different cost inputs to the Arbitrator to reflect Alaska-specific costs. Notably, ACS accepted the overwhelming majority of the FCC default values and chose to contest only a very small number of the cost inputs during the arbitration proceeding.

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2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

8 *Federal-State Joint Board on Universal Service; Forward-Looking Mechanism for High Cost Support for Non-Rural LECs*, CC Docket 96-45, Tenth Report and Order, 14 FCC Rcd 20156, ¶ 32 (1999).

9 GCI had proposed a version of the HAI proxy cost model whereas ACS had proposed an early version of its proprietary ACS cost model.

The point is that the FCC Synthesis Model, as structurally modified by ACS and GCI and populated with arbitrated cost inputs, is capable of generating fair and reasonable TELRIC-compliant rates. Importantly, no one has ever proposed that the RCA adopt the FCC default values without critical review and analysis.

Moreover, ACS' comments on the problems with the RCA's past selection of the modified FCC Synthesis Model overlook the Commission's recent attempt to accommodate ACS by selecting the ACS proprietary cost model (ACS Cost v7.2 model) as a process to generate loop rates in the Anchorage Arbitration in Docket U-96-89.[10] The Commission, however, recognized that ACS' proprietary model posed a number of considerable challenges:

> First, the use of a manual network design process is slow, potentially error prone, and because it relies on the expertise of individual design engineers, may lack the uniformity of a model that relies strictly on algorithms. Second, the ACS-AN model will produce only one category of rate elements – loop rates. Third, the spreadsheet portions of the model do not yet have a simple front end for inputs and changes to other factors can be difficult and time consuming. Fourth, potential modifications to the model may take considerably more time than the FCC model would require.[11]

Indeed, the ACS proprietary cost model in the Anchorage arbitration proved to be unwieldy and difficult to modify in a timely manner. The Commission

[10] Order U-96-89(26) (July 29, 2002). The Commission adopted the ACS model as a process to allow GCI the right to propose structural changes to the platform.

[11] *Id.* at 5.

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2550 Denali Street, Suite 1000
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recently abandoned its selection of the ACS cost model and instead has adopted a new approach that allows parties to propose prices and terms in accordance with whatever model or models the party chooses.[12]

In its comments, ACS also states that the Commission "could use a wide variety of models and inputs that would produce a range of TELRIC-complaint rates." ACS Comments, p. 20. As just discussed, the Commission, indeed, has adopted an approach that will allow each party to propose rates based on different models. ACS' statement, however, that the Commission could use a "wide variety" of cost inputs to set UNE rates is misleading. Although different model platforms can be used to set fair and reasonable UNE rates, the Commission must scrupulously examine the cost inputs to ensure that they reflect the forward-looking cost principles under the FCC's TELRIC standard. The Commission must be scrupulous in its examination and selection of the inputs otherwise the results using any of the parties' proposed models would be meaningless and arbitrary. A model is only useful in so far as the inputs used are meaningful and reasonable – otherwise, one can create a "garbage in, garbage out" conundrum.

In its comments, ACS also claims that the cost inputs should be based on the most efficient technology "actually deployed" by the provider. This comment is an attempt to revive the Commission's "efficient ILEC" standard,

12 Order U-96-89(35).

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2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

which the Commission first articulated in Order U-96-89(24) but abandoned in Order U-96-89(30). The Commission was correct in Order U-96-89(30) when it concluded that its "efficient ILEC" standard differs from the FCC's pricing methodology in Rule 51.505(b),[13] which requires state commissions to set UNE prices based on the most efficient telecommunications technology currently available in the industry and the lowest cost network configuration while using the existing location of the LEC's wire centers. By focusing on the technology actually deployed by the ILEC (as ACS again proposes in its comments) rather than the most efficient telecommunications technology currently available in the industry, the Commission's "efficient ILEC" standard potentially could have preserved more of the ILEC's embedded costs than is permissible under the FCC's pricing rules. The Commission should reject ACS' attempt to re-visit that issue again.

Likewise, ACS' comment that the "RCA's UNE pricing policies should begin with a rebuttable presumption of ILEC efficiency" also impermissibly differs from the FCC's pricing rules. Under Rule 51.506(e),[14] the incumbent must bear the burden of proving to the state commission that each of the UNE rates it proposes complies with the FCC's TELRIC rules. ACS' suggestion that the Commission start with a rebuttable presumption of ILEC

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2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

13 Order U-96-89(30) at 9.

14 47 C.F.R. § 51.507(e).

efficiency would impermissibly shift the burden of proof to the CLEC forcing it to find and prove the inefficiencies that underlie the ILEC's proposed rates.

Additionally, with respect to ACS' broad comments regarding how the Commission should resolve cost of capital and depreciation expense issues in a UNE rate proceeding, (ACS Comments, p. 20), GCI simply cautions the Commission that the FCC's TELRIC rules govern the determination of these cost issues as well in the setting of UNE rates,[15] and that the burden is on the ILEC to prove the reasonableness of its proposed forward-looking cost of capital and depreciation rates.[16]

Lastly, GCI wishes to respond to ACS' suggestion that the Commission consider the ILEC's historical, embedded costs in setting UNE rates. ACS Comments, p. 21. On this point, it is worth citing some of the FCC's lengthy discussion rejecting ILECs' claims that embedded costs should be considered in setting UNE rates:

> Section 252(d)(1)(A)(i) does not specify whether historical or embedded costs should be considered or whether only forward-looking costs should be considered in setting arbitrated rates. We are not persuaded by incumbent LEC arguments that prices for interconnection and unbundled network elements must or should include any difference between the embedded costs that have

15 *See* 47 C.F.R. §§ 51.505(b)(2) & (b)(3).

16 *See Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, First Report and Order*, 11 F.C.C.R. 15,499 (1996) ("*First Report and Order*") at ¶ 702 (wherein the FCC explains that the current authorized rate of return at the federal or state level is a reasonable starting point for TELRIC calculations and "the incumbent LECs bear the burden of demonstrating with specificity that the business risks that they face in providing unbundled network elements and interconnection services would justify a different risk-adjusted cost of capital or depreciation rate").

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2550 Denali Street, Suite 1000
Anchorage, AK 99503
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> incurred to provide those elements and their current economic costs. Neither a methodology that establishes the prices for interconnection and access network elements directly on the costs reflected in the regulated books of account, nor a price based on forward looking costs plus an additional amount reflecting embedded costs, would be consistent with the approach we are adopting. The substantial weight of economic commentary in the record suggests that an "embedded cost"-based methodology would be pro-competitor - -in this case the incumbent LEC—rather than pro-competition. We therefore decline to adopt embedded costs as the appropriate basis for setting prices for interconnection and access to unbundled network elements.[17]

ACS' suggestion that the Commission consider ILEC embedded costs would lead the Commission down an impermissible path of setting rates based on the ILEC's embedded costs in violation of the FCC's pricing rules.

2. ACS' Discussion On Fill Factors Is Vague and Appears Not To Comply With the FCC's Telric Rules.

At 27-28 in its Comments, ACS offers a few brief but vague suggestions on how the Commission should determine fill factors when setting UNE rates. Fill factors refer to the amount of spare capacity in cable sizes that network engineers include in the network design to accommodate administrative functions, such as testing and repair, and some amount of near-term growth.[18] These factors have a significant impact on the price of many network elements because they allow the cost of unused network capacity to be recovered from current customers for the ILECs' services. A lower fill factor increases the

17 *First Report and Order*, at ¶ 705.

18 *In the Matter of Federal-State Joint Board on Universal Service*, CC Docket No. 96-45 and *Forward-Looking Mechanism For High Cost Support For Non-Rural LECs*, CC Docket No. 97-160, Tenth Report and Order, 14 FCC Rcd 20156 (rel. November 2, 1999) at ¶ 186.

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2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

amount of spare capacity that the customers – CLECs, in the case of UNEs -- must pay for in the loop rate.

In its comments, ACS vaguely suggests that the Commission should determine fill factors based on "industry design standards" that "comply with applicable local and state laws." ACS Comments, p. 27. GCI is unsure what ACS means by this suggestion. Notably, ACS does not discuss TELRIC or mention efficiency in its comments. The implication of ACS' suggestion seems to be that "industry standards" and "applicable local and state laws" should supersede the FCC's TELRIC rules. Importantly, industry design standards by themselves (which may be decades old) or local and state laws may not reflect current technological capabilities or the application of economic pricing principles. GCI simply cautions the Commission to follow the FCC's TELRIC principles on the fill factor issue without bias towards claims regarding "industry standards" or "applicable local and state laws" unless ACS can establish the use of those standards is appropriate under the TELRIC construct.

3. GCI'S Specific Comments Regarding ACS' Proposed Chanes Regarding UNE Pricing.

In this section, GCI offers its specific comments on ACS' proposed rule changes to indicate where GCI expressly disagrees with ACS' language. Importantly, GCI recommends that the Commission not adopt any of ACS' proposed rules. ACS' proposed rules are largely self-serving and collectively would gut the FCC's mandatory TELRIC rules. Furthermore, ACS' proposed rule

GCI Communication Corp.
2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

changes attempt to convert key issues that must be carefully examined during the arbitration process into before-the-fact principles that effectively would remove the issues from the scrutiny of the arbitration process.

ACS PROPOSED RULE:

(a) Unbundled network element prices will be determined in conformance with the federal Telecommunications Act of 1996, the rules of the Federal Communications Commission adopted thereunder, and any other applicable state law.

GCI Comment: The language in this proposed rule would appear to impermissibly require the Commission to set UNE prices based on state law even if state law conflicts with the federal statute or FCC rules.

ACS PROPOSED RULE:

(b) In addition to the requirements prescribed by (a) of this section, the following additional guidelines will apply to the pricing of unbundled network elements:

(1) selecting a pricing model for unbundled network elements, the Commission will use the FCC's "hypothetical network standard" and will presume the existence of the most efficient technology actually deployed by the providing company.

GCI Comment: The language in the first sentence is confusing. The RCA must follow and implement the FCC's TELRIC pricing rules, including the standard set forth in 47 C.F.R. § 51.505(b)(1). ACS' language in the second sentence clearly violates the FCC's rules as discussed above.

ACS PROPOSED RULE:

(2) The Commission will ensure that the unbundled network element pricing model conforms to industry standard design and construction criteria and adheres to all applicable state and local laws.

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2550 Denali Street, Suite 1000
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GCI Comment: This language suggests that the Commission set UNE prices based on alleged industry standards and state law even if they conflict with the FCC's TELRIC rules. As discussed above, the Commission must follow and implement the FCC's TELRIC rules.

ACS PROPOSED RULE:

(3) Unbundled network element prices will be based on the reasonably anticipated forward looking cost of the company providing the network elements.

GCI Comment: This language is ambiguous suggesting that some of ACS' operating inefficiencies be retained when setting UNE rates. Again, the FCC has already set the pricing standard and rules for UNE pricing, and it is the FCC language and rules that the Commission must follow.

ACS PROPOSED RULE:

(4) Reasonably anticipated forward looking costs, including but not limited to the cost of labor and materials, will be determined by using the providing company's current actual cost adjusted for future charges.

GCI Comment: This language clearly conflicts with the FCC's TELRIC rules. This language seeks to preserve inefficient labor costs. Again, all costs must be determined in accordance with the FCC's TELRIC rules.

ACS PROPOSED RULE:

(5) In setting prices for unbundled network elements, the Commission will use fill factors that conform to industry standard design and construction criteria and adhere to all applicable state and local laws. Fill factors should reflect a reasonable projection of actual total usage of the elements in question.

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2550 Denali Street, Suite 1000
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GCI Comment: This language is vague and ambiguous and appears to conflict with the FCC's TELRIC rules as discussed above.

ACS PROPOSED RULE:

(6) Unbundled network element pricing will include a depreciation component that is based on the actual plant lives of the providing company. Actual plant lives will reflect the impact of technological change and the effects of competition. It is presumed that plant lives in competitive markets will be shorter than the ranges prescribed by the FCC for interstate services. Accelerated depreciation in competitive markets is deemed reasonable.

GCI Comment: This language is a clear attempt to set asset lives for depreciation purposes without regard to the FCC's TELRIC rules and the actual asset lives of the company's plant. In accordance with the proposed language, ACS could drive up its allowed expenses by writing plant off on an accelerated basis without critical evaluation of whether such practice is efficient or realistic. Moreover, the Commission should not presume shorter asset lives simply because of competition. UNE purchases by competitors may, indeed, prolong the life of ACS' plant.

ACS PROPOSED RULE:

(7) In evaluating the cost of capital component for unbundled network element pricing, the Commission will give consideration to the additional risks confronted by a providing company that operates in a competitive environment. It is presumed that application of a competitive risk premium will result in a higher cost of capital than prescribed by the FCC for interstate services.

GCI Comment: The language in the second sentence squarely conflicts with the FCC's rules requiring the ILEC to bear the burden of demonstrating the reasonableness of its proposed cost of capital adjustments.

GCI Communication Corp.
2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

C. Policy #2, Dominant Carrier Status.

ACS argues that Policy #2 requires an immediate change to the regulation that declares the incumbent carrier to be the dominant carrier. GCI agrees, and the regulations that GCI proposed in its initial comments include such a change.

The regulation proposed by ACS, however, does much more than change the regulation that declares the incumbent carrier to be the dominant carrier. Instead, ACS' proposed regulation totally eliminates dominant/nondominant regulation in any local exchange market as soon as a CLEC or CETC (presumably even a wireless CETC, including a wireless CETC that is affiliated with the ILEC, such as ACS proposes in Fairbanks) offers service to a majority of consumers in a service area.

As discussed in GCI's initial comments, Policy #2 actually presumes that dominant/nondominant carrier regulation will continue; the legislature simply required a change in the criteria for designation of the dominant carrier. If the legislature had intended to achieve the result ACS seeks, the legislature could have simply stated that no carrier will be designated as dominant in an area opened to competition. The legislature did not adopt such a requirement.

ACS also argues that the fact that GCI did not follow its rate increase in Anchorage proves that ACS does not have market power. That argument is

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2550 Denali Street, Suite 1000
Anchorage, AK 99503
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simplistic and inaccurate. As developed at length in initial comments, the concept of market power is relatively complex but involves, among other things, whether or not a price increase drives away so many customers as to make the increase not profitable. (GCI Comments, pp. 9-10) Given the fact that ACS retained its rate increase even though GCI did not follow, ACS must have determined that its increase was profitable. Thus, that experience would indicate that ACS did retain market power in Anchorage at that time.

D. Policy #4, Competitive Service Area.

In its comments and proposed regulation, ACS recognizes that the definition of competitive service area must be community-specific. GCI agrees, as set forth in initial comments.

GCI disagrees, however, with ACS' proposal that an area should be considered competitive as soon as more than 50% of the customers have a choice of provider, even if no actual competition has begun and even if the "choice" is from a cellular provider that has been designated an "eligible telecommunication carrier", or ETC. Cellular providers, even if designated as an ETC, generally compete against other wireless providers, not against local service providers. Furthermore, under ACS' proposal, even if the wireless ETC were the affiliate of the ILEC, the ILEC would nonetheless be designated as nondominant.

GCI's disagreement with the definition of competitive service is enhanced because, under ACS' proposal, the consequence of the "competitive

GCI Communication Corp.
2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

service area" designation is that the end of dominant/nondominant carrier regulation, as discussed above, and implementation of "notice tariff" procedures As set out in GCI's initial comments, the determination of dominant status is much more complex than whether a theoretical choice of carriers exists for some of the customers in a service area.

E. Policy #5, Depreciation.

ACS states that, to the extent that another governmental body has adopted industry accepted depreciation standards, they should be used as a test for reasonableness for ratemaking purposes. GCI agrees, and in fact the Commission has recently used FCC depreciation lives as a factor in determining appropriate lives for ACS plant. The lives adopted by the FCC, specific to telecommunications plant and specific to regulatory purposes, are clearly the most appropriate standards adopted by "another governmental body."

However, in its proposed regulations, ACS actually rejects the FCC depreciation lives, at least for the purpose of establishing UNE rates. ACS' desire to use standards set by another governmental body, but its rejection of FCC lives specifically designed for telecommunications plant, is inherently inconsistent.

ACS also fails to recognize that Policy #5 specifically refers to the actual service lives of depreciated equipment. Thus, while ACS wants to concentrate on "market dynamics" and "technological obsolescence", ACS fails to recognize that the actual import of Policy #5 is that the actual, experienced lives of

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2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

equipment in service must be considered by the Commission in setting depreciation rates.

F. Policy #6, Ratemaking Standards for Incumbents and Competitors.

In its discussion of the process and procedures that should be applied to tariff filings by carriers, ACS proposes that in competitive areas (defined by ACS as areas where more than 50% of consumers have a theoretical choice) "notice tariff" regulations should apply and that in areas with significant competition (defined by ACS as areas where 75% of consumers have a theoretical choice) service should be completely detariffed. In addition to GCI disagreement regarding the definition of "competitive service area" and "significant competition", as discussed elsewhere herein, GCI also disagrees with the process and procedures proposed by ACS. Instead, GCI believes that the 30 day notice periods now used in local markets, and used for over 10 years in long distance markets, are a better procedure. The existing process and procedures, applied equally to ILECs and CLECs once appropriate benchmarks have been passed, are appropriate and fully consistent with the requirements of HB 111. For example, both Policy #3 and #9 recognize that there are certain circumstances in which the Commission should disallow tariff changes, including both increases and decreases, and even in fully competitive markets. Even ACS recognizes that there will be some instance which the Commission should intervene to block a rate change. (ACS Comments,

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2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

p. 31) ACS does not, however, explain how the Commission would be able to block a rate increase if rates were detariffed and there were no notice, or even if there were 7 days notice. GCI believes that the Commission would be effectively unable to exercise its authority (and responsibility) to deny any tariff proposals under the procedures proposed by ACS.

In its consideration of whether either 7 day "notice tariffs" or complete detariffling should be allowed under any circumstances, the Commission should consider the nature of the charges that, left to its own discretion, ACS is likely to implement. Consider, for example, the "Competitive Market Equalization Charge" that ACS has now proposed be included in its tariff for the Fairbanks and Juneau markets. This proposed charge is a tax on each and every access line in the market, even lines served by a competitor and even lines that do not in any way rely on ACS facilities, with all of the revenue from the tax paid to ACS. ACS' competitors would be obligated—involuntarily—to collect the tax from its customers and pass the revenue to ACS. Apparently, ACS thinks such charges are appropriate and that they can be implemented by tariff. Under ACS' proposed notice tariff procedures, such a charge could be implemented by ACS upon only 7 days notice and with virtually no possibility of it being rejected by the Commission. Clearly, the Commission needs to maintain a fair notice period and the right to review filings in order to block proposals such as ACS' proposed tax.

G. Policy #8, Rate Increases in Competitive Markets.

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2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

Policy #8 provides that competitors should be allowed to increase rates under the same criteria in areas "where significant competition exists". ACS proposes that significant competition should be found to exist in any area that has a facilities-based competitor capable of serving 75% of all consumers. As with the definition of competitive service area, GCI disagrees that the standard for "significant competition" should be based entirely on the theoretical capability to service. The very words used by the Legislature—"where significant competition exists"—imply the actual existence of competition, not simply a capability or theoretical possibility of competition. For these reasons, GCI believes that the proposal in its initial comments to define an area where significant competition exists as an area where the dominant carrier serves less than 80% of the lines is appropriate and consistent with the Legislative Policy #8.

H. Other Matters.

In its comments ACS makes various other assertions that require at least a brief response. For example, ACS complains that, in applying the tariff regulations for dominant and nondominant carriers, the Commission has routinely granted waivers to CLECs that it denies to ILECs. ACS cites no actual examples, and as previously stated elsewhere GCI believes that ACS' perceived difference in treatment is actually the result of GCI's working with Commission staff to modify tariff proposals to be acceptable, while ACS attitude is "my way or no way."

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2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

ACS also asserts that "anti-bundling" prohibitions on ILECs are unfair and have hindered ILEC's ability to compete. However, as ACS has recognized elsewhere, the ONLY existing restriction on bundling involves the bundling of local exchange and intrastate interexchange service. Furthermore, as ACS has also recognized, the existing rules on geographic rate averaging for long distance rates also effectively precludes bundling of local and long distance service, and that rule applies equally to ILECs and CLECs. Thus, there is now effectively no difference in the extent to which ILECs and CLECs are allowed to offer bundled service.

In this regard, ACS proposes to waive application of the rule requiring geographic rate averaging (3 AAC 52.370(a)) to bundled services including local and long distance service. (See ACS Proposed 3 AAC 53.290(e), p. 8 of ACS Exhibit A) Given the fact that ACS offers long distance service primarily in low cost areas such as Anchorage, Fairbanks, and Juneau, GCI understands why ACS proposes that the rule requiring geographic rate averaging not apply to bundled services, since ACS would then be able to "cream skim" in the urban markets. However, the Commission should clearly understand that ACS' proposal would effectively eliminate the geographic rate averaging policy. ACS, serving low cost areas, would be certain to offer low rates in the urban areas. Competitors would be forced to match those lower rates in the low cost areas. Rural residents, however, would not have similar rates, and geographic rate averaging would end.

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2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

ACS also proposes that CLECs should be required to offer access to their networks comparable to the access that ILECs are required to offer. GCI has, in fact, offered such access to ACS and GCI intends to continue that policy. However, as a matter of federal law, CLECs cannot be required to unbundled network access like ILECs. Xxx The only way that this can be accomplished is if the CLEC is actually designated by the FCC as an ILEC. (47 CFR §51.233: "A state may not impose the obligations set forth in sectin 251(c) of the Act on a LEC that is not classified as an incumbent LEC as defined in section 251(h)(1) of the Act, unless the Commission issues and order declaring that such LECs or classes or categories of LECs should be treated as incumbent LECs")[19]

ACS also claims that current UNE rates "artificially signal CLECs to rely on a UNE strategy" and "not invest because they lack economic incentive to do so." (ACS Comments, pp. 16-17.) ACS claims are contradicted by the facts. GCI is investing significantly in its own alternative loop technology so that it does not have to rely on ACS loops, which come laden with unsatisfactory and discriminatory service[20]

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2550 Denali Street, Suite 1000
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(907) 265-5600

[19] As used by in that quote, "Commission" means the FCC, not the state commission.

[20] ACS does not seem to know what it wants. At times, ACS complains about the fact that GCI may discontinue use of ACS UNE loops. (ACS Comments, p. 12) At other times, ACS complains that GCI will continue to rely on ACS loops rather than making its own investment. (ACS Comments, p. 16-17) A rationale company would actually encourage GCI to remain on its loops by offering quality service at a good price, a price below GCI's alternative. Instead, ACS does everything it can to drive GCI off its loops, then complains about the consequences.

Finally, GCI will respond briefly to the affidavit of Dr. Lehman attached to ACS' Comments. There is much in Dr. Lehman's comments with which GCI agrees.[21] There is no disagreement that, as competition develops, regulation can give way to market forces. Even Dr. Lehman says this should occur when there is "sufficient competition." (Lehman affidavit, p. 7) GCI's main difference with Dr. Lehman is simply one of degree and when the change should occur. GCI's views are consistent with the longstanding practice of both the FCC and this Commission, as discussed in GCI's initial comments. Dr. Lehman's view are that the move to deregulation, based entirely on market forces, should occur immediately upon the availability of UNEs, even if there is absolutely no actual competition. (Lehman affidavit, p. 7) GCI simply believes that such a proposal goes too far, too fast. It is inconsistent with the practices of the vast majority of regulatory agencies. Furthermore, Dr. Lehman ignores the possibility that the availability of UNEs—the lynchpin of his analysis—could be eliminated in some markets. Similarly, ACS in its comments refers to the availability of UNEs are irrevocably allowing competition. (ACS Comments, p. 5) In both instances, Dr. Lehman and ACS ignore ACS' continuing appeal of the lifting of the rural exemption which, if successful, has the potential of eliminating UNEs, and

[21] Dr. Lehman would, apparently, reject the proposed "Competitive Market Equalization Charge" proposed by ACS in its rate design proceeding, as he agrees that "Guarantees are not consistent with competition." (Lehman affidavit, p. 8)

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2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

competition, in currently competitive markets. This reality must be considered by the Commission in any decision to rely on the "irrevocable" forces of competition.

II. Reply to AT&T Alascom.

In its comments, AT&T Alascom concentrates on the application of HB 111 to the interexchange market. AT&T Alascom proposes elimination of its treatment as a dominant carrier; creation of a new Universal Service Fund to create incentives for investment in interexchange facilities; and sharing of carrier of last resort responsibilities.

GCI believes that the regulations proposed in GCI's initial comments adequately address issues regarding AT&T Alascom's designation as the dominant carrier. The proposed regulation, consistent with Policy #2, would eliminate the fact that AT&T Alascom is designated dominant solely by virtue of being the incumbent carrier. The Commission would be required to determine, within 180 days, whether or not AT&T Alascom should continue to be treated as a dominant carrier, based on factors specifically set out in the regulation.

In reviewing AT&T Alascom's comments on this issue, GCI recognized, however, that its proposed regulation should be amended somewhat. As discussed in GCI's comments, determination of market power must be undertaken in regards to a specific product in a particular market. Therefore, there is a possibility that a carrier could be designated dominant for some purposes and

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2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

nondominant for other purposes. The regulations previously proposed by GCI should be modified to recognize that possibility.

In regards to AT&T Alascom's proposed subsidy for interexchange facility investment, GCI has some difficulty in responding because of the lack of any specifics provided by AT&T Alascom. In general, GCI disagrees than any such subsidy program is necessary or appropriate. Furthermore, GCI does not believe that ACS' proposal is supported by any of the nine specific legislative policies that are the subject of this document. Therefore, GCI suggest that this matter not be considered in this Docket.

Similarly, GCI has difficulty responding to AT&T Alascom's proposal regarding sharing of Carrier of Last Resort responsibility because it is so vague. In theory, GCI is not totally opposed to such sharing. However, GCI again suggests that this matter not be considered in this docket.

III. Reply to ATA.

The comments of ATA focus solely on the tariff review standards that should apply to competitive areas and whether or not any difference should exist for dominant carriers. In its comments, ATA focuses on the small size of many of its members.

As discussed in initial comments, decisions of the FCC make it clear that the issue of market power must be addressed for a specific service in a

GCI Communication Corp.
2550 Denali Street, Suite 1000
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(907) 265-5600

specific geographic area. Therefore, the overall size of a firm is often irrelevant to the determination of market power. Even an ILEC that is small in relation to the total size of a CLEC may retain market power over local service in the ILEC's own geographic service area, based on the factors set out in GCI's proposed regulation, such as market share.

IV. Response to Rural Coalition.

The comments of the Rural Coalition fall into two general areas. First, the Rural Coalition proposes extensive modifications to the Commission's current rules governing local exchange competition. To some extent, those comments would have been more appropriately filed in Docket R-02-6, which was specifically opened to address those regulations. However, the comments also relate in some instances to the provisions of HB 111 and GCI will therefore address those comments. Second, the Rural Coalition proposed nine pages of entirely new regulations focused solely on designation of eligible telecommunications carriers. Those proposed regulations do not relate to any of the provisions of HB 111 and, the Rural Coalition did not meet its burden of persuasion that such matters should be considered in this Docket. In view of the complexity of the issues associated with ETC designation, consideration of these matters would substantially increase the scope of this matter and delay its completion. In accordance with the Commission's statement in Order No. 1 that it

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would not consider additional issues absent special justification, GCI does not believe that the ETC issues should be considered in this Docket. Furthermore, the matter of ETC designation is now under consideration in regards to the application of Alaska Digitel for ETC status in the service area of Matanuska Telephone Association. Consideration of regulations regarding ETC designation would benefit from and proceed more smoothly after the Commission had addressed the issues in that proceeding.

The specific proposals of the Rural Coalition resemble, in many respects, the proposals of ACS. For example, "the Rural Coalition has eliminated the dominant/nondominant distinction in competitive service areas...." (Rural Coalition Comments, p. 8) As previously discussed, Policy #2 does not eliminate the dominant/nondominant distinction, it simply provides that the criteria for determining which carrier is dominant cannot include incumbency.

The Rural Coalition proposes five criteria for the determination of a competitive service area, which include mere certification of a second carrier, mere designation of a second ETC, and simple lifting of the rural exemption. (See Rural Coalition proposed 3 AAC 53.220). Thus, under the Rural Coalition proposal, an area would be deemed competitive, and the ILEC thus given nondominant carrier treatment, long before another carrier is actually providing any service. For example, the Commission lifted the rural exemption in ACS' Glacier State service area many years ago, but no competitive service is yet

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offered there. Even in the best of circumstance, it takes a substantial time to build facilities to provide local service after regulatory approval has been obtained. For these reasons, the proposals of the Rural Coalition are inconsistent with the Legislative policy that any definition of competitive service area shall take into account whether actual competition exists in the area.

The Rural Coalition also proposes to change the existing rules regarding discontinuance, suspension, or abandonment of service in a way that is inconsistent with HB 111. HB 111 specifically states that the incumbent carrier remains the carrier of last resort until changed by the Commission. However, under the Rural Coalitions proposals any local exchange carrier in a competitive market would be able to discontinue service under the standards previously applicable to nondominant carriers. (See Rural Coalition proposed 3 AAC 53.230)

The Rural Coalition proposes that ILECs operating under a rural exemption are exempt from the requirement to offer services for resale, even at retail rates. (See Rural Coalition proposed 3 AAC 53.250). That proposal is contrary to both state and federal law, both of which require all carriers to allow resale at retail rates. (Section 251(b) of the Telecommunications Act; AS 42.05.860.

The provisions specifically discussed above form the backbone of the Rural Coalitions proposals to modify the current regulations regarding local

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exchange competition. Each of the specific provisions discussed should be rejected for the reasons stated. Without those provisions, the rest of the proposals of the Rural Coalition are meaningless and out of context. Accordingly, the proposals of the Rural Coalition should be rejected in their entirety.

Conclusion

GCI looks forward to working with the Commission and other parties to accomplish the directives of HB 111. GCI urges the Commission to promulgate proposed rules as set forth in GCI's initial comments.

DATED at Anchorage, Alaska this 13th day of August, 2003.

GENERAL COMMUNICATION, INC.

BY: _____
James R. Jackson
Its: Regulatory Attorney

VERIFICATION

I, James R. Jackson, verify that I believe the statements contained in this pleading are true and accurate.

_____
James R. Jackson

SUBSCRIBED AND SWORN to before me this 13th day August, 2003.

CAROL S. CHAMBERS
NOTARY PUBLIC
STATE OF ALASKA
My Commission Expires:

_____
Notary Public in and for Alaska
My commission expires: 4-3-05

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STATE OF ALASKA

THE REGULATORY COMMISSION OF ALASKA

Before Commissioners: Mark Johnson, Chair
Kate Giard
Dave Harbour
James S. Strandberg
G. Nanette Thompson

In the Matter of the Commission Review of)
Rules and Regulations Governing)
Telecommunications Rates, Charges Between) Docket R-03-3
Competing Telecommunications Companies,)
And Competition in Telecommunications.)
)

AFFIDAVIT OF GREGORY F. CHAPADOS

STATE OF TEXAS)
) ss.
COUNTY OF DALLAS)

I, Gregory F. Chapados, being duly sworn, deposes and states the following:

1. My name is Gregory F. Chapados. I am a Managing Director at Hoak Breedlove Wesneski & Co. ("HBW"), an investment bank based in Dallas, Texas. The views expressed herein are my own and not HBW's. Prior to joining HBW, I served as senior vice president – new business development at Crown Media, Inc., a top-20 cable multiple system operator with approximately one million subscribers. In the first Bush administration, I served as Assistant Secretary of Commerce for

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Communications and Administration and Administrator of the National Telecommunications and Information Administration, which is the principal advisor to the President on communications policy. Prior to joining the Commerce Department, I served as chief of staff to Senator Ted Stevens of Alaska, where I was deeply involved in federal policy issues related to the development of long distance competition in the Alaska market. I was born and raised in Fairbanks, Alaska. I received a B.A. degree in government from Harvard College and a J.D. degree from Harvard Law School.

2. The purpose of this affidavit is to provide the Regulatory Commission of Alaska ("RCA") with information on the finances and operational performance of Alaska Communications Services Group ("ACS") that is relevant in the R-03-3 proceeding. In comments filed on July 16, ACS implies that ACS faces a near-term financial crisis with portentous statements such as "competition will not survive if ILECs do not survive" and "competition turns on the financial health of the infrastructure provider." ACS goes on to assert specifically (i) that the existing Alaska UNE rates have put ACS at an "unfair competitive disadvantage" that could lead to ACS' losing "virtually 100%" of the Anchorage, Fairbanks, and Juneau local telephone markets; (ii) that "below-cost UNE rates" both hinder ILEC efforts to secure capital for

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investment and discourage ILEC investment in new technology and infrastructure: and (iii) that the RCA has an obligation to "ensure the financial health and viability of regulated entities" like ACS. The following comments compare ACS' gloomy assertions to the on-the-ground reality of ACS' finances and operational performance.

3. Despite UNE competition and numerous strategic and tactical missteps by ACS, ACS' financial condition has steadily improved over the past several years. In a teleconference announcing its results for the second quarter of 2003 on July 31, 2003, ACS announced the successful public offering of its directory operation, which generated $160 million in gross proceeds to ACS. amortization (otherwise referred to in the financial community as a company's "EBITDA") ratio to 4.1x, net of cash, from a ratio of nearly 5.0x, net of cash, at the end of 2000. (EBITDA is a customary measure of the financial performance of a telecommunication company's business operations.) ACS ended the second quarter with nearly $140 million of liquidity (cash and an undrawn $75 credit facility). ACS' chief financial officer stated in the Using these proceeds and other resources, ACS has paid down $112 million of its debt, a move that has reduced its total debt/trailing twelve months' earnings before interest, taxes, depreciation and teleconference that ACS' "liquidity position is excellent" and that the company presented a "strong credit profile." He also touted substantial improvements in the EBITDA margins for ACS' local telephone and wireless businesses. Since the

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buyout, ACS' annual EBITDA (as disclosed by ACS in its communications with investors) has grown substantially from $111.6 million at the end of 2000 to approximately $129.3 million at the end of 2002. This growth in EBITDA, which reflects a substantial improvement in ACS' local telephone operational performance in response to competition, would be even higher if ACS were not funding millions of dollars of losses in poorly performing diversification ventures such as long distance and Internet services.

4. Overall, the RCA's implementation of UNE rates has encouraged local telephone competition without significantly harming ACS financially or operationally. In fact, UNE competition has led ACS to dramatically improve the efficiency of its local telephone operations. Despite its doomsday rhetoric, ACS has not presented, to date, credible evidence in any forum that it is facing a financial crisis that threatens its viability. To the contrary, ACS' 10-Q filing for the second quarter of 2003 states that ACS "believes it will have sufficient working capital and available borrowing capacity under the existing revolving credit facility to service its debts and fund its operations, capital expenditures and other obligations over the next 12 months." ACS' chief executive officer and chief financial officer both certified the 10-Q filing under the Sarbanes-Oxley Act, which requires a publicly traded company's chief executive

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(907) 265-5600

officer and chief financial officer to certify the accuracy of the company's quarterly SEC filings.

5. ACS' assertion that it risks losing 100% of the retail local telephone market as a result of UNE pricing is puzzling. GCI has not competed with ACS primarily on price but rather on the basis of bundling and customer service. Its basic local telephone service rates are very close to ACS' except for Anchorage, where ACS unilaterally increased local telephone rates in November 2001 by 24%, a rate increase that GCI declined to match. Despite this massive, self-inflicted wound, ACS retains more than half the local telephone market in Anchorage.

6. The competitive battle in Alaska's local telephone market ultimately will turn more on bundling, customer service, and innovation than on simple price cutting. The RBOCs have acknowledged the importance of bundling and are aggressively using wireless service in their bundling strategies. Despite ACS' statement in its July 31 investor teleconference, that it was winning back local telephone customers with new "bundled DSL, local and long distance service products," ACS has been late to the game both in bundling and in recognizing the key role that its wireless business can play in bundling. In 2000, Goldman Sachs, in an equity research report, noted that ACS had the only statewide wireless network and projected that ACS' wireless market penetration would rise

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from 15.7% in 1999 to 25% in 2004. As of the end of 2002, ACS' wireless penetration was only 17.2%, up only one-tenth of a percent from the previous year's penetration of 17.1% percent. There is no chance that ACS will meet Goldman's projection. ACS' failure to grow this strategic business despite its many advantages has nothing to do with the wireline regulatory regime.

7. Alaska's UNE rates have not deprived ACS of needed investment capital. ACS is, of course, correct that unless there is a prospect of a reasonable return, the capital markets will not provide capital for an investment, but that scenario is not remotely the case here. ACS' local telephone business is a valuable asset that generates substantial and reliable cash flows and has ready access to the capital markets. In fact, ACS has just announced that it is proceeding on a major new financing. In conjunction with the issuance of $175 million in new senior unsecured notes, ACS plans to enter into a new bank credit agreement, which includes a $200 million term loan facility and a $50 million revolving credit facility. ACS will use the proceeds from this financing to retire the $320.7 million outstanding on its existing term loans.

8. After the new financing is complete, ACS will have increased its cash (as well as its total outstanding debt) by more than $50

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(907) 265-5600

million and will have total liquidity approaching $170 million (cash plus the new revolving credit facility of $50 million). The question naturally arises: What is ACS going to do with all this liquidity? A possible answer is found in ACS' previously cited 10-Q filing. ACS states there that it is looking to refinance its senior secured debt facilities to support its future growth and "loosen certain restrictive covenants, including with respect to the payment of dividends." In other words, ACS may soon decide to pay dividends (potentially a massive, one-time special dividend) to its shareholders, an action that would primarily benefit ACS' private equity sponsor, Fox Paine, not ACS' customers. All in all, these are not the actions or disclosures of a company whose core business is performing so poorly that it has been frozen out of the capital markets.

9. ACS has not presented any credible evidence that Alaska's UNE rates have discouraged it from investing in Alaska's communications infrastructure. Since the beginning of 2000, ACS has invested more than $248 million in capital expenditures, including more than $62 million in unprofitable long distance, Internet services, and wireless cable ventures. On July 31, 2003, ACS reaffirmed its intention to invest $50 to 60 million in Alaska communications infrastructure this year. From these facts, one could easily argue that to the extent ACS is dissatisfied with its financial performance it is not due to a lack of capital

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(907) 265-5600

or access to capital or even an unwillingness to invest capital but is rather due to an inability to invest capital in a disciplined, return-oriented manner.

10. ACS' argument that the RCA has an obligation to "ensure the financial health and viability of regulated entities" raises novel questions. For example, is the RCA required to hold ACS' management, private equity sponsor, and public debt and equity holders harmless from the consequences of ACS' strategic and tactical mistakes, which include the overpriced, over-leveraged buyout that created ACS in 1999 and the unilateral Anchorage rate increase in 2001 that alienated ACS' customers? If so, who is left to protect the interests of Alaska consumers? Fortunately, the facts here do not require the RCA to answer these questions. ACS has yet to provide internal financial analyses, affidavits, and other materials to prove that its financial health and viability is at risk. ACS' public equity story, like that of many other ILECs, may not be ideal, but the fact that its stock is not performing as well as ACS would like (even though the stock has appreciated more than 100% from the end of March 2003) does not mean that ACS is facing any sort of crisis that endangers local telephone service in Alaska. It is simply part of the public equity market risk that ACS' management and private equity sponsor willingly undertook in the 1999 buyout.

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2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

11. This concludes my statement.

Gregory F. Chapados

SUBSCRIBED AND SWORN to before me this 13th day of August, 2003.

JANET BARRAGAN
MY COMMISSION EXPIRES
November 20, 2004

Janet Barragan
Notary Public in and for Texas
My commission expires on: 11-20-04

GCI Communication Corp.
2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5660

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STATE OF ALASKA

THE ALASKA PUBLIC UTILITIES COMMISSION

Before Commissioners:

Mark K. Johnson, Chair
Kate Giard
Dave Harbour
James S. Strandberg
G. Nanette Thompson

In the Matter of the Commission Review of Rules and Regulations Governing Telecommunications Rates, Charges Between Competing Telecommunications Companies, and Competition in Telecommunications	)	R-03-03

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REPLY AFFIDAVIT OF DALE E. LEHMAN
ON BEHALF OF ALASKA COMMUNICATIONS SYSTEMS

I. Scope and Summary

1. My name is Dale E. Lehman and I filed an affidavit on behalf of Alaska Communications Systems in the Comment phase of R-03-03. My comments addressed the appropriate triggers and scope of deregulation in retail telecommunications markets as a result of the pro-competitive provisions of the Telecommunications Act. I now respond to the initial comments filed by GCI, the Alaska Telephone Association, the Rural Coalition, and AT&T Alascom on these same issues.

2. All parties recognize that markets should be deregulated when no carrier has sufficient market power to raise prices above competitive levels. This determination should be made on a market by market basis, both geographical and by service (wholesale/retail). The parties differ, however, concerning what circumstances are

EXHIBIT A

appropriate for triggering deregulation, as well as the extent to which deregulation should provide equal treatment of competitors. GCI proposes retaining dominant/non-dominant carrier distinctions and proposes market share tests for moving carriers from dominant status to non-dominant status. ATA proposes a trigger of the "advent of competition" for deregulation and argues that deregulation should impose the same restrictions on incumbents and entrants alike. Similarly, the Rural Coalition proposes that designation of a second eligible telecommunications carrier (ETC) as the trigger for treating incumbent and entrant retail services alike. AT&T Alascom addresses regulatory parity in a different market, the interexchange market, and calls for regulatory parity based on this market's competitiveness.

3. I will reiterate, and expand upon, my original position that the wholesale provisions[1] of the Telecommunications Act require modification of the way that retail telecommunications markets are regulated. Indeed, the need for retail regulation is eliminated by the establishment of markets for unbundled network elements (UNEs), the designation of multiple ETCs in an area, or the availability of alternative facilities required for provision of local services. There can be no middle ground – attempts by this Commission to "manage" the transition to competition will actually prevent competition from working and will harm consumers. Additional consumer protection is better provided by direct price constraints than by continuation of an outdated regulatory paradigm.

[1] By "wholesale" I mean the establishment and pricing of unbundled network elements - the wholesale inputs to the provision of retail service. Wholesale services, purchased at a wholesale discount for offer on a total service resale basis, are different. I do not address the latter as it generally does not eliminate the incumbent's retail market power in the same way that UNEs do.

II. The parties all agree that retail market (de)regulation should reflect the pro-competitive wholesale provisions of the Telecommunications Act, but the parties diverge concerning both the timing and the extent of retail deregulation.

4. The comments filed by GCI, ATA, the Rural Coalition, and ACS all reflect the fact that regulation of retail markets is impacted by provisions in the Act.[2] All parties recommend deregulation of retail services when market power is not present. The basis for determining whether market power exists differs, however. GCI calls for a market-specific investigation by the Commission that would consider a number of factors. In addition, it proposes a market share test: rate increases would only be permitted when an ILEC's market share falls below 80%. They distinguish between freedom to reduce rates and freedom to increase rates on a perceived legislative distinction between markets that have competition and those that have "significant" competition.[3]

5. ATA calls for complete parity in regulation of ILECs and CLECs "in areas where the commission has determined there is competition among carriers."[4] The Rural Coalition goes further in calling for regulatory parity in "any service areas where multiple carriers have been designated as eligible telecommunications carriers."[5] AT&T Alascom claims that the interexchange market in Alaska is already competitive and that regulatory parity should be in place, specifically regarding reporting and retail tariff requirements. In my initial comments on behalf of ACS, I called for retail deregulation in local markets "when UNEs are available and being purchased."[6]

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[2] AT&T Alascom makes similar proposals for the interexchange market, though the changes it cites preceded the passage of the Act.
[3] See the discussion in the GCI Comments, at pages 20-22.
[4] ATA Comments, at page 3.
[5] Rural Coalition Comments, at page 7.
[6] Affidavit of Dale E. Lehman, at page 7.

6. The issue is: when does a carrier cease to have the ability to raise rates above competitive levels, i.e., when do they no longer have market power? As I explained in my direct comments, the availability of UNEs mitigates the retail market power of the incumbent. For carriers that have rural exemptions, either the removal of those exemptions or the designation of multiple ETCs has the same effect. The incumbent carrier cannot raise prices above competitive levels – it will provoke a bona fide request for UNEs and/or facilities-based entry by competitors. Any of these conditions should be sufficient for complete retail regulatory parity. Anything less will harm the process of competition and will harm consumers. Market share tests are inappropriate, as I will now discuss.

III. The dominance/non-dominance regulatory regime is outdated and likely to cause more damage than benefit to consumer interests. In particular, market share tests to trigger deregulation are inappropriate and backward-looking. The proper course is deregulation of retail markets as soon as UNEs are available and/or multiple ETCs have been designated in a market.

7. GCI cites "the clear rationale for continuing differential regulation of dominant and non-dominant carriers based on market power, but elimination of the regulation initially defining the incumbent carrier as dominant."[7] It is correct to focus on market power and it is correct to drop the presumption that the incumbent has such power. GCI's continued reliance on the dominant/non-dominant distinction is misplaced, however. GCI cites the lengthy history of FCC regulations based on this dominance distinction. It is misguided to rely on a regulatory history that evolved in a market that did not have the extensive requirements for interconnection and unbundling of essential facilities that are contained in the Telecom Act. Market dominance is a backward-looking concept and one

prone to misuse. If the Commission is careful to remember that a carrier may be dominant in a particular geographical wholesale market *but non-dominant in the same geographical retail market*, then little harm is caused (GCI recognizes this specific situation at page 13 of their comments). Dominance in the market for unbundled network elements is an unnecessary concept, as the provision of UNEs is governed by Federal law. It is precisely the availability of UNEs or alternative facilities that makes a carrier non-dominant in the retail market, so dominance in a market for UNEs generally implies non-dominance in the same geographical retail market. The dominance label does nothing to help with determining whether a carrier can raise prices above competitive levels, but it does risk asymmetrically imposing regulatory burdens on one competitor in the market.

8. The FCC history with dominance points in the direction of removing such labels. The FCC ordered detariffing of interexchange services in 1996 but it was not until 2000 that the court challenges finally ended.[8] The industry resisted detariffing. Tariffs were actually harming consumers by protecting competitors from the intensity of competition that results from more direct competitive pressures between carriers. The FCC had to fight for detariffing within the outdated dominance paradigm.

9. The FCC's treatment of local markets is markedly different than for interexchange markets. Section 271 of the Act provides a "competitive checklist" that must be complied with before the Regional Bell Operating Companies (RBOCs) are permitted to offer interLATA services. The purpose of the checklist is to ensure that the

[7] GCI Comments, at page 12, lines 6-9.

[8] See Charles H. Kennedy, *An Introduction to U.S. Telecommunications Law*, Artech House, 2001, pages 109-110. Detailed discussion of the potential anticompetitive effects of tariffing can be found in Paul W. MacAvoy, *The Failure of Antitrust and Regulation to Establish Competition in Long-Distance Telephone Services*, MIT Press, 1996. AT&T Alascom also cites the FCC detariffing of long-distance services in its comments.

local markets are open to competition – no particular degree of competitive entry is required. Rather, the checklist focuses on the conditions required to open the market to competition – availability of interconnection, UNEs, and resold services, at cost based prices.

10. As of May 1, 2003, the FCC has found that this checklist has been met in 42 jurisdictions. In only three (3) of these jurisdictions has the CLEC market share been 20% or greater and the lowest reported market share in which the FCC has approved RBOC Section 271 authority is 4% (in Kentucky).[9] Clearly, the FCC has found that determining whether an incumbent has market power is not tied to any particular competitive market share. It is the unbundling and interconnection requirements of the Act that make such market share data irrelevant to the determination of whether or not market power exists.

11. It is not just that market share data is irrelevant to the determination of market power – use of market share triggers will only harm competition and consumer interests. This is because consumers are best served by having two or more viable competitors and not by handicapping one competitor in the market. The evidence in Alaska suggests that once competitive entry occurs, it rises to 20% (GCI's suggested trigger) and then beyond. There is no magical threshold required for competition to be sustainable and the Commission should not (and cannot) manage market shares. Regulators should be in different between competitive market shares of 60% or 10%.

[9] The Section 271 data is from *Statistics of the Long Distance Telecommunications Industry*, May 2003, and the local competition data is from *Local Telephone Competition Report*, June 2003 (data as of December 31, 2002), Federal Communications Commission reports. The CLEC market share data is only reported for states where there are more than two CLECs so a number of states are not included in the above statements regarding CLEC shares.

provided that they result fr. ' fair and unfettered competition. The point is that the market should decide the eventual market shares, not regulators. This means that regulators should treat competitors equally, and also, that the regulation of competitive markets should be kept to a minimum. The regulatory role in the unbundled environment is to ensure that UNEs and interconnection are available at cost-based prices. Continued asymmetric retail regulation of carriers is not appropriate.

12. Market share tests can be particularly damaging to small ILECs. The loss of 20% of the lines may entail a revenue loss of far more than 20% and can threaten financial viability. Fine-tuning the market share measures and conducting proceedings to determine whether a particular market has become sufficiently competitive only prolongs the necessary deregulatory process By the time that sufficient evidence has been collected and sufficient market share lost, the damage (to both the ILEC and eventually consumers) is done. The Telecom Act rewrote the rules of the market and this, in turn, calls for more tangible changes in retail regulatory structures. The triggers for regulatory parity should be concrete and easily monitored. Availability and use of UNEs, removal of the rural exemption, and designation of multiple ETCs are such triggers.

IV. If additional consumer protection against rate increases is desired, it is better achieved through constraints on retail rate increases than continued reliance on an outdated regulatory regime.

13. To the extent that the Commission is wary of moving this quickly, additional consumer protection can be provided with minimal distortion of the competitive process. Maximum permitted price increases for basic residential service are simple to administer and safeguard consumers against abuse of regulatory freedom. ILECs will

worry about competition rather than spend their resources trying to work within regulatory constraints that their retail competitors don't face.[10] Consumers face enhanced choice and will benefit as a result. The dominant/non-dominant regime simply has no place in this environment, other than to thwart the workings of competition.

14. The Commission's recent decision in consolidated Dockets U-01-34, U-01-83, U-01-85, U-01-87 provides an example of the dangers of continuing the dominant carrier regime. Among the Commission's findings concerning the waiving of tariff requirements:

> *"The waivers sought by the ACS Companies are not supported by the record in this proceeding nor is this the appropriate forum to implement such substantive changes to our competitive policies."*
>
> *"we do not find that ACS-AN is no longer dominant in its market."*
>
> *"provides an opportunity for us to observe the market and consumer reactions to ACS-AN being on an equal tariff procedural treatment with its major competitor."*
>
> *"we do not extent our interim waiver to the ACS-F, ACS-AK or ACS-N markets. Competition in those markets is not developed as well as in Anchorage. Further review of the status of competition outside of Anchorage is necessary before we relax regulations in other markets."*[11]

15. While these investigations continue, competition happens. It is not the unfettered competition that most benefits consumers, however. It is competition where one competitor is limited in its ability to deaverage its prices, restrained from rapidly changing prices, and restricted in its ability to offer promotions, new services, and new bundles. As

[10] Regulatory parity is in consumers' interests, as is reduced regulation in a competitive market. Restrictions like public notice for price changes should be equally applied to competitors, and the requirements for such notice should be kept to a minimum, consistent with the need for consumers to be informed and be able to exercise choice.

[11] At pages 21-22.

a result, the competitive pressure it presents to others is less intense. In the name of consumer protection, consumers face more limited choices than they should in a competitive market. Such a situation may have been appropriate in the pre-Telecom Act environment. It does not reflect the sweeping changes that the Act presents. Consumers are protected by the interconnection, unbundling, and resale provisions of the Act. These provisions obviate the need for much of the retail regulatory apparatus that was constructed during the monopoly era. It is time for regulation to become as forward-looking as the cost models.

16. This completes my Affidavit.

DATED this 8 day of August, 2003, at Anchorage Alaska.

Dale E. Lehman

SUBSCRIBED AND SWORN to or affirmed before me this 8th day of August, 2003, at Anchorage Alaska.

Notary Public in and for Alaska
My Commission Expires 11-3-06

12

STATE OF ALASKA

THE ALASKA PUBLIC UTILITIES COMMISSION

Before Commissioners:

Mark K. Johnson, Chair
Kate Giard
Dave Harbour
James S. Strandberg
G. Nanette Thompson

In the Matter of the Commission Review of Rules and Regulations Governing Telecommunications Rates, Charges Between Competing Telecommunications Companies, and Competition in Telecommunications	)	R-03-03

AFFIDAVIT OF HOWARD A. SHELANSKI
ON BEHALF OF
ALASKA COMMUNICATIONS SYSTEMS

I. Qualifications

1. My name is Howard A. Shelanski. I am a professor of law at the University of California at Berkeley. My address is School of Law, Boalt Hall, University of California, Berkeley, CA 94720.

2. I received my B.A. from Haverford College in 1986, my J.D. from the University of California at Berkeley in 1992, and my Ph.D. in economics from the University of California at Berkeley in 1993. I have been a member of the Berkeley faculty since 1997. In 1998-2000 I was on leave from my faculty position to serve as a Senior Economist to the President's Council of Economic Advisers (1998-99) and then as Chief Economist of the Federal Communications Commission (1999-2000). I rejoined the Berkeley faculty on a full time basis in July 2000. I formerly practiced law in Washington,

EXHIBIT B

D.C. with the firm of Kellogg, Huber, Hansen, Todd and Evans and served as a law clerk to Justice Antonin Scalia of the United States Supreme Court.

3. I teach and conduct research in the areas of telecommunications regulation, antitrust, and applied microeconomics. My recent publications include articles in the *Journal of Law, Economics and Organization*, the *Yale Journal on Regulation*, the *University of Chicago Law Review*, the *Journal of Law and Economics*, the *University of Chicago Legal Forum*, the *Columbia Law Review*, and *Telecommunications Policy*. I am co-author of the legal textbook *TELECOMMUNICATIONS LAW AND POLICY* (Carolina Academic Press, 2001). My Curriculum Vitae is attached to my testimony as Exhibit 1.

II. Purpose of Declaration

4. The purpose of this declaration is to explain why local exchange competition and regulation of retail telephone rates are inconsistent with each other and why continuing with such regulation could interfere with the very competition that is the goal of RCA and legislative policy. I will also comment on the relevance of wholesale and UNE rate regulation to retail rate regulation and on how the question of ACS' market share should factor into retail rate policy.

III. Rate regulation is an imperfect Solution Even in the Best of Circumstances

5. Rate regulation is a tool that, in the absence of competition, can limit a firm's ability to extract monopoly profits from consumers. Courts, policy makers, and commentators recognize, however, that rate regulation is extremely difficult to implement effectively. Regulators often have difficulty obtaining the information they need to set prices—whether under a rate-of-return or price cap regime—efficiently. Even if the

regulated firm fully complies in good faith with the regulatory process, it is hard for regulators to know what levels of return are fair for carriers or what levels are necessary to sustain forward-looking investment and technological change in an industry. The challenges for regulation are particularly tricky to navigate during periods of change in an industry, such as the current transition to competition and increasingly advanced networks in local telecommunications.

6. Because of the difficulties of rate regulation, and because of the unintended consequences rate regulation may have for competition and market performance, regulators have generally retreated from such intervention when competition develops or is predicted to develop in a market. Telecommunications, in particular, provides several instructive examples of such caution and conservatism in regulating prices. Consider the de-tariffing of "dominant" long-distance carriers (i.e., AT&T) in 1991. In that proceeding, the FCC determined that even though competition in long-distance telephone service was not perfect, the increase in competition and the growth of competitive capacity made deregulation preferable to continued scrutiny of AT&T's filed tariffs.[1] The Commission concluded that in light of potential competitive pressure from MCI and Sprint, the costs of continued rate regulation would outweigh its benefits for consumers.[2]

7. The Commission exercised similar forbearance in the context of wireless telephony. When the Commission first licensed cellular spectrum beginning in the early 1980s, it assigned two licenses in each geographic area; a "B block" license to an affiliate

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[1] 1991 Report on Interexchange Competition, 6 F.C.C. Rcc. 5880, 5881-5882 ¶¶8-9 (1991).
[2] Id. at ¶9.

of the incumbent ILEC and an "A block" license to a new entrant.[3] Because there would be two competing providers in each market, the Commission did not regulate cellular prices, instead letting the market develop competitively. To be sure, a two-firm market is unlikely to be perfectly competitive, but the vigorous rivalry between the A and B block carriers to attract customers to the then-new wireless market kept prices falling and the prospect of grabbing any profits that remained in the market was sufficient to induce the development of superior digital technologies and the entry in the mid-1990s of numerous PCS carriers. Instead of a rate-regulated market of two cellular carriers, we now have a vigorously competitive market in which over 80 percent of Americans have a choice of at least five competing wireless providers, with all the ensuing benefits of lower prices and more innovative services.[4]

8. A final example of refraining from rate regulation in the face of emerging competition comes from the cable sector. The FCC and local governments had joint authority under the Cable Act of 1992 to regulate cable rates in the absence of effective competition. In 1993 the Commission established definitions of "effective competition" in cable markets that demonstrated caution about engaging in rate regulation and showed a decided preference for relying on competition rather than agency rules. Notably, the FCC determined that where an incumbent cable operator faces a competitor that (1) offers comparable service to 50% of the households in the franchise area, and (2) provides service to at least 15% of the households in the franchise area, the incumbent faces sufficiently

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[3] See Peter W. Huber, et al., Federal Telecommunications Law (1999) §10.4.2.
[4] FCC, Eight Annual Report and Analysis of Competitive Market Conditions with Respect to Commercial Mobile Services (July 14, 2003) at ¶18.

"effective competition" that rate regulation is unwarranted.[5] In adopting the above standard, the Commission made the judgment that competition can be effective and superior to rate regulation even where it is not ubiquitous and even when market shares remain greatly uneven as between incumbents and entrants.

9. The above examples demonstrate a consistent pattern at the FCC of reluctance to continue rate regulation in the face of emerging competition in a variety of telecommunications markets. That reluctance is anchored in both an appreciation of the difficulty and costs of regulation and an understanding of the benefits that can result when competition is allowed to run its course. The recent growth of competition in local exchange markets, which has been particularly strong in key areas of Alaska, suggests that the retail rate regulation that has to date been applied in Alaska may no longer be necessary and, more urgently, may interfere with the continued growth and expansion of local telephone competition in the State. The next section discusses in more detail why retail price regulation and competition are ultimately incompatible.

IV. How Rate Regulation Can Interfere With Competition

10. Firms enter markets when they see opportunities to under-price incumbents and take market share while still earning positive returns. The higher the prevailing prices in a market, the more likely entry is to occur. It is thus not surprising, for example, that local exchange entry has been most vigorous in the densely populated markets where entry costs are lowest and where retail rates tend most to exceed costs. Regulations that limit

[5] Rate Regulation of Cable Services, 8 F.C.C. Rec. 5631 at ¶8 (1993).

retail rates can have the effect of depressing the margins that make entry attractive, ultimately deterring the competition that could make the regulation unnecessary. Such substitution of regulation for competition is undesirable for two reasons. First, the regulation itself is costly, both for the regulator and for the firm under scrutiny. Second, while regulation may succeed in pushing prices for consumers down, it does not provide non-price benefits of competition such as innovation.

11. Retail rate regulation—and in particular increases in such regulation—can have particularly harmful effects where competitive entry into a market is already underway. Pushing an incumbent carrier's rates down when there is a competitor in the market might undermine the investment calculations that the entrant has made and slow the pace of the competitor's growth. Such regulation might also have the effect of chilling the entry of yet additional competitors whose presence in the market would provide vigorous and beneficial competition. This picture is particularly salient in Alaska. At present, ACS faces very substantial competition from GCI, with market share loss ranging from 20 to 40 percent in ACS' major markets of Juneau, Fairbanks, and Anchorage. But other providers, notably AT&T, have also begun to make inroads. AT&T's market share currently hovers around 6 percent in Anchorage—small by comparison to GCI but non-trivial. One need only ask the question of now downward regulation of ACS' retail rates would affect AT&T's entry incentives, not only in Anchorage but also in Fairbanks and Juneau, to see how such regulation can reduce competition. Entry follows profit opportunities, and as those opportunities diminish as regulation pushes down the incumbent's rates, which rates an entrant will have to beat or match to gain customers, entry and competition diminish as well. Customers may receive lower rates in the very short run, but they lose the more

robust price efficiency that results from true competition, they lose the innovations that result from true competitive incentives and, if regulated prices fail to capture the margins necessary to sustain dynamic network investment, they may lose on the level and variety of service they receive from the incumbent.

12. Other dimensions of rate regulation also li nit competition. If the incumbent firm alone must face regulatory review, the unregulated entrant may be spared the need to respond to rapid price cuts or changes in service offerings. Similarly, the competitor might gain valuable information during the regulatory process about the incumbent's cost structure or business strategies. Where one firm (the incumbent) is hampered in its ability to compete in a quick and aggressive manner, the competitive process becomes is less beneficial for consumers.

13. The hazards discussed above are particularly salient in a market, such as local exchange service, in which cross-subsidies are built into rates and where rates often do not correspond meaningfully to costs. Under a regulatory program in which rates for some customers do not cover costs, *economically efficient* entry will occur only in markets where retail prices exceed the costs of providing service and will focus on markets in which those margins are largest. To be sure, entrants might serve otherwise unprofitable customers if they do not have to bear the true costs of doing so. Thus, if rates for unbundled network elements (UNEs) are averaged across service areas, then UNE prices in high cost areas will be lower than the ILEC's actual service costs and entry that is profitable for the CLEC, but that is socially inefficient because it is not covering its costs, may occur. Under such a regime, however, new entrants need not compete as vigorously as they would in an unregulated regime. The ILEC is in no position to cut retail rates in

competitive response because to do so would only increase its losses. Moreover, in no such case of subsidized entry will a CLEC have any incentive to make the transition from UNEs to its own network and provide true, facilities-based, competition. For such competition to occur, both UNE prices and retail rates must reflect the true incremental costs of providing the service or element at issue. Because the incumbent must meet its overall revenue requirements from customers in its low-cost markets, it will not have either the incentive or ability to engage in a price war in profitable markets either. To do so would leave the incumbent with reduced profits from its low-cost markets but bearing the same losses in its high-cost markets. Eventually, of course, prices in the profitable market will erode with entry but the economic viability of the incumbent network will have been compromised. The result is a poorer network of last resort for consumers and a weakened incumbent competitor in major markets. Unless rates are deregulated to the extent that they at least reflect costs, both of the problems identified above—selective entry by CLECs and a weakened, competitively constrained ILEC—will persist.

14. Implicit in the discussion above is that some rates, those that are below cost, will rise as rate regulation is removed. To the extent such cost-based pricing is contrary to state universal service objectives, the high-cost problem can be alleviated in part through more neutral and targeted subsidy mechanisms that do not depend on a carrier's revenues from profitable markets. But two things must be kept in mind: first, the rates that would rise are rising to more efficient, *i.e.*, cost-covering levels; and second, the higher rates are more likely to attract competitive entry that will over time provide firms with incentives to reduce costs and once again lower prices. The CLECs themselves have recognized that letting prices rise to efficient levels is likely to benefit competition and consumers. For

example, Dr. John Mayo, AT&T's expert economist in a recent Massachusetts retail rate proceeding, stated that:

> *Prices that do not--at a minimum--recover the incremental cost of providing a service will simply fail to encourage any other parties to consider entry into the market. In this case, while consumers are nominally "protected" from monopoly through a policy of low prices, such a policy actually acts to prevent the introduction and growth of competition. ... A necessary (but not sufficient) condition for the emergence and growth of competitors is the removal of regulatory barriers to entry, and there can be no more effective barrier to entry than prices that are lower than the incremental cost of providing a service.*[6]

15. Dr. Mayo further advocated letting retail rates rise when entry has occurred and allowing competition to provide the necessary discipline, noting that "despite the larger *potential* price increases permitted, competitors and competition will provide a meaningful check on [the ILEC's] upward pricing."[7]

16. The discussion above demonstrates that where competition has developed sufficiently to prevent the incumbent from exercising market power, rate regulation is unnecessary and will do more harm than good. I turn next to an explanation of market power and of why the evidence shows an absence of such power for ACS.

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[6] Pre-filed Direct Testimony of John W. Mayo on Behalf of AT&T Communications of New England, Sept. 4, 2002, at p.15. Mass. Dept. of Telecommunications and Energy, DTE 01-31 (Phase 2).

[7] Id. at p.21.

V. ACS Does Not Today Possess Market Power in Local Exchange Services

17. Market power is a firm's ability profitably to raise prices above the competitive level for a significant period of time, or to otherwise dictate the terms of trade in a market through the firm's decisions on quality or level of output of the good or service at issue. Accepted economic theory holds that two conditions are necessary for a firm to exercise market power. First, there must not be competition from existing firms producing substitute products in the relevant market. If competitors have sufficient capacity, they can step in and meet any demand for alternative sources of supply that would accompany an increase in price (or decrease in output or quality) by the firm attempting to exercise market power. When such competitive capacity is available, it is not long profitable for an incumbent firm to raise prices above the competitive level. A firm might decide to raise prices, but if in so doing it loses market share to competitors then the firm lacks market power. ACS has in fact rapidly lost market share to GCI. The fact that GCI has been able to take customers from ACS so effectively refutes the notion that ACS retains market power.

18. Second, for a firm to be able to exercise market power, entry into a market by firms not currently in the market must be relatively difficult. Where barriers to entry are low, even where there are few current competitors or substitutable products/services, any attempt to increase price above the competitive level would stimulate entry by new firms offering competitive products at a competitive price, and the attempt to increase price would not be sustainable. When a market is susceptible to such entry, it is sometimes referred to as being "contestable." It is important to recognize that in local telephone service, contestability is being achieved over multiple platforms. Use of UNEs and resale is perhaps the competitive path that is most often mentioned. But alternative platforms

such as wireless and cable networks also provide important avenues for entry through which ILEC can be challenged competitively. Such entry paths are not speculative, but real. For example, GCI recently told financial analysts that it intends to roll out telephone service on its monopoly cable network to as many as 60,000 customers over the next three years.[8] Given the competitive results GCI has already achieved against ACS and given its ability to enter at an even greater rate over its proprietary cable networks, there is no question that GCI has rendered ACS' markets fully contestable.

19. Unless the above two conditions—absence of competition and barriers to entry—hold, a firm cannot exercise market power. Neither of those necessary conditions for market power holds for ACS. The company unquestionably faces competition in is core markets, most strongly from GCI but also from AT&T and others. Moreover, the wholesale and unbundled network element (UNE) regimes ensure that there is "elastic" supply for increased competitive service, so there is no difficulty of entry or expansion of supply by existing competitors. Accordingly, ACS will not be able to control prices in its markets even if rate regulation is eliminated.

VI. Regulation at the Wholesale Level Undermines the Case for Regulation at the Retail Level

20. The point made in the previous paragraph about entry through resale or use of UNEs bears emphasis. Because CLECs can purchase the inputs they need to provide competing service at regulated wholesale prices, ACS would face a strong constraint on its

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[8] General Communications (GNCMA) –Q2 2003 Financial Release Conference Call, Thursday, July 31, 2003 2 PM, Transcript Produced by Fair Disclosure Financial Network Inc, at p.12.

ability to raise retail prices to consumers. As soon as ACS' profits rose to attractive levels, new firms would enter or existing CLECs would expand their operations. This result is not speculative. In those markets where rates contain a margin over cost, GCI and other CLECs have already availed themselves of the opportunity to purchase UNEs from ACS or to resell ACS' own service and to take customers away through lower-priced services than those offered by ACS. In this way, the existence of wholesale price regulation for service inputs undermines the need for retail price regulation on service outputs. There is, moreover, something of a contradiction between retail and wholesale price regulation in local telecommunications. As explained above and as corroborated in the cited testimony of AT&T witness John Mayo, retail price regulation acts as a deterrent to competitive entry and thus renders the regulatory program for incumbent provision of wholesale inputs less effective. Therefore, not only does the competition that has emerged from the UNE and resale regimes diminish the need for retail rate regulation, but elimination of such regulation is likely to increase the incentives of competitors to take advantage of UNEs and resale to enter and further improve market performance for consumers.

VII. High Market Share is a Poor Proxy for Market Power in Local Telecommunications

21. Some parties might still object that, despite competitive entry, ACS retains the majority share of its service markets, and in some places still faces no competition. Yet these facts do not support the conclusion that ACS has market power or that rate regulation should persist. Indeed, high market share does not in itself suffice to show market power. Market share measures are backward looking. They reflect the point to which a firm has come, perhaps because of past competitive behavior or, as in the case of local telephony, a

history of being a regulated monopoly. Market share fails, however, to show the extent of current competition and how that competition will proceed from this point forward. This is a particularly critical shortcoming of relying on market shares to set policy in a regulated industry making the transition to competition. The fact that ACS has been the regulated provider of telecommunications services in the territory it covers, with the legacy of a large market share in that market, is of little help in understanding the competition that ACS faces right now or the competitive prospects in the market from today forward.

22. To take just one example of how static market share can misrepresent market power, consider local exchange service nationwide. In December 1999, CLECs reported serving just over eight (8) million switched access lines, or about 4.3% of the market. Only 18 months later, in June 2001, the CLECs had more than doubled their lines to over 17 million, or about 9% of the market.[9] Clearly, CLECs have been able to enter the local exchange market, to increase their supply of services, and provide substitutes for consumers of local telephone services. An analysis of the local market that equated ILEC market share with ILEC market power in 1999 would clearly have proven erroneous by 2001. The case is even more compelling in Alaska, where the competitive market shares are far, far higher than the nationwide average. Competition is not a mere prospect in Alaska's major markets, it is a clear reality.

23. In the face of such market evidence, it is particularly inappropriate to rely on market share as evidence of an incumbent's market power. Where the change in that market share has been sharply negative, as it has for ACS, market power simply cannot be

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[9] FCC, Industry Analysis Division, Local Telephone Competition: Status as of June 30, 2001 (Feb. 2002), Table 1.

inferred from the share that remains at any given point in time. Nor can market power be inferred from the fact that ACS has not faced significant, if any, competitive entry in some of the territories it serves. The economic literature makes this point forcefully:

> *To the extent that regulation is effective, its effect is to sever market power from market share...This is obviously so when the effect of regulation is to limit a monopolist's price to the competitive price level. A subtler effect should also be noted, however.* ***Regulation may increase a firm's market share in circumstances where only the appearance and not the reality of monopoly power is created thereby.*** *For example, ... price may be above marginal cost in some markets and below market cost in others. In the latter group of markets, the regulated firm is apt to have 100% market share. The reason is not that it has market power but that the market is so unattractive to sellers that the only firm that will serve it is one that is either forbidden by regulatory fiat to leave the market or that is induced to remain in it by the opportunity to recoup its losses in its other markets. .... In these circumstances, a 100% market share is a symptom of a lack, rather than the possession, of market power.*
>
> *Notice in this case that the causality between market share and price is reversed. Instead of a large market share leading to a high price, a low price leads to a large market share; and it would be improper to infer market power from observing the large market share.*[10]

24. The U.S. Federal Trade Commission/Department of Justice Horizontal Merger Guidelines similarly state that in changing markets current market share may be an inaccurate measure of a firm's forward-looking competitive significance. (Section 1.521). Given the shortcomings inherent in a market share analysis, there is strong consensus

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[10] William M. Landes and Richard A. Posner, "Market Power in Antitrust Cases," *Harvard Law Review*, Vol. 95, pp. 975-76 (1981) (footnotes omitted).

among economists that capacity to enter and expand in a market is of much greater significance when assessing competition than the percentage of total customers the incumbent has lost to date. It is thus especially imperative that in this case the focus be on supply and demand conditions and not on a static snapshot of market share data.

25. Emphasis on market share or the adoption of any market share threshold for retail rate deregulation can lead to strategic behavior by an entrant that ultimately diminishes competition. Thus, in the FCC Non-Dominance Proceeding, AT&T's experts argued against a policy of delaying regulatory relief until the achievement of a threshold level of market share loss by making the following point:

> *AT&T would, under such a policy, be encouraged to refrain from aggressive competition in order to allow its market share to fall below a threshold level. ... At the same time, the firms attempting to prolong regulation of AT&T would face an incentive not to capture too much market share... A contest is created to see who can turn in the worst performance.*[11]

26. If ACS' competitors gain somehow from retail regulation of ACS—perhaps by being spared rapid competitive responses by the incumbent or by obtaining informational advantages—then the possibility of such strategic behavior as the threshold level of competitive market share is being reached cannot be ignored.

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[11] *"Is AT&T Dominant?" An Assessment of the Evidence*, by David Kaserman and John Mayo: June 1995, Attachment to AT&T Ex Parte Letter from Charles L. Ward to William C. Caton. Re Ex Parte CC Docket 79-252.

VIII. Entry by Even a Single Strong Competitor Erodes the Case for Rate Regulation

27. An additional argument that might be made is that competition between two firms is not enough to protect consumers from high prices. It is true that a market with two competing firms—a "duopoly"—may not yield the same degree of price-reducing rivalry that a market with multiple competitors produces. Yet it is important to recognize that the relevant economic comparison for retail rate policy is not between duopoly and perfect competition, but between duopoly and a market with retail rate regulation. Once the direct and indirect costs of rate regulation are factored in, consumers will often be better off under an unregulated duopoly than under a duopoly in which one of the firms faces retail price regulation. Part of the reason for this has already been discussed above: market processes avoid the inefficiencies that regulated rates may entail and also send more accurate economic signals to new entrants. But another reason is that duopoly, particularly in markets newly opened to competition, my entail aggressive rivalry that immediately constrains rates, improves services, and benefits consumers. The rapid loss of market share experienced by ACS is strong evidence for how effective a single competitive entrant can be in improving market performance for consumers.

28. Precedent strongly supports retail rate deregulation when a second firm begins successfully competing in a telecommunications market. Consider the examples I discussed at the beginning of this declaration. In the cases of both cellular telephony and cable television, the FCC declined to impose retail rate regulation in a duopoly setting. In the cellular context, the market began as a duopoly and retail rates were never regulated. In the cable context, rate regulation was permitted in absence of competition but the FCC determined that once a single new competitor entered the market, even if it had capacity to serve only half the market and even if it had only a 15 percent market share, rate regulation

should cease. The case for deregulation is even stronger in Alaska than in either of the above cases. Not only is there more than one CLEC in the state's major markets, but the leading CLEC has shown itself capable of rapidly taking customers and eliminating any market advantage that the incumbent ACS might once have had.

IX. Conclusions

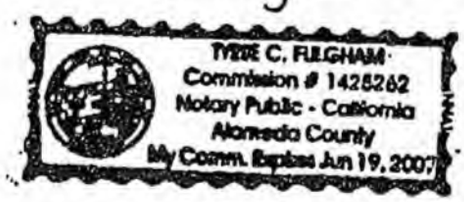
29. For the reasons discussed above, I conclude that competition in ACS' local exchange markets has reached the point where continued retail rate regulation raises substantial concerns. Such regulation is likely to impede the growth of competition in markets where entry has occurred and will perpetuate conditions that make entry uneconomic in areas where regulated rates do not cover the incremental costs of service. The long-run interests of consumers will be better served by relying on competition to discipline prices and send efficient signals to competitors. Should the market fail to perform as needed to protect consumers, regulation could then be re-imposed.

30. This completes my Affidavit.

DATED this 9th day of August, 2003.

Howard A. Shelanski
Howard A. Shelanski

SUBSCRIBED AND SWORN to or affirmed before me this 9 day of August, 2003, at Berkeley, California.



Tere C. Filgham
Notary Public in and for California
My Commission Expires 6/19/2007

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STATE OF ALASKA

THE ALASKA PUBLIC UTILITIES COMMISSION

Before Commissioners: Mark K. Johnson, Chair
Kate Giard
Dave Harbour
James S. Strandberg
G. Nanette Thompson

In the Matter of the Commission Review of Rules and Regulations Governing Telecommunications Rates, Charges Between Competing Telecommunications Companies, and Competition in Telecommunications	R-03-3

NOTICE OF ERRATA

ACS of Anchorage, Inc. ("ACS-ANC"), ACS of Fairbanks, Inc. ("ACS-F"); ACS of Alaska, Inc. ("ACS-AK"), ACS of the Northland, Inc. ("ACS-N"), and ACS Long Distance, Inc. ("ACS-LD"), hereinafter collectively referred to as ACS, file an errata to their Reply Comments filed on August 13, 2003. The errata filing submits the curriculum vitae of Howard A. Shelanski and is Attachment 1 to Exhibit B of the Reply Comments.

Respectfully submitted this 13th day of August, 2003,

ACS of ALASKA, INC.
ACS of ANCHORAGE, INC.
ACS of FAIRBANKS, INC.
ACS of the NORTHLAND, INC.
ACS LONG DISTANCE, INC.

Ted Moninski, Director
Regulatory Affairs/Carrier Relations

Alaska Communications Systems
600 Telephone Avenue, M565
Anchorage, AK 99503
907. 297.3103 • Fax: 907. 297.3153

HOWARD A. SHELANSKI
School of Law, Boalt Hall
University of California
Berkeley, CA 94720
shelanski@law.berkeley.edu
(510) 643-2743

Current Position

University of California at Berkeley, School of Law
Professor of Law, and Director, Berkeley Center for Law and Technology. Teaching areas include antitrust law, telecommunications law, regulated industries, and contract law.

Experience

Federal Communications Commission, Washington, D.C.
Chief Economist, 1999-2000.

President's Council of Economic Advisers, Washington, D.C.
Senior Economist, responsible for issues of industrial organization, competition policy, regulation, and trade, 1998-99.

Kellogg, Huber, Hansen, Todd & Evans, Washington, D.C.
Associate, telecommunications and general litigation practice, 1995-97.

Law Clerk to Justice Antonin Scalia, United States Supreme Court, 1994–95.

Law Clerk to Judge Louis H. Pollak, U.S. District Court, Eastern District of Pennsylvania, 1993-94.

Law Clerk to Judge Stephen F. Williams, United States Court of Appeals, D.C. Circuit, 1992-93.

Education

University of California at Berkeley, Economics Department
Ph.D. 1993; M.A. 1989
Dissertation: "Transfer Pricing and the Organization of Intrafirm Exchange."

University of California at Berkeley, School of Law (Boalt Hall)
J.D. 1992; Order of the Coif
Senior Articles Editor, *California Law Review*

Haverford College, Pennsylvania
B.A. (history) with high honors, 1986
Phi Beta Kappa; varsity track and cross country

Other

Speak French and Spanish;
Enjoy brewing beer, outdoor sports, travel, and jazz;
Admitted to the Bar in the District of Columbia and in Pennsylvania.

Selected Research & Publications

(With Peter Klein) "Empirical Research in Transaction Cost Economics: A Review and Assessment," 11 *Journal of Law, Economics, & Organization* 335 (1995).

"Transaction-Level Determinants of Transfer Pricing Policy: Evidence From the High Technology Sector," working paper, U.C. Berkeley School of Law, (1997, revised May 2002). Under review at the *Journal of Industrial and Corporate Change*.

"The Bending Line Between Conventional Broadcast and Wireless Carriage," 97 *Columbia Law Review* 1048 (1997).

"Video Competition and the Public Interest Debate," Mackie-Mason and Waterman (eds.), Telephony, the Internet, and the Media: Selected Papers, 25th Annual Telecommunications Policy Research Conference (1998).

(With Peter Huber) "Administrative Creation of Property Rights to Radio Spectrum," XLI(2) *Journal of Law and Economics* 581 (October 1998).

(With Jerry Hausman) "Economic Welfare and Telecommunications Regulation: The E-Rate Policy for Universal-Service Subsidies," 16 *Yale J. Reg.* 19 (1999).

"The Speed Gap: Broadband Infrastructure and Electronic Commerce," 14 *Berkeley Tech. L. J.* 721 (1999).

"A Comment on Competition and Controversy in Local Telecommunications," 50 *Hastings L. J.* 1617 (2000).

"Competition and Deployment of New Technology in U.S. Telecommunications," 2000 *The U. Chicago Legal Forum* 85 (2000).

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14

STATE OF ALASKA

THE ALASKA PUBLIC UTILITIES COMMISSION

Before Commissioners:

Mark K. Johnson, Chair
Kate Giard
Dave Harbour
James S. Strandberg
G. Nanette Thompson

In the Matter of the Commission Review of Rules and Regulations Governing Telecommunications Rates, Charges Between Competing Telecommunications Companies, and Competition in Telecommunications	)	R-03-03

AFFIDAVIT OF HUGH MCKENNA
ON BEHALF OF
ALASKA COMMUNICATIONS SYSTEMS

Impact Analysis of Tariff Reviews in a Competitive Telecommunications Environment

I. Qualifications

1. My name is Hugh E. McKenna. I am Managing Director of Mountainside Enterprises, Inc., which is my own independent management consulting company. My address is 6 Mountainside Drive, Morristown, New Jersey 07960.

2. I received my B.A. from the University of Notre Dame in 1970, and my M.B.A. from Cornell University in 1972. I joined AT&T in 1972 immediately following graduate school, and during the next twenty-six years completed assignments with successively higher levels of responsibility in a wide range of functional areas. One primary set of activities while at AT&T related to helping the company create new

products and enter new markets. This was accomplished through helping to develop new market entry plans for Lucent products for thirty international target countries in the early 1980s, and through promoting the development of enhanced service offers for Business Communications Services, helping to establish AT&T's new Solutions business unit, and preparing new product and service offers for AT&T's Local Services market during the early and mid-1990s. While at AT&T I also held various other positions within Strategic Planning, Finance, and in Operations Planning and Engineering.

3. I established Mountainside Enterprises, Inc. in 1998, and it has operated successfully during the past five years. I have completed numerous assignments related to the telecommunications, Information Technology and the emerging Electronic Business areas. Selected highlights include publishing a major market research report on wireless data applications for Enterprise customers, acting as Program Manager for an ISP/CLEC startup in Buenos Aires, Argentina, and helping AT&T Laboratories assess the commercial viability of new Web-based technologies. My Curriculum Vitae is attached to my testimony.

II. Purpose of Declaration

4. This analysis addresses the impact of continuing the traditional tariff review process for Incumbent LECs (ILECs) within a competitive telecommunications environment. In his analysis, Professor Howard Shelanski notes that the ongoing application of retail regulation can artificially depress prices and, as such, acts as a disincentive for new market entrants.[1] In addition to this observation, my conclusion is that continuing traditional tariff reviews not only serves no evident purpose, but also acts to

[1] R-03-3, Affidavit of Howard A. Shelanski, August 11, 2003, Section IV, beginning at p.5.

increase the time and cost needed for an ILEC to introduce new services. Further, it provides unfair advantages to other competitive telecom entities that have already entered a particular market.

5. The first relevant point to consider is whether genuine competition does exist in Alaska for local telecommunications services, and how one would measure the degree of competition that does exist. Relatively simple examples should suffice here. Since underlying competitive conditions have been established following the Telecommunications Act of 1996, ACS' market share for local services in Anchorage has been reduced from 100% share to somewhere around half of that amount at the present time. Significant but less severe reductions in market share have also been experienced in both Fairbanks and Juneau. While I do not endorse the use of market share tests for determining the point at which relaxed regulation is appropriate, it is evident from these simple facts alone that consumers not only have a choice of competing telecommunications offers, they are also actively selecting them in many cases.

6. A relevant measure of competitiveness suggested by ACS in its July 16 comments does have considerable merit, and I suggest that the commission give it serious consideration. It states that competitive conditions exist in a market where 75% of consumers can currently be served by more than one facilities-based carrier, where facilities-based is understood to mean either using its own facilities or those it procures on a UNE basis from another carrier. It is the availability of attractive, alternative offers that truly characterizes a competitive marketplace, and this is more important than the relative mix of services that are currently procured from any single one of the competitive entities.

7. To illustrate, many types of consumer goods are currently available to be purchased at the local supermarket. Even though one may continue to purchase the same brand of goods as in the past, it is an awareness of viable alternatives where changes may be made in price and other conditions that characterize a competitive market situation. With a sufficient change in one of the offer conditions relevant to the consumer, he or she will choose to change their supplier, and this is precisely what disciplines the market leader to change its offer only after careful consideration. Where viable alternatives exist that the consumer is sufficiently aware of, competitive conditions have been achieved, and the market leader must always act in the context of potential competitive response to its actions. It is recommended that the commission give serious consideration to using the 75% consumer coverage rule, as noted above, as a benchmark for determining when competitive conditions have been achieved in local telecommunications markets.

8. Where competitive market conditions can be shown to exist, a second relevant point relates to the value and role of ongoing tariff reviews by a regulatory commission, and whether rules relating to these reviews should differ among market participants. If competitive market conditions have been achieved, it is not clear what value remains in regulatory review and oversight, other than assurance that some implicit collusion among participants is not taking place, and that safety net and carrier of the last resort requirements will be satisfied. Safety net and related conditions should be examined before new market offers are introduced in cases where it is apparent that these requirements could be impacted, while potential collusion is probably best addressed by observing the market behavior of competitors over some period of time. Beyond these two areas, regulatory review of new product and service offers only serves to slow the

increase the time and cost needed for an ILEC to introduce new services. Further, it provides unfair advantages to other competitive telecom entities that have already entered a particular market.

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introduction of these offers by the time it takes to review them, adds a cost burden for the company that must submit them, and it adds to the workload of the commission that must review them. The efficient working of the marketplace will truly take care of disciplining the offers and the behavior of the market participants completely aside from regulatory review. It is certainly not in the public interest to continue such regulatory review unless clear benefit can be demonstrated.

9. It logically follows that if such a review is unwarranted for an individual carrier in a competitive market, then the need to apply different forms of regulatory review for different participants in that market is also not clear. If review is not needed for any individual carrier in a competitive market, the need to differentiate among them for review purposes ceases to be relevant.

10. Most important in examining the impact of the tariff review process in competitive markets are cases where harm may be done to both competitive markets and to individual competitors as part of the process. Such harm does indeed appear to result from continuing the tariff review process in competitive markets, and this provides the strongest argument yet for moving to the new paradigm of detariffing local services in these cases. In addition to slowing new market offers and adding to the cost basis for providing them, in order to fulfill review requirements, the current process also provides competing carriers with an unreasonable opportunity to review competitive market plans in advance of introduction, and it reduces a carrier's ability to fully capitalize upon its own creative marketing efforts as a consequence. Finally, potential disclosure of confidential cost information to competitors is fundamentally inconsistent with the basic tenets of competitive markets, as companies need to safeguard the right to keep such information

about their own internal efficiency completely confidential. The harm caused to an ILEC by disclosing information within the tariff review process will be covered in greater detail below, under the separate topics of time-to-market advantages, product and service differentiation, and implications of disclosing underlying cost information.

III. Time to Market

11. The ability to correctly perceive market needs and to rapidly introduce products that meet them are fundamental elements of a successful competitive enterprise. Market studies demonstrate repeatedly that companies that perceive market needs quickly, and respond rapidly, become market leaders. This ability is often called a time-to-market advantage, and superior skills in this area are increasingly separating the winners from the losers in the market. While time-to-market advantages may seem somewhat apparent, some illustrations and supporting information may serve to highlight appropriate insights in this area.

12. A recent article in the Wall Street Journal observed that Motorola was increasingly lagging behind market leader Nokia in cell phone development and sales, due to inability to rapidly bring new products to market. It noted that while Nokia was able to field on the order of twenty-five new phone designs in the market each year, Motorola was averaging only five or six. In its analysis of the situation, the article went on to note that Nokia had developed an underlying product design that made maximum reuse of common components among models, while Motorola had designed each product uniquely, and shared little or no synergies among products. Two fundamental consequences result from Nokia's superior approach. It has the advantage of testing many more product concepts in the market than its competitor, and as a result to continue to "recycle" more rapidly those

introduction of these offers by the time it takes to review them, adds a cost burden for the company that must submit them, and it adds to the workload of the commission that must review them. The efficient working of the marketplace will truly take care of disciplining the offers and the behavior of the market participants completely aside from regulatory review. It is certainly not in the public interest to continue such regulatory review unless clear benefit can be demonstrated.

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designs that fail to successfully meet customer needs. And second, it is able to make much more efficient use of development resource by effectively sharing among designs, fueling the engine that produces many more numerous new designs per year than Motorola. It is interesting to note that this is precisely the strategy now being undertaken by Daimler Chrysler to improve the joint success of its Mercedes and Chrysler car divisions. Nokia's ability to correctly perceive needs and rapidly deliver on them has solidified its place for the time being as market leader in cell phone sales. We should consider whether it would enjoy comparable success if its competitors had the ability to review its new product offers before their introduction, in some cases including the underlying cost estimates for the latest models. Nokia is not required to do so, and it is free to enjoy the benefits of its superior approach through superior market and financial results.

13. A second example will be familiar to those who have actively followed long distance market developments in the "Lower 48" states over the past decade. MCI has repeatedly bested its archrival AT&T with new marketing ideas and superior time-to-market delivery. For collect calls, it determined that the 800 numbers were available that corresponded to 1-800-COLLECT on the dial pad, and it rapidly moved this offer to market. AT&T appeared to be completely caught off guard, and with the numbers for the "COLLECT" offer now owned by MCI, it came up with a competing offer of 1-800-OPERATOR, which had considerably less cachet and probably was less easy for a consumer to recall. Based upon innovation and rapid delivery, MCI clearly won the time-to-market game, and it was rewarded appropriately in the marketplace. It is not clear who would have won this market skirmish if MCI had been required to share its plans with AT&T before market introduction.

14. Another MCI example that is relevant relates to its calling plan "Friends and Family", which leveraged flexibility in its new billing platform to permit discounted service to other MCI customers (i.e., friends and family). After introduction it took AT&T several years to produce a comparable offer, due to the greater challenge it experienced in making needed changes in its own billing platform. In this case MCI was amply rewarded in the market by excellence in time-to-market skills as well, and secrecy in preparing this market offer clearly worked to its advantage.

15 A third example deals specifically with the period of time a new consumer-related idea remains new and novel in the market, and thus the time an innovative company has available to recoup its investment in resources in this new offering. Even genuinely new product ideas may have a very short "shelf life" in which they retain special appeal in the market, and are either promptly imitated or rapidly go from fame to fad. Think of new consumer ideas such as Pet Rocks, Scooters, Hoola Hoops and Tickle-Me-Elmo dolls. Each had rapid market introduction and a single season of success, with a very limited time to recoup its investment in the new product. In all likelihood, the companies introducing these new products were more than adequately rewarded for their marketing flair with these products, although one wonders whether they would have been willing to share their ideas in advance with a set of key competitors before product introduction, or to bring these products to market if they had been required to do so. Even if they had chosen to proceed with market introduction following disclosure of their plans, the limited time they would have to recoup their investment with serious market competition would have been measurably diminished.

16. Finally, certain major companies make conscious choices about where to position themselves in the innovation and time-to-market game, and not all choose to be the "first mover". Certain companies have concluded that there is generally too much risk in being first to market with a new idea, and that a wiser choice is to let someone else spend the resource and do a market test of new ideas before they will spend significant resources on those concepts on their own. Microsoft and IBM are two prime examples here. Little of what either company introduces is first to market, but generally is inspired by efforts made by smaller competitors that are subsequently imitated after they first test the waters. Both have chosen to be "fast follower" instead of "first movers", and due to market force and sufficiently rapid response have won more than their share of battles over time. Again in this case the innovating company has the opportunity to bring a fresh approach to the marketplace and to have a corresponding head start in the race, without first reviewing its plans with its primary competitors.

17. Each of these cases above shows a different aspect of how time-to-market considerations contribute strongly to a company's competitive strategy, and in no case is a company normally required to share its market plans and strategy with its primary competitors before introduction of a new product and service. Companies that are successful in the time-to-market dimension take either calculated or more significant risk, but in every case they are free to earn the appropriate reward for risk-taking in the marketplace without sharing of critical market plan information.

IV. Product Differentiation

18. The second significant dimension of competitiveness relates to whether a company is able to develop and sell products and services that are different from those of

its competitors in meaningful ways. If all products and services within a specific category are fundamentally the same, then all that is left to differentiate them is price, and marketing people typically seek many additional ways in which to demonstrate the specific appeal of their products. This dimension of competitiveness is generally called product and service differentiation. We'll examine several ways in which differentiation is sought wit.. varying degrees of success within the telecommunications industry today.

19. Despite the fact that telecommunications providers offer very similar services, product differentiation is still possible. The specific way in which a service is packaged, offered and supported in the market does serve to differentiate it in the eyes of the typical consumer, and marketing groups for the service providers make every effort to make best use of this "product mix". Although price does remain the primary element of differentiation for most consumers, other attributes do play a role in the product mix. Some companies think of the total customer experience with a vendor as the real service that they are selling. In this case, attributes such as billing accuracy, speed of repair service efforts and courtesy and competence of customer service representatives are stressed as part of the total package.

20. Other approaches may attempt to stress the quality of the service itself. Consider the efforts of Sprint during the last decade to stress its superior voice quality, touting its "all fiber network" and asserting that "you can hear a pin drop". AT&T once claimed superiority of service based upon the shortest call setup time, which addresses the time between completion of dialing and connection to the called party. AT&T also makes a generalized claim to greater reliability of service, although data to support this claim are seldom offered. Innovative approaches to determining the product mix can also stress

inclusion of additional "external" benefits such as frequent flier miles, or selection of some special gift every quarter based upon the volume of service usage. Finally, innovative service providers have discovered that bundling of various telecommunications services into attractive packages has strong appeal to consumers, and bundled offers of local and long distance services have now become standard practice among leading service providers in the "Lower 48" states.

21. Although these are genuinely creative efforts to achieve product and service differentiation, there are generally no real barriers to adopting a competitors' chosen approach if it appears to be winning in the marketplace. Consider developments related to offering cellular telecommunications service in the "Lower 48" states as a useful example. Beyond selection of underlying CDMA versus GSM cellular network technologies, the service offered by all service providers is fundamentally similar. Efforts to differentiate individual service offers include the following. Cingular Wireless has adopted a plan where unused minutes from one month are "rolled over", to be used in subsequent months and never paid for and lost. Verizon Wireless has adopted a scheme where calls among family members signed up under the same collective family offer are not included within the total number of minutes permitted on a monthly basis, effectively making them free in cases where they would have exceeded the limit otherwise. Verizon has also claimed superiority in effective coverage within its service area, and Sprint has recently echoed this claim as well, although there is no apparent mechanism to validate or disprove either one's claim.

22. Various service providers make distinctions regarding night and weekend minutes versus "anytime minutes", and it is now becoming the norm to include "free" long

distance service as part of the premium cellular service offers. All major service providers claim to offer a service that is national in scope, accomplished by using their own facilities where they are available and reselling a competitors' service where they have none. Services related to the new third generation (3G) cellular networks are also evolving in similar fashions, including photo service, games, PDA functionality and internet access in addition to basic voice services.

23. The messages to be drawn from the intense competitive efforts of these cellular service providers are clear. Creative marketing will play a significant role in determining the ultimate victors in the marketplace, and new approaches such as bundling and creative connections to other services will be required. However, most marketing approaches could also be promptly replicated if they appeared to be winning efforts. Telecommunications service providers will continue to have every incentive to achieve product and service differentiation in ways that are most meaningful to their customers. In the case of cellular services in the "Lower 48", it would be regarded as an unnecessary burden and an impediment to open competition if these service providers were required to share their marketing plans with their competitors before introducing new services. They would rightfully ask what would be gained from such disclosure, other than valuable advanced notice to their competitors, and limits to their ability to achieve differentiation.

V. Efficiency

24. A third key dimension of competitiveness relates to the fundamental efficiency achieved in delivering the product or service that the company offers. In addition to the attributes of speed and agility noted above, another key measure of efficiency relates to the cost levels incurred by a company in providing these products and

services. A company's underlying cost structure is a prime determinant of both profitability and its competitive position in the marketplace. Clearly, companies with higher costs per unit of product sold either need to charge their customers more for the product, or to accept lower margins on the resulting sale. Accordingly, companies place intense focus on minimizing their underlying cost structure compared to their competitors in order to achieve competitive advantage.

25. Because of the central nature of costs to a company's competitive position, information regarding costs is typically closely held and seldom shared with anyone without an absolute need to know them. A company will publish its overall financial results in its annual reports and related financial statements, but it exercises considerable discretion about making statements of cost or profitability below aggregate levels. It may opt to break out financial results according to company division or product groups, in order to highlight superior performance in specific areas, but most major corporations choose to only make these statements at the aggregate level in order to protect this highly valuable, proprietary information.

26. In fact, greater degrees of disaggregation in available cost data offer increasingly greater potential value to a competitor. Such detail starts to provide intelligence on whether this competitor will be able to match a company's offer on a sustained basis in the marketplace, and on how a company needs to position its own products on a relative basis in the market. For instance, if you were aware that your costs for a specific product were 10% less than those of your competitor, you would know the precise price point at which it would be losing money by matching your own product offer.

27. Alternatively, if you knew that your competitor was pricing below its own average cost for some special product promotion, it would in all likelihood limit the time of this promotion in order to minimize the financial consequences. In another case, if you knew that your own costs were 10% higher than your competitor's on a unit cost basis, you would need to either accept lower margins by matching its price levels, or to convince your own customers that your product is justifiably priced at a premium over theirs due to effective differentiation. It is due to the significant value of cost information about a competitor's products that such significant efforts are directed toward reverse engineering them, as well as toward outright industrial espionage in some cases.

28. Accurate perceptions about costs will also drive significant business decisions and strategies for a company, and misperceptions about costs can also be highly damaging. AT&T for years undertook successive rounds of cost cutting in attempting to achieve the cost levels being publicly reported by Worldcom (now MCI). None of AT&T's business analysts or accountants could determine how it was possible for MCI to continue to make money with the service rates it was charging in the market, and the costs reported on its financial statements. It has now been fully reported how true costs were not disclosed by MCI for several years, although during this period AT&T undertook significant efforts to achieve cost parity based upon its best available intelligence at the time.

29. Without a doubt, companies in a competitive environment make significant efforts to both protect their own proprietary cost information, and to seek such information about competitors using available legal and sometimes other less wholesome methods. Accordingly, maintaining an appropriate competitive environment suggests the important

need to safeguard such proprietary information with all required diligence. If cost information continues to be an important topic of regulatory review, considerable efforts should be directed toward ensuring that it is not inadvertently shared with competitors.

VI. Conclusion

30. In summary, a significant degree of competition has now been introduced in the telecommunications market in Alaska and, to a lesser degree, throughout the U.S. As a consequence, consumers are beginning to reap the benefits of a considerably wider range of choices, resulting from an increased set of competitors constantly seeking better ways to serve them. The underlying dynamic of competitive markets will in most instances yield the desired results of increased choices at lower costs. In order to achieve this goal, however, it is imperative that companies be treated fairly and equitably, and they should also able to reap the rewards of creative marketing and innovation.

31. Where a competitive environment has been achieved, which has occurred in significant portions of Alaska, it is not clear what benefits a continued tariff review process would offer. Where tariff reviews are no longer needed, the distinction in treatment among different competitors loses relevance. As currently conducted, this review process only appears to slow the service introduction process, add associated costs, increase the workload of the commission, and raise the risks for seriously damaging information disclosure regarding the creative market plans and underlying cost structures of specific participants, especially ACS. Adopting the new paradigm of a detariffed environment where competitive conditions exist would be the most promising approach to achieving the desired benefits of competition, while at the same time permitting competitive parties to reap appropriate rewards for their innovative efforts.

32. This completes my Affidavit.

DATED this 11th day of August, 2003, at Morristown, New Jersey.

Hugh McKenna, Managing Director
Mountainside Enterprises

SUBSCRIBED AND SWORN to or affirmed before me this 11 day of August, 2003, at Morristown, New Jersey.

Notary Public in and for New Jersey
My Commission Expires Dec 20, 05

FARRAH J. BAUM
NOTARY PUBLIC OF NEW JERSEY
My Commission Expires Dec. 20, 2005

HUGH E. McKENNA
6 Mountainside Drive
Morristown, NJ 07960
(973) 267-7728
hugh.mckenna@att.net

SUMMARY

Versatile telecommunications and IT industry professional, seeks new consulting engagements and specialized contract work. Combines creativity with strong analytical skills, to address strategic, technical and operations analysis and management. Offers broad industry expertise with significant strength and proven track record in:

- New business development and technology assessment
- Operations and business process analysis
- Customer Relationship Management and effective customer service
- Wireless technologies and applications
- E-business software and services
- Professional market research

PROFESSIONAL EXPERIENCE

Mountainside Enterprises, Inc., Management Consulting (1998-Present)

- Prepared assessment of AT&T Laboratories software tool used to access information from targeted websites, to support competitive analysis, monitoring and surveillance purposes. Conducted market scan to determine capabilities of tools and techniques used for similar purposes, examined range of associated analytics needed to support advanced usage, and specified development program needed to support competitive market entry in 2003.
- Prepared Expert Witness testimony for use in class action suit in Alaska, related to bundling long distance and local telecommunications services offers into integrated offerings. Participated in development of litigation defense strategy. Will serve as Expert Witness during jury trial anticipated in 2003.
- Prepared strategic overview of emerging market and technical developments in the Customer Relationship Management (CRM) area, to support development of service offers for a new consulting practice for a rapidly growing telecommunications-based consultancy.
- Co-author of wireless industry analysis and market research report entitled *Wireless Applications: Strategies for Capturing the Business Market*, published in July, 2001 in collaboration with Phillips Infotech, Inc. Conducted interviews with fifteen leading industry services suppliers, and analyzed over eighty structured survey responses from corporate wireless customers. This report provides in-depth analysis of current wireless industry issues and trends, and identifies key success factors for major market participants.
- Developed detailed recommendations for SprintPCS to improve current approach to supporting Enterprise customers, related to integration of wireless and wireline offerings, targeting high value added Enterprise applications, and use of partners to support sales channel and systems integration requirements.
- Developed Local Access strategy to enable Teleglobe to enter new U.S. and European markets for wholesale and commercial IP and hosting services. Examined current marketing and operational processes supporting new market entry, including partnership strategy for obtaining leased fiber capacity. Assessed significant business development and partnership options to accelerate market entry and to augment existing Teleglobe capabilities.

- Program Manager for commercial services launch of iPlan Networks, a new ISP/CLEC in Buenos Aires, Argentina. Led team of seven Subject Matter Experts in defining information requirements and process flows for key operational areas. Issued and analyzed RFP's for operations and financial systems support, and assisted in refining product offers to ensure integration with operations support capabilities. Provided advice in key strategic areas. Instituted overall program management planning and tracking systems to ensure effective transition of capabilities to iPlan Networks management team.
- Provided technology and market assessment of various Korean products identified by government-sponsored export development agency (KIPA) for potential distribution in the US market. Identified appropriate market entry strategies for selected wireless and CRM products, and identified target US companies to approach for use as potential distribution channels.
- Developed comprehensive process model of Frame Relay and Private Line maintenance Call Centers, addressing incoming call handling, diagnostic and repair activities and expert systems software, to optimize overall center effectiveness. Placed special emphasis upon migrating customers to greater use of web-based self-servicing capabilities.
- Project Manager of AT&T and BellSouth assessment team, evaluating customized software supporting T-1 maintenance in future network environments.
- Engagement Leader for Call Center optimization project, addressing AT&T Metro Markets billing inquiry and trouble resolution processes. Directed extensive process work flow and systems analysis, stakeholder interviews, direct timing observations, structured workgroup sessions and Interactive Voice Response (IVR) assessment to identify recommended improvements in overall center management processes. Placed special emphasis on migrating customers to greater use of IVR and web-based self-servicing capabilities.
- Prepared detailed assessment of AT&T Metro Markets Local Fulfillment activities, supporting effective creation and validation of new customer orders for local service. Examined current process, systems and management decision rules to identify critical areas for immediate improvement. Supervised preparation of Microsoft Access database architecture to address key information needs for a streamlined Local Fulfillment process.
- Conducted overall assessment of Enterprise-level data integrity for a rapidly growing CLEC (McLeodUSA). Participated with team of analysts to address current data inconsistencies among network, customer provisioning and billing systems, and provided longer-term process-based improvements to ensure superior data integrity levels in the future.

AT&T Corporation

Business Development Director-Local Service Organization (1996-1998)

- Successfully negotiated operations and technical serving arrangements with numerous Competitive Local Access Providers, to supply dedicated and switched access in support of local market entry.
- Led operations and technical assessment of 38 GHz, LMDS and MMDS wireless technologies for use within local services. Prepared overall assessment of wireless options to replace RBOC resale arrangements (Total Services Resale and Unbundled Network Elements), or to use in place of other key technologies (Hybrid Fiber-Coax, Digital Subscriber Line). Established approved technology road map for use of key wireless technologies.
- Led in-depth analysis of strategic business development options in local markets. Addressed preferred partnering arrangements with cable companies, utilities and new wireless entities, including the full range of contractual, franchising, equity-based and acquisition options.
- Managed group with primary business development and service contract negotiation responsibilities for Western U.S., and also included responsibilities for numerous national service suppliers (MCI, WinStar, Time Warner Cable).

Product Development Manager-AT&T Solutions (1994-1996)

- Directed comprehensive customer needs assessment for new Managed Network Services and Outsourcing offers. Identified required technical and feature/function improvements beyond existing offers. Developed and introduced specialized MNS and Outsourcing offers for middle-market customers.
- Defined overall capability requirements for AT&T Solutions' new Network Management and Outsourcing practice. Performed detailed benchmarking of targeted capabilities compared to key strategic competitors. Introduced initial service offers to Global 2000 target customers.
- Identified Merger and Acquisition requirements to support Network Management and Outsourcing practice. Directed financial and operational assessments of partnering options and service deployment scenarios. Conducted initial M&A discussions with potential partners (Accenture, CompuCom, Vanstar).
- Identified Supply Chain Management solutions for Logistics and Transportation industries, utilizing emerging Internet and AT&T-internal capabilities.

Market Development Manger-Business Communications Services (1991-1994)

- Conducted primary market research addressing Health Care and Insurance industry information technology applications. Prepared integrated product/service offers for leading industry customers (Blue Cross/Blue Shield, Travelers Insurance)
- Managed strategic, financial and technical assessment of $250M Electronic Claims Processing joint venture with leading Health Care systems group (Shared Medical Systems). Presented joint venture plans and obtained approvals up through Vice-Chairman level.
- Prepared specialized value-added data communications services for the Health Care and Insurance industries. Defined market and technical requirements, and managed related Bell Labs development.
- Examined the full range of partnership proposals received by AT&T to create business development partnerships in the services area. Prepared detailed analysis of potential partnership with The New York Times, to create an electronic information service to be deployed on a national basis.

Strategic Planning Manager-Corporate Strategy & Development (1987-1991)

- Identified requirements to increase corporate emphasis on Data Networking capabilities, and to make a major computer industry acquisition.
- Guided development of AT&T's international market development strategy.
- Assessed joint venture and acquisition options in Far East. Supported discussions with potential key alliance partner (Fujitsu).
- Created and deployed interactive, high-tech executive decision support system (Situation Room)
- Conducted numerous in-depth strategic analyses (Data Networking Strategy, PBX spin-off options, HDTV implications and requirements). Resulted in AT&T retention of $6B PBX business and intensified focus on corporate HDTV initiatives.

Additional experiences include:

- Developed and taught Financial Analysis courses.
- Prepared business case analyses related to international product development and market entry.
- Prepared organizational design recommendations for significant Bell System reorganization.
- Completed various operations planning and engineering assessments, evaluating operational and economic impact of proposed network and software upgrades.
- Created overall data model to address Business Marketing information requirements.

EDUCATION

M.B.A. Cornell University, Ithaca, New York. Finance concentration, *With Distinction (top 10%)*
B.A. University of Notre Dame, South Bend, Indiana. Double major in Economics and French, *Cum Laude (top 15%)*

Additional Honors Programs:

L'Universite Catholique de l'Ouest, Angers, France. Completed one-year honors program conducted entirely in French language.
Clarkson College of Technology, Potsdam, New York. National Science Foundation advanced mathematics and science program.

15

STATE OF ALASKA

THE REGULATORY COMMISSION OF ALASKA

Before Commissioners:

Mark K. Johnson, Chair
Kate Giard
Dave Harbour
James S. Strandberg
G. Nanette Thompson

In the Matter of the Commission Review of Rules and Regulations Governing Telecommunications Rates, Charges Between Competing Telecommunications Companies, and Competition in Telecommunications	)	Docket No. R-03-3

AT&T ALASCOM'S REPLY COMMENTS

I. INTRODUCTION

AT&T Alascom has reviewed the comments filed by other parties and will focus its written reply comments on a few issues that are most important to it in its dual capacity as a long distance carrier (or inter-exchange carrier "IXC") and a competitive local exchange carrier. As the incumbent long distance carrier, AT&T Alascom is most directly concerned with Legislative Policy No. 2 (determination of dominance and non-dominance) and Legislative Principle No. 3 (prohibition on placing incumbent at unfair competitive disadvantage) and Principle No. 6 (encouragement of infrastructure development). AT&T Alascom's reply comments as an IXC argue in favor of a new regulation on dominance, creation of a competitively neutral fund to support facilities-

ASHBURN & MASON
LAWYERS
A PROFESSIONAL CORPORATION
SUITE 100
1130 WEST SIXTH AVENUE
ANCHORAGE, ALASKA
99501-6914
(907) 276-4331
FAX (907) 277-8235

based Bush service, and, in appropriate circumstances, shared Carrier of Last Resort ("COLR") responsibilities.

As a competitive local exchange carrier, AT&T Alascom is primarily concerned with Policy No. 1 (mandating fair payment for use of another carrier's facilities) and Policy No. 4 (considering the existence of actual competition before relaxing regulations). AT&T Alascom's reply comments on the local exchange rules argue in favor of maintaining the availability of unbundled network elements ("UNEs") from the incumbent local exchange carrier ("ILEC") at a fair and reasonable price in accordance with the Telecommunications Act of 1996.

II. IXC ISSUES

A. A New Approach To Dominance Is Necessary

In Policy No. 2, the Legislature clearly states that the fact that a carrier in a competitive market is the incumbent carrier is not relevant in determining whether or not it is dominant. Yet, today in contravention to Policy No. 2, AT&T Alascom is regulated as dominant just for being the incumbent IXC. *See* 52.363(b). Overwhelmingly, the facts do not support AT&T Alascom's classification as a dominant carrier. Over 10 years after intrastate competition began, and eight years after AT&T Alascom was considered by the FCC to be non-dominant for most interstate services, there is no other basis on which AT&T Alascom could be considered to possess market power or to require regulation as the dominant carrier.

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In 2002, AT&T Alascom's statewide total IXC market share had dropped to 42 percent.[1] In 1995, when the FCC reclassified AT&T Corp. as non-dominant, AT&T had a market share of 60 percent. *See*, In Re Motion Of AT&T Corp. To Be Reclassified As A Non-Dominant Carrier, Order dated October 12, 1995 ("Reclassification Order"), at ¶ 67.

Changing circumstances make AT&T Alascom no longer a dominant carrier even for transport. In 1991 AT&T Alascom was designated as dominant. Since then, however, AT&T Alascom's share of the transport capacity in the state has declined dramatically. In addition to the high capacity GCI and WCI undersea cables, there has been substantial new development of fiber optic capacity since 1995 within Alaska. Fiber optic cable systems have been built by Alaska Fiberstar ("AFS"), which is part of the WCI system, and KANAS, Inc., a consortium of Alaska Native Corporation, and MFS, Inc. The AFS facility, controlled by ACS, connects Anchorage and Fairbanks, as well as Eagle River, Wasilla, Talkeetna, Cantwell, Healy, Clear, and Nenana, and through WCI, provides direct interconnection among these Alaska locations, Seattle, Washington and Portland, Oregon. The KANAS facility, which is now owned and operated by GCI, runs along the 800-mile TransAlaska Pipeline connecting Valdez with Prudhoe Bay and providing interconnection at numerous places along that route. Additional fiber optic cable systems have been installed or are being installed between Klawock and Craig and Hollis; Fairbanks and Ft. Graham, Gilmore Creek, and the Delta Junction / Poker Flats area; Homer and Soldotna and Moose Pass; and Anchorage and

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[1] Bearing Point Study, page 17.

Wasilla. These projects are examples of entirely new fiber optic deployment since 1995. In addition, GCI has recently announced plans to build a new fiber link to the Lower 48, to be completed by summer, 2004.

Also, AT&T Alascom is not the only company that has deployed a satellite to serve Alaska. Although AT&T Alascom has taken the (expensive) steps necessary to ensure the continuity of satellite service to Alaska, other satellites now also provide service coverage to Alaska, separate from Alascom. For example, in January 2000, Galaxy-10 was launched, a satellite that provides GCI with both C-band and Ku-band capacity. Generally speaking, all geostationary satellites located west of 199 degrees west longitude have the capability to serve Alaska. Presently, the domestic satellites permanently in these positions include: Galaxy-9, Galaxy-5, Satcom C-3, Galaxy-1R, Satcom C-4, Satcom C-1, and Aurora II (also known as Satcom C-5). Certain international satellites could provide service to Alaska, at least in part, and most or all non-geostationary satellite systems which offer world-wide coverage also provide the potential for service to Alaska. Therefore, there are numerous alternative satellite facilities potentially available to entities seeking to compete in Alaska. The deployed satellites are able to offer Alaska consumer services such as email, voice over IP calls, and mobile phones.

As an IXC, AT&T Alascom provides three general categories of service: Message Toll Service (MTS), private line dedicated service, and wholesale service.

Message Toll Service. While it is true that there are multiple Bush locations where AT&T Alascom has the only MTS facilities, those locations combined represent a

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mere 10 percent of the access lines in Alaska.[2] Moreover, equal access is available and functional for the vast majority of access lines in the state, and is available, should a carrier request it, everywhere in Alaska, permitting GCI and other IXCs to offer competitive MTS service in Bush locations. In addition, a significant change in the treatment of MTS service in Bush areas has occurred. In 2000, the RCA lifted the intrastate "facilities restriction" in Bush Alaska that had prevented other carriers from building facilities. *See*, R-98-1(6). Now, the FCC has done the same for interstate. *See* FCC Press Release, attached as Exhibit A. The FCC's written order to this effect was issued August 12, 2003, and is attached to these comments as Exhibit B. As a result, AT&T Alascom no longer has a legal monopoly on MTS facilities in Bush Alaska. Should a carrier wish to build there it will be fully able to do so. This action by the FCC eliminates the last remaining justification for maintaining the anticompetitive, discriminatory treatment of one carrier over another in the interexchange market in Alaska.

Even more importantly, if no other carrier ever builds MTS facilities in these locations, AT&T Alascom cannot exploit these Bush facilities to raise MTS rates *because of the legal requirement that all MTS rates must be geographically averaged.* Customers calling to and from Bush locations pay the same rates as customers living in urban Alaska and calling on high-density routes. If AT&T Alascom tried to raise its rates to exploit its alleged facilities bottleneck, its urban market share would erode still further. AT&T

[2] By comparison, incumbent LECs have control of bottleneck facilities – local loops – that affect competitive access to 100 percent of the market.

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Alascom has zero ability to exercise market power by virtue of its ownership of Bush facilities. On the contrary, the expense of maintaining these facilities actually impedes AT&T Alascom's ability to compete statewide and to earn a profit. They detract from market power; they do not enhance it.

Private Line. It has been argued in the past that private line rates are not geographically averaged, therefore AT&T Alascom must have market power in the private line product market in those Bush locations where it has the only facilities. That is untrue or irrelevant for a variety of reasons. First, there are not now, nor have there been, legal barriers to entering the private line market. The fact that GCI has done so with great success illustrates the benefits of a fully competitive marketplace. The federal Bush facilities restriction (which AT&T Alascom has actively sought to eliminate at the FCC) never has prohibited GCI from installing private line facilities in the Bush. GCI has exploited this fact by skillfully and aggressively pursuing the largest private line customers, the rural health care providers, which it serves with its Ku-Band Satellite facilities. Second, AT&T Alascom has repeatedly committed in Docket R-98-1 and in public testimony, and hereby recommits, to cap its private line rates at current levels, preventing it from exercising any market power it might be perceived to have. Finally, it is important that the Commission not let the proverbial "tail wag the dog." There is only a small number of private line customers in the tiny villages where AT&T Alascom has the only facilities, and these limited number of customers do not give AT&T Alascom overall market power.

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Wholesale. In the wholesale market, AT&T Alascom offers its retail business services to carriers for resale statewide (even in the extraordinarily high-cost Bush communities where it has the only MTS facilities) at pennies above *access* costs. Moreover, AT&T Alascom has pledged, and hereby recommits, to cap its wholesale rates at existing levels, thereby eliminating any conceivable concern that it could somehow use its control of any perceived "bottleneck" or "essential facilities" it might have to raise prices to its wholesale carrier customers.[3]

By mentioning these facts, AT&T Alascom does not intend to argue in this regulatory docket its case whether it, as an individual carrier, should or should not be deemed dominant. It believes, however, that these background circumstances are important for the Commission to understand when it considers the need for, and structure of, a new regulation on interexchange dominance. The abstract economic concepts in the proposed regulation have more meaning when considered in the context of real markets.

GCI's proposed dominance regulation, set forth on page 14 of its initial comments, is not a bad first effort. As proposed by GCI, however, the test of market power is overly simplistic, inconsistent with the FCC's approach, and could cause AT&T Alascom to continue to be regulated as dominant in the long distance market for improper reasons. For many years now, GCI has thrived in the telecommunications market in Alaska, where it enjoys non-dominant status and competes against carriers that are

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[3] Wholesale rates are almost exclusively used by carriers who do not wish an end-to-end service such that CustomNet-type services offer, but instead wish the call to be carried either at the originating or terminating leg on their network.

burdened with onerous dominant carrier obligations that GCI does not have. Adoption of GCI's modification of 3 AAC 52.363, as proposed, could perpetuate that imbalance.

AT&T Alascom believes strongly that any rewrite of 3 AAC 52.363 must expressly recognize critical factors that can mitigate or eliminate altogether market power that a carrier might otherwise possess. Geographic rate averaging is a prime example. In the AT&T Reclassification Order at ¶¶ 107-115, 146, the FCC expressly acknowledged the relationship between geographic rate averaging and non-dominant status. Any dominance regulation adopted by this Commission must necessarily recognize geographic averaging as a key factor in the market power analysis. GCI's proposal would perpetuate dominance regulation for an incumbent controlling even a single "bottleneck" facility, but absolutely no ability to exercise market power. For that reason, the Commission should look towards *market power* as the test for dominance, and not historical incumbency or control of a single bottleneck facility.

AT&T suggests that one way the Commission may use this market power test is by examining, on a confidential basis, the *market share* of each competitor in a segment of telecommunications industry. The FCC has also taken a practical and balanced approach to dominance issues. It looks at markets in their entirety and does not impose burdensome dominant carrier regulation where some *de minimus* or discrete market segment may not be completely competitive. *See* AT&T Reclassification Order, ¶¶ 20-21, 26 (noting in ¶ 26 that "addressing AT&T Alascom's market power by an "all-services" standard (i.e., requiring AT&T Alascom to establish that it lacks the ability to

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control price in all service segments), would result in a situation where the economic costs of regulation outweighs its public benefits.

The FCC does not insist on perfection either. In its decision to classify the Bell operating companies ("BOCs") as non-dominant in the provision of both in-region and out-of-region long distance services, the FCC stated:

> The actions we take in this proceeding will further the pro-competitive, deregulatory objectives of the 1996 Act by eliminating unnecessary regulation that is currently imposed on interexchange carriers affiliated with BOCs and independent LECs. Although we are classifying these carriers as non-dominant with respect to their provision of in-region and out-of-region long distance services, as summarized above, we recognize that as long as these carriers retain market power in providing local exchange and exchange access services, they will have some incentive and ability to misallocate costs to local exchange and exchange access services, they will have some incentive and ability to discriminate against their long distance competitors, and to engage in other anticompetitive conduct. We conclude, however, the regulatory structure we adopt today will continue the process of enhancing competition in all telecommunications markets as envisioned by the 1996 Act.[4]

In revising GCI's draft regulation, AT&T Alascom has attempted to make it more accurately reflect the analytical process that the FCC uses in its dominance and market power analyses. AT&T Alascom's improvements include:

(1) reversal of the presumption in subsection 363(c) that the incumbent remains dominant until proven otherwise, which conflicts with Legislative Policy No. 2;

(2) the explicit mention of mitigating factors like geographic averaging and price caps[5]

(3) consideration of the capabilities of the competing firms;

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[4] In Re Regulatory Treatment Of LEC Provision Of Interexchange Services Originating In The LEC's Local Exchange Area, 2d Report & Order CC Doc. 96-149; Third Report & Order CC Doc. 96-61, ¶ 10.

[5] *See*, AT&T Alascom Reclassification Order, at ¶¶ 10, .

(4) reference to the interexchange "market as a whole" to avoid the problem of the tail wagging the dog, which we confront today;

(5) consideration of the magnitude of the impact of any bottleneck facilities (e.g., an ILEC's 100 percent vs. AT&T Alascom's 10 percent);

(6) deletion of GCI's all or nothing idea that owning a single bottleneck facility, however, insignificant, constitutes prima facie evidence of market power; and

(7) addition of a mandatory cost-benefit analysis.

AT&T Alascom suggests that the GCI proposal to add three subsections to 3 AAC 52.363 should be modified to read as follows:

> (b) When the commission grants a certificate of public convenience and necessity to provide intrastate interexchange service, the commission shall determine whether or not the carrier should be classified as dominant or non-dominant.
>
> (c) Within 180 days after the adoption of this regulation, the commission will determine whether or not any carrier holding a previously issued certificate for intrastate interexchange service should be designated as dominant.
>
> (d) In its determination of whether or not a carrier should be designated as dominant or non-dominant, the commission must first determine whether the carrier possesses market power. In making that determination, the commission shall determine the relevant product market and the relevant geographic market and shall consider the following factors in the relevant product and geographic market: the market share of the carrier; the number, size distribution and capability of competing firms; the existence and nature of barriers to entry in the market as a whole; the availability of reasonably substitutable service; whether the carrier controls any bottleneck or essential facilities affecting participation in a substantial component of the relevant market; and the presence or absence of factors that restrain the exercise of market power, such as geographic rate averaging, voluntary or mandatory rate caps, and similar safeguards.
>
> (e) If the commission determines that a carrier possesses market power, before designating the carrier as dominant, the commission must

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> consider whether the threat of harm from such market power is sufficiently great to justify the costs that dominant carrier regulation would impose on the carrier.

AT&T Alascom believes that this proposed regulation more accurately captures the analytical method used by the FCC. It also recognizes the complexity of the market power analysis and the need to balance the benefits of regulation against its costs. AT&T Alascom urges the Commission to give AT&T's proposal its careful consideration.

B. A Bush IXC Subsidy Would Be The Best Way To Encourage Infrastructure Development

In its initial comments, AT&T Alascom advocated adopting new regulations creating the competitively neutral Bush IXC subsidy that is authorized by AS 42.05.840.[6] AT&T Alascom argued that the creation of such a fund would be the best response to the Legislature's *imprecation* to the RCA to encourage development of a modern telecommunications infrastructure.

AT&T Alascom was pleased to find support for is proposal in Professor Dale Lehman's Affidavit. Exhibit B to ACS Comments. Dr. Lehman states:

> In the past this "carrier-of-last-resort" (COLR) responsibility has resided with the "dominant" or incumbent provider. In a competitive market, COLR cannot rest with one provider that is trying to compete with providers that do not have these costly obligations. The COLR responsibility requires a competitively neutral funding mechanism.

As AT&T Alascom's earlier comments illustrate, the COLR obligation to serve roughly 150 high-cost, low-revenue Bush communities is not a bottleneck to be exploited

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[6] AS 42.05.840 provides: The commission may establish a universal service fund or other mechanism to be used to ensure the provision *of long distance telephone* service at reasonable rates throughout the state and to otherwise preserve universal service. [Emphasis added.]

by AT&T Alascom, it is an old regulatory loophole that is exploited by AT&T Alascom's competitors. When they have finished cherry-picking the most lucrative, federally subsidized customers in these locations (*e.g.*, schools, libraries and health care facilities), GCI and other IXCs have no incentive to construct long distance MTS facilities. As the COLR, AT&T Alascom is required to incur the disproportionate cost of serving these locations and, as its reward, it is regulated as dominant, which imposes still greater costs.[7] It is a cycle with no balance or logic. Under these circumstances, AT&T Alascom has no financial incentive to invest in modern infrastructure. Current regulations are completely at odds with the *Legislative principles.*

A competitively neutral funding mechanism—based on forward-looking costs and equally available to all IXCs that construct Bush facilities—is the only feasible way to encourage rural infrastructure development. The APUC's well-intended Bulk Bill weighting scheme was not an effective compensation for AT&T Alascom's COLR obligations. Now that it has been repealed, a new, more effective solution is required.

AT&T Alascom recognizes the complexities involved in creating such a mechanism. There are several ways to go about it and AT&T Alascom is not wedded to the methods it has suggested in the past. AT&T Alascom would be satisfied if one result of this docket were an Order from the Commission clearly stating its intention to create such a fund as part of the Alaska Universal Service Fund, describing the goal of such a fund, and directing the Commission Staff to convene an industry workshop to develop a workable proposal within a specified deadline.

[7] AT&T Alascom estimates that the accounting and reporting costs caused by its dominant carrier status,

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C. Sharing Of COLR Responsibilities

In addition to the Bush IXC fund, another method of encouraging Bush infrastructure development could be the sharing of COLR obligations in certain circumstances. As AT&T Alascom has repeatedly stated, it has no intention of abandoning Bush Alaska. It does believe, however, that a competitively neutral sharing of the burden could be beneficial. If the responsibility for serving the smallest communities were borne proportionately by GCI and the other IXCs, for example, AT&T Alascom would be able to free up resources to better serve those areas allocated to it. Additionally, communities in the Bush would receive the benefit of relying on multiple carriers.

III. LOCAL EXCHANGE ISSUES

A. Implementation of Legislative Policy No. 1

Legislative Policy No. 1 provides that,

> There shall be fair payment by a user carrier for use of another carrier's equipment and facilities, including existing and newly constructed equipment and facilities.

"Fair payment" is assured through compliance with federal costing standards. Indeed, federal law requires nothing less.

The Telecommunications Act of 1996 provides that.

> Determinations by a State commission of the just and reasonable rate for the interconnection of facilities and equipment for purposes of subsection (c)(2) of section 251, and the just and reasonable rate for network elements for purposes of subsection (c)(3) of such section--

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not borne by any of its competitors, are from $3 – 5 million per year.

(A) shall be—

(i) based on the cost (determined without reference to a rate-of-return or other rate-based proceeding) of providing the interconnection network element (whichever is applicable), and

(ii) nondiscriminatory, and

(B) may include a reasonable profit.[8]

In its August 8, 1996 *First Report and Order*,[9] often referred to as the "Local Competition Order," the Federal Communications Commission ("FCC") established the applicable costing standard to implement Congress' "pro-competition" goal in passing the Telecommunications Act of 1996.[10] Pursuant to this standard, state public utility commissions may not set prices lower than the forward-looking incremental costs directly attributable to provision of a given element, and may not set prices higher than that cost plus "a reasonable share of forward-looking joint and common costs of network elements."[11]

Specifically, federal regulations provide that the UNE rates of incumbent carriers *shall* comply with the FCC's "forward-looking economic cost-based pricing methodology."[12] The FCC explained that this methodology,

> best replicates, to the extent possible, the conditions of a competitive market. In addition, a forward-looking cost methodology reduces the

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[8] 47 U.S.C. § 252(d)(1).
[9] First Report and Order, *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996 (CC Docket No. 96-98); Interconnection between Local Exchange Carriers and Commercial Mobile Radio Service Providers (CC Docket No. 95-185)*, FCC No. 96-325 (rel. Aug. 8, 1996) (hereinafter "Local Competition Order").
[10] Local Competition Order ¶ 618.
[11] Local Competition Order ¶ 620.
[12] 47 C.F.R. § 51.503(b)(1).

> ability of an incumbent LEC [local exchange carrier] to engage in anti-competitive behavior. Congress recognized in the 1996 Act that access to the incumbent LECs' bottleneck facilities is critical to making meaningful competition possible. As a result of the availability to competitors of the incumbent LEC's unbundled elements at their economic cost, consumers will be able to reap the benefits of the incumbent LECs' economies of scale and scope, as well as the benefits of competition. Because a pricing methodology based on forward-looking costs simulates the conditions in a competitive marketplace, it allows the requesting carrier to produce efficiently and to compete effectively, which should drive retail prices to their competitive levels. We believe that our adoption of a forward-looking cost-based pricing methodology should facilitate competition on a reasonable and efficient basis by all firms in the industry by establishing prices for interconnection and unbundled elements based on costs similar to those incurred by the incumbents, which may be expected to reduce the regulatory burdens and economic impact of our decision for many parties, *including both small entities seeking to enter the local exchange markets* and small incumbent LECs.[13]

Generally, the FCC's forward-looking economic cost of an element equals the sum of (1) the Total Element Long run Incremental Cost (TELRIC) of the element, and (2) a reasonable allocation of forward-looking common costs.[14] The TELRIC of an element is "the forward-looking cost over the long run of the total quantity of the facilities and functions that are directly attributable to, or reasonably identifiable as incremental to, such element, calculated taking as a given the incumbent LEC's [local exchange carrier's] provision of other elements."[15]

Critically, the TELRIC of an element "should be measured based on the use of *the most efficient telecommunications technology currently available* and *the lowest cost network configuration*, given the existing location of the incumbent LEC's wire

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[13] Local Competition Order ¶ 679 (footnote omitted).
[14] 47 C.F.R. § 51.505(a).
[15] 47 C.F. R. § 51.505(b).

centers."[16] In other words, UNE prices should be "based on costs that assume that wire centers will be placed at the incumbent LEC's current wire center locations, but that *the reconstructed local network* will employ *the most efficient technology* for reasonably foreseeable capacity requirements."[17]

FCC regulations specify that "embedded costs" and "retail costs" "shall not be considered in a calculation of the forward-looking economic cost of an element...."[18] "Embedded costs" are defined as "the costs that the incumbent LEC incurred in the past that are recorded in the incumbent LEC's books of accounts."[19] "Retail costs include the costs of marketing, billing, collection, and other costs associated with offering retail telecommunications services to subscribers who are not telecommunications carriers...."[20]

Incumbent carriers immediately and repeatedly challenged the FCC's cost standard. The incumbents argued that the FCC's standard resulted in costs that are too low because it is based on a "hypothetical" "most efficient" network, not the incumbents' "actual" network. The United States Supreme Court resoundingly rejected this argument:

> As for an embedded-cost methodology, the problem with a method that relies *in any part* on historical cost, *the cost the incumbents say they actually incur in leasing network elements*, is that it will pass on to lessees the difference between most-efficient cost and embedded cost. *Any such cost difference is an inefficiency*, whether caused by poor management resulting in higher operating costs or poor investment strategies that have inflated capital and depreciation. *If leased elements were priced according to embedded costs, the incumbents could pass these*

[16] 47 C.F.R. § 51.505(b)(1) (emphasis added).
[17] Local Competition Order ¶ 685 (emphasis added).
[18] 47 C.F.R. § 51.505(d).
[19] 47 C.F.R. § 51.505(d)(1).
[20] 47 C.F.R. § 51.505(d)(2).

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> *inefficiencies to competitors in need of their wholesale elements, and to that extent defeat the competitive purpose of forcing efficient choices on all carriers whether incumbents or entrants. The upshot would be higher retail prices consumers would have to pay.*
>
> There are, of course, objections other than inefficiency to any method of ratemaking that relies on embedded costs as allegedly reflected in incumbents' book-cost data, with the possibilities for manipulation this presents. Even if incumbents have built and are operating leased elements at economically efficient costs, the temptation would remain to overstate book costs to ratemaking commissions and so perpetuate the intractable problems that led to the price-cap innovation.[21]

The United States Supreme Court explained that the Act establishes a "novel ratesetting *designed to give aspiring competitors every possible incentive to enter local retail telephone markets*, short of confiscating the incumbents' property."[22] The Court observed that "Congress called for ratemaking different from any historical practice, to achieve the entirely new objective of *uprooting the monopolies that traditional rate-based methods had perpetuated.*"[23] "For the first time, Congress passed a ratesetting statute *with the aim* not just to balance interests between sellers and buyers, but *to reorganize markets by rendering regulated utilities' monopolies vulnerable to interlopers*, even if that meant swallowing the traditional federal reluctance to intrude into local telephone markets."[24]

This remarkable departure was described by one leading Senate supporter as follows:

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[21] Verizon Comm. Inc. v. FCC, 122 S.Ct. 1646, 1673 (2002) (emphasis added; citations and footnote omitted).
[22] Verizon, 122 S.Ct. at 1661 (emphasis added).
[23] Verizon, 122 S.Ct. at 1660 (*citing* H.R. Conf. Rep. No. 104-230, p. 113 (1996)) (emphasis added).
[24] Verizon, 122 S.Ct. at 1661 (emphasis added).

> This is extraordinary in the sense of telling private industry that this is what they have to do in order to let the competitors come in and *try to beat your economic brains out*.... [¶] It is kind of almost a *jump-start... I will do everything I have to let you into my business*, because we used to be a bottleneck; we used to be a monopoly; we used to control everything. [¶] Now, this legislation says you will not control much of anything....[25]

To achieve these purposes, Congress established "a hybrid jurisdictional scheme with the FCC setting a basic, default methodology for use in setting rates when carriers fail to agree, but leaving it to state utility commissions to set the actual rates."[26] The RCA is required by federal law to adopt UNE prices that comply with these mandates.

Despite these clear mandates of federal law, ACS requests that the RCA reject forward-looking cost models and instead "begin with a rebuttable presumption of ILEC efficiency."[27] Such an approach would be a clear violation of the FCC's TELRIC rules which, as described above, require the TELRIC of an element "be measured based on the use of *the most efficient telecommunications technology currently available* and *the lowest cost network configuration*, given the existing location of the incumbent LEC's wire centers."[28] In other words, UNE prices cannot be based on the ILEC's embedded network and practices, but instead must be "based on costs that assume that wire centers will be placed at the incumbent LEC's current wire center locations, but that *the reconstructed local network* will employ *the most efficient technology* for reasonably foreseeable capacity requirements."[29]

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[25] Verizon, 122 S.Ct. at 1661 (*quoting* 141 Cong. Rec. 15572 (1995), Remarks of Sen. Breaux (La.) on Pub.L. 104-104 (1995)).
[26] Verizon, 122 S.Ct. at 1661.
[27] ACS Comments, p. 20.
[28] 47 C.F.R. § 51.505(b)(1) (emphasis added).
[29] Local Competition Order ¶ 685 (emphasis added).

ACS' request turns TELRIC on its head. Creating a rebuttable presumption that ILECs are efficient would in effect create a rebuttable presumption that the ILECs' embedded costs are efficient. But this is expressly forbidden by the FCC's rules, which list embedded costs as a "factor" that "*shall not be considered*" in applying TELRIC.[30]

Incredibly, ACS claims that "[t]he ILEC's embedded cost is not a precluded consideration," and that "[e]mbedded cost is the 'actual cost' of service."[31] But, in reality, embedded cost *is* a precluded consideration. Again, the FCC's regulations plainly state that "embedded costs" "*shall not be considered* in a calculation of the forward-looking cost of an element...."[32] The FCC could not have made it clearer.

ACS again requests the RCA to violate federal law when it asks that costs be based only on technology "actually deployed by the provider."[33] As indicated above, the FCC's TELRIC rules require costs to be based on the "use of the most efficient telecommunications technology *currently available*."[34]

AT&T Alascom respectfully requests that the RCA reject the regulations proposed by ACS on this issue in their entirety because they are based on a gross misinterpretation of, and would be clearly contrary to, federal law. Indeed, the regulations proposed by ACS are similar to legislation recently advocated by SBC Communications, Inc. in Illinois. Upon review, that legislation was found by the Federal District Court to conflict with federal law. The District Court noted that "incumbent

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1130 WEST SIXTH AVENUE
ANCHORAGE, ALASKA
99501-5914
(907) 276-4331
FAX (907) 277-8235

[30] 47 C.F.R. § 51.505(d)(1).
[31] ACS Comments, p. 20.
[32] 47 C.F.R. § 51.505(d)(1) (emphasis added).
[33] ACS Comments, p. 20.
[34] 47 C.F.R. § 51.505(b)(1) (emphasis added).

LECS can only recover costs that an efficient provider would incur in providing the network elements irrespective of the costs of their actual practices."[35] It elaborated,

> The Illinois legislation conflicts with federal law in several respects. The legislation orders the ICC [Illinois Commerce Commission] to determine fill factor and depreciation costs based on SBC's actual fill and depreciation as accounted to the SEC. FCC Rule 51.505 clearly bars any such emphasis on the incumbent's actual practices. 47 C.F.R. § 51.505. Under TELRIC, element costs can only be based on a hypothetical efficient provider's costs determined on a forward-looking basis. *Id.* The FCC rule instructs the ICC to look at a hypothetical efficient provider's costs rather than SBC's actual costs. 47 C.F.R. § 51.505. The Illinois legislature then tells the ICC to use SBC's actual costs as the most reasonable projection of a hypothetical efficient provider's costs. 220 ILCS 5/13-408(a)-(b). Thus section 408 [of the legislation] completely reads out the hypothetical efficient provider standard from TELRIC. The Illinois legislation has, by fiat, rendered TELRIC irrelevant with respect to two key factors in the rate setting exercise.[36]

In sum, the District Court held that the Illinois legislation conflicted with federal law because "[t]he methodology to be used in federal rate determinations is eviscerated – TELRIC is effectively repealed."[37] ACS' proposed regulations would achieve the same result.

AT&T Alascom intends to provide further comment on this issue in subsequent phases of this proceeding.

B. Implementation of Legislative Policy No. 5

Legislative Policy No. 5 provides,

> Any method of depreciation used by the commission shall consider the actual useful life of depreciated equipment and facilities.

ASHBURN & MASON
LAWYERS
A PROFESSIONAL CORPORATION
SUITE 100
1130 WEST SIXTH AVENUE
ANCHORAGE, ALASKA
99501-3914
(907) 276-4331
FAX (907) 277-8235

[35] Voices for Choices v. Illinois Bell Telephone Co., Inc. (03 C 3290). *slip opinion*, p. 5 (N. Dist. Ill.) (June 9, 2003) (attached as Exhibit C).
[36] Voices for Choices, p. 9.
[37] Voices for Choices, p. 14.

ACS appears to suggest that the RCA use some form of financial depreciation lives based on ACS' actual practices - either lives reported to the Internal Revenue Service ("IRS") or the Securities and Exchange Commission ("SEC"). Either approach would violate federal law.

Again, a similar tactic was attempted by SBC Communications in Illinois. The Illinois legislation advocated by SBC mandated the use of the depreciation costs SBC reports to the SEC. The District Court held this was contrary to federal law because depreciation "must be based on a hypothetical efficient incumbent LEC's practices rather than SBC's actual practices."[38] In striking down the Illinois legislation, the District Court noted that "FCC Rule 51.505 clearly bars any such emphasis on the incumbent's actual practices."[39] Similarly, basing depreciation on ACS' actual practices with either the IRS or the SEC would contravene federal law.

AT&T Alascom intends to provide further comment on this issue in subsequent phases of this proceeding.

C. Implementation of Legislative Policy No. 7

Legislative Policy No. 7 provides:

> The use of fill factors shall consider the application of the fill factors in setting unbundled network element rates.

ASHBURN & MASON
LAWYERS
A PROFESSIONAL CORPORATION
SUITE 100
1130 WEST SIXTH AVENUE
ANCHORAGE, ALASKA
99501-5914
(907) 276-4331
FAX (907) 277-8235

[38] Voices for Choices, p. 7.
[39] Voices for Choices, p. 9.

ACS proposes that fill factors represent "a reasonable projection of actual total usage of the elements in question."[40] This, again, would reflect embedded costs and thus violate federal law.

SBC tried this approach in Illinois, as well. The Illinois legislation required that fill factors be based on "SBC's actual fill, rather than on the fill of an efficient incumbent LEC."[41] This too was struck down by the Federal District Court, which again held that "FCC Rule 51.505 clearly bars any such emphasis on the incumbent's actual practices."[42] ACS' similar attempt to require the use of actual fill levels plainly contravenes federal law.

D. Miscellaneous

ACS has proposed 3 AAC 53.250 Wholesale Service and Rate. The regulations proposed by ACS would allow ACS to offer services for resale at retail rates, with no discount.[43] AT&T Alascom objects to ACS's proposed language for several reasons. First, like the suggestions discussed above, this proposal is plainly contrary to federal law, which provides that,

> The wholesale rate that an incumbent LEC may charge for a telecommunications service provided for resale to other telecommunications carriers shall equal the incumbent LEC's existing retail rate for the telecommunications service, *less avoided retail costs*, as described in § 51.609 of this part.[44]

This section also requires that,

ASHBURN & MASON
LAWYERS
A PROFESSIONAL CORPORATION
SUITE 100
1130 WEST SIXTH AVENUE
ANCHORAGE, ALASKA
99501-5914
(907) 276-4331
FAX (907) 277-8235

[40] ACS Comments, p. 27.
[41] Voices for Choices, p. 7.
[42] Voices for Choices, p. 9.
[43] ACS Comments, Exhibit A, p. 6.
[44] 47 C.F.R. § 51.607(a) (emphasis added).

[a] CLEC that has an established interconnection agreement with an incumbent provider is obligated to offer reciprocal services and unbundled network elements at rates, terms and conditions at least as favorable as those found in the interconnection agreement.

In addition, this requirement would create barriers to entry, an act that is contrary to federal law. AT&T Alascom opposes ACS's proposed resale regulation.

IV. CONCLUSION

For the reasons stated above, and based on the Legislative principles and policies underlying this docket, AT&T Alascom urges the Commission to adopt a new resolution on dominance, creation of a competitively neutral fund to support facilities-based Bush service, and, in appropriate circumstances, shared COLR responsibilities. As a competitive local exchange carrier, AT&T Alascom asks the Commission to maintain the availability of UNEs at fair and reasonable prices in accordance with the Telecommunications Act of 1996.

Dated: August 13, 2003

ASHBURN & MASON
Attorneys for AT&T Alascom

By _____
William S. Cummings

ASHBURN & MASON
LAWYERS
A PROFESSIONAL CORPORATION
SUITE 100
1130 WEST SIXTH AVENUE
ANCHORAGE, ALASKA
99501-5914
(907) 276-4331
FAX (907) 277-8235

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Federal Communications Commission
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August 6, 2003

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Linda L. Haller, 202-418-1408

NEW TELECOMMUNICATIONS POLICY FOR ALASKA AREAS

Increased Service and Lower Costs Expected for Consumers in Isolated Communities

Washington, D.C.– Today, the Commission charted a new course to increase availability of affordable, innovative interstate long-distance telecommunications services for consumers in certain remote areas in Alaska by abolishing the long-standing "Alaska Bush" satellite earth station policy and instead allowing open-entry, facilities-based competition.

The Alaska Bush communities are rural areas, small in population and isolated in geography. The Commission's Alaska Bush earth station policy prohibited the installation or operation of more than one satellite earth station in any Alaska Bush community for competitive carriage of interstate Message Telephone Service (MTS) communications, *i.e.*, ordinary interstate, interexchange toll telephone service.

In a Report and Order adopted today, the Commission eliminated this out-dated policy. Expanding entry for facilities-based competition in the interstate telecommunications market, this action promises development of improved satellite network infrastructure, lower interstate long-distance rates and greater service options ranging from telephone calls and Internet usage to emergency services, telemedicine and distance learning.

In 1995, the Regulatory Commission of Alaska (RCA) granted General Communication, Inc. (GCI), an Alaskan facilities-based interstate long-distance carrier, a temporary waiver allowing it to install earth stations in 50 Alaska Bush communities to provide *intrastate* telephone service in competition with Alascom Inc. (Alascom) on an experimental basis.

In 1996, the International Bureau granted GCI a waiver of the FCC Alaska Bush earth station policy, allowing it to provide *interstate* services in those same 50 communities. The results of this trial were positive: introduction of new technology and competition provided many benefits to consumers.

In the Alaska Bush communities where GCI constructed a second earth station in competition with the incumbent carrier, AT&T Alascom, the quality of voice service and facsimile transmissions improved; consumers were able to send and receive data transmissions and use the Internet for the first time; upgrades in the network provided more reliability for public safety and emergency services; and, for the first time, communities were able to apply

satellite telecommunications technology for telemedicine purposes and connections to schools and libraries, which has translated into large savings on medical and transportation costs.

In its decision today, the Commission found that through a series of regulatory steps, the environment that once called for the Alaska Bush earth station policy has changed. Thus, the Commission determined that there no longer is a need for the Alaska Bush earth station policy and that it is appropriate to remove it.

Action by the Commission, August 6, 2003, by Report and Order (FCC 03-197). Chairman Powell, Commissioners Abernathy, Copps, Martin, and Adelstein.

-FCC-

International Bureau contact: JoAnn Lucanik, 202-418-0873, JoAnn.Lucanik@fcc.gov.

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

In the Matter of	)	
	)	
Policy for Licensing Domestic Satellite Earth Stations in the Bush Communities of Alaska	)	IB Docket No. 02-30
	)	RM No. 7246
	)	
	)	
	)	
	)	

REPORT AND ORDER

Adopted: August 6, 2003 **Released: August 12, 2003**

By the Commission:

I. INTRODUCTION

1. By this action, we discontinue the Alaska Bush Earth Station Policy (Alaska Bush Policy), which precludes installing or operating more than one satellite earth station in any Alaskan Bush community[1] for competitive carriage of interstate Message Telephone Service (MTS) communications, *i.e.*, ordinary interstate, interexchange toll telephone calls. By discontinuing the Alaska Bush Policy, we are eliminating a long-standing exception to the Commission's general policy favoring open entry for facilities-based competition in the provision of interstate MTS telecommunications services. We believe that allowing facilities-based competition of interstate MTS in Alaska Bush communities will encourage improvement in the quality of service available in those communities, promote more efficient delivery of service, and reduce incentives for overcharging for use of these facilities.

II. BACKGROUND

2. A complete history of the Alaska Bush Policy may be found in the Notice of Proposed Rulemaking in this proceeding and will not be repeated here.[2] Briefly, the policy of

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[1] Alaska Bush communities, as defined for purposes of the policy, are rural Alaskan communities of less than 1,000 residents that are isolated from larger cities by rugged terrain and harsh weather conditions. *See, e.g., Policies Governing the Ownership and Operation of Domestic Satellite Earth Stations in the Bush Communities in Alaska*, Tentative Decision, 92 FCC 2d 736 (1982) (*Tentative Decision*) at n.1 and ¶61.

[2] *See Policy for Licensing Domestic Satellite Earth Stations in the Bush Communities of Alaska*, Notice of

licensing only one satellite earth station in each Alaska Bush community to provide conventional interexchange MTS was formulated in the Commission's *Tentative Decision* in 1982.[3] Pursuant to the Alaska Bush Policy, Alascom, Inc. (Alascom), now a wholly owned subsidiary of AT&T Corp., alone or in partnership with United Utilities, Inc. (United), a local exchange carrier, was authorized to construct and operate the earth station facilities in the Alaska Bush communities and to provide MTS service. The Alaska Bush Policy was based on the principle that duplicative proposals for facilities in the Alaska Bush communities are mutually exclusive because one facility could provide all the services provided by either party, and there was no public interest benefit in the construction of duplicate MTS facilities.

3. When the Commission formally adopted the Alaska Bush Policy in 1984,[4] no MTS competition, in any form, had been authorized in Alaska. In 1990, however, the Alaska legislature opened most of the State's telecommunications markets to facilities-based competition, but not the Alaska Bush communities.[5] Five years later the Regulatory Commission of Alaska (RCA)[6] granted General Communication, Inc. (GCI), an Alaskan facilities-based interstate long distance carrier, a temporary waiver, allowing it to install earth stations in 50 Alaska Bush communities and to provide intrastate MTS in competition with Alascom on an experimental basis. The following year the International Bureau (Bureau) granted GCI's request to waive the Alaska Bush Policy in the same 50 Alaska Bush communities, thus allowing GCI to use its earth stations to provide both interstate and intrastate MTS in these 50 communities.[7] The Bureau concluded that the potential public interest benefits of providing the 50 Alaska Bush communities with increased service options, improved quality, and lower rates outweighed a rigid adherence to a policy that does not provide for technological

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Proposed Rulemaking, 17 FCC Rcd 2979 (2002) (*NPRM*) at 2980-84.

[3] Prior to 1969, the United States Air Force provided communications within Alaska, via the Alaska Communication System (ASC). Alascom purchased the ASC in 1970.

[4] *See Policies Governing the Ownership and Operation of Domestic Satellite Earth Stations in the Bush Communities in Alaska*, Final Decision, 96 FCC 2d 522 (1984) (*Final Decision*).

[5] *See* Act of June 7, 1990, 1990 Alaska Sess. Laws Ch. 93; *see also Regulations Governing the Market Structure for Interstate Interexchange Telecommunications Services*, 10 APUC 407 (1990).

[6] The agency was then known as the Alaska Public Utilities Commission.

[7] *See Petition of General Communication, Inc. for a Partial Waiver of the Bush Earth Station Policy*, Memorandum Opinion and Order, 11 FCC Rcd 2535 (Int'l Bur. 1996) (GCI Waiver). The Bureau granted GCI a waiver to construct and operate no more than 50 earth station sites for a period of time to run concurrently with the Alaska Public Utilities Commission's two year waiver. *Id.* at 2537. Thereafter, GCI has continued operation of the earth stations in these Alaska Bush communities pursuant to Special Temporary Authority (STA). *See e.g.*, Letter from Kathy L. Shobert, Director, Federal Affairs, GCI Communications Corp. to FCC, Common Carrier Domestic Earth Stations, dated August 3, 1998; *see also* Letter from Tina M. Pidgeon, CGI Communications Corp. to FCC, International Bureau – Earth Stations, dated July 26, 2002.

advancements and market changes.[8]

4. In 2000, the RCA found that allowing GCI to construct duplicate earth stations in the 50 Alaska Bush communities had, in fact, led to a more efficient use of available satellite resources, resulting in consumers benefiting from lower retail rates and improved service quality. In view of its finding, the RCA eliminated Alaska's restrictions on facilities-based MTS competition in the Alaskan Bush.[9] Thus, the FCC's Bush Policy remains the only significant regulatory barrier to facilities-based MTS competition throughout Alaska.

5. On February 15, 2002, the Commission released the *NPRM* in this proceeding, proposing to discontinue the Alaska Bush Policy. The Commission noted in the *NPRM* that the Alaska Bush Policy is based on the proposition that applications for "duplicative" Alaska Bush earth stations are mutually exclusive. It also noted that the Alaska Bush Policy was formulated prior to the advent of MTS competition, and is based on a regulatory policy designed to prevent non-dominant carriers from investing in facilities at their own expense to compete with a carrier with an established facilities monopoly. Finally, the Commission pointed to the fact that the RCA has removed the parallel intrastate entry barrier. Consequently, the Commission tentatively concluded that the time has arrived to remove the barrier against facilities-based interstate MTS in the Alaska Bush as well. The Commission also tentatively concluded that facilities-based competition in the provision of interstate MTS in Alaska Bush communities will result in public interest benefits comparable to those that were realized in the 50 Alaska Bush communities in which GCI has been allowed to provide competitive MTS service. Accordingly, the Commission invited comment on its proposal to abolish the Alaska Bush Policy.

III. DISCUSSION

6. Three parties, Alascom and AT&T, GCI, and the RCA, have filed comments in response to the *NPRM*. All three commenters support the Commission's proposal to eliminate its prohibition on the installation or operation of more than one satellite earth station in any Alaska Bush community for the competitive carriage of interstate MTS.

7. The RCA submits that since 1995, when both the RCA and the FCC waived applicable Alaska Bush facility restrictions to allow GCI to construct duplicate earth stations in Bush communities, consumers have benefited from lower retail rates and improved service quality. According to the RCA, these benefits are what ultimately motivated it to eliminate the State's restrictions on facilities-based intrastate MTS competition in Bush Alaska in 2000. The RCA states that elimination of the FCC's Alaska Bush Policy will remove the final regulatory barrier to facilities-based interexchange competition throughout Alaska, and thus, it fully

[8] *Id.* at 2537.

[9] *See Consideration of the Reform of Intrastate Interexchange Telecommunications Market Structure and Regulations in Alaska*, Docket R-98-1, Order No. 6 (RCA, Nov. 20, 2000).

supports the Commission's proposal set forth in the *NPRM*. Moreover, the RCA says that it shares the Commission's belief that facilities-based MTS competition in Alaska Bush communities will produce public interest benefits and will also establish an incentive for Alascom to operate more efficiently.[10]

8. The same arguments advanced by the RCA are made by GCI, which provides specific examples of how competition between it and Alascom has benefited the Alaska Bush communities with improved telecommunication efficiency and new service offerings. According to GCI, the first and perhaps most significant technological improvement was the implementation of its Demand Assigned Multiple Access (DAMA) satellite transmission system, which allows bandwidth to be used more efficiently. Before the introduction of DAMA, GCI explains that all channels were assigned exclusively to a certain community and could not be used for other communities.[11] GCI adds that DAMA also eliminates the need for a "double hop" configuration. Double hop refers to a call that requires two satellite hops to complete. The earth station technology that was used before DAMA was introduced required all traffic to or from an Alaska Bush location to first be transmitted to a satellite, then to Anchorage, Fairbanks or Juneau for switching, even for calls not destined for those markets, and then transmitted a second time to a satellite for transmission to the call's final destination. This resulted in signal delay and frequency echo, rendering facsimile transmission unreliable and data transmission impossible.[12] Finally, GCI states that the success it has achieved with DAMA has caused Alascom to upgrade many of its Alaska Bush earth station facilities to digital DAMA technology.[13]

9. On the service side of the equation, GCI points out that greater facilities efficiency has enabled telemedicine to be offered in Alaska Bush communities. In those Alaska Bush communities where telemedicine is now available, GCI states that a village medical practitioner is able to provide a doctor in a regional center with detailed information regarding a patient's symptoms, medical history, and images, *e.g.*, of skin problems, trauma, lacerations, to aid the doctor in formulating a diagnoses of the patient's condition and in determining whether the patient should be flown to Anchorage, at a cost that sometimes exceeds $20,000. Accordingly, unnecessary expenses can be avoided. More importantly, however, GCI states that satellite-provided telemedicine capabilities enable a doctor in a regional center to guide a local medical practitioner to provide both routine and emergency medical care.[14] GCI further notes that it has also provided reliable Internet connection for schools and libraries in nearly all of the Alaska

10 *See* RCA Comments at 2-5.

11 *See* GCI Comments at 5-6.

12 *Id.* at 6-7.

13 *Id.* at 7.

14 *Id.* at 8-9.

Bush communities it serves.[15]

10. Along with improved service and service offerings, GCI says all customers in Alaska have benefited significantly from decreased long-distance rates since it entered the market. Due to the general rate reductions, GCI says many Bush customers now have an incentive to abandon high "basic" rates and opt for less-expensive calling plans that save them money. Notwithstanding these improvements, GCI contends that lifting the Alaska Bush Policy completely will result in the Alaska Bush realizing the full benefits of competition in both intrastate and interstate MTS service.[16]

11. Alascom and AT&T also support repeal of the Alaska Bush Policy. Alascom and AT&T contend, however, that other deregulatory actions, which they requested in a March 10, 2000 Petition, "are indivisible aspects of the [Alaska]Bush Policy" and thus, must be acted upon simultaneously.[17] In the March 10, 2000 Petition, Alascom and AT&T requested, among other relief, that the Commission eliminate structural separation and tariffing requirements under which Alascom has been providing certain carrier-to-carrier services in Alaska.[18] In addition, on January 7, 2003, Alascom filed a petition for waiver from the requirement that it annually file revised cost-based rates for these carrier-to-carrier services.[19] Alascom and AT&T point out in these petitions that Alascom now must disaggregate all of its service costs within Alaska by location, resulting in more than 900 separate cost points. Alascom and AT&T contend that no other carrier has ever been forced to provide a service based upon stand-alone location-specific costs. The present tariff requirements, they submit, impose unwarranted competitive regulatory burdens that are preventing Alascom from providing its customers with improved service.[20] These petitions are under consideration in separate dockets.[21]

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15 *Id.* at 9.

16 *Id.* at 9-11.

17 Alascom and AT&T Comments at 1. *See also* Public Notice, *Pleading Cycle Established for Comments on AT&T and Alascom Petition for Structural and Other Regulatory Relief*, DA 00-603, CC Docket No. 00-46, March 17, 2000.

18 The services are the transport and switching services by which Alascom transmits interexchange carriers' traffic to and from Alascom's points of interconnection with Alaska local exchange carriers in both Alaska Bush and non-Bush communities. *See Integration of Rates and Services for Provision of Communications by Authorized Common Carriers between the Contiguous States and Alaska, Hawaii, Puerto Rico and the Virgin Islands*, Final Recommended Decision, 9 FCC Rcd 2197, 2204 (Joint Board 1993) (*FRD*), *adopted and modified*, Memorandum Opinion and Order, 9 FCC Rcd 3023 (1994) (*Alaska Market Order*). Alascom provides these services under its Tariff FCC No. 11.

19 *See* Public Notice, *Pleading Cycle Established for Alascom, Inc., Petition for Waiver of the Commission's Rules Regarding Its Annual Tariff FCC No. 11*, WC Docket No. 03-18, DA 03-169 (Jan. 21, 2003).

20 Alascom and AT&T Comments at 3.

12. The need for the Alaska Bush Policy is over. As was noted in the *NPRM*, the "Alaska Bush Policy is an isolated exception to the Commission's interstate MTS open-entry policy."[22] It was based on the assumption that authorizing more than one earth station in a Alaska Bush community would be duplicative and thus needlessly expensive, since a single earth station is sufficient to accommodate all the calls placed to or from the community. The GCI experience has demonstrated that the concern underlying the Alaska Bush Policy is no longer warranted. GCI has provided us with what we believe to be a preview of the public interest benefits that will be realized by allowing open-entry, facilities-based competition in the provision of interstate MTS in Alaska Bush communities. We believe that by eliminating the Alaska Bush Policy, citizens of the Alaska Bush communities will benefit from improved telecommunications services provided by both Alascom and its competitors at lower prices. For these reasons, we eliminate the Alaska Bush Policy.

13. Finally, we note that this proceeding was established for the limited purpose of considering the elimination of the Alaska Bush Policy. Consequently, we decline to address at this time other potential changes to our regulatory requirements for Alaska. In particular, because, as indicated above, eliminating the Alaska Bush Policy would promote important public interests, we decline to defer this deregulatory step pending our consideration of Alascom's and AT&T's March 2000 and January 2003 petitions.

IV. CONCLUSION

14. For the reasons set forth on the record in this proceeding, we abolish the Alaska Bush Policy, thus eliminating the restriction on facilities-based competition in the Alaska Bush.

V. PROCEDURAL MATTERS

15. *Final Regulatory Flexibility* Analysis. The Final Regulatory Flexibility Analysis for this Report and Order, pursuant to the Regulatory Flexibility Act, 5 U.S.C. § 604, is contained in the Appendix.

VI. ORDERING CLAUSES

16. Accordingly, IT IS ORDERED that the Alaska Bush Earth Station Policy, formally adopted by the Commission in *Policies Governing the Ownership and Operation of Domestic Satellite Earth Stations in the Bush Communities in Alaska*, Final Decision, 96 FCC 2d 522 (1984) IS DISCONTINUED.

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21 *See supra* notes 17 and 19 and accompanying text.

22 *NPRM*, 17 FCC Rcd at 2979.

17. IT IS FURTHER ORDERED that the Commission's Consumer and Government Bureau, Reference Information Center, *SHALL* SEND a copy of this *Report and Order*, including the Final Regulatory Flexibility Certification, to the Chief Counsel for Advocacy of the Small Business Administration.

FEDERAL COMMUNICATIONS COMMISSION

Marlene H. Dortch
Secretary

APPENDIX

FINAL REGULATORY FLEXIBILITY CERTIFICATION

18. The Regulatory Flexibility Act of 1980, as amended (RFA)[23] requires that a regulatory flexibility analysis be prepared for rulemaking proceedings, unless the agency certifies that "the rule will not have a significant economic impact on a substantial number of small entities."[24] The RFA generally defines "small entity" as having the same meaning as the terms "small business," "small organization," and "small governmental jurisdiction."[25] In addition, the term "small business" has the same meaning as "small business concern" under the Small Business Act.[26] A small business concern is one that: (1) is independently owned and operated; (2) is not dominant in its field or operation; and (3) satisfies any additional criteria established by the Small Business Administration (SBA).[27]

19. The Report and Order repeals a regulatory policy that prevented companies from obtaining licenses to operate earth stations in rural Alaska that would carry telephone calls between users in certain Alaskan communities and users in other states if such service was already available in those communities via facilities provided by an established carrier. Because the Report and Order does not impose any regulatory burden, we certify that it will not have a significant economic impact on a substantial number of small businesses. The Commission will send a copy of the Report and Order, including a copy of this final certification, in a report to Congress pursuant to the Small Business Regulatory Enforcement Fairness Act of 1996.[28] In addition, the Report and Order and this final certification will be sent to the Chief Counsel for Advocacy of the SBA and will be published in the Federal Register.

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23 *See* 5 U.S.C. § 603. The FRA, *see* 5 U.S.C. § 601 *et seq.*, has been amended by the Contract With America Advancement Act of 1996, Pub. L. No. 104-121, 110 Stat. 847 (1996) (CWAA). Title II of the CWAAA is the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA).

24 5 U.S.C. § 605(b).

25 5 U.S.C. § 605(6).

26 5 U.S.C. § 605(3) (incorporating by reference the definition of "small business concern" in the Small Business Act, 15 U.S.C. § 632). Pursuant to 5 U.S.C. § 601(3), the statutory definition of a small business applies "unless an agency, after consultation with the Office of Advocacy of the Small Business Administration and after the opportunity for public comment, establishes one or more definitions of such term that are appropriate to the activities of the agency and publishes such definition(s) in the Federal Register

27 Small Business Act, 15 U.S.C. § 632 (1996).

28 5 U.S.C. § 801(a)(1)(A).

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

VOICES FOR CHOICES; AT&T COMMUNICATIONS OF ILLINOIS, INC.; MCI METRO ACCESS TRANSMISSION SERVICES, LLC; and ASSOCIATION FOR LOCAL COMMUNICATIONS SERVICES,	)	
Plaintiffs,	)	
vs.	)	03 C 3290
ILLINOIS BELL TELEPHONE CO., INC. d/b/a SBC Illinois; AMERITECH CORP. d/b/a SBC Midwest; and EDWARD C. HURLEY, ERIN M. O'CONNELL-DIAZ, LULA M. FORD, MARY FRANCES SQUIRES, and KEVIN K. WRIGHT, in their capacities as Commissioners of the Illinois Commerce Commission and not as Individuals,	)	
Defendants.	)	

MEMORANDUM OPINION

CHARLES P. KOCORAS, Chief District Judge:

This matter comes before the court on a motion for temporary restraining order or preliminary injunction brought by Plaintiffs Voices for Choices, AT&T Communications of Illinois, Inc. ("AT&T"), MCI Metro Access Transmission Services, LLC ("MCI"), Associations for Local Telecommunications Services, McLeodUSA Telecommunications Services, Inc., TDS Metrocom, LLC, Mpower

Exhibit C

Communications Corp. d/b/a Mpower Communications of Illinois, Citizens Utility Board, Talk America Inc., XO Illinois, Inc., Globalcom, Inc., and Forte Communications, Inc. Plaintiffs bring the motion against Defendants Illinois Bell Telephone Co., Inc. d/b/a SBC Illinois and Ameritech Corp. d/b/a SBC Midwest (collectively "SBC") and against Illinois Commerce Commission ("ICC") commissioners Edward Hurley, Erin O'Connell-Diaz, Lula Ford, Mary Frances Squires, and Kevin Wright. For the reasons set forth below we grant the motion.

BACKGROUND

On May 9, 2003, the Illinois legislature, with the governor's signature, enacted sections 13-408 and 13-409 to Illinois' Public Utilities Act. Plaintiffs contend that these new provisions, sections 408 and 409, violate the Supremacy Clause of the U.S. Constitution, U.S. CONST. art. VI, § 1, because they conflict with the Federal Telecommunications Act of 1996 (the "FTA"), 47 U.S.C. § 251-261, and related FCC regulations. Thus, a thorough explanation of the purpose and framework of the FTA is necessary. In *MCI Telecommunications Corp. v. Illinois Bell Telephone Co.*, 222 F.3d 323 (7th Cir. 2000), Circuit Judge Ripple provides just such a thorough explanation:

> Congress enacted the 1996 Telecommunications Act "[t]o promote competition and reduce regulation in order to secure lower prices and higher quality services for American telecommunications consumers and

encourage the rapid deployment of new telecommunications technologies." Pub.L. No. 104-104, 110 Stat. 56, 56 (1996). The Act "fundamentally restructures local telephone markets" by transforming the "long-standing regime of state-sanctioned monopolies" into a competitive market. *AT & T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 371, 119 S. Ct. 721, 142 L.Ed.2d 835 (1999). Congress recognized that, even after the removal of regulatory restrictions on competition, significant economic barriers would remain to block entry into local telephone markets. Prospective market entrants would face the cost of duplicating an incumbent provider's local network infrastructure. To remove this economic barrier, the Act essentially requires incumbent local exchange carriers ("LECs") [such as SBC] to share their networks with competitors [such as Plaintiffs]. Section 251 of the Act requires incumbent LECs to allow new entrants to interconnect with existing local networks, to lease elements of existing local networks at reasonable rates, and to purchase the incumbents' services at wholesale rates and resell those services to retail customers. *See* 47 U.S.C. § 251 (Supp. II 1996).

Section 252 sets out the process by which incumbent LECs and prospective carriers establish interconnection agreements. First, incumbent LECs and prospective carriers must negotiate in good faith to reach voluntary interconnection agreements. At any time during the negotiations, a party may ask the appropriate state commission to participate as a mediator in the negotiations. *See id.* § 252(a)(2). If negotiations prove unsuccessful, subsection 252(b) provides for compulsory arbitration of any open issues. During the period from the 135th to the 160th day after an incumbent LEC receives a request for negotiation, any party to the negotiation may petition the state commission to arbitrate any open issues. *See id.* § 252(b)(1). Sections 251 and 252 establish certain standards that the state commission must follow in resolving open issues by arbitration and in imposing conditions on the parties. The state commission is also bound by Federal Communications Commission ("FCC") regulations issued pursuant to § 251.

Subsection 252(e) requires any interconnection agreement reached by negotiation or arbitration to be submitted to the state commission for approval and specifies the grounds on which a state commission can reject an agreement. Specifically, state commissions may reject

negotiated interconnection agreements only if the commission finds (1) that the agreement discriminates against a carrier that is not a party to the agreement or (2) that implementation of the agreement (or a part thereof) would be inconsistent with "the public interest, convenience, and necessity." *Id.* § 252(e)(2)(A). A state commission may reject an arbitrated interconnection agreement only if the agreement (or part thereof) (1) does not meet the requirements of § 251 and its implementing regulations or (2) fails to meet the pricing standards set forth in subsection 252(d). *See id.* § 252(e)(2)(B).

Subsection 252(e)(5) further provides that, if a state commission fails to carry out any of its responsibilities under § 252, then the FCC must assume responsibility for the proceeding and act for the state commission in carrying out its functions. An implementing regulation to § 252 provides that a state commission "fails to act" for purposes of subsection 252(e)(5)-- thus prompting the FCC to step in and assume the state commission's responsibilities--if it fails to respond within a reasonable time to a request for mediation or a request for arbitration, or if it fails to complete an arbitration within the established time limits. *See* 47 C.F.R. § 51.801(b). A state commission will not be deemed to have failed to act, however, if it merely fails to approve or reject an agreement within the established time limits. *See id.* § 51.801(c). In such a case, the agreement will be deemed approved. *See* 47 U.S.C. § 252(e)(4) (Supp. II 1996).

Therefore, subsections 252(e)(1), (e)(4), and (e)(5), taken together and read in conjunction with the FCC regulations, create a scheme that provides regulatory oversight of interconnection agreements, either by a state commission or by the FCC in the state commission's place.

• • •

The Act provides that federal district courts have exclusive jurisdiction to review FCC or state commission actions relating to interconnection agreements. In subsection 252(e)(4), Congress expressly eliminated state court jurisdiction to review actions of state commissions in approving or rejecting agreements under § 252. Moreover, subsection 252(e)(6), titled "Review of State commission actions," provides that, whenever a state commission fails to act, the exclusive remedies for that

> failure to act will be proceedings by the FCC and any judicial review of the FCC's actions. Subsection 252(e)(6) also provides that, "[i]n any case in which a State commission makes a determination under this section, any party aggrieved by such determination may bring an action in an appropriate Federal district court to determine whether the agreement or statement meets the requirements of section 251 [and section 252].

Id at 328-329.

In setting rates for the lease of network elements (in an arbitrated dispute rather than a freely negotiated agreement), the state commission must take into account the incumbent LEC's cost of providing the elements on a "forward-looking" basis only. 47 C.F.R. § 51.505. The FCC calls this the "total element long-run incremental cost" or TELRIC. 47 C.F.R. § 51.505(a)(1). The TELRIC "of an element should be measured based on the use of the most efficient telecommunications technology currently available and the lowest cost network configuration, given the existing location of the incumbent LEC's wire centers." 47 C.F.R. § 51.505(b)(1). In calculating the TELRIC, the incumbent LEC's embedded costs may not be considered. 47 C.F.R. § 51.505(d)(1). "Embedded costs are the costs that the incumbent LEC incurred in the past and that are recorded in the incumbent LEC's books of accounts". *Id.* In other words, incumbent LECs can only recover costs that an efficient provider would incur in providing the network elements irrespective of the costs of their actual practices.

SBC is an incumbent LEC that owns and operates local telecommunications network infrastructure in Illinois. Under the FTA, SBC is required to lease access to its infrastructure, also called unbundled network elements or UNEs, to competing LECs "on rates, terms, and conditions that are just, reasonable, and nondiscriminatory in accordance with the terms and conditions of the agreement and the requirements of this section and section 252 of this title." 47 U.S.C. § 251(c)(3). Section 252 contemplates the formation of interconnection agreements between incumbent LECs and competing LECs that govern the rates on which competing LECs lease UNEs from the incumbent LECs. Interconnection agreements may be reached through negotiation between the parties or through arbitration at the state commission, here the ICC, (or the FCC if the state opts out of the FTA framework). 47 U.S.C. § 252(a)-(b). SBC, having failed to negotiate higher UNE rates with the competing LECs, initiated an ICC arbitration. Before the ICC could make a final determination, however, the Illinois legislature enacted section 408. Section 408 abated the ongoing ICC arbitration and instructed the ICC to institute a new proceeding to adjust UNE rates based on specific instructions contained in section 408. 220 ILCS 5/13-408. Section 408 further instructs the ICC to adjust the UNE rates by June 9. 220 ILCS 5/13-408(c). The specific instructions are to adjust rates based on changes to two criteria: fill factors and depreciation. 220 ILCS 5/13-408(a)-(b).

A fill factor is a measure of the percentage of an incumbent LEC's network capacity that is actually used. For example, a fill factor of 60% means 60% of the network capacity is being utilized while 40% remains idle. Fill factors are considered in setting UNE rates because the incumbent LEC must recover the costs of actual fill and idle fill. Again, for example, at an approved fill factor of 60%, UNE rates are set to allow an incumbent LEC to recover its costs for five telephone lines for every three lines that are leased. The rationale for this is that the cost in providing three lines to a competing LEC includes the cost of two idle lines for a total of five lines. Under TELRIC, fill factors are supposed to be based on the most efficient use of the network on a forward-looking basis. 47 C.F.R. § 51.505(b)(1). The Illinois legislation, however, instructs the ICC to employ fill factors based on SBC's actual fill, rather than on the fill of an efficient incumbent LEC. 220 ILCS 5/13-408(a).

Depreciation is a more familiar term. In setting UNE rates, the ICC must employ economic depreciation costs that are "efficiently incurred" and cannot consider embedded costs. 47 C.F.R. § 51.505(c)(1) and (d)(1). Thus, like fill factors, depreciation must be based on a hypothetical efficient incumbent LEC's practices rather than SBC's actual practices. The Illinois legislation, however, instructs the ICC to employ the depreciation costs that SBC reports in its books of accounts as submitted to the SEC. 220 ILCS 5/13-408(b).

Plaintiffs contend that the Illinois legislation violates federal law and, if not enjoined by June 9, will cause them irreparable injury for which no adequate remedy at law exists.

LEGAL STANDARD

Plaintiffs have moved for a either a temporary restraining order or a preliminary injunction. Since both sides have been heard fully on the merits of the motion, both in writing and orally, in an *inter partes* fashion, we treat the motion as one for a preliminary injunction. In any event, "[t]he standards for a temporary restraining order and a preliminary injunction are identical." *Frederick Atkins, Inc. v. Carson Pirie Scott & Co.*, 1999 WL 1249342, *1 (N.D. Ill. Dec. 13, 1999). To be entitled to a preliminary injunction, Plaintiffs must demonstrate:

> (1) that [they have] a reasonable likelihood of success on the merits of [their] claim;
> (2) that no adequate remedy at law exists;
> (3) that [they] will suffer irreparable harm if the preliminary injunction is denied;
> (4) that the irreparable harm [they] will suffer without preliminary injunctive relief outweighs the irreparable harm the nonmoving party will suffer if the preliminary injunction is granted; and
> (5) that the injunction will not harm the public interest.

Id (citing *Platinum Home Mortgage Corp. v. Platinum Fin. Group, Inc.*, 149 F.3d 722, 726 (7th Cir. 1998)).

DISCUSSION

I. Preliminary Injunction

A. Likelihood of Success on the Merits

The Illinois legislation conflicts with federal law in several respects. The legislation orders the ICC to determine fill factor and depreciation costs based on SBC's actual fill and depreciation as accounted to the SEC. FCC Rule 51.505 clearly bars any such emphasis on the incumbent's actual practices. 47 C.F.R. § 51.505. Under TELRIC, element costs can only be based on a hypothetical efficient provider's costs determined on a forward-looking basis. *Id.* The FCC rule instructs the ICC to look at a hypothetical efficient provider's costs rather than SBC's actual costs. 47 C.F.R. § 51.505. The Illinois legislature then tells the ICC to use SBC's actual costs as the most reasonable projection of a hypothetical efficient provider's costs. 220 ILCS 5/13-408(a)-(b). Thus, section 408 completely reads out the hypothetical efficient provider standard from TELRIC. The Illinois legislation has, by fiat, rendered TELRIC irrelevant with respect to two key factors in the rate setting exercise.

As the FTA is designed to foster competition, it is not surprising that a delegation of federal authority to a state commission, with all of its attendant experience in these matters, was made to perform the adjudicatory function with respect to interconnection agreements. Possessed of professional staffs and expertise,

it was the logical unit of state government to play the key arbitral role when agreements were not forthcoming. Not coincidently and, in addition to their expertise, proceedings are conducted in an adversarial process designed to permit all interested parties the opportunity to make their own respective cases and oppose their adversaries' positions. The FTA expressly designates these state commissions and agencies and not state legislatures to perform the arbitral function.

With due respect, it cannot be said that the Illinois General Assembly is possessed of comparable expertise and experience in these rate setting matters and arbitrations. Nor can it be said that the history of the Illinois legislation under challenge reflects the procedural rights and safeguards which generally attend hearings before state commissions. No record need be made of reasons legislators may have for the particular exercise of their ballot privileges. In contrast, the orders reflecting the results of the Illinois Commerce Commission are earmarked by the evidence considered, presentations made by parties, and the reasons for Commission decisions. It is little wonder that the state commissions which are charged with similar duties in state rate-setting matters were those the federal government saw fit to empower in hearing and resolving federal issues. A clear usurpation of authority took place here in a way neither authorized nor contemplated by the FTA when the Illinois Legislature decreed fill and depreciation rates, matters heretofore determined by the ICC.

In Section 252 of the FTA, Congress delegated arbitral powers to state commissions, not to the states themselves. 47 U.S.C. § 252. Specifically enumerated is the state commission's power to "establish any rates for interconnections, services, or network elements". 47 U.S.C. § 252(c)(2). For FTA purposes, state commission is defined as "the commission, board, or official (by whatever name designated) which under the laws of any State has regulatory jurisdiction with respect to intrastate operations of carriers." 47 U.S.C. § 153(41). It is undisputed that the ICC is the state commission in Illinois to which the FTA grants the rate-making powers under section 252.

The Illinois legislation displaces much of the ICC's rate-making authority and substitutes its own. 220 ILCS 5/13-408(a)-(b). SBC maintains that, because the ICC is a creature of the legislature, the legislature is free to usurp the ICC's powers. SBC cites case law for the propositions that all of the ICC's "power is derived from the legislature" and that the ICC's primary task is "to do what is reasonably necessary to accomplish the [Illinois] legislature's objective." (SBC Opp. at 16 (citing *Business and Prof'l People for Pub. Interest v. Illinois Commerce Comm'n*, 585 N.E.2d 1032,1039 (Ill. 1991), and *Abbott Labs. v. Illinois Commerce Comm'n*, 682 N.E.2d 340, 347 (Ill. App. Ct. 1997).) Neither of the cases SBC cites dealt with the telecommunications industry or the ICC's role under the FTA. The ICC's rate-making authority with

respect to the rates an incumbent LEC may charge competing LECs for use of UNEs, is derived from Congress, not the Illinois legislature; the ICC's task is to accomplish Congress' objective in enacting the FTA. *MCI Telecommunications*, 222 F.3d at 341 ("Congress has expressed unmistakably that, under the 1996 Telecommunications Act, states could participate in the *federal regulatory function* delegated to them *by the federal government*") (emphasis added). Additionally, section 252(e)(4) of the FTA demonstrates that Congress was bestowing federal, as opposed to state, rate-making powers onto the various states' commissions. Section 252(e)(4) decrees that state courts have *no jurisdiction* to review their own state commissions' actions in approving or rejecting interconnection agreements. 47 U.S.C. § 252(e)(4). Clearly, the ICC's rate-making power in this context is derived from Congress, and not from the Illinois legislature. As such, SBC's argument that that which giveth can take away falls by the wayside.

In section 252, the FTA mandates the procedure for determining UNE rates, whether conducted by the ICC at Illinois' option or by the FCC should Illinois decline the option. Under section 252, parties may freely negotiate, and enter into, interconnection agreements. 47 U.S.C. § 252(a). If the parties fail to resolve any or all issues, a party may petition the ICC for arbitration of those "open issues". 47 U.S.C. § 252(b)(1). The Illinois legislation completely circumvents this procedure by

(1) undermining the FTA's contemplation of a 134-day period of voluntary negotiation by allowing SBC to go straight to the legislature,[1] and (2) resolving contested issues in SBC's favor without arbitration. Not only does the Illinois legislation circumvent the arbitration procedure contemplated by the FCC, it actually abated just such an arbitration that was ongoing at the time the legislation was enacted. 220 ILCS 5/13-408(c). Moreover, it is of no moment that the Illinois legislation decrees that the sham ICC proceeding that it directs to take place "be deemed" an arbitration for FTA purposes. *See* 220 ILCS 5/13-408(c) A state legislature cannot prevent federal court review of actions governed by a federal statute by decreeing that the federal statute has been honored.

Having the issues resolved in their favor by the legislature rather than in an ICC arbitration allowed SBC to avoid its burden of proof under FCC regulation 51.505. Not only is an incumbent LEC required to arbitrate contested element rates, it carries the burden of proof in demonstrating that a rate it seeks does "not exceed the forward-looking economic costs of providing the element, using a cost study that complies with the [TELRIC] methodology . . .." 47 C.F.R. § 51.505(e). The Illinois legislation

[1] This did not actually occur here. SBC did not go to the legislature until after the negotiation period ended and the arbitration proceeding had begun. Nevertheless, upholding this legislation would necessarily condone going straight to the legislature at any time and, therefore, would undermine the 134-day period of voluntary negotiation.

commands the ICC to set fill factor and depreciation rates without arbitration and regardless of whether SBC can or does meet its burden of proof under 47 C.F.R. § 51.505(e).

To summarize, the Illinois legislation which added sections 13-408 and 13-409 to the Illinois Public Utilities Act clashes with federal law embodied in the 1996 Telecommunications Act and related regulations in the following material ways:

1. The methodology to be used in federal rate determinations is eviscerated – TELRIC is effectively repealed;

2. The incumbent LEC no longer has a burden to prove its rates, terms and conditions are just and reasonable;

3. The proceeding mandated to take place and "deemed" to be an arbitration is, in truth, specious and hollow;

4. The will of the Legislature, reasoned or otherwise, displaces the expertise of the ICC;

5. Procedural safeguards, designed to insure fairness in rate-setting exercises, are eliminated; and

6. The absence of a record of proceedings in two key areas renders impossible meaningful federal judicial review.

For all of the foregoing reasons, we find Plaintiffs have a strong likelihood of success on the merits of their Supremacy Clause claims.

B. No Adequate Remedy at Law & Irreparable Injury

Plaintiffs argue that they will be irreparably harmed in a manner for which they have no adequate remedy at law if the ICC implements new rates as directed by the Illinois legislation. We agree. The substantially higher rates, which are projected to go into effect June 9, will immediately effect all lines leased by competing LECs in excess of 35,000. Under section 409, there is a two year stay of increased rates for the first 35,000 lines that each competing LEC leases. 220 ILCS 5/13-409(a). Only MCI and AT&T lease more than 35,000 lines–they will be immediately effected by the rate hikes. The remaining Plaintiffs are relatively smaller competitors that will be allowed to retain temporarily the same rates at their present size because they lease less than 35,000 lines. Nevertheless, the smaller competing LECs are clearly discouraged from expanding beyond 35,000 lines. Thus, to the extent the smaller competing LECs are capable of expanding beyond 35,000 lines, they will have to choose between forgoing the expansion or proceeding with the expansion and paying higher rates. Either way, they suffer irreparable harm. Additionally, the larger competing LECs may have to leave the Illinois local telephone market while the smaller competing LECs could suffer a worse fate. Of course, SBC vehemently attacks these predictions. Even if we

take SBC's factual allegations–that the competing LECs are making windfalls under the present pricing scheme and will continue to get by with profitable margins under the proposed rate hikes–as true, the competing LECs will still suffer an injury for which no remedy exists if the rates are permitted to increase and are later invalidated upon a full disposition of this case on the merits. In such a scenario, we are unaware of any cause of action that will be available to the competing LECs to recoup the excess portion of the rates which they paid SBC once it is established that the rates were invalidly adjusted. Although SBC claims to have offered to "true up" the difference in rates should the Illinois legislation ultimately be overturned, SBC fails to convince us that this offer translates into a cause of action that would ensure Plaintiffs an adequate remedy at law. (According to Plaintiffs, the offer to "true up" has only been made in SBC's brief in opposition to the present motion, and there is no guarantee that SBC will adhere to its word.)

C. Balancing the Harms and the Public Interest

Enjoining Defendants from implementing the Illinois legislation will harm SBC less than Plaintiffs would be harmed if we denied the motion. First, SBC will be permitted to pursue rate changes under the provisions of the FTA as always–we are not enjoining rate changes generally, only rate changes as directed by the Illinois legislature. Secondly, SBC may move this court to set an appropriate bond to protect

its financial interests should the Illinois legislation ultimately be found valid. On the other side of the coin, if we deny the motion, at least two of the Plaintiffs will be forced to pay significantly higher rates immediately, monies which may never be recoverable even if the Illinois legislation is ultimately invalidated. Additionally, Plaintiffs may feel compelled to freeze their investment and advertising in the Illinois market, and the smaller competing LEC's may withdraw from the market altogether.

The public interest factor also weighs heavily in favor of enjoining the legislation. The legislation is anti-competitive. It will make it harder for competitors to compete with SBC. Less competition means less choices for consumers, and less choices for consumers ultimately leads to higher prices.

II. Power to Hear This Case

Defendant ICC commissioners oppose this motion on non-substantive grounds only. They contend that they are immune from suit because they are acting (or will act) in a legislative nature and that the suit is not yet ripe. These issues are entwined with one another and will be dealt with together.

First, there is clearly no 11th Amendment immunity available to the commissioners with respect to the allegations that the legislation violates federal law. *MCI Telecommunications*, 222 F3d at 343-44 (holding that states that voluntarily choose to have their state commission, rather than the FCC, regulate FTA matters

implicitly waive 11th Amendment immunity). The commissioners do not rely on 11th Amendment immunity but rather on what has been termed legislative immunity in a string of cases beginning with *Prentis v. Atlantic Coast Line Co.*, 211 U.S. 210 (1908). The idea behind this doctrine is that state legislatures and their subordinate legislating bodies cannot be enjoined from legislating. *Id* at 229-30. State laws can certainly be invalidated and/or enjoined (for good reason) once passed in final form but the federal courts cannot keep watch on state legislatures to prevent them from passing invalid laws in the first instance. *Id.* This is where the ripeness issue becomes entwined. The commissioners argue that since the rates have not yet been set, there is no final legislation to invalidate. To enjoin the ICC from carrying out its rate-making function, it is argued, would intrude on state legislating, which is immune from suit until complete.

Under *Prentis*, rate-making is a legislative function, and the states are immune from suit during the legislative process. *Id* at 226, 232. In *Prentis*, several railroad companies sought to enjoin the Virginia State Corporation Commission from publishing or taking further steps to enforce a certain order fixing passenger rates on trains. *Id* at 216. The railroad companies alleged that enforcing the rates would deprive them of property without due process in violation of the 14th Amendment. *Id.* Under Virginia law, before the order fixing the rates could go into effect, the Virginia

commission had to give notice (by four weeks' publication in a newspaper) of the substance of the contemplated action and of a time and place when the commission would hear objections and evidence against it. *Id* at 224.

Prentis and its progeny do not apply to the present suit for two reasons. First, by enjoining the ICC commissioners, we are not interfering with a state legislative process. Even if the ICC had any real discretion to set rates in light of the Illinois legislation, the ICC would not be acting as a *state* rate-making body but as a *federal* rate-making body. *See MCI Telecommunications*, 222 F.3d at 341 ("Congress has expressed unmistakably that, under the 1996 Telecommunications Act, states could participate in the *federal regulatory function*" of setting rates) (emphasis added).

Secondly, unlike in *Prentis*, in the present case federal law has already been violated. In *Prentis*, the railroads sought to enjoin further steps toward the implementation of fixed passenger rates which they believed would be unconstitutional. *Prentis*, 211 U.S. at 216. Thus, at the time the railroads sued, no violation of federal law had occurred. In the present situation, several provisions of FTA and FCC Rule 51.505 have already been violated by the Illinois legislation. Even though the ICC has not set any rates, the Illinois legislature has already abated an on-going federal rate-making arbitration and made findings of fact in favor of SBC without requiring SBC to meet its burden of proof on these issues. Additionally, the

ICC is in the midst of a procedurally unauthorized rate-making proceeding. Furthermore, it is clear from the ICC administrative law judges' proposed order that the ICC intends to set UNE rates in violation of TELRIC. Unlike in *Prentis*, there remains no time and place when and where the ICC will hear objections and evidence against the proposed order.

CONCLUSION

The Plaintiffs claim that the Illinois legislation sought to be enjoined is special interest legislation of the rankest sort, designed solely to benefit the incumbent local telephone monopolist in Illinois and twelve other states. It has been called a legislative fix to the sponsors' fear that the ICC might not agree with their view of the issues. The Plaintiffs assert that having only SBC's interests in mind necessarily retards and impedes the competitive climate, and departure from the market of some of SBC's competitors is likely to follow.

SBC, on the other hand, claims that it has, in fact, been subsidizing its competitors and that this Court's focus should be on the fairness of rates produced by the legislative change and not the manner in which the result is ordained. The fundamental problem with SBC's position is twofold. Its direct appeal to the Illinois legislature for rate relief is expressly contrary to federal law. If the ICC should act niggardly toward SBC in a way inconsistent with relevant evidence, the appeal must

be to the Federal District Court and not to the legislators of the state in which it may hold sway.

Additionally, the legislative process can be both inelaborate and unscientific when compared to the adjudicatory procedures mandated by state commissions in the conduct of their business. The ICC, and this Court, are perfectly capable of determining whether SBC has been forced to subsidize its competitors in some unlawful way such that its own competitive abilities have been compromised. There is no evidentiary or procedural record of like kind in legislative considerations, so there is no present basis to test SBC's thesis that it has been shortchanged lo these many years. The beauty of administrative and judicial proceedings include, among other things, standing to those who may be affected and an opportunity to be heard.

None of this discussion is intended to denigrate the legislative process, for the benefits produced by our system of government are obvious to all. But when a federal statute is enacted to expressly preempt a field and procedural mechanisms are elaborately set forth, state acts inconsistent with either the substantive or procedural federal law cannot stand. The rate issues which underlay the Illinois legislation have been declared by federal law to be adjudicatory in nature, not legislative. The action of the Illinois General Assembly in declaring the method by which fill factors and

depreciation rates are to be determined are an intrusion into federal law and are clearly inconsistent with it. As such, they cannot stand and must be enjoined.

Based on the foregoing analysis, we grant the motion. Defendants are preliminarily enjoined from implementing sections 13-408 and 13-409 of Illinois' Public Utilities Act (220 ILCS 5/13-408 and -409).

Charles P. Kocoras
Chief Judge
United States District Court

Dated: June 9, 2003

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2200 FIRST NATIONAL BANK BUILDING
332 MINNESOTA STREET
SAINT PAUL, MINNESOTA 55101
TELEPHONE (651) 808-6600
FACSIMILE (651) 808-6450

BRIGGS AND MORGAN
PROFESSIONAL ASSOCIATION

WRITER'S DIRECT DIAL
(651) 808-6561
WRITER'S E-MAIL
mayotte@briggs.com

August 12, 2003

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VIA FEDERAL EXPRESS

Regulatory Commission of Alaska
701 West Eighth Avenue
Suite 300
Anchorage, Alaska 99501

Re: In the Matter of the Commission Review of Rules and Regulations Governing Telecommunications Rates, Charges Between Competing Telecommunications Companies, and Competition in Telecommunications Commission Docket No.: R-03-3

Dear Sir or Madame:

Please find enclosed for filing in the above matter the original and ten (10) copies of the Reply Comments of Dobson Cellular Systems, Inc. in Response to the Rural Coalition's Comments and Proposed Regulations. Also find enclosed an electronic copy of the document in MS Word format.

If you should have any questions regarding the enclosed, please contact me at the above number.

Very truly yours,

Mark J. Ayotte

MJA/
Enclosures

cc: Herbert Kenney (w/enclosure)
Heather H. Grahame (w/enclosure)

1558868v1

STATE OF ALASKA

THE REGULATORY COMMISSION OF ALASKA

Before Commissioners:

Mark K. Johnson, Chair
Kate Giard
Dave Harbour
James S. Strandberg
G. Nanette Thompson

In the Matter of the Commission Review of Rules and Regulations Governing Telecommunications Rates, Charges Between Competing Telecommunications Companies, and Competition in Telecommunications	))))))	R-03-3

REPLY COMMENTS OF DOBSON CELLULAR SYSTEMS, INC. IN RESPONSE TO THE RURAL COALITION'S COMMENTS AND PROPOSED REGULATIONS

I. INTRODUCTION

1. Dobson Cellular Systems, Inc. ("Dobson") submits the following comments in response to the Notice of Inquiry ("Notice") of the Regulatory Commission of Alaska ("Commission") dated June 11, 2003. Specifically, Dobson submits these comments in opposition to the Comments and Proposed Regulations filed by the Rural Coalition on July 16, 2003.

2. Dobson is an Oklahoma based company who began providing commercial mobile radio services ("CMRS") in Alaska in January 2000 and is now the largest wireless service provider in the State. Dobson's licensed service areas are in Alaska Rural Service Area ("RSA") 1, Alaska RSA2, Alaska RSA 3, and the Anchorage Metropolitan Service Area ("MSA"). Dobson's licensed areas cover approximately 91% of the population of the State.

3. On July 11, 2003, Dobson filed its Application for Designation as a Carrier Eligible to Receive Federal Universal Service Support under the Telecommunications Act of 1996 and Petition for Redefinition of Certain Rural Service Areas ("Application"). Dobson's Application is currently pending before the Commission in Docket No. U-03-48.

4. As a CMRS provider, the Federal Communications Commission ("FCC") has determined that Dobson is not "a local exchange carrier" under state or federal law. *In the Matter of Implementation of Local Competition Provisions in the Telecommunications Act of* 1996, CC Dockets 96-98 & 95-185, FCC 96-325, ¶ 1004 (rel. Aug. 8, 1996). Therefore, Dobson takes no position regarding the Commission's review of its Local Exchange Competition Rules (3AAC 53.200 – 53.299), since the resulting rules will not be applicable to CMRS providers. Dobson's reply comments are limited to the Rural Coalition's proposed "New Universal Service Fund Regulations" ("ETC Rules") set forth in Section II of Exhibit A to its comments.

5. Although couched in terms of eliminating the dominant/non-dominant carrier distinction present in the Commission's existing Local Exchange Competition Rules based on the designation of multiple eligible telecommunications carriers ("ETC") within a service area, the Rural Coalition has simply used this docket as a springboard to promote its unduly burdensome and anti-competitive proposed ETC Rules.

6. The Commission should not endorse the Rural Coalition's dubious effort to expand the scope of this proceeding beyond issues of landline local competition and should not entertain any proposed universal service regulations in the context of this proceeding. Rather, the Commission should consider the development of competitive ETC rules, if at all, only after a Notice of Inquiry or Notice of Proposed Rule Making that gives clear notice that such rules will be considered and affords all interested parties adequate notice and an opportunity to respond.

II. DOBSON'S COMMENTS

A. The Rural Coalition's Proposed ETC Rules Should Not Be Considered In This Proceeding

1. The Rural Coalition Failed To Meet The "Increased Burden Of Persuasion" Required to Obtain Consideration Of Its ETC Rules

7. Pursuant to the Notice in this matter, the Commission sought comment directed toward the nine legislative policies set forth in HB0111 and its existing telecommunications regulations governing local exchange carriers. Notice at 2. The Commission also required any commentator seeking consideration of issues beyond the scope of HB0111 to meet an "increased burden of persuasion" in order to invoke the Commission's administrative review. *Id.* at 4 & 6. Moreover, the Commission specifically directed that any commentator submitting newly proposed regulations shall provide the rationale and policy reasons supporting each proposal. *Id.* at 3.

8. Despite these clear dictates, the Rural Coalition's submittal is devoid of any supporting legal authority or policy arguments supporting its proposed ETC Rules. Therefore, the Commission should not expend its administrative resources addressing the Rural Coalition's conclusory and arbitrary ETC Rules in this proceeding.

2. Many of The Rural Coalition's Proposed ETC Rules Are Unsound and Contrary To Federal Law

9. More importantly, the Commission should not consider the Rural Coalition's proposed ETC Rules because they are in many respects contrary to sound policy, the Telecommunication Act of 1996 (the "Act") and FCC regulations and Orders.

a. The Commission Is Bound By Federal Statues And FCC Regulations When Designating A Federal ETC

10. Pursuant to Section 214(e)(2) of the Act, Congress delegated to State regulatory commissions the authority to designate federal ETCs for purposes of eligibility to receive support from the universal service funds:

> A State commission shall upon its own motion or upon request designate a common carrier that meets the requirements of paragraph (1) as an eligible telecommunications carrier for a service area designated by the State commission. Upon request and consistent with the public interest, convenience, and necessity, the State commission may, in the case of an area served by a rural telephone company, and shall, in the case of all other areas, designate more than one common carrier as an eligible telecommunications carrier for a service area designated by the State commission, so long as each additional requesting carrier meets the requirements of paragraph (1). Before designating an additional eligible telecommunications carrier for an area served by a rural telephone company, the State commission shall find that the designation is in the public interest.

47 U.S.C. § 214(e)(2). Stated otherwise, Congress deputized the State commissions to make the initial determination as to whether an applicant meets the requirements to be designated as a federal ETC. Notwithstanding this limited delegation of authority, the State commissions must act consistent with federal law and the FCC's promulgated regulations and standards in considering an application for federal ETC designation. Yet, the Rural Coalition's proposed ETC Rules go far beyond the Commission's authority delegated by Section 214(e). State commissions are in no position to change, modify or add to the federally-established criteria for ETC designation.

11. Nor can a State commission impose such burdensome procedural or substantive rules in designating federal ETCs so as to frustrate the Act's twin goals to both preserve universal service and to promote competition. *See In the Matter of Federal-State Joint Board on Universal Service*, CC Docket 96-45, *Comments of the Regulatory Commission of Alaska* at 11 (Aug. 30, 2002) (The FCC's "stated historic policy has been to promote the dual goals of universal service and market competition.") A simple review of the Rural Coalition's proposed ETC Rules

demonstrates they are designed to burden the application process and render it virtually impossible for any competitive ETC to acnieve designation.

b. Because The Rural Coalition's Proposed ETC Rules Are Largly Contrary to Federal Law They Must be Rejected

12. Set forth below are just some of the examples by which the Rural Coalition's proposed ETC Rules run afoul of the Act, FCC regulations and prior decisions of the FCC. This list is not exhaustive, but rather illustrates the lack of reasoned analysis throughout the Rural Coalition's proposals.

(1) Proposed Rule 53.360(b)(2)(A) – demonstration of a "concrete intent" to serve the entire service area within a "reasonably short period of time"

13. As established by the FCC, an applicant for federal ETC designation is not obligated at the application stage to prove that it can provide service throughout its requested service areas. Rather, an applicant must only show that it has an intent and ability to serve once designated, and to make a commitment to meet reasonable requests for service over time. To hold otherwise creates a barrier to entry. *In the Matter of Federal-State Joint Board on Universal Service Western Wireless Corporation Petition for Preemption of an Order of the South Dakota Public Utilities Commission, Declaratory Ruling*, CC Docket 96-45, FCC 00-248, 15 FCC Rcd at 15175 (rel. August 10, 2000) ("*Declaratory Ruling*") ("A telecommunications carrier's inability to demonstrate that it can provide ubiquitous service at the time of its request for designation as an ETC does not preclude its designation as an ETC. To do so would have the effect of prohibiting new entrants from providing telecommunications service.")

14. Indeed, an applicant for ETC designation must be given the same reasonable opportunity to develop its network as that afforded the incumbent local exchange carrier:

> We find the requirement that a carrier provide service to every potential customer throughout the service area before receiving ETC designation has the effect of prohibiting the provision of service in high-cost areas. As an ETC, the incumbent

> LEC is required to make service available to all consumers upon request, but the incumbent LEC may not have facilities to every possible consumer. We believe the ETC requirements should be no different for carriers that are not incumbent LECs. A new entrant, once designated as an ETC, is required, as the incumbent is required, to extend its network to serve new customers upon reasonable request. We find, therefore, that new entrants must be allowed the same reasonable opportunity to provide service to requesting customers as the incumbent LEC, once designated as an ETC. Thus, we find that a telecommunications carrier's inability to demonstrate that it can provide ubiquitous service at the time of its request for designation as an ETC should not preclude its designation as an ETC.

Id. (emphasis added).

15. Accordingly, this Commission cannot impose a heightened burden of persuasion requiring proof of a "concrete intent" to serve with a "reasonably short period of time" as proposed by the Rural Coalition To the contrary, the ETC applicant must be afforded the same opportunity as the incumbent to develop its network over time and to address service requests on a case-by-case basis.

(2) Proposed Rule 53.360(b)(2)(C) – demonstration of "financial wherewithal" to provide the supported services throughout the service area

16. There is no provision in the Act or FCC regulations establishing a financial competency test to be met prior to designation as a federal ETC. Indeed, the incumbent ETCs – including the members of the Rural Coalition – were not required to meet any financial fitness standard prior to obtaining their ETC designations. Thus, rather than promoting regulatory parity as the Rural Coalition suggests, this provision is plainly discriminatory and intended to prevent designation of any competitive ETCs within the Coalition members' service areas.

17. In addition, the Rural Coalition's proposed standard – *i.e.*, "financial wherewithal" – is so ambiguous as to be incapable of application and should not be adopted by the Commission in any event.

(3) Proposed Rule 53.360(b)(2)(F) – whether designation will harm consumers through "unacceptable 'dead spots'"

18. The Rural Coalition's reference to "unacceptable 'dead spots'" in proposed rule 53.360(b)(2)(F) is entirely at odds with recent FCC rulings rejecting similar arguments by rural incumbents in Alabama. Consistent with its *Declaratory Ruling* in the Western Wireless South Dakota proceeding, the FCC designated RCC Holdings and Cellular South License, Inc. as federal ETCs over objection of the Alabama Rural LEC intervenors, writing:

> 15. We reject the Alabama Rural LECs' argument that RCC Holdings does not offer all of the services supported by the Federal universal service support mechanisms as required by section 214(e)(1)(A). Specifically, the Alabama Rural LECs claim that RCC Holdings: (1) does not currently provide all of the supported services in all of the areas where it requests designation because of "dead spots" in RCC Holdings' network; and (2) fails to allege that it is currently providing local usage and has not described its universal service offerings. The "dead-spots" referred to in affidavits submitted by the Alabama Rural LECs are identified as pinpoint locations where certain Alabama rural telephone company employees were unable to place calls, or were unable to communicate clearly with a called party on a RCC Holdings, Inc. d/b/a Unicel cellular phone. In addition, the Alabama Commission states in its comments that "[t]he lack of [wireless] coverage in rural areas also raises serious concerns whether RCC presently has, or will acquire, the ability in a timely manner to provide emergency services in all of its rural service territories."
>
> 16. We find that the existence of "dead spots" in RCC Holdings' network, if any, does not preclude us from designating RCC Holdings as an ETC. The Commission has already determined that a telecommunications carrier's inability to demonstrate that it can provide ubiquitous service at the time of its request for designation as an ETC should not preclude its designation as an ETC. To require a carrier to actually provide the supported services before it is designated an ETC has the effect of prohibiting the ability of prospective entrants from providing telecommunications service. Instead, "a new entrant can make a reasonable demonstration . . . of its capability and commitment to provide universal service without the actual provision of the proposed service." Moreover, RCC Holdings has committed to improve its network. It states that coverage gaps can and will be filled once RCC Holdings begins receiving high-cost support.
>
> 17. In addition, the Commission's rules acknowledge the existence of dead spots. "Dead spots" are defined as "[s]mall areas within a service area where the field strength is lower than the minimum level for reliable service." Section 22.99 of the Commission's rules states that "[s]ervice within dead spots is

> presumed." Additionally, the Commission's rules provide that "cellular service is considered to be provided in all areas, including dead spots . . . ." Because "dead spots" are acknowledged by the Commission's rules, we do not agree with the Alabama Rural LECs that finding current "dead spots" in RCC Holdings' network demonstrates that RCC Holdings is not "willing or capable of providing acceptable levels of service" throughout its service area.

In the Matter of Federal State Joint Board on Universal Service RCC Holdings, Inc. Petition for Designation as an Eligible Telecommunications Carrier Throughout its Licensed Service Area In the State of Alabama, Memorandum Opinion and Order, CC Docket No. 96-45, DA 02-3181 (rel. Nov. 27, 2002) (emphasis added). One week later, the FCC issued a nearly verbatim opinion in *In the Matter of Federal State Joint Board on Universal Service Cellular South License, Inc. Petition for Designation as an Eligible Telecommunications Carrier Throughout its Licensed Service Area In the State of Alabama, Memorandum Opinion and Order*, CC Docket No. 96-45, DA 02-3317 (rel. Dec. 4, 2002).

19. Accordingly, because the Commission cannot establish rules contrary to the FCC's controlling interpretations of federal law, it must similarly reject the Rural Coalition's effort to insinuate a ubiquitous coverage requirement as part of an ETC proceeding. *See, e.g., Consolidated Tel. v. W. Wireless Corp.*, 637 N.W.2d 699, 707 (N.D. 2001) ("Unless the FCC's rulings and regulations have been appropriately challenged in the proper federal forum, we are not at liberty to review the FCC's statutory interpretation even if we doubted its soundness, and we must apply the rulings and regulations as written.")

(4) Proposed Rules 53.360(b)(2)(G) and 53.360(c)(3)(A)(xi) – certification of use of universal service fund support

20. While not directly contrary to federal law, the Rural Coalition's proposed rule 53.360(b)(2)(G) is simply redundant and unnecessary as part of an ETC application process. Under FCC Rules 54.313 and 54.314, every designated ETC is obligated to annually certify to the FCC and the Universal Service Administrative Company ("USAC"), that all federal universal

service support will be used only for the provision, maintenance, and upgrading of facilities and services for which the support is intended, consistent with section 254(e) of the Act. 47 C.F.R. §§ 54.313 & 54.314.

21. Proposed rule 53.360(c)(3)(A)(xi) impermissibly seeks to expand this certification obligation to include a requirement that the ETC applicant publicly disclose its specific business plans relating to the development or expansion of its network and/or use of the universal service funds to subsidize rate cuts. This requirement, at the very least, infringes on an ETC applicant's proprietary business plans. At its worst, the proposed rule is plainly anti-competitive as providing the ETC applicant's direct competitors – including the incumbent LEC members of the Rural Coalition – with an unfair business advantage.

(5) Proposed Rule 53.360(c)(3)(A)(viii) – requiring explanation of all agreements the applicant has with long distance carriers, including the provision of "equal access"

22. Like many of the Rural Coalition's rules, proposed rule 53.360(c)(3)(A)(viii) is plainly anti-competitive as it purports to require full disclosure of non-public agreements between the ETC applicant and interchange carriers ("IXCs"). More importantly, the proposed rule ignores the fact that the FCC has rejected an "equal access" requirement under Section 214(e)(1) and FCC Rule 54.101(a)(7) for any ETC. On reconsideration, the FCC more recently again declined to require any federal ETC to provide equal access and deferred consideration of the issue pending resolution of its *Portability Proceeding*. *In the Matter of the Federal-State Board on Universal Service*, CC Docket 96-45, FCC 03-170 at 14-15 (rel. July 14, 2003). Moreover, Congress has specifically exempted CMRS providers from any requirement to provide equal access to long distance carriers. 47 U.S.C. § 332(c)(8). The FCC specifically recognized that this might mean incumbent landline carriers would be subject to different regulatory requirements than other carriers. *In the Matter of Federal-State Joint Board on Universal Service*, CC Docket

No. 96-45, FCC 97-157, Report and Order, ¶ 79 ("*Universal Service Order*") (rel. May 8, 1997) ("[C]ompetitive neutrality does not require that, in areas where incumbent LECs are required to offer equal access to interexchange service, other carriers receiving universal service support in that area should also be obligated to provide equal access.") Consequently, the Rural Coalition's proposed regulation is contrary to federal law.

(6) Proposed Rule 53.360(c)(3)(B)(ii) – requiring detailed analysis of unserved/underserved rural areas and build out plans

23. The Rural Coalition's proposed ETC Rules become even more burdensome and anti-competitive when a federal ETC applicant seeks designation within a rural service area, like those areas served by the Coalition members themselves. For example, attempting to bootstrap various extra-regulatory requirements under the guise of the "public interest" analysis required by 47 U.S.C. § 214(e)(2), the Rural Coalition's proposed rule 53.360(c)(3)(B)(ii) goes well beyond any showing required by the FCC or any State commission to date. Indeed, under the FCC's well-reasoned public interest analysis, the competitive benefits of designating a competitive ETC in a rural service area are presumed to be in the public interest absent a showing that such benefits will be outweighed by some real, demonstrable harm to the consumer.

24. In December 2000, the FCC for the first time conducted a "public interest" analysis under Section 214(e)(6),[1] resulting in the designation of a wireless provider – Western Wireless – as an additional ETC in certain rural service areas in Wyoming. This decision represents the FCC's binding interpretation of federal law concerning the public interest standard under Section 214(e).

[1] Section 214(e)(6) sets forth standards for ETC designation by the FCC that are identical to the standards for State commissions under Section 214(e)(1)-(2). The FCC proceeds under Section 214(e)(6) when a State commission does not have jurisdiction to proceed under Section 214(e)(2).

25. First recognizing that the "public interest" under Section 214(e) involves the balancing of the benefits of competition against any demonstrated detriments to universal service, the FCC stated:

> Public Interest Analysis. We conclude that it is in the public interest to designate Western Wireless as an ETC in Wyoming in those designated service areas that are served by rural telephone companies. Western Wireless has made a threshold demonstration that its service offering fulfills several of the underlying federal policies favoring competition. We find that there is no empirical evidence on the record to support the contention that the designation of Western Wireless as an ETC in those designated service areas served by rural telephone companies in Wyoming will harm consumers. In fact, we conclude that those consumers will benefit from the provision of competitive service and new technologies in high-cost and rural areas.
>
> We note that an important goal of the Act is to open local telecommunications markets to competition. Designation of competitive ETCs promotes competition and benefits consumers in rural and high-cost areas by increasing customer choice, innovative services, and new technologies. We agree with Western Wireless that competition will result not only in the deployment of new facilities and technologies, but will also provide an incentive to the incumbent rural telephone companies to improve their existing network to remain competitive, resulting in improved service to Wyoming consumers. In addition, we find that the provision of competitive service will facilitate universal service to the benefit of consumers in Wyoming by creating incentives to ensure that quality services are available at "just, reasonable, and affordable rates."
>
> Although we recognize the substantial benefits of competition to consumers, we conclude that additional factors may be taken into consideration in the public interest examination required by section 214(e)(6) prior to the designation of an additional ETC in an area served by a rural telephone company, such as whether consumers will be harmed. In so doing, we recognize that Congress expressed a specific intent to preserve and advance universal service in rural areas as competition emerges.
>
> * * *
>
> We reject the general argument that rural areas are not capable of sustaining competition for universal service support. We do not believe that it is self-evident that rural telephone companies cannot survive competition from wireless providers. Specifically, we find no merit to the contention that designation of an additional ETC in areas served by rural telephone companies will necessarily create incentives to reduce investment in infrastructure, raise rates, or reduce service quality to consumers in rural areas. To the contrary, we believe that

> competition may provide incentives to the incumbent to implement new operating efficiencies, lower prices, and offer better service to its customers. While we recognize that some rural areas may in fact be incapable of sustaining more than one ETC, no evidence to demonstrate this has been provided relating to the requested service areas. We believe such evidence would need to be before us before we could conclude that it is not in the public interest to designate Western Wireless as an ETC for those areas served by rural telephone companies.

In the Matter of Western Wireless Corporation Petition for Designation as an Eligible Telecommunications Carrier In the State of Wyoming, CC Docket No. 96-45, DA 00-2896, Memorandum Opinion and Order ("*Wyoming Order*") ¶¶ 16-22 (rel. Dec. 26, 2000) (footnotes omitted) (emphasis added).

26. Thus, contrary to the Rural Coalition's urging, the Commission cannot under the pretext of a public interest analysis require an applicant for ETC designation to support its application with the type of burdensome market studies advocated by the Rural Coalition.

(7) Proposed Rule 53.360(c)(3)(B)(iv) – requiring demonstration that applicant's provision of advanced services will be made available at "reasonable cost"

27. Likewise, proposed rule 53.360(c)(3)(B)(iv) goes well beyond any FCC or State commission determination in seeking to bootstrap an "affordability" test under the pretext of a public interest analysis. This proposed requirement must be rejected because "affordability" is not a statutory criterion for ETC designation under the plain language of Section 214(e)(1), and the FCC has rejected any attempt to expand the list of criteria necessary for ETC designation:

> [W]e find that these provisions dictate that a state commission must designate a common carrier as an eligible carrier if it determines that the carrier has met the requirements of section 214(e)(1) . . . . The statute does not permit [the FCC] or a state commission to supplement the section 214(e)(1) criteria that govern a carrier's eligibility to receive federal universal service support.

Universal Service Order ¶ 135 (emphasis added).

28. Moreover, the affordability principle is identified in 47 U.S.C. § 254(b)(1), where Congress directed the Joint Board and FCC (not a State commission) to consider the principle of

"quality services . . . at just, reasonable, and affordable rates" in defining the scope of services considered to be "universal." The FCC did just that in defining the list of supported services set forth in FCC Rule 54.101(a). Yet, affordability is not a criterion for ETC designation under Section 214(e)(1) and, therefore, cannot be considered as part of an ETC application under the guise of a 214(e)(2) "public interest" analysis.

(8) Proposed Rule 53.360(c)(6)(A)(i)-(v) – generally imposing discriminatory obligations and requirements specific to CMRS providers

29. The Rural Coalition's proposed ETC Rules targeted specifically toward CMRS providers are even more objectionable from both a legal and policy perspective. The proposed rules seek to discriminate against a certain technology in complete opposition to the FCC's stated principals of competitive and technological neutrality.

30. To promote competition and preserve and advance universal telecommunications services, the FCC adopted an express policy of competitive and technological neutrality:

> A principal purpose of Section 254 is to create mechanisms that will sustain universal service as competition emerges. We expect that applying the policy of competitive neutrality will promote emerging technologies that, over time, may provide competitive alternatives in rural, insular, and high cost areas and thereby benefit rural consumers.

Universal Service Order ¶ 50 (emphasis added). The FCC has described its policy of "competitive neutrality" as follows:

> Universal service support mechanisms and rules should be competitively neutral. In this context, competitive neutrality means that universal service support mechanisms and rules neither unfairly advantage nor disadvantage one provider over another, and neither unfairly favor nor disfavor one technology over another.

Id. ¶ 47 (emphasis added). Reinforcing the principle of technological neutrality in the promotion of universal service, the FCC has also explained:

> By following the principle of technological neutrality, we will avoid limiting providers of universal service to modes of delivering that service that are obsolete or not cost effective. The Joint Board correctly recognized that the concept of

> technological neutrality does not guarantee the success of any technology supported through universal service support mechanisms, but merely provides that universal service support should not be biased toward any particular technologies. We anticipate that a policy of technological neutrality will foster the development of competition and benefit certain providers, including wireless, cable, and small businesses that may have been excluded from participation in universal service mechanisms if we had interpreted universal service eligibility criteria so as to favor particular technologies.

Id. ¶ 49 (emphasis added).

31. Moreover, the Commission must remain mindful of the Act's prohibition against state regulation of the entry or rates of CMRS providers (47 U.S.C. § 332(c)(3)(A)), which the Rural Coalition's proposed ETC Rules appear to invite in the form of requiring specific tariff, service quality and build-out requirements, as well as an ill-defined "catch-all" provision (*i.e.*, proposed rule 53.360(c)(6)(B)).

c. The Rural Coalition's Proposed ETC Rules Would Unreasonably Delay Competitive Entry

32. Lastly, the Commission must reject the Rural Coalition's suggestion that the designation of a competitive ETC be made contingent on the incumbent LEC's opportunity to first eliminate implicit subsidies — something that should already be occurring as the implicit subsidies are supplanted by explicit universal service support.

33. Indeed, pursuant to the Rural Coalition's proposed ETC Rules 53.360(e)(1)-(5), the incumbent LEC is vested with discretionary power to unreasonably delay the designation of a competitive ETC in its service area while the incumbent LEC develops cost studies, applies for modification of its rates and then prosecutes its application – presumably in a contested case proceeding as the proposed rules contemplate full consideration of "affordability concerns" that may result from the rate adjustments. *See* Proposed ETC Rule 53.360(e)(5). Consequently, the incumbent LEC could substantially delay competitive entry in its service area. The Commission should obviously not endorse such an anti-competitive result.

III. CONCLUSION

34. For the forgoing reasons, the Commission should reject the Rural Coalition's self-serving invitation to convert this proceeding into an ETC rulemaking docket. In any event, the Commission should decline to consider the Rural Coalition's proposed ETC Rules as it has plainly failed to meet the "increased burden of persuasion" necessary to invoke the Commission's administrative review of its existing ETC Rules. Moreover, the Rural Coalition's proposed ETC Rules are so riddled with defects that the Commission simply cannot afford the rules full consideration within the limited scope and timeframes of this proceeding.

Respectfully submitted,

Dated: August 12, 2003

BRIGGS AND MORGAN, P.A.

By _____

Mark J. Ayotte (MN 166315)
Matthew A. Slaven (MN 288226)
2200 First National Bank Building
322 Minnesota Street
Saint Paul, MN 55101
Telephone: 651-808-6561
Facsimile: 651-808-6450
mayotte@briggs.com

DOBSON COMMUNICATIONS CORPORATION

Herbert Kenney
Associate Corporate Counsel
14201 Wireless Way
Oklahoma City, Oklahoma 73134-2512
Telephone: 405-529-8336
Facsimile: 405-529-8765
herbert.kenney@dobson.net

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STATE OF ALASKA

THE REGULATORY COMMISSION OF ALASKA

Before Commissioners: Mark Johnson, Chair
Dave Harbour
Kate Giard
James S. Strandberg
G. Nanette Thompson

In the Matter of the Commission Review of Rules and Regulations Governing Telecommunications Rates, Charges Between Competing Telecommunications Companies, and Competition in Telecommunications	)	R-03-03

REPLY COMMENTS OF GCI

Introduction

On June 16, 2003, initial comments were submitted in this matter by ACS[1], AT&T Alascom[2], ATA[3], the Rural Coalition, and GCI[4]. GCI submits these comments in reply to the comments of ACS, AT&T Alascom, ATA, and the Rural Coalition.

Discussion

I. Reply to ACS.

[1] "ACS" includes ACS of Anchorage, Inc., ACS of Fairbanks, Inc., ACS of Alaska, Inc., ACS of the Northland, Inc., and ACS Long Distance, Inc.

[2] "AT&T Alascom" is Alascom, Inc.

[3] "ATA" is the Alaska Telephone Association.

[4] "GCI" is GCI Communication Corp. d/b/a General Communication, Inc., and d/b/a GCI.

GCI Communication Corp.
2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

A. General.

The comments of ACS echo its familiar themes: UNE rates are too low, competition is unfair, and markets should be instantly deregulated as soon as competition is authorized. GCI will address each of ACS' specific contentions and proposals below. While—as set forth in its initial comments--GCI agrees that in many instances regulation of ACS should be relaxed in competitive markets, ACS' proposals go too far, too fast.

As a general matter, GCI believes that ACS consistently misinterprets the intent of the Legislature. ACS generally interprets the provisions of HB 111 as endorsing the proposals that it put forth during the past legislative session and as mandating that the Commission adopt regulations that reverse course on previous decisions. In doing so, ACS ignores the specific statutory provision stating that "the legislature does not take a position on the propriety of existing commission rulings or regulations." (Section 2(d) of HB 111).

Additionally, in many instances the specific principles set forth by the Legislature in HB 111 are completely contrary to ACS' positions. In these instances, ACS simply ignores the specific language of the legislation. For example, Principle 5 simply states that "competition among telecommunications companies shall be encouraged." ACS stands that principle on its head and argues that the principle really means that "the 'rural exemption' must not be casually set

GCI Communication Corp.
2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

aside" and that "competition may put many desired outcomes at risk." (ACS Comments, p 14, 15)

The point of this genera. discussion thus far is that the Commission should not be under any misconception that it is compelled to adopt the proposals of ACS and it should not feel bullied by ACS' threat to obtain the relief it seeks from the legislature, through CSHB 106, if it does not get such relief in this proceeding.[5] Instead, the Commission should simply evaluate all of the proposals based on their substantive merits and consistency with the actual requirements of HB 111.

Another general matter that must be addressed concerns ACS' overall financial condition and the effects that competition has had on ACS. In its comments ACS makes a number of implicit allegations that current competitive policies must be changed because they threaten ACS' financial viability. ACS states, for example, that "in the context of this docket, perhaps the most persuasive argument is that competition will not survive if ILECs do not survive" (ACS Comments, p. 17); "ongoing competition turns on the financial health of the infrastructure provider" (ACS Comments, p. 31); and, "current policies could result to a return to a monopoly when CLECs gain 100% market share." (ACS comments, p. 11). These ACS comments are consistent with more specific

[5] See ACS Comments, p. 4-5. As indicated in GCI's initial comments, many of the provisions of CSHB 106 are clearly preempted by federal law.

GCI Communication Corp.
2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

allegations that ACS has made in other contexts that competition threatens its ongoing financial viability.

GCI has engaged an expert who is thoroughly familiar with Alaskan telecommunications and with corporate finance to evaluate these claims. The affidavit of Gregory F. Chapados is attached. Mr. Chappados' qualifications are of the highest order. Born and raised in Fairbanks and educated at Harvard, Mr. Capados served as Chief of Staff for Senator Ted Stevens and was actively involved in telecommunications policy at the time. Mr. Chapados also served as the principal advisor to President Bush (Senior) on telecommunications policy, holding the office of Assistant Secretary of Commerce for Communication and Administration and Administrator of the National Telecommunications and Information Administration. Since leaving public service Mr. Chapados was senior vice president of Crown Media, Inc., and is now a Managing Directory of an investment banker based in Dallas, Texas.

As is clearly set forth in Mr. Chapados affidavit, ACS' financial condition has steadily improved over the past several years and ACS has not been significantly harmed by competition. ACS has actually become dramatically more efficient as a result of competition, as one would expect. Furthermore, ACS just announced a major new financing package. In sum, Mr. Chapados affidavit demonstrates that ACS' claims of financial ruin are clearly no more than "crying wolf."

GCI Communication Corp.
2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

Mr. Chappados also addresses another claim often made by ACS, that it cannot afford to invest in telecommunications facilities. (See ACS Comments, p. 15-17.) As Mr. Chappados sets out, ACS continues to invest significantly in telecommunications facilities in Alaska. ACS continues to maintain large cash reserves that are available for investment.

Thus, the second point of this general discussion is that the Commission should not be under any misconception that it needs to change existing policies in order to save ACS from financial ruin. ACS remains a viable company and, to the extent it has suffered harm, most of that harm has been self-inflicted.

GCI now turns to the various specific proposals set forth in ACS' comments.

B. Policies #2 and #7, UNE Rates and Fill Factors.

1. ACS' Suggestions on How to Set UNE Rates Are Misguided and, If Adopted, Would Violate FCC Pricing Rules.

In its comments, ACS claims that the RCA has not properly implemented the FCC's TELRIC principles in the past, and, therefore, has not set fair UNE rates in prior arbitrations. Based on this premise, ACS offers various suggestions to the Commission on how it should implement TELRIC in the future to set UNE rates that, at least in ACS' view, would be fairer. GCI disagrees both with ACS' premise and its suggested changes. Collectively, the changes proposed by ACS would gut the FCC's TELRIC construct, for instance, by imposing "applicable state laws" and "industry standards" that may or may not be consistent

GCI Communication Corp.
2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

with TELRIC, and by allowing ACS to recover its uneconomic embedded costs through UNE rates in direct contradiction to the FCC's requirement that such embedded costs not be considered.

ACS begins its TELRIC discussion by claiming that the RCA's "prior interpretation of TELRIC principles and the application of the RCA's "hypothetical carrier" standard do not produce fair payment by user carriers." ACS Comments, p. 18. ACS argues that the RCA's past UNE rate decisions are flawed because of the Commission's reliance on a "hypothetical carrier" standard rather than a "hypothetical network" standard. Apart from a difference in terminology, GCI fails to understand what prior error ACS is trying to correct. The FCC's Rule 51.505(b)(1)[6] requires state commissions to set UNE rates based "on the most efficient telecommunications technology currently available and the lowest cost network configuration given the existing location of the incumbent LEC's wire centers." This rule is the heart of the FCC's TELRIC pricing standard. It is unimportant whether one semantically refers to the efficiency standard that underlies the FCC's rule either as a "hypothetical network" or a "hypothetical carrier" standard. What is important, however, is that the RCA follow and implement the FCC's rule.

In Order U-96-89(30), the RCA recently granted GCI's motion for clarification in the Anchorage arbitration confirming that the Commission intends

6 47 C.F.R. § 51.505(b)(1).

GCI Communication Corp.
2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

to follow (as indeed the Commission must in accordance with the Supreme Court's decision in *Verizon Communications, Inc. v. FCC*, 122 S.Ct. 1646 (2002)), and implement the FCC's standard as promulgated in Rule 51.505(b)(1).[7] With this clarification, nothing further remains for the Commission to correct or do on this subject.

Next, ACS claims that "it simply makes no sense to use pricing models that have been expressly discounted by the FCC" to set UNE rates. ACS Comments, p. 18. This comment implies that the RCA's use of a modified version of the FCC Synthesis Model to set UNE rates has been improper and that the Commission should no longer use the modified FCC's proxy model in the future to generate UNE rates. To be clear, the FCC has not prohibited state commissions from using a modified version of the Synthesis Model to develop TELRIC-compliant UNE rates. The FCC developed its Synthesis Model for the purpose of determining federal universal service support and in that context relied on nation-wide default cost values rather than company-specific cost inputs to determine universal service funding for non-rural carriers. Additionally, the FCC made certain assignments of cost that were immaterial for universal service funding purposes but are inappropriate for generating UNE rates. Thus, the FCC

GCI Communication Corp.
2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

7 Order U-96-89(30) at 9 (April 14, 2003).

cautioned that its Synthesis Model, unmodified, "may not be appropriate for other purposes, such as determining prices for UNEs."[8]

In March 2000, in the context of the ACS-GCI arbitration proceedings for Juneau, Fairbanks, and the Glacier State Study Area in Consolidated Docket U-99-141/U-99-142/U-99-143, the Commission hired an independent consultant, Ben Johnson Associates, Inc., to assist the Commission in its review of the parties' competing contentions regarding the selection of an appropriate model to set UNE rates.[9] Ultimately, Ben Johnson issued a report recommending that the FCC's Synthesis Model be modified and used because it is a neutral platform capable of generating TELRIC-compliant UNE rates. The Commission selected the FCC Synthesis Model based on Mr. Johnson's recommendation. The parties, thereafter, worked together and agreed on a method to modify the FCC Synthesis Model platform making it capable of generating individual UNE rates. Moreover, although the FCC's default values were used as a starting point in the Juneau-Fairbanks-Glacier State arbitrations, either party was free to propose different cost inputs to the Arbitrator to reflect Alaska-specific costs. Notably, ACS accepted the overwhelming majority of the FCC default values and chose to contest only a very small number of the cost inputs during the arbitration proceeding.

GCI Communication Corp.
2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

[8] *Federal-State Joint Board on Universal Service: Forward-Looking Mechanism for High Cost Support for Non-Rural LECs*, CC Docket 96-45, Tenth Report and Order, 14 FCC Rcd 20156, ¶ 32 (1999).

[9] GCI had proposed a version of the HAI proxy cost model whereas ACS had proposed an early version of its proprietary ACS cost model.

The point is that the FCC Synthesis Model, as structurally modified by ACS and GCI and populated with arbitrated cost inputs, is capable of generating fair and reasonable TELRIC-compliant rates. Importantly, no one has ever proposed that the RCA adopt the FCC default values without critical review and analysis.

Moreover, ACS' comments on the problems with the RCA's past selection of the modified FCC Synthesis Model overlook the Commission's recent attempt to accommodate ACS by selecting the ACS proprietary cost model (ACS Cost v7.2 model) as a process to generate loop rates in the Anchorage Arbitration in Docket U-96-89.[10] The Commission, however, recognized that ACS' proprietary model posed a number of considerable challenges:

> First, the use of a manual network design process is slow, potentially error prone, and because it relies on the expertise of individual design engineers, may lack the uniformity of a model that relies strictly on algorithms. Second, the ACS-AN model will produce only one category of rate elements – loop rates. Third, the spreadsheet portions of the model do not yet have a simple front end for inputs and changes to other factors can be difficult and time consuming. Fourth, potential modifications to the model may take considerably more time than the FCC model would require.[11]

Indeed, the ACS proprietary cost model in the Anchorage arbitration proved to be unwieldy and difficult to modify in a timely manner. The Commission

10 Order U-96-89(26) (July 29, 2002). The Commission adopted the ACS model as a process to allow GCI the right to propose structural changes to the platform.

11 *Id.* at 5.

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2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

recently abandoned its selection of the ACS cost model and instead has adopted a new approach that allows parties to propose prices and terms in accordance with whatever model or models the party chooses.[12]

In its comments, ACS also states that the Commission "could use a wide variety of models and inputs that would produce a range of TELRIC-complaint rates." ACS Comments, p. 20. As just discussed, the Commission, indeed, has adopted an approach that will allow each party to propose rates based on different models. ACS' statement, however, that the Commission could use a "wide variety" of cost inputs to set UNE rates is misleading. Although different model platforms can be used to set fair and reasonable UNE rates, the Commission must scrupulously examine the cost inputs to ensure that they reflect the forward-looking cost principles under the FCC's TELRIC standard. The Commission must be scrupulous in its examination and selection of the inputs otherwise the results using any of the parties' proposed models would be meaningless and arbitrary. A model is only useful in so far as the inputs used are meaningful and reasonable – otherwise, one can create a "garbage in, garbage out" conundrum.

In its comments, ACS also claims that the cost inputs should be based on the most efficient technology "actually deployed" by the provider. This comment is an attempt to revive the Commission's "efficient ILEC" standard,

12 Order U-96-89(35).

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2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

which the Commission first articulated in Order U-96-89(24) but abandoned in Order U-96-89(30). The Commission was correct in Order U-96-89(30) when it concluded that its "efficient ILEC" standard differs from the FCC's pricing methodology in Rule 51.505(b),[13] which requires state commissions to set UNE prices based on the most efficient telecommunications technology currently available in the industry and the lowest cost network configuration while using the existing location of the LEC's wire centers. By focusing on the technology actually deployed by the ILEC (as ACS again proposes in its comments) rather than the most efficient telecommunications technology currently available in the industry, the Commission's "efficient ILEC" standard potentially could have preserved more of the ILEC's embedded costs than is permissible under the FCC's pricing rules. The Commission should reject ACS' attempt to re-visit that issue again.

Likewise, ACS' comment that the "RCA's UNE pricing policies should begin with a rebuttable presumption of ILEC efficiency" also impermissibly differs from the FCC's pricing rules. Under Rule 51.506(c),[14] the incumbent must bear the burden of proving to the state commission that each of the UNE rates it proposes complies with the FCC's TELRIC rules. ACS' suggestion that the Commission start with a rebuttable presumption of ILEC

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2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

13 Order U-96-89(30) at 9.

14 47 C.F.R. § 51.507(e).

efficiency would impermissibly shift the burden of proof to the CLEC forcing it to find and prove the inefficiencies that underlie the ILEC's proposed rates.

Additionally, with respect to ACS' broad comments regarding how the Commission should resolve cost of capital and depreciation expense issues in a UNE rate proceeding, (ACS Comments, p. 20), GCI simply cautions the Commission that the FCC's TELRIC rules govern the determination of these cost issues as well in the setting of UNE rates,[15] and that the burden is on the ILEC to prove the reasonableness of its proposed forward-looking cost of capital and depreciation rates.[16]

Lastly, GCI wishes to respond to ACS' suggestion that the Commission consider the ILEC's historical, embedded costs in setting UNE rates. ACS Comments, p. 21. On this point, it is worth citing some of the FCC's lengthy discussion rejecting ILECs' claims that embedded costs should be considered in setting UNE rates:

> Section 252(d)(1)(A)(i) does not specify whether historical or embedded costs should be considered or whether only forward-looking costs should be considered in setting arbitrated rates. We are not persuaded by incumbent LEC arguments that prices for interconnection and unbundled network elements must or should include any difference between the embedded costs that have

15 *See* 47 C.F.R. §§ 51.505(b)(2) & (b)(3).

16 *See Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, First Report and Order*, 11 F.C.C.R. 15,499 (1996) ("*First Report and Order*") at ¶ 702 (wherein the FCC explains that the current authorized rate of return at the federal or state level is a reasonable starting point for TELRIC calculations and "the incumbent LECs bear the burden of demonstrating with specificity that the business risks that they face in providing unbundled network elements and interconnection services would justify a different risk-adjusted cost of capital or depreciation rate").

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2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

> incurred to provide those elements and their current economic costs. Neither a methodology that establishes the prices for interconnection and access network elements directly on the costs reflected in the regulated books of account, nor a price based on forward looking costs plus an additional amount reflecting embedded costs, would be consistent with the approach we are adopting. The substantial weight of economic commentary in the record suggests that an "embedded cost"-based methodology would be pro-competitor - -in this case the incumbent LEC—rather than pro-competition. We therefore decline to adopt embedded costs as the appropriate basis for setting prices for interconnection and access to unbundled network elements.[17]

ACS' suggestion that the Commission consider ILEC embedded costs would lead the Commission down an impermissible path of setting rates based on the ILEC's embedded costs in violation of the FCC's pricing rules.

2. ACS' Discussion On Fill Factors Is Vague and Appears Not To Comply With the FCC's Telric Rules.

At 27-28 in its Comments, ACS offers a few brief but vague suggestions on how the Commission should determine fill factors when setting UNE rates. Fill factors refer to the amount of spare capacity in cable sizes that network engineers include in the network design to accommodate administrative functions, such as testing and repair, and some amount of near-term growth.[18] These factors have a significant impact on the price of many network elements because they allow the cost of unused network capacity to be recovered from current customers for the ILECs' services. A lower fill factor increases the

GCI Communication Corp.
2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

17 *First Report and Order*, at ¶ 705.

18 *In the Matter of Federal-State Joint Board on Universal Service*, CC Docket No. 96-45 and *Forward-Looking Mechanism For High Cost Support For Non-Rural LECs*, CC Docket No. 97-160, Tenth Report and Order, 14 FCC Rcd 20156 (rel. November 2, 1999) at ¶ 186.

amount of spare capacity that the customers – CLECs, in the case of UNEs -- must pay for in the loop rate.

In its comments, ACS vaguely suggests that the Commission should determine fill factors based on "industry design standards" that "comply with applicable local and state laws." ACS Comments, p. 27. GCI is unsure what ACS means by this suggestion. Notably, ACS does not discuss TELRIC or mention efficiency in its comments. The implication of ACS' suggestion seems to be that "industry standards" and "applicable local and state laws" should supersede the FCC's TELRIC rules. Importantly, industry design standards by themselves (which may be decades old) or local and state laws may not reflect current technological capabilities or the application of economic pricing principles. GCI simply cautions the Commission to follow the FCC's TELRIC principles on the fill factor issue without bias towards claims regarding "industry standards" or "applicable local and state laws" unless ACS can establish the use of those standards is appropriate under the TELRIC construct.

3. GCI'S Specific Comments Regarding ACS' Proposed Chanes Regarding UNE Pricing.

In this section, GCI offers its specific comments on ACS' proposed rule changes to indicate where GCI expressly disagrees with ACS' language. Importantly, GCI recommends that the Commission not adopt any of ACS' proposed rules. ACS' proposed rules are largely self-serving and collectively would gut the FCC's mandatory TELRIC rules. Furthermore, ACS' proposed rule

GCI Communication Corp.
2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

changes attempt to convert key issues that must be carefully examined during the arbitration process into before-the-fact principles that effectively would remove the issues from the scrutiny of the arbitration process.

ACS PROPOSED RULE:

(a) Unbundled network element prices will be determined in conformance with the federal Telecommunications Act of 1996, the rules of the Federal Communications Commission adopted thereunder, and any other applicable state law.

GCI Comment: The language in this proposed rule would appear to impermissibly require the Commission to set UNE prices based on state law even if state law conflicts with the federal statute or FCC rules.

ACS PROPOSED RULE:

(b) In addition to the requirements prescribed by (a) of this section, the following additional guidelines will apply to the pricing of unbundled network elements:

(1) selecting a pricing model for unbundled network elements, the Commission will use the FCC's "hypothetical network standard" and will presume the existence of the most efficient technology actually deployed by the providing company.

GCI Comment: The language in the first sentence is confusing. The RCA must follow and implement the FCC's TELRIC pricing rules, including the standard set forth in 47 C.F.R. § 51.505(b)(1). ACS' language in the second sentence clearly violates the FCC's rules as discussed above.

ACS PROPOSED RULE:

(2) The Commission will ensure that the unbundled network element pricing model conforms to industry standard design and construction criteria and adheres to all applicable state and local laws.

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2550 Denali Street, Suite 1000
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GCI Comment: This language suggests that the Commission set UNE prices based on alleged industry standards and state law even if they conflict with the FCC's TELRIC rules. As discussed above, the Commission must follow and implement the FCC's TELRIC rules.

ACS PROPOSED RULE:

(3) Unbundled network element prices will be based on the reasonably anticipated forward looking cost of the company providing the network elements.

GCI Comment: This language is ambiguous suggesting that some of ACS' operating inefficiencies be retained when setting UNE rates. Again, the FCC has already set the pricing standard and rules for UNE pricing, and it is the FCC language and rules that the Commission must follow.

ACS PROPOSED RULE:

(4) Reasonably anticipated forward looking costs, including but not limited to the cost of labor and materials, will be determined by using the providing company's current actual cost adjusted for future charges.

GCI Comment: This language clearly conflicts with the FCC's TELRIC rules. This language seeks to preserve inefficient labor costs. Again, all costs must be determined in accordance with the FCC's TELRIC rules.

ACS PROPOSED RULE:

(5) In setting prices for unbundled network elements, the Commission will use fill factors that conform to industry standard design and construction criteria and adhere to all applicable state and local laws. Fill factors should reflect a reasonable projection of actual total usage of the elements in question.

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2550 Denali Street, Suite 1000
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(907) 265-5600

GCI Comment: This language is vague and ambiguous and appears to conflict with the FCC's TELRIC rules as discussed above.

ACS PROPOSED RULE:

(6) Unbundled network element pricing will include a depreciation component that is based on the actual plant lives of the providing company. Actual plant lives will reflect the impact of technological change and the effects of competition. It is presumed that plant lives in competitive markets will be shorter than the ranges prescribed by the FCC for interstate services. Accelerated depreciation in competitive markets is deemed reasonable.

GCI Comment: This language is a clear attempt to set asset lives for depreciation purposes without regard to the FCC's TELRIC rules and the actual asset lives of the company's plant. In accordance with the proposed language, ACS could drive up its allowed expenses by writing plant off on an accelerated basis without critical evaluation of whether such practice is efficient or realistic. Moreover, the Commission should not presume shorter asset lives simply because of competition. UNE purchases by competitors may, indeed, prolong the life of ACS' plant.

ACS PROPOSED RULE:

(7) In evaluating the cost of capital component for unbundled network element pricing, the Commission will give consideration to the additional risks confronted by a providing company that operates in a competitive environment. It is presumed that application of a competitive risk premium will result in a higher cost of capital than prescribed by the FCC for interstate services.

GCI Comment: The language in the second sentence squarely conflicts with the FCC's rules requiring the ILEC to bear the burden of demonstrating the reasonableness of its proposed cost of capital adjustments.

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2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

C. Policy #2, Dominant Carrier Status.

ACS argues that Policy #2 requires an immediate change to the regulation that declares the incumbent carrier to be the dominant carrier. GCI agrees, and the regulations that GCI proposed in its initial comments include such a change.

The regulation proposed by ACS, however, does much more than change the regulation that declares the incumbent carrier to be the dominant carrier. Instead, ACS' proposed regulation totally eliminates dominant/nondominant regulation in any local exchange market as soon as a CLEC or CETC (presumably even a wireless CETC, including a wireless CETC that is affiliated with the ILEC, such as ACS proposes in Fairbanks) offers service to a majority of consumers in a service area.

As discussed in GCI's initial comments, Policy #2 actually presumes that dominant/nondominant carrier regulation will continue; the legislature simply required a change in the criteria for designation of the dominant carrier. If the legislature had intended to achieve the result ACS seeks, the legislature could have simply stated that no carrier will be designated as dominant in an area opened to competition. The legislature did not adopt such a requirement.

ACS also argues that the fact that GCI did not follow its rate increase in Anchorage proves that ACS does not have market power. That argument is

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2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

simplistic and inaccurate. As developed at length in initial comments, the concept of market power is relatively complex but involves, among other things, whether or not a price increase drives away so many customers as to make the increase not profitable. (GCI Comments, pp. 9-10) Given the fact that ACS retained its rate increase even though GCI did not follow, ACS must have determined that its increase was profitable. Thus, that experience would indicate that ACS did retain market power in Anchorage at that time.

D. Policy #4, Competitive Service Area.

In its comments and proposed regulation, ACS recognizes that the definition of competitive service area must be community-specific. GCI agrees, as set forth in initial comments.

GCI disagrees, however, with ACS' proposal that an area should be considered competitive as soon as more than 50% of the customers have a choice of provider, even if no actual competition has begun and even if the "choice" is from a cellular provider that has been designated an "eligible telecommunication carrier", or ETC. Cellular providers, even if designated as an ETC, generally compete against other wireless providers, not against local service providers. Furthermore, under ACS' proposal, even if the wireless ETC were the affiliate of the ILEC, the ILEC would nonetheless be designated as nondominant.

GCI's disagreement with the definition of competitive service is enhanced because, under ACS' proposal, the consequence of the "competitive

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2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

service area" designation is that the end of dominant/nondominant carrier regulation, as discussed above, and implementation of "notice tariff" procedures As set out in GCI's initial comments, the determination of dominant status is much more complex than whether a theoretical choice of carriers exists for some of the customers in a service area.

E. Policy #5, Depreciation.

ACS states that, to the extent that another governmental body has adopted industry accepted depreciation standards, they should be used as a test for reasonableness for ratemaking purposes. GCI agrees, and in fact the Commission has recently used FCC depreciation lives as a factor in determining appropriate lives for ACS plant. The lives adopted by the FCC, specific to telecommunications plant and specific to regulatory purposes, are clearly the most appropriate standards adopted by "another governmental body."

However, in its proposed regulations, ACS actually rejects the FCC depreciation lives, at least for the purpose of establishing UNE rates. ACS' desire to use standards set by another governmental body, but its rejection of FCC lives specifically designed for telecommunications plant, is inherently inconsistent.

ACS also fails to recognize that Policy #5 specifically refers to the actual service lives of depreciated equipment. Thus, while ACS wants to concentrate on "market dynamics" and "technological obsolescence", ACS fails to recognize that the actual import of Policy #5 is that the actual, experienced lives of

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2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

equipment in service must be considered by the Commission in setting depreciation rates.

F. Policy #6, Ratemaking Standards for Incumbents and Competitors.

In its discussion of the process and procedures that should be applied to tariff filings by carriers, ACS proposes that in competitive areas (defined by ACS as areas where more than 50% of consumers have a theoretical choice) "notice tariff" regulations should apply and that in areas with significant competition (defined by ACS as areas where 75% of consumers have a theoretical choice) service should be completely detariffed. In addition to GCI disagreement regarding the definition of "competitive service area" and "significant competition", as discussed elsewhere herein, GCI also disagrees with the process and procedures proposed by ACS. Instead, GCI believes that the 30 day notice periods now used in local markets, and used for over 10 years in long distance markets, are a better procedure. The existing process and procedures, applied equally to ILECs and CLECs once appropriate benchmarks have been passed, are appropriate and fully consistent with the requirements of HB 111. For example, both Policy #3 and #9 recognize that there are certain circumstances in which the Commission should disallow tariff changes, including both increases and decreases, and even in fully competitive markets. Even ACS recognizes that there will be some instance which the Commission should intervene to block a rate change. (ACS Comments,

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2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

p. 31) ACS does not, however, explain how the Commission would be able to block a rate increase if rates were detariffed and there were no notice, or even if there were 7 days notice. GCI believes that the Commission would be effectively unable to exercise its authority (and responsibility) to deny any tariff proposals under the procedures proposed by ACS.

In its consideration of whether either 7 day "notice tariffs" or complete detariffling should be allowed under any circumstances, the Commission should consider the nature of the charges that, left to its own discretion, ACS is likely to implement. Consider, for example, the "Competitive Market Equalization Charge" that ACS has now proposed be included in its tariff for the Fairbanks and Juneau markets. This proposed charge is a tax on each and every access line in the market, even lines served by a competitor and even lines that do not in any way rely on ACS facilities, with all of the revenue from the tax paid to ACS. ACS' competitors would be obligated—involuntarily—to collect the tax from its customers and pass the revenue to ACS. Apparently, ACS thinks such charges are appropriate and that they can be implemented by tariff. Under ACS' proposed notice tariff procedures, such a charge could be implemented by ACS upon only 7 days notice and with virtually no possibility of it being rejected by the Commission. Clearly, the Commission needs to maintain a fair notice period and the right to review filings in order to block proposals such as ACS' proposed tax.

G. Policy #8, Rate Increases in Competitive Markets.

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2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

Policy #8 provides that competitors should be allowed to increase rates under the same criteria in areas "where significant competition exists". ACS proposes that significant competition should be found to exist in any area that has a facilities-based competitor capable of serving 75% of all consumers. As with the definition of competitive service area, GCI disagrees that the standard for "significant competition" should be based entirely on the theoretical capability to service. The very words used by the Legislature—"where significant competition exists"—imply the actual existence of competition, not simply a capability or theoretical possibility of competition. For these reasons, GCI believes that the proposal in its initial comments to define an area where significant competition exists as an area where the dominant carrier serves less than 80% of the lines is appropriate and consistent with the Legislative Policy #8.

H. Other Matters.

In its comments ACS makes various other assertions that require at least a brief response. For example, ACS complains that, in applying the tariff regulations for dominant and nondominant carriers, the Commission has routinely granted waivers to CLECs that it denies to ILECs. ACS cites no actual examples, and as previously stated elsewhere GCI believes that ACS' perceived difference in treatment is actually the result of GCI's working with Commission staff to modify tariff proposals to be acceptable, while ACS attitude is "my way or no way."

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2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

ACS also asserts that "anti-bundling" prohibitions on ILECs are unfair and have hindered ILEC's ability to compete. However, as ACS has recognized elsewhere, the ONLY existing restriction on bundling involves the bundling of local exchange and intrastate interexchange service. Furthermore, as ACS has also recognized, the existing rules on geographic rate averaging for long distance rates also effectively precludes bundling of local and long distance service, and that rule applies equally to ILECs and CLECs. Thus, there is now effectively no difference in the extent to which ILECs and CLECs are allowed to offer bundled service.

In this regard, ACS proposes to waive application of the rule requiring geographic rate averaging (3 AAC 52.370(a)) to bundled services including local and long distance service. (See ACS Proposed 3 AAC 53.290(e), p. 8 of ACS Exhibit A) Given the fact that ACS offers long distance service primarily in low cost areas such as Anchorage, Fairbanks, and Juneau, GCI understands why ACS proposes that the rule requiring geographic rate averaging not apply to bundled services, since ACS would then be able to "cream skim" in the urban markets. However, the Commission should clearly understand that ACS' proposal would effectively eliminate the geographic rate averaging policy. ACS, serving low cost areas, would be certain to offer low rates in the urban areas. Competitors would be forced to match those lower rates in the low cost areas. Rural residents, however, would not have similar rates, and geographic rate averaging would end.

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2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

ACS also proposes that CLECs should be required to offer access to their networks comparable to the access that ILECs are required to offer. GCI has, in fact, offered such access to ACS and GCI intends to continue that policy. However, as a matter of federal law, CLECs cannot be required to unbundled network access like ILECs. Xxx The only way that this can be accomplished is if the CLEC is actually designated by the FCC as an ILEC. (47 CFR §51.233: "A state may not impose the obligations set forth in sectin 251(c) of the Act on a LEC that is not classified as an incumbent LEC as defined in section 251(h)(1) of the Act, unless the Commission issues and order declaring that such LECs or classes or categories of LECs should be treated as incumbent LECs")[19]

ACS also claims that current UNE rates "artificially signal CLECs to rely on a UNE strategy" and "not invest because they lack economic incentive to do so." (ACS Comments, pp. 16-17.) ACS claims are contradicted by the facts. GCI is investing significantly in its own alternative loop technology so that it does not have to rely on ACS loops, which come laden with unsatisfactory and discriminatory service[20]

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2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

[19] As used by in that quote, "Commission" means the FCC, not the state commission.

[20] ACS does not seem to know what it wants. At times, ACS complains about the fact that GCI may discontinue use of ACS UNE loops. (ACS Comments, p. 12) At other times, ACS complains that GCI will continue to rely on ACS loops rather than making its own investment. (ACS Comments, p. 16-17) A rationale company would actually encourage GCI to remain on its loops by offering quality service at a good price, a price below GCI's alternative. Instead, ACS does everything it can to drive GCI off its loops, then complains about the consequences.

Finally, GCI will respond briefly to the affidavit of Dr. Lehman attached to ACS' Comments. There is much in Dr. Lehman's comments with which GCI agrees.[21] There is no disagreement that, as competition develops, regulation can give way to market forces. Even Dr. Lehman says this should occur when there is "sufficient competition." (Lehman affidavit, p. 7) GCI's main difference with Dr. Lehman is simply one of degree and when the change should occur. GCI's views are consistent with the longstanding practice of both the FCC and this Commission, as discussed in GCI's initial comments. Dr. Lehman's view are that the move to deregulation, based entirely on market forces, should occur immediately upon the availability of UNEs, even if there is absolutely no actual competition. (Lehman affidavit, p. 7) GCI simply believes that such a proposal goes too far, too fast. It is inconsistent with the practices of the vast majority of regulatory agencies. Furthermore, Dr. Lehman ignores the possibility that the availability of UNEs—the lynchpin of his analysis—could be eliminated in some markets. Similarly, ACS in its comments refers to the availability of UNEs are irrevocably allowing competition. (ACS Comments, p. 5) In both instances, Dr. Lehman and ACS ignore ACS' continuing appeal of the lifting of the rural exemption which, if successful, has the potential of eliminating UNEs, and

[21] Dr. Lehman would, apparently, reject the proposed "Competitive Market Equalization Charge" proposed by ACS in its rate design proceeding, as he agrees that "Guarantees are not consistent with competition." (Lehman affidavit, p. 8)

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2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

competition, in currently competitive markets. This reality must be considered by the Commission in any decision to rely on the "irrevocable" forces of competition.

II. Reply to AT&T Alascom.

In its comments, AT&T Alascom concentrates on the application of HB 111 to the interexchange market. AT&T Alascom proposes elimination of its treatment as a dominant carrier; creation of a new Universal Service Fund to create incentives for investment in interexchange facilities; and sharing of carrier of last resort responsibilities.

GCI believes that the regulations proposed in GCI's initial comments adequately address issues regarding AT&T Alascom's designation as the dominant carrier. The proposed regulation, consistent with Policy #2, would eliminate the fact that AT&T Alascom is designated dominant solely by virtue of being the incumbent carrier. The Commission would be required to determine, within 180 days, whether or not AT&T Alascom should continue to be treated as a dominant carrier, based on factors specifically set out in the regulation.

In reviewing AT&T Alascom's comments on this issue, GCI recognized, however, that its proposed regulation should be amended somewhat. As discussed in GCI's comments, determination of market power must be undertaken in regards to a specific product in a particular market. Therefore, there is a possibility that a carrier could be designated dominant for some purposes and

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2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

nondominant for other purposes. The regulations previously proposed by GCI should be modified to recognize that possibility.

In regards to AT&T Alascom's proposed subsidy for interexchange facility investment, GCI has some difficulty in responding because of the lack of any specifics provided by AT&T Alascom. In general, GCI disagrees than any such subsidy program is necessary or appropriate. Furthermore, GCI does not believe that ACS' proposal is supported by any of the nine specific legislative policies that are the subject of this document. Therefore, GCI suggest that this matter not be considered in this Docket.

Similarly, GCI has difficulty responding to AT&T Alascom's proposal regarding sharing of Carrier of Last Resort responsibility because it is so vague. In theory, GCI is not totally opposed to such sharing. However, GCI again suggests that this matter not be considered in this docket.

III. Reply to ATA.

The comments of ATA focus solely on the tariff review standards that should apply to competitive areas and whether or not any difference should exist for dominant carriers. In its comments, ATA focuses on the small size of many of its members.

As discussed in initial comments, decisions of the FCC make it clear that the issue of market power must be addressed for a specific service in a

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2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

specific geographic area. Therefore, the overall size of a firm is often irrelevant to the determination of market power. Even an ILEC that is small in relation to the total size of a CLEC may retain market power over local service in the ILEC's own geographic service area, based on the factors set out in GCI's proposed regulation, such as market share.

IV. Response to Rural Coalition.

The comments of the Rural Coalition fall into two general areas. First, the Rural Coalition proposes extensive modifications to the Commission's current rules governing local exchange competition. To some extent, those comments would have been more appropriately filed in Docket R-02-6, which was specifically opened to address those regulations. However, the comments also relate in some instances to the provisions of HB 111 and GCI will therefore address those comments. Second, the Rural Coalition proposed nine pages of entirely new regulations focused solely on designation of eligible telecommunications carriers. Those proposed regulations do not relate to any of the provisions of HB 111 and, the Rural Coalition did not meet its burden of persuasion that such matters should be considered in this Docket. In view of the complexity of the issues associated with ETC designation, consideration of these matters would substantially increase the scope of this matter and delay its completion. In accordance with the Commission's statement in Order No. 1 that it

GCI Communication Corp.
2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

would not consider additional issues absent special justification, GCI does not believe that the ETC issues should be considered in this Docket. Furthermore, the matter of ETC designation is now under consideration in regards to the application of Alaska Digitel for ETC status in the service area of Matanuska Telephone Association. Consideration of regulations regarding ETC designation would benefit from and proceed more smoothly after the Commission had addressed the issues in that proceeding.

The specific proposals of the Rural Coalition resemble, in many respects, the proposals of ACS. For example, "the Rural Coalition has eliminated the dominant/nondominant distinction in competitive service areas...." (Rural Coalition Comments, p. 8) As previously discussed, Policy #2 does not eliminate the dominant/nondominant distinction, it simply provides that the criteria for determining which carrier is dominant cannot include incumbency.

The Rural Coalition proposes five criteria for the determination of a competitive service area, which include mere certification of a second carrier, mere designation of a second ETC, and simple lifting of the rural exemption. (See Rural Coalition proposed 3 AAC 53.220). Thus, under the Rural Coalition proposal, an area would be deemed competitive, and the ILEC thus given nondominant carrier treatment, long before another carrier is actually providing any service. For example, the Commission lifted the rural exemption in ACS' Glacier State service area many years ago, but no competitive service is yet

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2550 Denali Street, Suite 1000
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offered there. Even in the best of circumstance, it takes a substantial time to build facilities to provide local service after regulatory approval has been obtained. For these reasons, the proposals of the Rural Coalition are inconsistent with the Legislative policy that any definition of competitive service area shall take into account whether actual competition exists in the area.

The Rural Coalition also proposes to change the existing rules regarding discontinuance, suspension, or abandonment of service in a way that is inconsistent with HB 111. HB 111 specifically states that the incumbent carrier remains the carrier of last resort until changed by the Commission. However, under the Rural Coalitions proposals any local exchange carrier in a competitive market would be able to discontinue service under the standards previously applicable to nondominant carriers. (See Rural Coalition proposed 3 AAC 53.230)

The Rural Coalition proposes that ILECs operating under a rural exemption are exempt from the requirement to offer services for resale, even at retail rates. (See Rural Coalition proposed 3 AAC 53.250). That proposal is contrary to both state and federal law, both of which require all carriers to allow resale at retail rates. (Section 251(b) of the Telecommunications Act; AS 42.05.860.

The provisions specifically discussed above form the backbone of the Rural Coalitions proposals to modify the current regulations regarding local

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2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

exchange competition. Each of the specific provisions discussed should be rejected for the reasons stated. Without those provisions, the rest of the proposals of the Rural Coalition are meaningless and out of context. Accordingly, the proposals of the Rural Coalition should be rejected in their entirety.

Conclusion

GCI looks forward to working with the Commission and other parties to accomplish the directives of HB 111. GCI urges the Commission to promulgate proposed rules as set forth in GCI's initial comments.

DATED at Anchorage, Alaska this 13th day of August, 2003.

GENERAL COMMUNICATION, INC.

BY: _____
James R. Jackson
Its: Regulatory Attorney

VERIFICATION

I, James R. Jackson, verify that I believe the statements contained in this pleading are true and accurate.

_____
James R. Jackson

SUBSCRIBED AND SWORN to before me this 13th day August, 2003.

CAROL S. CHAMBERS NOTARY PUBLIC STATE OF ALASKA My Commission Expires:

_____
Notary Public in and for Alaska
My commission expires: 4-2-05

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STATE OF ALASKA

THE REGULATORY COMMISSION OF ALASKA

Before Commissioners: Mark Johnson, Chair
Kate Giard
Dave Harbour
James S. Strandberg
G. Nanette Thompson

In the Matter of the Commission Review of)
Rules and Regulations Governing)
Telecommunications Rates, Charges Between) Docket R-03-3
Competing Telecommunications Companies.)
And Competition in Telecommunications.)
)

AFFIDAVIT OF GREGORY F. CHAPADOS

STATE OF TEXAS)
) ss.
COUNTY OF DALLAS)

I, Gregory F. Chapados, being duly sworn, deposes and states the following:

1. My name is Gregory F. Chapados. I am a Managing Director at Hoak Breedlove Wesneski & Co. ("HBW"), an investment bank based in Dallas, Texas. The views expressed herein are my own and not HBW's. Prior to joining HBW, I served as senior vice president – new business development at Crown Media, Inc., a top-20 cable multiple system operator with approximately one million subscribers. In the first Bush administration, I served as Assistant Secretary of Commerce for

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(907) 265-5600

Communications and Administration and Administrator of the National Telecommunications and Information Administration, which is the principal advisor to the President on communications policy. Prior to joining the Commerce Department, I served as chief of staff to Senator Ted Stevens of Alaska, where I was deeply involved in federal policy issues related to the development of long distance competition in the Alaska market. I was born and raised in Fairbanks, Alaska. I received a B.A. degree in government from Harvard College and a J.D. degree from Harvard Law School.

2. The purpose of this affidavit is to provide the Regulatory Commission of Alaska ("RCA") with information on the finances and operational performance of Alaska Communications Services Group ("ACS") that is relevant in the R-03-3 proceeding. In comments filed on July 16, ACS implies that ACS faces a near-term financial crisis with portentous statements such as "competition will not survive if ILECs do not survive" and "competition turns on the financial health of the infrastructure provider." ACS goes on to assert specifically (i) that the existing Alaska UNE rates have put ACS at an "unfair competitive disadvantage" that could lead to ACS' losing "virtually 100%" of the Anchorage, Fairbanks, and Juneau local telephone markets; (ii) that "below-cost UNE rates" both hinder ILEC efforts to secure capital for

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(907) 265-5600

investment and discourage ILEC investment in new technology and infrastructure; and (iii) that the RCA has an obligation to "ensure the financial health and viability of regulated entities" like ACS. The following comments compare ACS' gloomy assertions to the on-the-ground reality of ACS' finances and operational performance.

3. Despite UNE competition and numerous strategic and tactical missteps by ACS, ACS' financial condition has steadily improved over the past several years. In a teleconference announcing its results for the second quarter of 2003 on July 31, 2003, ACS announced the successful public offering of its directory operation, which generated $160 million in gross proceeds to ACS, amortization (otherwise referred to in the financial community as a company's "EBITDA") ratio to 4.1x, net of cash, from a ratio of nearly 5.0x, net of cash, at the end of 2000. (EBITDA is a customary measure of the financial performance of a telecommunication company's business operations.) ACS ended the second quarter with nearly $140 million of liquidity (cash and an undrawn $75 credit facility). ACS' chief financial officer stated in the Using these proceeds and other resources, ACS has paid down $112 million of its debt, a move that has reduced its total debt/trailing twelve months' earnings before interest, taxes, depreciation and teleconference that ACS' "liquidity position is excellent" and that the company presented a "strong credit profile." He also touted substantial improvements in the EBITDA margins for ACS' local telephone and wireless businesses. Since the

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buyout, ACS' annual EBITDA (as disclosed by ACS in its communications with investors) has grown substantially from $111.6 million at the end of 2000 to approximately $129.3 million at the end of 2002. This growth in EBITDA, which reflects a substantial improvement in ACS' local telephone operational performance in response to competition, would be even higher if ACS were not funding millions of dollars of losses in poorly performing diversification ventures such as long distance and Internet services.

4. Overall, the RCA's implementation of UNE rates has encouraged local telephone competition without significantly harming ACS financially or operationally. In fact, UNE competition has led ACS to dramatically improve the efficiency of its local telephone operations. Despite its doomsday rhetoric, ACS has not presented, to date, credible evidence in any forum that it is facing a financial crisis that threatens its viability. To the contrary, ACS' 10-Q filing for the second quarter of 2003 states that ACS "believes it will have sufficient working capital and available borrowing capacity under the existing revolving credit facility to service its debts and fund its operations, capital expenditures and other obligations over the next 12 months." ACS' chief executive officer and chief financial officer both certified the 10-Q filing under the Sarbanes-Oxley Act, which requires a publicly traded company's chief executive

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officer and chief financial officer to certify the accuracy of the company's quarterly SEC filings.

5. ACS' assertion that it risks losing 100% of the retail local telephone market as a result of UNE pricing is puzzling. GCI has not competed with ACS primarily on price but rather on the basis of bundling and customer service. Its basic local telephone service rates are very close to ACS' except for Anchorage, where ACS unilaterally increased local telephone rates in November 2001 by 24%, a rate increase that GCI declined to match. Despite this massive, self-inflicted wound, ACS retains more than half the local telephone market in Anchorage.

6. The competitive battle in Alaska's local telephone market ultimately will turn more on bundling, customer service, and innovation than on simple price cutting. The RBOCs have acknowledged the importance of bundling and are aggressively using wireless service in their bundling strategies. Despite ACS' statement in its July 31 investor teleconference, that it was winning back local telephone customers with new "bundled DSL, local and long distance service products," ACS has been late to the game both in bundling and in recognizing the key role that its wireless business can play in bundling. In 2000, Goldman Sachs, in an equity research report, noted that ACS had the only statewide wireless network and projected that ACS' wireless market penetration would rise

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(907) 265-5600

from 15.7% in 1999 to 25% in 2004. As of the end of 2002, ACS' wireless penetration was only 17.2%, up only one-tenth of a percent from the previous year's penetration of 17.1% percent. There is no chance that ACS will meet Goldman's projection. ACS' failure to grow this strategic business despite its many advantages has nothing to do with the wireline regulatory regime.

7. Alaska's UNE rates have not deprived ACS of needed investment capital. ACS is, of course, correct that unless there is a prospect of a reasonable return, the capital markets will not provide capital for an investment, but that scenario is not remotely the case here. ACS' local telephone business is a valuable asset that generates substantial and reliable cash flows and has ready access to the capital markets. In fact, ACS has just announced that it is proceeding on a major new financing. In conjunction with the issuance of $175 million in new senior unsecured notes, ACS plans to enter into a new bank credit agreement, which includes a $200 million term loan facility and a $50 million revolving credit facility. ACS will use the proceeds from this financing to retire the $320.7 million outstanding on its existing term loans.

8. After the new financing is complete, ACS will have increased its cash (as well as its total outstanding debt) by more than $50

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(907) 265-5600

million and will have total liquidity approaching $170 million (cash plus the new revolving credit facility of $50 million). The question naturally arises: What is ACS going to do with all this liquidity? A possible answer is found in ACS' previously cited 10-Q filing. ACS states there that it is looking to refinance its senior secured debt facilities to support its future growth and "loosen certain restrictive covenants, including with respect to the payment of dividends." In other words, ACS may soon decide to pay dividends (potentially a massive, one-time special dividend) to its shareholders, an action that would primarily benefit ACS' private equity sponsor, Fox Paine, not ACS' customers. All in all, these are not the actions or disclosures of a company whose core business is performing so poorly that it has been frozen out of the capital markets.

9. ACS has not presented any credible evidence that Alaska's UNE rates have discouraged it from investing in Alaska's communications infrastructure. Since the beginning of 2000, ACS has invested more than $248 million in capital expenditures, including more than $62 million in unprofitable long distance, Internet services, and wireless cable ventures. On July 31, 2003, ACS reaffirmed its intention to invest $50 to 60 million in Alaska communications infrastructure this year. From these facts, one could easily argue that to the extent ACS is dissatisfied with its financial performance it is not due to a lack of capital

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Anchorage, AK 99503
(907) 265-5600

or access to capital or even an unwillingness to invest capital but is rather due to an inability to invest capital in a disciplined, return-oriented manner.

10. ACS' argument that the RCA has an obligation to "ensure the financial health and viability of regulated entities" raises novel questions. For example, is the RCA required to hold ACS' management, private equity sponsor, and public debt and equity holders harmless from the consequences of ACS' strategic and tactical mistakes, which include the overpriced, over-leveraged buyout that created ACS in 1999 and the unilateral Anchorage rate increase in 2001 that alienated ACS' customers? If so, who is left to protect the interests of Alaska consumers? Fortunately, the facts here do not require the RCA to answer these questions. ACS has yet to provide internal financial analyses, affidavits, and other materials to prove that its financial health and viability is at risk. ACS' public equity story, like that of many other ILECs, may not be ideal, but the fact that its stock is not performing as well as ACS would like (even though the stock has appreciated more than 100% from the end of March 2003) does not mean that ACS is facing any sort of crisis that endangers local telephone service in Alaska. It is simply part of the public equity market risk that ACS' management and private equity sponsor willingly undertook in the 1999 buyout.

GCI Communication Corp.
2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

11. This concludes my statement.

Gregory F. Chapados

SUBSCRIBED AND SWORN to before me this 13th day of August, 2003.

JANET BARRAGAN
MY COMMISSION EXPIRES
November 20, 2004

Janet Barragan
Notary Public in and for Texas
My commission expires on: 11-20-04

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2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

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STATE OF ALASKA

THE REGULATORY COMMISSION OF ALASKA

Before Commissioners: Mark K. Johnson, Chair
Dave Harbour
Kate Giard
James S. Strandberg
G. Nanette Thompson

In the Matter of the Commission Review of Rules and Regulations Governing Telecommunications Rates, Charges Between Competing Telecommunications Companies, and Competition in Telecommunications	)	R-03-3

THE RURAL COALITION'S REPLY COMMENTS

The Rural Coalition submits the following reply to the comments and proposed rules filed on July 16, 2003, by the Alaska Telephone Association ("ATA"), Alaska Communications Systems ("ACS"), AT&T Alascom ("ATTA"), and GCI Communications Corp. d/b/a General Communications, Inc. ("GCI") (collectively the "Commentors").

I. Introduction

The Commentors have raised a variety of issues in response to the Policies of House Bill ("HB") 111 and within the ambit of local competition regulation. However, the Commentors are not a homogeneous group, nor do their comments speak to the same aspects of local competition. ATTA raised issues of competition with respect to

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Suite 600
Anchorage, AK 99501
(907) 276-4557

interexchange service. GCI and ACS addressed mainly those issues surrounding UNE-based local competition in certain urban areas in which these two companies compete. In contrast, the Rural Coalition, as well as the ATA, have addressed local competition in rural and remote Alaska - geographically, the largest portion of the State.

It is in rural and remote regions where local competition regulations have been most neglected and where the most work needs to be done. Indeed, the existing rules do not encompass service areas beyond Anchorage, Fairbanks, and Juneau; nor do they contemplate the type of competition currently evolving in more rural regions of the State. This omission must be remedied.

The Rural Coalition agrees in principle with some concepts raised by the Commentors. It also disagrees with the limited (and insufficient) approach advocated by others – most notably GCI. But it is the areas that are completely absent from the comments of GCI, ACS, and ATTA, which may be the most important with respect to competition in rural and remote regions in Alaska.

In its reply comments, the Rural Coalition responds to the issues raised by other Commentors (**Sections II, IV and V** below), emphasizes the unique aspects of local competition addressed in the Rural Coalition's proposed rules (**Section III** below), and explains why these aspects are vital to local competition regulation in Alaska.

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II. The status quo is not acceptable

The Legislative mandate of HB 111 requires a "hard look" at the entire set of Commission's competition rules, not a cosmetic fix. The proposed rules of other Commentors – in particular, GCI – do not go far enough.

The local competition rules adopted in this docket must define a "competitive service area" (which the current rules do not) and must establish among competitors fair and equal regulations, tariffing standards, and rate-adjustment flexibility.[1] The end result must ensure, among other things, that incumbent carriers are not placed at a competitive disadvantage.[2] These objectives cannot be reached without a fundamental restructuring of the existing local competition regulations.

For example, the majority of Commentors agree that the dominant/nondominant distinction under the existing local competition rules is no longer workable. The ATA explained that the threat an incumbent LEC "might be held to a higher 'dominant carrier' threshold than that required of a new, perhaps far more affluent, entrant" creates the spectre of unfair competition and is a disincentive to investment.[3] ACS declared: "[i]n a competitive market, the incumbent lacks market power and must be declared non-dominant."[4] Likewise, ATTA deemed the concept of dominance "outdated" and

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1 HB 111, Policy Nos. 4, 6, 8.

2 HB 111, Principle No. 3.

3 ATA Comments, p. 3.

4 ACS Comments, p. 7.

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inappropriate in a competitive marketplace.[5] The Rural Coalition agrees, and its proposed rules eliminate the dominant/nondominant disparity once the parameters of a "competitive service area" are met.

GCI alone has asked the Commission to maintain the current notions of dominance. As support, GCI points to 20-year old discussions on "market power". A lot has happened both in the telecommunications industry and in telecommunications regulation since 1985. The Telecommunications Act of 1996 controls market power and anticompetitive conduct through mechanisms such as interconnection and structural separation rules. The Federal Communication Commission ("FCC") has found (in connection with an order referenced by GCI) that as long as these rules are attended to, dominant carrier regulation is both unnecessary and "possibly counterproductive".[6] In addition to being disfavored, GCI's approach also maintains incumbents as the dominant carriers for an undefined period of time,[7] which is directly contrary to HB 111 Policy No. 2; and relies on the grant of a certificate of public convenience and necessity as the triggering event to determine whether the incumbent will be granted nondominant

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5 ATTA Comments, p. 4.

6 *In the Matter of Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area*, 12 F.C.C.R. 15,756, FCC 97-142, rel. April 18, 1997, Separate Statement of Commissioner Susan Ness, ¶ 3.

7 *See* GCI's proposed rule 3 AAC 53.220(b).

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status,[8] which ignores the entry of wireless carriers that do not require a certificate to compete for local exchange customers.

In any event, GCI's proposed "market power" approach is redundant. The malady that GCI is seeking to cure by creating a cumbersome "market power" analysis and clinging to the outmoded dominant/nondominant distinction is the threat that: "a carrier 'with market power is able to engage in conduct that may be anticompetitive or otherwise inconsistent with the public interest'".[9] The Commission already has ample authority to prohibit conduct or deny rates that are anticompetitive or prejudice a carrier or customer. *See, e.g.*, 3 AAC 53.240 (and the Rural Coalition's proposed amendment to the same). Consequently, GCI's approach is both inappropriate and unnecessary.

GCI has also taken too narrow a view with respect to rate reductions. GCI suggests that the Legislature's mandate that "all carriers may unilaterally reduce consumer rates" must somehow be limited to existing rates, and that new service packages cannot be included. There is no support for GCI's approach. This is a transparent attempt to saddle incumbent LECs with disproportionate regulatory restrictions and provide competitors with an unfair advantage with respect to bundled or repackaged services. Again, the only rationale that GCI proposes for such a restriction is that the Commission must retain authority to "address any such terms and conditions

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8 *See* GCI's proposed rule 3 AAC 53.220(b).

9 GCI Comments, p. 10.

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that might be unduly discriminatory and otherwise unreasonable".[10] As explained above, the Commission already has such authority, and, consequently, GCI's proposal is unnecessary.

In sum, GCI's minor tweaks to the Commission's existing rules, that give lip service to the Legislature's policies but in fact retain the existing regulatory structure, simply perpetuate the very flaws that compelled the Legislature to order change in the first place. This proceeding calls for a more thoughtful and comprehensive approach to the Commission's local competition rules and requires a structural change as set forth in the Rural Coalition's proposed rules.

III. Rules regarding ETC designation are imperative

Both GCI and ACS focused their comments on how to address the regulatory problems that have arisen in Anchorage, Fairbanks, and Juneau. While some of the competitive issues raised may be important, the Commission cannot simply focus on the "problems-of-the-day" in Alaska's urban centers if it is to accomplish the mandate of HB 111. Instead, the Commission must determine what rules must be changed and/or created to permit the long-term, healthy regulation of local competition *throughout* Alaska.

Wireless carriers already actively compete with incumbent local exchange carriers ("LECs") in the more populated pockets of rural Alaska. A growing number of carriers are also seeking ETC status. Since 2002, four wireless carriers have petitioned

[10] GCI Comments, p. 15.

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for ETC designation in rural service areas, including: (i) AP&T Wireless, Inc., which petition was subsequently withdrawn; (ii) Alaska DigiTel LLC, which petition was argued before the Commission in May of this year, (iii) ACS Wireless, Inc., which petition has been noticed for comment, and, most recently, (iv) Dobson Cellular Systems, Inc., which petition asks the Commission to grant Dobson ETC status in portions of rural service areas throughout Alaska. There is no reason to believe that this trend will cease. In short, competition in rural Alaska between incumbents and stand-alone wireless networks already exists.

This type of competition raises the immediate problem of unfairly disadvantaging incumbent LECs unless the Commission acts to broaden the scope of existing local competition regulations and eliminates inappropriate disparities. FCC Commissioners have recently expressed their concern that "the ETC designation process – and in particular the public interest analysis – has been conducted in an inconsistent and sometimes insufficiently rigorous manner".[11] The Commissioners have also explained the importance of establishing appropriate ETC regulation to ensure that "companies that have traditionally invested in infrastructure to serve rural and high cost areas are not subject to a framework that unintentionally undercuts their ability to perform their critical universal service function".[12] This is exactly the type of "unfair

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11 *Federal-State Joint Board on Universal Service*, ORDER AND ORDER ON RECONSIDERATION, FCC 03-170 (rel. July 14, 2003), Joint Statement of Commissioners Kathleen Q. Abernathy and Jonathan S. Adelstein, ¶ 4.

12 *Id.*

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Anchorage, AK 99501
(907) 276-4557

competitive disadvantage" to incumbents that the Alaska Legislature has asked the Commission to expunge in this docket.

The current rules neglect: (i) the ETC designation process, (ii) the changes an incumbent LEC must be permitted to undergo prior to the designation of a second ETC (*e.g.*, deaveraging, removal of implicit subsidies), and (iii) local competition in rural service areas if multiple ETCs are designated. ETC issues have also been excluded from concurrent Commission proceedings on local competition rules.[13] With multiple ETC applications pending and rural incumbent LECs increasingly facing unfair regulatory disparities, ETC issues can no longer be ignored. The ETC provisions set forth in the Rural Coalition's Proposed Rules must be addressed in the current proceeding to ensure that the principles set forth in HB 111 are realized.[14]

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[13] *See In the Matter of the Consideration of the Revision to the Regulations Governing Competitive Local Exchange Market in Alaska*, R-02-6(2), February 19, 2003, p. 2 ("We are not seeking comment on issues concerning . . . eligible telecommunications status . . . .") (quoting R-02-6(1), November 21, 2002).

[14] As part of the Alaska DigiTel proceeding, the Rural Coalition argued that the Commission should defer ruling on ADT's application, or any ETC application in rural and remote service areas in Alaska, until the Federal-State Joint Board on Universal Service made its recommendation and the FCC ruled on ETC designation issues, including filing requirements and the public interest showing. *In the Matter of the Federal-State Joint Board on Universal Service*, CC Docket No. 96-46, FCC 02-307, rel. November 8, 2002. The RCA chose not to defer consideration and instead proceeded through a hearing on public interest issues. Now that the Commission has decided to move ahead with considering ETC applications, it is vital that ETC regulations be put in place immediately. The number of ETC petitions is mounting and regulation of designation and entry must be defined to ensure that such processes occur in a sufficiently rigorous and competitively neutral manner.

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Suite 600
Anchorage, AK 99501
(907) 276-4557

IV. Depreciation

Several Commentors addressed Legislative Policy No. 5 regarding the methods used to calculate depreciation. ACS proposed that the Commission adopt a streamlined approach, but deferred specific details on how such an approach might be put into practice.[15] The Rural Coalition agrees that a streamlined method for calculating depreciation would be useful, and describes below how such a method could be implemented. The Rural Coalition also has prepared proposed rules memorializing this method, attached as Exhibit A.

As an initial matter, it is clear that any method of depreciation must be prospective in nature – as opposed to solely focused on historical experience. While GCI appears to acknowledge that Policy No. 5 does not require that depreciation rates be based on historical experience alone, GCI's proposed rules in practice are almost entirely retrospective. GCI, for example, would require a carrier to analyze equipment and facilities retired in the previous four years. GCI's focus on historical experience is mistaken and has been previously disavowed by the FCC:

> In 1980, the Commission departed from its previous practice of relying largely on historical experience to project equipment lives and began to rely on analysis of company plans, technological developments, and other future oriented studies.[16]

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15 ACS Comments, p. 25 (proposing an "administratively simple, yet substantively more appropriate way to set depreciation rates in regulated [sic] proceedings").

16 *In the Matter of 1998 Biennial Review – Review of Depreciation Requirements for Incumbent Local Exchange Carriers*, REPORT AND ORDER, CC Docket No. 98-137, FCC 99-397, rel. December 30, 1999, ¶ 5.

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(907) 276-4557

It is also apparent that any depreciation methodology adopted by the Commission should be streamlined. The Commission's current approach has resulted in substantial delays as depreciation studies filed with the Commission in practice have taken as much as two years (or more) to process. The value of a streamlined approach has already been recognized by the FCC and other state commissions.

To simplify the depreciation calculation, the FCC established a pre-approved set of prescribed depreciation ranges:

> In order to simplify this process, the Commission has prescribed ranges of acceptable values for projected lives and future net salvage percentages . . . . The ranges are treated as safe harbors, such that carriers that incorporate values within the ranges into their depreciation filings will not be challenged by the Commission. Carriers that submit life and salvage values outside the prescribed range must justify their submissions with additional documentation and support.[17]

The Rural Coalition believes that the FCC's streamlining approach has merit and has drafted a set of proposed rules that incorporate the concepts of a pre-approved rate table, as well as the specific requirements of Policy No. 5.

The Rural Coalition's proposed rules on depreciation have three major components:

[17] *In the Matter of Federal-State Joint Board on Universal Service*, TENTH REPORT AND ORDER, CC Docket No. 96-45, FCC 99-304, rel. November 2, 1999, ¶ 426.

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(1) Pre-approved rate table[18] and streamlined approval process. If a carrier selects depreciation rates from within an approved range for any or all of its property accounts, the carrier's new depreciation rates go into effect immediately without the need for further review by the Commission. To the extent that the carrier requests depreciation rates that are outside the pre-approved ranges, the carrier will submit additional information in support of its proposed depreciation rate, which the Commission then considers for approval within a defined timeframe.

(2) Interim booking policy. This provision addresses those situations where additional information and studies are submitted in support of a proposed depreciation rate. To rectify the problems associated with the processing time of depreciation studies, the Rural Coalition recommends that the Commission adopt an interim booking policy whereby a carrier may book proposed depreciation rates subject to true-up upon final Commission action.

(3) Special amortization. For those situations when a substantial portion of a property account or subaccount is retired earlier than anticipated, and the reserve for that account is less than the amount to be retired, the Rural Coalition's proposed rules incorporate a special amortization, whereby the carrier can recover for the undepreciated assets over a period of time.

V. Additional issues

A. Significant competition

Both ACS and GCI seized upon the term "significant" in Legislative Policy No. 8, and advocated separate definitions of what "significant" might mean. The Rural Coalition takes no position on the appropriateness of a distinction between mere "competition" and "significant competition" in urban areas.[19] However, such a two-tiered approach to defining competition is unsuitable to rural and remote Alaska.

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[18] The Rural Coalition proposes that a depreciation rate table be established by collaboration between the Commission and interested stakeholders, and be finalized prior to or concurrent with the promulgation of the rules adopted as part of this docket. This process can be facilitated by considering those depreciation rates that have already been approved for Alaska carriers and the rate ranges established by the FCC.

[19] The Rural Coalition is dubious that the proposed definitions could reasonably be quantified.

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Suite 600
Anchorage, AK 99501
(907) 276-4557

In the absence of universal service funding, the economies of scale necessary to provide local exchange service throughout rural and remote service areas are insufficient to support a single carrier, let alone multiple carriers. As the ATA explained, the advent of competition may immediately compromise the already challenging circumstances by which rural customers receive affordable service if disparities in the regulatory regime are not alleviated. Consequently, once a second carrier is granted a certificate to provide local exchange service and begins to serve customers, or once a second ETC is designated,[20] such competition in a rural service area is significant without a separate competitive trigger. Any disproportionate restrictions on the incumbent LEC (including those restrictions on raising rates) must be removed without delay.

B. Competitive neutrality.

The ATA has correctly highlighted the need for regulatory parity. The Rural Coalition agrees with this focus on parity and has structured its proposed regulations to provide safeguards to ensure that an incumbent carrier is not put at a competitive disadvantage by rules that are unfair.

To ensure fairness, the Commission must consider that an incumbent LEC and a competitive entrant may not be similarly situated. Local competition rules must be structured accordingly. Unlike a competitive entrant, a rural incumbent LEC has costs

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Suite 600
Anchorage, AK 99501
(907) 276-4557

[20] An ETC is obligated to provide supported services to any requesting customer within a service area and must advertise its services. Thus, actual competition exists upon ETC designation whether or not the carrier has existing customers.

associated with operating and maintaining a ubiquitous network and bears carrier of last resort obligations. In addition, technology differences (wireless/wireline) may result in materially different capital costs between an incumbent LEC and a competitive entrant, unequal investment risk, and disproportionate amounts of capital tied up in infrastructure. These types of differences should be considered when adopting rules, to ensure that regulations are not just equal in form but are also fair and competitively neutral in impact.

C. TELRIC pricing

The Rural Coalition generally supports ACS' approach with regard to TELRIC principles and agrees that fair payment must be the touchstone of UNE pricing. Federal guideline permit the Commission sufficient latitude to establish an Alaska-appropriate model that incorporates and balances both the concepts of embedded and forward-looking costs.

VI. Conclusion

For all the foregoing reasons, the Rural Coalition respectfully requests that the Commission adopt the regulations proposed Rural Coalition.

Dated this 13th day of August, 2003.

DORSEY & WHITNEY LLP
Attorneys for the Rural Coalition

By: Heather H. Grahame
Heather H. Grahame

DORSEY & WHITNEY LLP
1031 WEST 4th Avenue
Suite 600
Anchorage, AK 99501
(907) 276-4557

EXHIBIT A
THE RURAL COALITION'S PROPOSED RULES[1]

I. NEW RULES ON DEPRECIATION

3 AAC Section 53.***. DEPRECIATION RATES

(a) **General.** Local telecommunications carriers shall use depreciation rates approved by the commission to determine depreciation expense and provide for accumulated depreciation (also referred to as depreciation reserve). For purposes of this section, depreciation rates used prior to December 31, 2003 and those in effect on December 31, 2003 shall be deemed appropriate for use unless subsequently modified by the Commission.

(b) **Simplified depreciation rate changes.** If a local exchange carrier selects depreciation rates from within the approved ranges developed by the commission for any or all of its property accounts, the carrier's selected depreciation rates may go into effect upon written notice to the Commission.[2]

(c) **Other depreciation rate changes.** Any local exchange carrier requesting a change in depreciation rates not otherwise covered by (a) or (b) of this section must obtain commission approval. Any such change in depreciation rate shall be based on the actual useful life of depreciated equipment and facilities.

(1) Considerations. In making its approval decision under this section, the commission shall consider whether the new depreciation rates promote deployment of new technology and infrastructure, as well as any company plans, technological developments, and other studies provided by the local exchange carrier.

(2) Depreciation method. Depreciation rates may be based on any reasonable method of depreciation; however the commission may consider upon its own motion an alternative method of depreciation on a case-by-case basis.

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1 Amendments are delineated by underlining, deletions by ~~strikethrough~~.

2 The Rural Coalition proposes that a depreciation rate table be established by collaboration between the Commission and interested stakeholders, and be finalized prior to or concurrent with the promulgation of the rules adopted as part of this docket. This process can be facilitated by considering those depreciation rates that have already been approved for Alaska carriers and the rate ranges established by the FCC.

(3) Contents of petition. Any request made under this section must include the following information:

(A) For each property account or subaccount for which a depreciation rate change is proposed:

(i) the plant in service and the accumulated depreciation as of the requested effective date for the proposed depreciation rates;

(ii) a comparison of current depreciation rates with the proposed rates;

(iii) a comparison of both existing and proposed service lives; and

(iv) reasons for the proposed changes, including estimated useful life, remaining life, and net salvage value;

(B) The requested effective date of the changes; and

(C) The change in annual depreciation expense that would result from adoption of the proposed depreciation rates, expressed both as a dollar amount and as a percentage of current depreciation expense.

(4) Commission decision. The commission shall make its final determination on any petition submitted under this section within 12 months of the date that the carrier submits a complete petition in accordance with subsection (3).

(d) Burden of proof. For proposed changes in depreciation rates, other than those initiated by (a) or (b) of this section, the local exchange carrier shall have the burden of proof to show that depreciation or amortization expense is reasonable and in accordance with sound accounting and economic principles.

(e) Interim booking. Unless otherwise ordered by the commission, a local exchange carrier may book proposed depreciation or amortization expense on an interim basis from the month a proposed depreciation rate is filed with the commission in accordance with (c) of this section until a final decision is reached by the commission. Interim booking shall be adjusted, if necessary, upon final commission approval of depreciation rates. A local exchange carrier shall maintain records to show the interim booking and the adjustments, if any, that were made upon final approval of the rates.

(f) Special amortization. Where all or a substantial portion of a property account or subaccount is retired earlier than anticipated, and the reserve for that account is less than

the amount to be retired less salvage, or in other circumstances when an amortization is appropriate, a local exchange carrier may request special amortization.

(1) If the amortization period is less than or equal to two years, and the annual amount to be amortized is less than or equal to 2% of annual intrastate revenues of the carrier, such amortization shall go into effect upon written notice to the Commission.

(2) If the amortization period is more than two years, or the amount to be amortized is more than 2% of annual intrastate revenues of the carrier, the carrier shall petition the commission for approval of the proposed amortization.

(g) New class of property. When a local exchange carrier needs to establish a depreciation rate for a new class of property, it may adopt a depreciation rate in accordance with (b) or (c) of this section.

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STATE OF ALASKA

THE REGULATORY COMMISSION OF ALASKA

Before Commissioners: Mark Johnson, Chair
Dave Harbour
Kate Giard
James S. Strandberg
G. Nanette Thompson

In the Matter of the Commission Review of Rules and Regulations Governing Telecommunications Rates, Charges Between Competing Telecommunications Companies, and Competition in Telecommunications	)	R-03-3

REQUEST TO PROVIDE INFORMATION

During the public hearing in this matter the Commission requested various parties to provide post-hearing responses to certain specific information requests. GCI requests the Commission to accept the following limited responses from GCI to information requests directed to ACS.

During the public hearing in this matter, the Commissioners often emphasized its need for specific factual information, rather than general assertions and arguments, addressing various issues. Furthermore. the Commissioners generally allowed all parties to respond to questions initially addressed to another party. GCI's provision of the following information is consistent with the hearing procedures in both these respects.

GCI Communication Corp.
2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

Commissioner Harbour requested ACS to provide specific information regarding its net income by line of business for each year since 2000. (Tr. 366-367) The information attached as Exhibit A shows ACS' operating income for its local exchange, wireless, directory, Internet, and interexchange (long distance) businesses for 2000, 2001, 2002, and the first six months of 2003. All of this information is taken from ACS' publicly filed SEC Forms 10-K and 10-Q. The exhibit also shows the operating income of each business segment as a percentage of total operating income. This portion of Exhibit A shows that ACS derives over 80% of its operating income from local exchange service and that both its Internet and Interexchange (Long Distance) segments produce operating losses. This same information is shown graphically on Exhibit B.

The information on Exhibit A and B, summarized above, is provided in terms of operating income, not net income. The operating income provided is essentially the same as the commonly used measure called EBITDA. Operating income, rather than net income, by business segment has been provided because the difficulty of assigning total company interest expense among segments makes calculation of net income by segment difficult or impossible. Exhibit A does include a reconciliation of the total operating income to total company net income.

During the hearing, Commissioner Giard requested information from ACS regarding its claims to be efficient compared to other carriers. (Tr. 458) On this matter, GCI simply references the prefiled testimony of Thomas L.

GCI Communication Corp.
2550 Denali Street, Suite 1000
Anchorage, AK 99503
(907) 265-5600

Brand/Arthur Menko, submitted by GCI in Docket U-96-89, which provides specific information regarding the efficiency of ACS in comparison with other carriers.

Respectfully submitted at Anchorage, Alaska this 19th day of September, 2003.

GENERAL COMMUNICATION, INC.

BY: _____
James R. Jackson
Its: Regulatory Attorney

VERIFICATION

I, James R. Jackson, verify that I believe the statements contained in this pleading are true and accurate.

_____
James R. Jackson

SUBSCRIBED AND SWORN to before me this 19th day September, 2003.

CAROL R. CHAMBERS
NOTARY PUBLIC
STATE OF ALASKA
My Commission Expires

_____
Notary Public in and for Alaska
My commission expires: 4-2-05

G:\Chambers\Mary's Documents\Filings\R-03-03\R-03-03 Reply Comments of GCI.doc

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Anchorage, AK 99503
(907) 265-5600

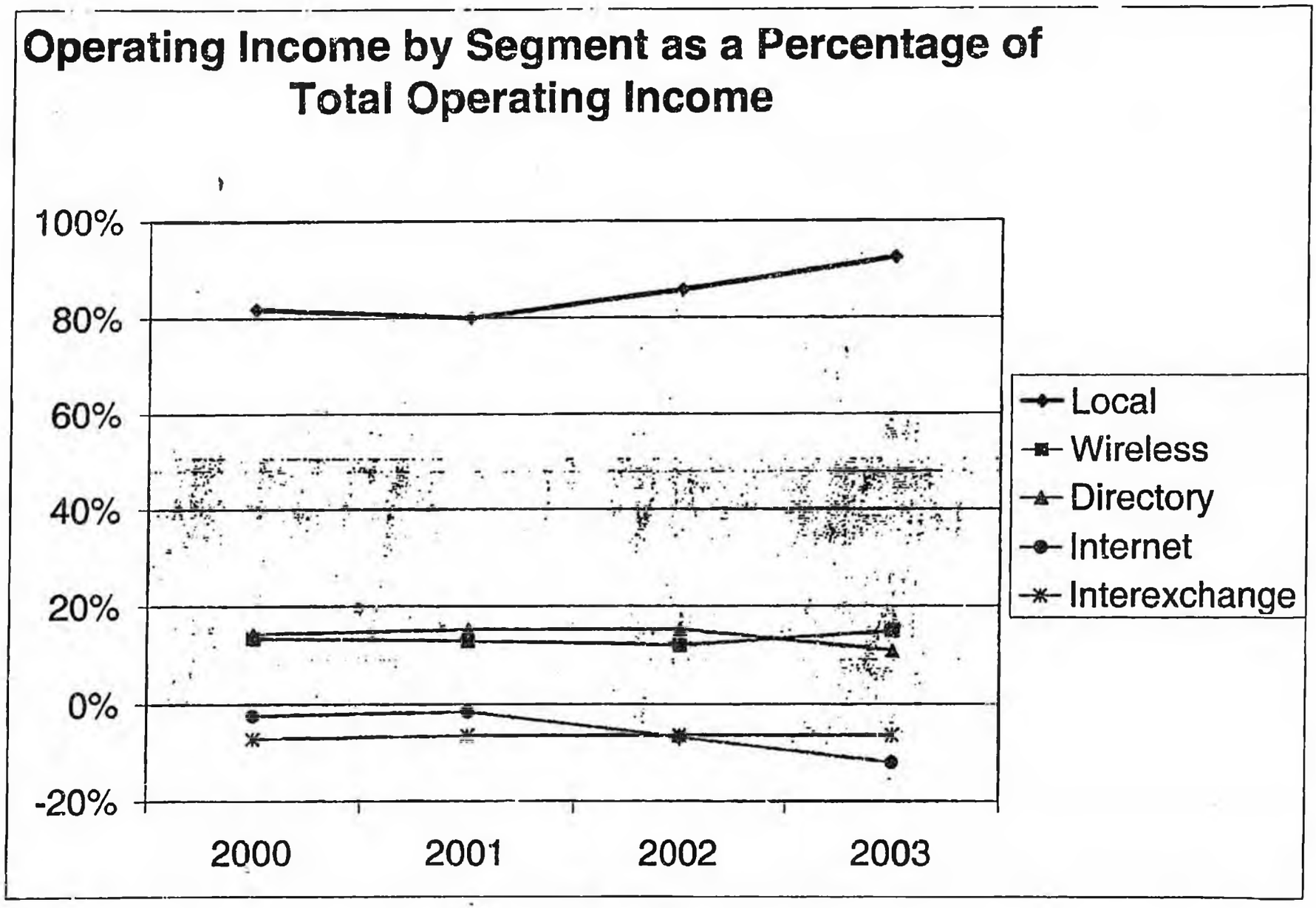
Revenues	2000	2001	2002	First 6 Months 2003
Local	222,268	221,411	226,447	109,211
Wireless	41,155	41,894	43,180	22,277
Directory	29,156	33,870	33,604	11,631
Internet	9,170	13,724	20,847	16,193
Interexchange	11,778	21,316	19,424	10,005
	313,527	332,215	343,502	169,317

Direct Expenses	2000	2001	2002	First 6 Months 2003
Local	131,642	120,465	117,277	55,334
Wireless	26,306	25,649	27,912	13,583
Directory	13,334	14,684	14,170	5,249
Internet	11,785	15,677	29,502	23,186
Interexchange	19,749	29,509	27,547	13,713
	202,716	205,984	216,408	111,065

Operating Income	2000	2001	2002	First 6 Months 2003
Local	90,726	100,946	109,170	53,877
Wireless	14,849	16,245	15,268	8,694
Directory	15,822	19,186	19,434	6,382
Internet	(2,615)	(1,953)	(8,655)	(6,993)
Interexchange	(7,971)	(8,193)	(8,123)	(3,708)
	110,811	126,231	127,094	58,252

Segment Operating Income as a Percent of Total	2000	2001	2002	First 6 Months 2003
Local	82%	80%	86%	92%
Wireless	13%	13%	12%	15%
Directory	14%	15%	15%	11%
Internet	-2%	-2%	-7%	-12%
Interexchange	-7%	-6%	-6%	-6%
	100%	100%	100%	100%

Reconciliation of Operating Income to Net Income	2000	2001	2002	First 6 Months 2003
Operating Income	110,811	126,231	127,094	58,252
Less Unusual Charges	(5,288)			
Less Depreciation and Amortization	(71,755)	(79,108)	(82,940)	(44,691)
Gain/Loss on Disposal of Assets			(2,163)	96,539
Less Goodwill Impairment Loss			(64,755)	
Less Net Interest Expense	(57,950)	(56,907)	(49,501)	(23,913)
Equity in Income (loss) of Investments	(303)	69		
Income Taxes	197	195		
Loss from Discontinued Operations	(917)	(1,718)	(7,632)	(52)
Cumulative Effect of Change in Accounting Principle	-	-	(105,350)	-
Net Income	(25,205)	(11,238)	(185,247)	86,135


Operating Income by Segment as a Percentage of Total Operating Income
100%
80%
60%
40%
20%
0%
-20%
2000
2001
2002
2003
Local
Wireless
Directory
Internet
Interexchange

20

STATE OF ALASKA

THE REGULATORY COMMISSION OF ALASKA

Before Commissioners:

Mark K. Johnson, Chair
Dave Harbour
Kate Giard
James S. Strandberg
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In the Matter of the Commission Review of Rules and Regulations Governing Telecommunications Rates, Charges Between Competing Telecommunications Companies, and Competition in Telecommunications	)))))	R-03-3

SUPPLEMENTAL INFORMATION FILED BY THE RURAL COALITION

The Rural Coalition submits for the Commission's review and consideration the following supplemental information on the status of and impact of wireline/wireless competition. See Exhibit A (attached). This information was requested at the recent hearing in this docket by Commissioner Harbour, who specifically solicited any data or information on "the effect of wireless use on the wire network." See Hearing Transcript, pp. 344-355.

The attached information is an excerpt from the Federal Communication Commission's ("FCC") *Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services*, Eighth Report, WT Docket No. 02-379, FCC 03-150 (rel. July 14, 2003) ("FCC Annual Report"), 101-106.[1]

[1] The full order is available electronically at the FCC's website, http://www.fcc.gov.

DO & WHITNEY LLP
WEST 4th Avenue
Suite 600
Anchorage, AK 99501
(907) 276-4557

While the FCC states that specific data on wireless/wireline competition is largely unavailable, the FCC finds there is "much evidence . . . that consumers are substituting wireless service for traditional wireline communications." See FCC Annual Report, 102. The FCC further finds that the local segment of wireline telecommunications has been "losing business to wireless substitution" and cites one analyst who estimates that "wireless has now displaced about 30 percent of total wireline minutes." See id. at 102-103.

The Rural Coalition would be pleased to submit upon request any additional information that the Commission may desire with respect to the Rural Coalition's proposed rules or any other issues in the current rulemaking docket.

DATED this 19th day of September, 2003, at Anchorage, Alaska.

DORSEY & WHITNEY LLP
Attorneys for Rural Coalition

By: Heather H Grahame
Heather H. Grahame

DORSEY & WHITNEY LLP
1031 WEST 4th Avenue
Suite 600
Anchorage, AK 99501
(907) 276-4557

CERTIFICATE OF SERVICE

This certifies that on September 19, 2003, the following individuals were served via mail:

William Saupe
Ashburn & Mason
1130 West 6th Avenue, Suite 100
Anchorage, AK 99501

Jim Rowe
Alaska Telephone Association
201 East 56th Avenue, Suite 114
Anchorage, AK 99518

Mark Ayotte
Briggs & Morgan
Professional Association
2200 First National Bank Building
332 Minnesota Street
St. Paul, Minnesota 55101

Ted Moninski
Directory
Regulatory Affairs
Alaska Communications Systems
510 L Street, Suite 210
Anchorage, AK 99501

Jimmy Jackson,
Corporate Counsel
General Communication Corp. d/b/a GCI
2550 Denali Street, Suite 1000
Anchorage, AK 99503

VP Wilson

CERTIFICATION SIGNATURE

4838-0819-4560\1

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

EXCERPT

In the Matter of	)	
	)	
Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993	)	WT Docket No. 02-379
	)	
Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services	)	

EIGHTH REPORT

Adopted: June 26, 2003 **Released: July 14, 2003**

By the Commission: Chairman Powell issuing a statement; Commissioner Copps concurring and issuing a statement.

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aimed at the youth portion of the population.[343]

d. Wireless/Wireline Competition

101. Once solely a business tool, wireless phones are now a mass-market consumer device.[344] The overall wireless penetration rate (defined as the number of wireless subscribers divided by the total U.S. population) in the United States is now at 49 percent.[345] Industry survey firm Telephia estimated that 53 percent of the total population in 40 major metropolitan areas subscribed to wireless service at the end of 2002, with some areas much higher, including Greenville, SC (71 percent), St. Louis (69 percent), Raleigh, NC (65 percent), Orlando (65 percent), Atlanta (64 percent), Washington DC (64 percent) and Boston (63 percent).[346] In addition, one study found that 56 percent of households in the 27 largest U.S. markets use wireless phone service.[347] Merrill Lynch estimated that, as of June 2002, more than 55 percent of Americans between the ages of 15 and 59 had wireless phones, including 71 percent between the ages of 20 and 34, 69 percent between 35 and 39, 68 percent between 40 and 44, and 65 percent between 45 and 49.[348]

(i) Wireless Substitution

102. While specific data is largely unavailable, it appears that only a small percent of wireless customers use their wireless phones as their only phone, and that relatively few wireless customers have "cut the cord" in the sense of canceling their subscription to wireline telephone service.[349] There is much evidence, however, that consumers are substituting wireless service for traditional wireline communications. At a recent Congressional hearing on the health of the telecommunications industry, for example, Blake Bath, managing director of Lehman Brothers, pointed out that while in 1996 wireless made up 5 percent of the sector's revenues, it now accounts for 30 percent.[350] Robert Crandall of the

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[343] *See* Section II.C.2, Resellers, *infra*.

[344] *See Sixth Report*, at 13381.

[345] *See* note 214, *supra*.

[346] *U.S. Mobile Phone Penetration Reaches 53% of Total Population in December 2002*, News Release, Telephia, Feb. 11, 2003.

[347] *Wireless Phone Penetration Among U.S. Households Slows Down as Fewer First-Time Subscribers Enter the Marketplace*, News Release, J.D. Power and Associates, Sept. 25, 2002.

[348] Linda Mutschler *et al.*, *Initiation Report: From Top to Bottom Line - Part I*, Merrill Lynch, Equity Research, Sept. 19, 2002, at 19. In addition, there is some evidence that wireless penetration is inversely related to household income. According to a 2001 survey conducted by the Energy Information Administration (EIA), a statistical agency of the U.S. Department of Energy, the percent of housing units having cell phones increases with household income: household income less than $15,000 (23 percent of households with cell phones); $15,000 – $29,999 (38 percent); $30,000 – $49,999 (54 percent); $50,000 – $74,999 (71 percent); $75,000 or more (82 percent). Energy Information Administration, *2001 Residential Energy Consumption Survey* (visited May 19, 2003) <http://www.eia.doe.gov/emeu/recs/appliances/appliances.html>.

[349] *See Seventh Report*, at 13017.

[350] *Health of the Telecommunications Sector: A Perspective from Investors and Economists, before the House Subcommittee on Telecommunications and the Internet*, 108th Cong. (Feb. 5, 2003) (statement of Blake Bath, Managing Partner, Lehman Brothers).

Brookings Institute, also speaking at the hearing, claimed that wireless "has siphoned enormous amounts of traffic from the wireline network."[351] One analyst estimates that wireless has now displaced about 30 percent of total wireline minutes.[352] For the average household, wireless represents 27 percent of total telecommunications expenditures.[353]

103. The long distance, local, and the payphone segments of wireline telecommunications have all been losing business to wireless substitution. Long distance volumes and revenues are down at AT&T, MCI, and Sprint as customers shift to wireless services to make their calls.[354] Verizon, SBC, and BellSouth saw business and consumer access lines fall 3.6, 4.1, and 3.2 percent, respectively, in 2002, for a total decrease of 5.5 million lines, with wireless substitution being a significant factor.[355] Similarly, the number of payphones has declined from 2.7 million in the mid-1990s to about 1.9 million today, in large part due to wireless phones.[356] Even the prepaid calling card business is suffering, as consumers are now "utilizing their wireless phones for the same reasons they once used prepaid phone cards."[357]

104. Certainly, this is due to the declining cost and widespread use of wireless service. In fact, a number of analysts argue that wireless service is cheaper than wireline. According to Blake Bath, "[w]ireless pricing is currently below that of wireline."[358] Merrill Lynch claims that, for many wireless customers making a long distance call in the evening "using a wireless phone would actually be cheaper than using the fixed line phone in most cases."[359] UBS Warburg agrees:

> Why use a pay phone, a calling card, or a hotel phone when prices are

[351] *Health of the Telecommunications Sector: A Perspective from Investors and Economists, before the House Subcommittee on Telecommunications and the Internet*, 108th Cong. (Feb. 5, 2003) (statement of Robert Crandall, Senior Fellow, The Brookings Institute).

[352] Cannon Carr and Gregor Dannacher, *Can Wireline Cannibalization Save Wireless ARPU in 2003?*, CIBC World Markets, Dec. 11, 2002, at 8. According to the CEO of Verizon, Ivan Seidenberg, wireless accounts for 30 percent of all voice minutes. Jeffrey Bartash, *Verizon CEO Urges Regulatory Relief*, CBS.MARKETWATCH.COM, Sept. 19, 2002.

[353] Based on a survey of the telecommunications bills of 32,000 households for the third quarter of 2002. *TNS Telecoms Data ranks Verizon the Third Largest Long Distance Provider in the U.S., Surpassing Sprint*, News Release, TNS Telecoms, Jan. 7, 2003. The breakdown: Local (26 percent); Local Toll (2 percent); Long Distance (8 percent); Wireless (27 percent); Cable/Satellite (27 percent); Internet (11 percent). *Id.*

[354] Sarah Z. Sleeper, *Who Needs Home Telephones? More Users Going All Wireless and That's Cutting Into Revenue For Local Bells and Long-Distance Firms*, INVESTOR'S BUSINESS DAILY, Aug. 8, 2002, at 1.

[355] Reinhardt Krause, *Local Bells Losing Second Lines as Users Go Broadband, Wireless*, INVESTOR'S BUSINESS DAILY, Feb. 11, 2003, at A01.

[356] Yuki Noguchi, *Requiem for the Payphone: As Cell Phone Use Increases, an Icon gradually Dies*, WASHINGTON POST, Dec. 30, 2002, at E1.

[357] *Wireless Threatens Growth for U.S. Prepaid Calling Cards*, News Release, IDC, Dec. 23, 2002.

[358] *Health of the Telecommunications Sector: A Perspective from Investors and Economists, before the House Subcommittee on Telecommunications and the Internet*, 108th Cong. (Feb. 5, 2003) (statement of Blake Bath, Managing Partner, Lehman Brothers).

[359] *NextGen VII*, at 40.

> generally higher on a per-minute basis relative to wireless? Also, given that a large number of night and weekend minutes are now regularly included in wireless pricing schemes . . ., it is often cheaper to use your wireless phone while in your home.[360]

(ii) Wireless Alternatives

105. An increasing number of mobile wireless carriers offer service plans designed to compete directly with wireline local telephone service. The largest of such providers, Leap, under its "Cricket" brand, offers mobile telephone service in 40 markets in 20 states.[361] At the end of the third quarter of 2002, Leap had roughly 1.5 million customers.[362] Leap's service allows subscribers to make unlimited local calls and receive calls from anywhere for about $30 per month.[363] Leap claims that 26 percent of its customers do not have a wireline phone at home.[364] As discussed above, Leap states that its bankruptcy filing will not interrupt its operations or result in employee layoffs.[365]

106. Other companies offering unlimited local calling plans include: Triton PCS in Virginia, North Carolina, South Carolina, Georgia, and Tennessee (with more than 200,000 subscribers to its unlimited calling plan);[366] Qwest in Arizona, Colorado, Idaho, Minnesota, Montana, Nebraska, New Mexico, Utah, and Wyoming;[367] ALLTEL in Arizona, New Mexico, North Carolina, Nebraska, and Arkansas;[368] MetroPCS in California, Florida, and Georgia;[369] Northcoast PCS in Ohio;[370] First Cellular of Southern Illinois in Illinois;[371] Kiwi PCS in North Carolina;[372] Rural Cellular in Vermont, New Hampshire, New

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[360] *Wireless 411*, at 54.

[361] *Leap Reports Results for Third Fiscal Quarter of 2002*, News Release, Leap, Nov. 13, 2002.

[362] *Id.*

[363] The monthly fee, paid in advance, varies slightly by service area. *See also, Seventh Report*, at 13018, note 225.

[364] *Leaping Over Landline: Leap Leads Wireless Displacement Trend*, News Release, Leap Wireless, Jun. 24, 2002.

[365] *See* Section I.A.1.a(i)(c), Restructurings, *supra*.

[366] SunCom, *SunCom UnPlan "FREE" Zones* (visited Mar. 28, 2003) <http://www.suncom.com/maps/suncom_unplan_maps.html>; Linda Mutschler *et al.*, *Triton PCS Holdings, Inc.*, Merrill Lynch, Equity Research, Mar. 12, 2003, at 2.

[367] Qwest, *Q by Qwest* (visited Apr. 9, 2003) <http://www.qwestwireless.com/qxq/coverage/>.

[368] Conversation with ALLTEL sales representative, Mar. 26, 2003.

[369] *See* MetroPCS, *Service & Phone* (visited Apr. 9, 2003) <http://www.metropcs.com/coverage.shtml>.

[370] *See* Northcoast PCS, *Service Plans* (visited Apr. 9, 2003) <http://www.Northcoastpcs.com/NewFiles/Service%20Plans.html>.

[371] *See* First Cellular, *Southern Illinois Unlimited* (visited Apr. 9, 2003) <http://www.firstcellular.com/wireless_clear_connect_d.htm>.

[372] *See* Kiwi PCS, *Welcome!* (visited Apr. 9, 2003) <http://www.kiwipcs.com>.

York, Kansas, Minnesota, Maine, North Dakota, and South Dakota;[373] and Ntelos in Virginia.[374] In addition, for around $40-$60 per month, many carriers offer regional or national calling plans with 500 or more "anytime" minutes and over 3000 night and weekend minutes.[375]

e. Geographical Comparisons: Urban vs. Rural

107. Since the release of the *Sixth Report*, the Commission has attempted to obtain a better understanding of the state of competition below the national level, in particular in rural areas. The primary difficulty for the Commission in this task is the lack of data specific to rural markets. At its Public Forum held in February 2002, the Wireless Telecommunications Bureau asked participants to address this issue.[376] The Commission continued this inquiry in its *NOI*, where the Commission invited comments on a range of rural issues. In our analysis below, we have attempted to incorporate commenters' suggestions.

(i) Definition of Rural

108. As the Department of Education stated in 1994, "few issues bedevil analysts and planners . . . more than the question of what actually constitutes 'rural.'"[377] The difficulties that this question brings are evidenced by the fact that within the federal government, the term rural has been defined in many different ways. The variety of definitions reflects the numerous purposes for which the definitions are used throughout the federal government.[378]

109. The Commission does not have a statutory definition of what constitutes a rural area. The Commission has used RSAs as a proxy for rural areas for certain purposes, such as the current cellular cross-interest rule and the former CMRS spectrum cap, stating that "other market designations used by the Commission for CMRS, such as [EAs], combine urbanized and rural areas, while MSAs and RSAs are defined expressly to distinguish between rural and urban areas."[379] In its *NOI*, the Commission asked the public to comment on how it should define rural for purposes of this report.[380]

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[373] *See* Rural Cellular, *Welcome To Rural Cellular Corporation* (visited Apr. 9, 2003) <http://www.ruralcellular.com/>.

[374] *See* Ntelos, *nTown* (visited Apr. 9, 2003) <http://www.ntelos.com/P/pdr_ntown.html>.

[375] For a sampling of pricing plans, *see* Linda Mutschler *et al.*, *Wireless Pricing: What Are They Thinking*, Merrill Lynch, Equity Research, Aug. 1, 2002; Colette Fleming *et al.*, *AT&T Wireless Group, Inc.*, UBS Warburg, Equity Research, Feb. 12, 2003.

[376] *See Public Forum Presentations* <http://wireless.fcc.gov/cmrs-crforum.html#pres>.

[377] Joyce D. Stern, *The Condition of Education in Rural Schools*, U.S. Department of Education (Jun 1994) [*cited in* National Center for Education Statistics, *Urban\Rural Classification Systems* (visited Apr. 4, 2002) <http://nces.ed.gov/surveys/ruraled/definitions.asp>].

[378] *See Seventh Report*, at 13021.

[379] Biennial Regulatory Review, Spectrum Aggregation Limits for Wireless Telecommunications Carriers, *Report and Order*, 15 FCC Rcd 9219, 9256 at note 203 (1999).

[380] *NOI*, at 24937.

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STATE OF ALASKA

THE ALASKA PUBLIC UTILITIES COMMISSION

Before Commissioners:

Mark K. Johnson, Chair
Kate Giard
Dave Harbour
James S. Strandberg
G. Nanette Thompson

In the Matter of the Commission Review of Rules and Regulations Governing Telecommunications Rates, Charges Between Competing Telecommunications Companies, and Competition in Telecommunications	R-03-3

ALASKA COMMUNICATIONS SYSTEMS NOTICE OF FILING REQUESTED INFORMATION

ACS of Anchorage, Inc. ("ACS-ANC"), ACS of Fairbanks, Inc. ("ACS-F"); ACS of Alaska, Inc. ("ACS-AK"), ACS of the Northland, Inc. ("ACS-N"), and ACS Long Distance, Inc. ("ACS-LD"), hereinafter collectively referred to as ACS, submit the following information in response to the Regulatory Commission of Alaska's ("RCA") inquiries at the September 2-4, 2003 public hearing. ACS has reviewed the transcripts and offers the following responses and exhibit list of documents in response to the Commissioner's inquiries.

The documents cited in the ACS comments and reply comments as requested on September 3, 2003 at page 308, line 22 appear as the attached Exhibit A.

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600 Telephone Avenue, MS65
Anchorage, AK 99503
907.297.3103 • Fax: 907.297.3153

ACS also provides the chart comparison of how ACS compares with other similarly situated companies and their cost of provisioning as requested at page, 330, line 3. Exhibit B. A comparison of ATU and ACS shows that the revenue requirement per line using Form M data demonstrates that ACS of Anchorage, Inc., in 2002, the company is 13% more efficient than ATU in 1997 and 9% more efficient than ATU in 1998.

Numerous studies and research including excerpts from FCC wireless competition reports were located. The materials also include the Berkley Study referenced by Professor Lehman on September 4, 2003, page 345, line 24. Exhibit C.

On September 4, 2003 at page 366, line 22 through page 367, line 17, Commissioner Harbour asked several questions of ACS. ACS does not have publicly available analyses that would adequately respond to these questions other than the Form 10-K filed with the Securities and Exchange Commission. Information regarding the local services, interexchange, wireless, Internet, and former directory services can be found in the 2002 business segment reports. ACS includes the business segment pages from its 2002 Form 10-K in response to these questions at Exhibit D.

Given the abbreviated time to respond to Commissioner Giard's inquiry for a listing of tariffing standards used in the lower 48 similar to the proposed regulations that ACS presented in its comments, ACS was not able to review all 48 contiguous states' regulations and tariffing provisions. Transcript Volume 3,

Alaska Communications Systems
600 Telephone Avenue, MS65
Anchorage, AK 99503
907. 297.3103 • Fax: 907. 297.3153

September 4, 2003 at page 418, line 10. Instead, ACS made a review of those states which would likely have faced competitive issues somewhat similar to those encountered in Alaska. In that review, ACS did find a number of states that utilized abbreviated tariffing procedures for local exchange service when competitive triggers were reached. A listing of those tariffing standards as well as citations to the regulations is provided at Exhibit E. The competitive triggers varied in complexity and application as a result of the alternative regulations which prompted their use.

Commissioner Harbour also requested additional information to aid the RCA in understanding the events after the Illinois decision at Transcript Volume 3, page 439, line 12. ACS has obtained copies of the briefs filed by both the appellants and appellees in the consolidated proceeding but due to the voluminous nature of the briefs has only filed a single copy of those briefs with the original filing. Exhibit F.

In addition to the chart requested at page 330, line 6 as well as page 457, line 18, Commissioner Giard requested a comparison of ACS's efficiency in comparison with GCI's. ACS does not have the data necessary to make that comparison. ACS also believes that such comparison would be of limited value given the substantial difference in performance obligations imposed on the two companies.[1]

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[1] For example, as Carrier of Last Resort, ACS is required to build, extend and maintain a network capable of serving all customers in its markets. GCI does not have a similar obligation.

In response to Commissioner Giard's inquiry on September 4, 2003, page 464, line 20, ACS negotiated its current Collective Bargaining Agreement ("CBA") in 1999 after the acquisition of ATU and the PTI companies on May 14, 1999. The CBA went into effect on November 7, 1999. The current CBA is in effect until December 31, 2006.

Respectfully submitted this 19th day of September, 2003,

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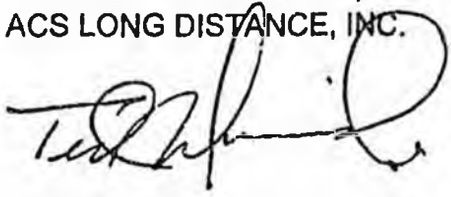
ACS of FAIRBANKS, INC.
ACS of the NORTHLAND, INC.
ACS LONG DISTANCE, INC.



Ted Moninski, Director
Regulatory Affairs/Carrier Relations

Alaska Communications Systems
600 Telephone Avenue, MS65
Anchorage, AK 99503
907. 297.3103 • Fax: 907. 297.3153

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THE ALASKA PUBLIC UTILITIES COMMISSION

Before Commissioners:

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Dave Harbour
James S. Strandberg
G. Nanette Thompson

In the Matter of the Commission Review of Rules and Regulations Governing Telecommunications Rates, Charges Between Competing Telecommunications Companies, and Competition in Telecommunications	R-03-3

ALASKA COMMUNICATIONS SYSTEMS
EXHIBIT LIST

EXHIBIT	DESCRIPTION	TRANSCRIPT REFERENCE
A	Documents cited in ACS Comments and Reply Comments	Volume 2, page 308, line 22
B	Chart comparison with how ACS compares with other similarly situated companies and their cost of provisioning	Volume 2, page 330, line 3-6
C	Articles regarding wireless substitution for wireline; the Berkely Study	Volume 3, page 345, line 24
D	Business segment reports from ACS Form 10-K	Volume 3, page 366, line 22
E	List of tariffing standards	Volume 3, page 418, line 10
F	Appellant and appellee briefings	Volume 3, page 439, line 12

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600 Telephone Avenue, M565
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907. 297.3103 • Fax: 907. 297.3153

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Alaska Communications Systems
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As the Commission considered Staff's analysis during the course of the three Public Meetings that were held,[1] it was obvious that a tension was building between the continuation of "dominant/non-dominant carrier" regulation and the institution of some new concept for the appropriate level of regulatory oversight for competitive markets in Alaska. Initially it appeared that the Commission might actually reach the correct conclusion that distinctions between dominant and non-dominant classifications had become meaningless. However, Staff seems to have convinced the Commission that these "form-over-substance" concepts should be perpetuated. No better evidence of ACS' critique of these backward-looking regulatory precepts can be found than the most recent experience of ACS-ANC as it made its initial two tariff filings pursuant to its interim non-dominant status.[2]

In the first filing,[3] ACS-ANC proposed a change to its local private line tariff. ACS received no feedback from the Staff regarding issues of concern and the Commission received no comments from the public or potentially affected customers. Instead of taking the matter to a TA Meeting, as is the typical practice for tariffs that are being contested, Staff circulated its proposal to commissioners. Deliberation was conducted off record. ACS-ANC first became aware that there

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Although TA 457-120 was submitted by ACS-ANC "as if it were a non-dominant carrier", Staff expressed concerns that the rates may not be just and reasonable. Instead of acknowledging the highly competitive characteristics of the Anchorage local market and deferring to customers to judge the reasonableness of the new prices, Staff recommended suspension and further regulatory proceedings. Instead of allowing rate payers the choice of accepting ACS' proposed private line rate design or seeking the services of an alternative provider, ACS will now be subjected to a traditional, dominant carrier determination of "just and reasonable" rates.[6] It is clear that, in the context of TA 457-120, the interim designation of non-dominance has little or no impact on the way ACS-ANC's tariffs are being considered.

ACS-ANC also submitted another tariff filing "as if it were a non-dominant carrier". This filing proposed modifications to ACS-ANC's pay telephone tariff.[7] In this second case, Staff indicated its willingness to recommend approval, but only after ACS-ANC met certain conditions. First, ACS was required to identify in writing

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[6] Although the Commission has not yet requested the submission of cost support for TA 457-120, the staff has raised issues about whether ACS-ANC's proposed private line rates meet the test of "just and reasonable". Since this test is a rate base, rate of return concept, ACS-ANC anticipates that a request for cost support will be forthcoming as the matter is being adjudicated.

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the sole customer impacted by the tariff change.[8] Staff also required ACS to represent that the "customer" had been individually informed of the proposed tariff change and that the "customer" did not object to the change. Setting aside the rather unusual circumstance that the filing utility and the customer were one in the same in the case of TA 458-120, it appears that Staff is proposing a whole new set of tariff compliance obligations that were not imposed on ACS-ANC prior to the Commission's grant of an interim waiver. In its supplemental TA letter, ACS has asked the Commission to clarify whether, in the future, it will be required to identify by name, all affected customers; to individually inform customers of rate changes; and to seek customers' non-opposition and report on such consent as part of the tariff review process.

Other than moving from a 45-day to a 30-day review process, it is obvious that there are few, if any real-world distinctions between dominant and non-dominant tariff filings. In fact, if TA 458-120 ultimately sets any precedents, ACS may be facing higher regulatory hurdles as a non-dominant carrier than it did as dominant carrier. All of this suggests that the Commission carefully consider the Staff's R-03-3 recommendation that the revised regulatory structure continue to be based on a dominant carrier model. Although time is short, the Commission is urged to rethink the wisdom of perpetuating the dominant/non-dominant carrier model and, instead, look to more progressive and meaningful ways to deregulate

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Continued Regulation of "Data Services" and "Private Line Services"

Closely related to the comments above is the inexplicable Staff position that even if dominant carrier regulation is relaxed to some limited degree, such relaxation should totally exclude "data services" and "private line services".[9] Were the Commission to adopt such an exclusion, it would constitute one of the most serious flaws of the draft regulations.

First, Staff has not even taken the time to define "data services". Nor has it explained why these services or private line services should be exempt from the otherwise minimal level of regulatory relief being considered in the draft regulations. With GCI offering facilities-based competition – both via its own facilities and via UNEs – in all of the currently competitive markets, "data services" and private line constitute the most fiercely contested segments of these markets.

Of equal importance is the nature of the customers for these services. Data and private line customers tend to be business customers. They are often among the largest and most technologically sophisticated customers. They tend to be

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Even at this "draft regulations" stage of R-03-3, ACS strongly urges the Commission to correct this major error and eliminate reference to "data services" and private line services from any exclusionary language that is being considered.

Conclusion

ACS understands that the Commission is only days away from its November 15, 2003 draft regulations issue date. ACS notes that there are numerous issues it intends to address once the draft regulations have been issued for public comment.[10] However, the questions surrounding the continuation of the dominant/non-dominant carrier model and the exclusion from regulatory relief of what are clearly among the most competitive services in the market today requires a more immediate response. ACS urges the Commission to consider these comments and make the necessary adjustments to its draft regulations in the time that it has remaining to do so.

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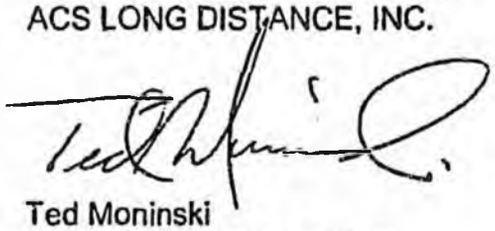

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The Regulatory Commission of Alaska ("RCA" or "Commission") is in the final steps of promulgating draft regulations in time to meet the Legislature's November 15, 2003 deadline as required by CSHB111. ACS recognizes that these proposed regulations will be issued for public comment and that a subsequent phase of this proceeding, one that could take as long as twenty-two additional months to complete, will provide for new opportunities for interested parties to comment. ACS anticipates continuing its active participation in this rulemaking. However, given RCA Staff's R-03-3 recommendations presented to the Commission last month and subsequent related events associated with ACS-ANC's "non-dominant carrier" tariff filings, ACS is compelled to bring isolated and specific issues to the Commission's attention at this time.

Staff's R-03-3 Recommendations

RCA Staff presented approximately 120 pages of analysis and recommendations to the Commission during the initial phase of R-03-3. ACS anticipates submitting a detailed response to most of these items when the Commission's draft regulations are issued for public comment. For purposes of this filing, ACS will focus on two issues: (1) Staff's continued advocacy in favor of dominant carrier regulation; and, (2) Staff's unexplained exclusion of "data services" and "private line service" from consideration for any form of regulatory relief.

Alaska Communications Systems
600 Telephone Avenue, M565
Anchorage, AK 99503
907. 297.3103 • Fax: 907. 297.3153

Dominant Carrier Regulation

As the Commission considered Staff's analysis during the course of the three Public Meetings that were held,[1] it was obvious that a tension was building between the continuation of "dominant/non-dominant carrier" regulation and the institution of some new concept for the appropriate level of regulatory oversight for competitive markets in Alaska. Initially it appeared that the Commission might actually reach the correct conclusion that distinctions between dominant and non-dominant classifications had become meaningless. However, Staff seems to have convinced the Commission that these "form-over-substance" concepts should be perpetuated. No better evidence of ACS' critique of these backward-looking regulatory precepts can be found than the most recent experience of ACS-ANC as it made its initial two tariff filings pursuant to its interim non-dominant status.[2]

In the first filing,[3] ACS-ANC proposed a change to its local private line tariff. ACS received no feedback from the Staff regarding issues of concern and the Commission received no comments from the public or potentially affected customers. Instead of taking the matter to a TA Meeting, as is the typical practice for tariffs that are being contested, Staff circulated its proposal to commissioners. Deliberation was conducted off record. ACS-ANC first became aware that there

[1] October 22, 29 and 31, 2003.
[2] ACS-ANC has filed a Petition for Reconsideration in docket U-03-99 and a supplemental Tariff Advice Letter in TA 456-120. The Commission is urged to review these documents for further details about the two tariff filings referred to in these Supplemental Comments.
[3] TA 457-120

Alaska Communications Systems
600 Telephone Avenue, MS65
Anchorage, AK 99503
907. 297.3103 • Fax: 907. 297.3153

was problem with this filing when it received Order No. 1 in Docket U-03-99[4] – an order suspending permanent operation of TA 457-120 and setting the matter for further investigation.[5]

Although TA 457-120 was submitted by ACS-ANC "as if it were a non-dominant carrier", Staff expressed concerns that the rates may not be just and reasonable. Instead of acknowledging the highly competitive characteristics of the Anchorage local market and deferring to customers to judge the reasonableness of the new prices, Staff recommended suspension and further regulatory proceedings. Instead of allowing rate payers the choice of accepting ACS' proposed private line rate design or seeking the services of an alternative provider, ACS will now be subjected to a traditional, dominant carrier determination of "just and reasonable" rates.[6] It is clear that, in the context of TA 457-120, the interim designation of non-dominance has little or no impact on the way ACS-ANC's tariffs are being considered.

ACS-ANC also submitted another tariff filing "as if it were a non-dominant carrier". This filing proposed modifications to ACS-ANC's pay telephone tariff.[7] In this second case, Staff indicated its willingness to recommend approval, but only after ACS-ANC met certain conditions. First, ACS was required to identify in writing

[4] TA 457-120 filed on October 3, 2003; U-03-99(1) issued on October 29, 2003.

[5] The Commission also directed that the tariff be implemented on an interim refundable basis. ACS-ANC is addressing the issues posed in U-03-99(1), including the non-sequitor presented by interim refundability, in a Petition for Reconsideration filed on November 7, 2003.

[6] Although the Commission has not yet requested the submission of cost support for TA 457-120, the staff has raised issues about whether ACS-ANC's proposed private line rates meet the test of "just and reasonable". Since this test is a rate base, rate of return concept, ACS-ANC anticipates that a request for cost support will be forthcoming as the matter is being adjudicated.

Alaska Communications Systems
600 Telephone Avenue, M565
Anchorage, AK 99503
907.297.3103 • Fax: 907.297.3153

the sole customer impacted by the tariff change.[8] Staff also required ACS to represent that the "customer" had been individually informed of the proposed tariff change and that the "customer" did not object to the change. Setting aside the rather unusual circumstance that the filing utility and the customer were one in the same in the case of TA 458-120, it appears that Staff is proposing a whole new set of tariff compliance obligations that were not imposed on ACS-ANC prior to the Commission's grant of an interim waiver. In its supplemental TA letter, ACS has asked the Commission to clarify whether, in the future, it will be required to identify by name, all affected customers; to individually inform customers of rate changes; and to seek customers' non-opposition and report on such consent as part of the tariff review process.

Other than moving from a 45-day to a 30-day review process, it is obvious that there are few, if any real-world distinctions between dominant and non-dominant tariff filings. In fact, if TA 458-120 ultimately sets any precedents, ACS may be facing higher regulatory hurdles as a non-dominant carrier than it did as dominant carrier. All of this suggests that the Commission carefully consider the Staff's R-03-3 recommendation that the revised regulatory structure continue to be based on a dominant carrier model. Although time is short, the Commission is urged to rethink the wisdom of perpetuating the dominant/non-dominant carrier model and, instead, look to more progressive and meaningful ways to deregulate

Alaska Communications Systems
600 Telephone Avenue, MS65
Anchorage, AK 99503
907.297.3103 • Fax: 907.297.3153

[7] TA 458-120

[8] In this case, the only customer impacted was the unregulated payphone activity of ACS-ANC, itself.

markets like Anchorage, Fairbanks and Juneau – among the most competitive local exchange markets in the entire country.

Continued Regulation of "Data Services" and "Private Line Services"

Closely related to the comments above is the inexplicable Staff position that even if dominant carrier regulation is relaxed to some limited degree, such relaxation should totally exclude "data services" and "private line services".[8] Were the Commission to adopt such an exclusion, it would constitute one of the most serious flaws of the draft regulations.

First, Staff has not even taken the time to define "data services". Nor has it explained why these services or private line services should be exempt from the otherwise minimal level of regulatory relief being considered in the draft regulations. With GCI offering facilities-based competition – both via its own facilities and via UNEs – in all of the currently competitive markets, "data services" and private line constitute the most fiercely contested segments of these markets.

Of equal importance is the nature of the customers for these services. Data and private line customers tend to be business customers. They are often among the largest and most technologically sophisticated customers. They tend to be

[8] R-01-02/R-02-06/R-03-03, Telecommunications Policy Issues and Options, Prepared by Communications Common Carrier Staff of the Regulatory Commission of Alaska, October 15, 2003, Section 53-220 – Determination of Dominant Status, p. 9-10 (of 119), proposed Option 3(c):

> (c) Notwithstanding (a) a carrier that holds a facilities monopoly for the provision of local loops in a location is dominant in regard to the following services until the Commission directs otherwise: 1) line extension services; 2)construction services; 3) subdivision agreements; 4)interexchange access services; ***5) data services; 6) private line services;*** and 7) Interconnection services not subject to review under federal rules. (emphasis added).

Alaska Communications Systems
600 Telephone Avenue, MS65
Anchorage, AK 99503
907. 297.3103 • Fax: 907. 297.3153

frequently and directly marketed to by competing carriers. And, when they do not think they are getting competitive telecommunications offers from one carrier, they quickly turn to another. In other words, the data services and private line segment customers are the least likely to benefit from or perceive the need for the protections of the regulatory process.

Even at this "draft regulations" stage of R-03-3, ACS strongly urges the Commission to correct this major error and eliminate reference to "data services" and private line services from any exclusionary language that is being considered.

Conclusion

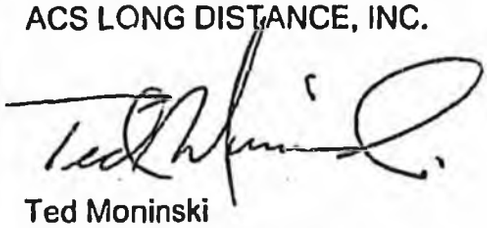
ACS understands that the Commission is only days away from its November 15, 2003 draft regulations issue date. ACS notes that there are numerous issues it intends to address once the draft regulations have been issued for public comment.[10] However, the questions surrounding the continuation of the dominant/non-dominant carrier model and the exclusion from regulatory relief of what are clearly among the most competitive services in the market today requires a more immediate response. ACS urges the Commission to consider these comments and make the necessary adjustments to its draft regulations in the time that it has remaining to do so.

Alaska Communications Systems
600 Telephone Avenue, M565
Anchorage, AK 99503
907. 297.3103 • Fax: 907. 297.3153

[10] ACS' specific refence to Section 53.220, Option 3(c) in Footnote 9 should not be construed as concurrence with the other exclusions recommended by Staff. To the extent that the Commission adopts those other Option 3 exclusions, ACS expects to note its objections when it files comments in response to RCA's public notice of the draft regulations.

Respectfully submitted this of 12th day of November, 2003,

ACS of ALASKA, INC.
ACS of ANCHORAGE, INC.
ACS of FAIRBANKS, INC.
ACS of the NORTHLAND, INC.
ACS LONG DISTANCE, INC.



Ted Moninski
Director, Regulatory Affairs

Alaska Communications Systems
600 Telephone Avenue, MS65
Anchorage, AK 99503
907.297.3103 • Fax: 907.297.3153