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Alaska State Legislature

REPRESENTATIVE BILL HUDSON

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October 8, 1993

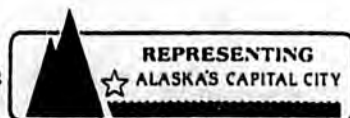
The Honorable Ted Stevens
United States Senate
522 Hart Building
Washington, DC 20510-0201

Dear Senator Stevens:

As you well know, the Federal Communications Commission (FCC) has Alaska's telecommunications industry under active review. This may very likely lead to a major restructuring of our markets. Currently, this review is being carried out by the Commission's Joint Federal/State Board. It is my understanding that the Commission, following its consideration of Board recommendations, will be issuing a ruling by November 1, 1993.

Obviously, there is much at stake for the citizens of Alaska. The more salient concerns include: preservation of universal service; termination of the Alascom/AT&T joint service arrangement; cost shifting from interstate to intrastate (in particular bush residents) users; and overall system quality. At the same time we recognize, and appreciate, the need for greater competition, market efficiency and new investments in state-of-the-art technology.

In response to developments at the federal level, House Speaker Ramona Barnes established the House Telecommunications Task Force. As Chairman, I was given the responsibility of monitoring pertinent FCC activities, soliciting public input and keeping House members informed. These duties were accomplished, in part, by conducting a day-long public hearing in Anchorage, and through the submission of a Task Force Report (see attachments).



While the record on this subject is extensive, many Alaskans remain concerned, and somewhat skeptical. Will new competitors merely skim off urban profits; leaving our rural residents to shoulder even higher costs, and rapidly aging equipment? Will universal service, itself, be sacrificed? As the hearing transcript can attest, the Task Force went to great lengths to answer these, and other, lingering questions. Industry representatives were solicited for answers and commitments.

To further assure our citizens, I respectfully request that your office review the transcript of our hearing. As a federal matter, do you find the direction of this proceeding to be in the state's long-term best interest? Do you find the industry's commitments sufficient to protect all consumers? In short, I would appreciate any advice or recommendations you may have regarding this matter.

Respectfully,

A handwritten signature in dark ink, appearing to read 'Bill Hudson', with a stylized, cursive script.

Bill Hudson

Attachments: Transcript
 Telecommunications Task Force Report

cc: Speaker Ramona Barnes
 Telecommunications Task Force Members



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October 7, 1993

Commissioner Susan M. Knowles
Alaska Public Utilities Commission
1016 West 6th Avenue, Suite 400
Anchorage, AK 99501

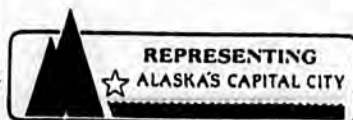
Dear Commissioner Knowles:

First, I want to thank you, personally, for participating in our House Telecommunications Task Force hearing, held in Anchorage, on August 27th, 1993. Your testimony, and that of your staff, was crucial to the overall success of this undertaking.

Enclosed you will find a transcript from the hearing. In addition, you will also find a copy of the Task Force's Report to Speaker Ramona Barnes.

I respectfully request that both the transcript, and the Report, be formally incorporated into the Joint Board's official file In the Matter of: Integration of Rates and Service for the Provision of Communications by Authorized Common Carriers between the Contiguous States and Alaska, Hawaii, Puerto Rico and the Virgin Islands.

As noted in the Task Force's Report, Recommendations section, I committed myself to bringing, to the Board's attention, a specific and lingering concern. In short, while the files on this issue could fill a large cabinet, there is virtually no "meaningful analysis of the long term implications in changes proposed...", and to what extent they "may harm the Alaskan consumer." This type of information was requested, repeatedly, during the hearing. At that time neither the industry, nor the Board, were in a position to provide the information.



I strongly encourage the Board to rectify this situation. At a minimum, the Board should request that the private parties supplement the record with a long-term economic, and market structure, analysis. If this is not possible, the Board should seriously consider contracting for a public report.

Respectfully,



Bill Hudson

Attachments: Transcript
Telecommunications Task Force Report

cc: Speaker Ramona Barnes
Telecommunications Task Force Members



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October 8, 1993

Mr. Jack Ryner
Alaska Telephone Association
2121 Abbott Road
Anchorage, AK 99507

Dear Mr. Ryner:

First, I want to extend my appreciation to you for participating in our recent House Telecommunications Task Force hearing, held in Anchorage, on August 27, 1993. A complete transcript of the hearing is available through my office.

Enclosed you will find a copy of the Task Force Report. This report is being distributed among all interested parties. Furthermore, it has been submitted to the Joint Board, with a request that it be incorporated into their official file on this matter.

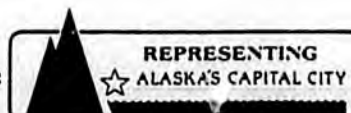
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BH/db

Enclosure: Task Force Report





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October 8, 1993

Ms. Gail Garey
MCI
707 17th Street, #4200
Denver, Colorado 80202

Dear Ms. Garey:

First, I want to extend my appreciation to you, and your staff, for participating in our recent House Telecommunications Task Force hearing, held in Anchorage, on August 27th, 1993. A complete transcript of the hearing is available through my office.

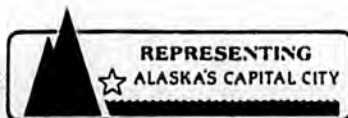
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October 8, 1993

Ms. Dana Tindall
Vice President
GCI
2550 Denali, Suite 1000
Anchorage, AK 99503

Dear Ms. Tindall:

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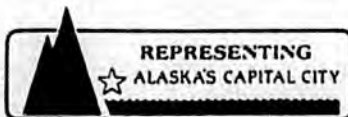
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October 8, 1993

Mr. John Ayers
General Manager
ALASCOM
210 E. Bluff Road
Anchorage, AK 99501

Dear Mr. Ayers:

First, I want to extend my appreciation to you, and your staff, for participating in our recent House Telecommunications Task Force hearing, held in Anchorage, on August 27th, 1993. A complete transcript of the hearing is available through my office.

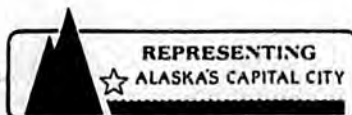
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October 8, 1993

Mr. Doug Wilcox
General Manager, Alaska
AT&T
2627 "C" Street
Anchorage, AK 99503

Dear Mr. Wilcox:

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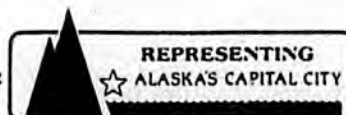
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October 8, 1993

Mr. John Katz
Special Counsel
Governor's Office
State of Alaska
444 N. Capitol NW
Suite 336
Washington, D.C. 20001-1512

Dear Mr. Katz:

First, I want to extend my appreciation to you, and your staff, for participating in our recent House Telecommunications Task Force hearing, held in Anchorage, on August 27th, 1993. A complete transcript of the hearing is available through my office.

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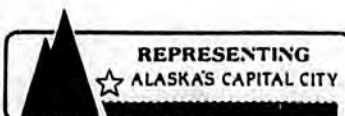
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Enclosure: Task Force Report



Can Anybody Figure Out Alaska's Phone Wars?

*The story behind Alascom,
GCI and AT&T's fight for
the Last Frontier's long-
distance lines.*

By Sean Reid

"This process is virtually incomprehensible to the average humanoid." That candid and mostly serious concession comes from an expert on Alaskan telecommunications — Susan Knowles of the Alaska Public Utilities Commission (APUC), which oversees long-distance telephone service in Alaska. Just about everyone agrees that long-distance service has become a complicated tangle of corporations, regulations, history, consumer interests, special interests and competition. Only on a daytime soap opera could you find something more complicated or bizarre.

The major corporate players in the unfolding drama include Alascom (an Anchorage-based, wholly-owned subsidiary of Vancouver, Wash.-based Pacific Telecom Inc., which is 87 percent owned by utility conglomerate PacifiCorp of Portland, Ore.); and GCI (an Anchorage-based corporation

now 30 percent owned by MCJ). The latest entrant into the fray is global telecommunications giant AT&T (based in New York). Of the three, Alascom has the deepest Alaskan roots and probably stands to undergo the most change as a result of the upcoming industry restructuring.

The Evolution of Confusion

The confusing mix of regulations and competing interests evident today has much to do with how Alaskan telecommunications evolved. It was gov-

ernment, not private industry, that in 1900 took the first serious step to provide Alaska with a communications network. A 25-mile military telegraph line from Nome to an outpost at Safety, Alaska, was part of an ambitious plan by the Army Signal Corps to connect scattered military outposts in the Alaska territory with the United States. The system allowed public and commercial use as well as government business.

By 1905, thousands of miles of land lines, a submarine cable and a rudimentary wireless radio link formed a



Feature: Phone Wars

moderately reliable network known as the Washington-Alaska Military Cable and Telegraph System. In 1935, the growing system changed its name to Alaska Communications System (ACS) — a name and a government system that would last well into the 1960s, when most of the traffic was commercial, not military.

By 1967 Congress decided the system, now handling 95 percent of public and commercial traffic, should be sold to private enterprise. The Air Force, operating the Alaskan system,

evaluated bids from seven major communications corporations. RCA was the winner with a bid of nearly \$28.5 million. The newly created RCA Alascom division took control in 1971 of most "long lines" facilities and became the only company other than AT&T providing long-distance service in the United States.

Bush Communication

As a condition of state certification, Alascom promised to provide tele-

phone service by 1973 to 142 villages not being served by the existing network. The company quickly fell behind schedule and over budget. The state pressured Alascom to revise plans for rural Alaska. Alascom first refused, then later proposed alternatives unacceptable to the state.

The Legislature in 1975 appropriated \$5 million for construction of small satellite earth stations in 120 villages with a permanent population of 25 or more. First planned as an entirely state-run operation, Alascom was later granted permission to be a partner in the project with responsibility for installation, operation and maintenance of state equipment. In addition to the 120 state-owned earth stations, Alascom later began construction on 21 larger satellite earth stations to replace the obsolete White Alice network of transmitters scattered across Alaska.

Additions and improvements to the network continued. In 1973, long-distance telephone service via satellite began between Alaska and the Lower 48. Six years later, in 1979, RCA sold its Alascom division to Pacific Power and Light (now PacifiCorp); the acquisition formed the core of Pacific Corp's new Pacific Telecom division.

By the mid-1980s, Alascom had invested millions of dollars to create a modern satellite and terrestrial microwave telecommunications network serving all major Alaska towns and more than 160 rural communities. The network was viewed as a successful model for developing countries worldwide faced with similar problems of serving a relatively small population scattered across vast distances, often under inhospitable climatic conditions.

For its efforts, Alascom reaped the benefits of monopolistic service. And while the rates it could charge were regulated by the APUC and the Federal Communications Commission (FCC), the company had the opportunity to receive a regulated rate of return on its investment. It also received a large annual subsidy from AT&T, with whom it connected to carry calls to and from the Lower 48 and the rest of the world.

Starting a Subsidy

In 1972, the FCC stated that with

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Seattle • P.O. Box 24627, Seattle, WA 98124 Ph. (206) 623-3256 Fax (206) 233-0786

the inauguration of domestic satellite service, Alaskan interstate rates should come down and eventually match rates for like-distance calls between other Lower 48 states. The concept was known as "rate integration."

To accomplish this, Alascom took a decrease in its annual revenue and argued that it could ill afford such a cut while operating where the cost of doing business was considerably higher than in the Lower 48.



Anchorage Museum

The FCC agreed, and in time, Alascom and AT&T agreed to a plan (called the Joint Service Arrangement) under which AT&T would pay Alascom's costs to provide interstate service. In exchange, AT&T was entitled to Alascom's revenues generated by the interstate service. In essence, a subsidy was created that covered the difference between costs and revenues.

The concept of subsidizing a particular long-distance market was not unique. AT&T routinely subsidized less profitable portions of their own system with revenue from more lucrative markets. A complex formula for determining Alascom's reimbursable costs was created, which today allows Alascom to attribute 86 percent of its key investments in major circuit equipment (microwave facilities, etc.) for interstate service (costs that are subsidized). The remaining 14 percent is allocated for providing intrastate service (which is not subsidized by AT&T). It works out to an annual AT&T subsidy to Alascom of some \$80 million to \$100 million per year to make up Alascom's interstate expenses not covered by toll revenues.

David and Goliath

A lot has changed in the telecommunications industry since the 1970s when the Alascom/AT&T interstate subsidy was formulated. Since 1982, Alascom's competition has been primarily GCI, which began as a company some people thought would prove to be little more than a temporary thorn in Alascom's side. For some 10 years, Alaskans watched David-and-Goliath phone companies battle for

long-distance telephone dollars.

The battles were fought in the courts, the Legislature, the regulatory arena, in the press and in advertising. GCI, essentially free to set its rates at will, attacked Alascom with interstate rates that were typically just below Alascom's, which by regulation were, and still are, tied directly to AT&T's Lower 48 rates. GCI seemed to claim credit for forcing down Alascom's interstate rates by introducing Alaskan competition. In fact, Alascom's interstate rates were going down because AT&T, facing in-

creased competition from MCI and others, was cutting its rates. And as AT&T rates fell, Alascom's had to fall.

On the intrastate side, where Alascom is not bound by AT&T rates but still must secure APUC approval, GCI often continued to undercut Alascom rates by pennies or fractions of pennies per minute — even as Alascom cut its own rates. Alascom also countered with claims of superior equipment, service, experience and a long history of investing in Alaska.

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it could and by leasing space on Alascom's network elsewhere, the young GCI sometimes appeared larger than it really was. Some services were initially bare-boned (GCI had no long-distance operators for several years), and the advertising budget was stretched thin. Today, GCI claims it has about 50 percent of the long-distance customers in markets where it competes with Alascom. Stressing customer service, GCI executive vice president and general manager Wilson Hughes (a former Alascom engineer) explains, "People want other services than just POTS — plain old telephone service."

Alascom, feeling the sting of competition after years of regulated monopoly, responded by paring its large work force, cutting costs, increasing its advertising budget and improving its network and services, including upgrading to digital technology.

Meanwhile, GCI's market success as well as Alascom's continued profitability did not go unnoticed by AT&T. The corporate giant, growing tired of shelling out nearly \$100 million a year to Alascom; at the same time AT&T faced new competition of its own in the Lower 48. GCI and other Alascom critics also began to argue that the long-standing AT&T/Alascom subsidy provided Alascom with an unfair advantage. Particularly irksome to GCI was the fact that Lower 48 dollars provided by AT&T could be used by Alascom for advertising and promotion.

New Competition and a New Joint Board

By as early as 1983, it was clear a new round of open competition would again change the face of Alaska telecommunications. A federal/state body, called the Alaska Joint Board, was created to examine the interstate telecommunications market and reconcile the often contradictory principles of open competition and regulated rate integration or mandated averaging.

An impediment to open intrastate competition has been the concern that competitors would choose to serve only the most profitable areas and not the smallest rural communities — a practice called "skimming." This argument has long been central to Alascom's posi-

tion resisting GCI's entrance into the intrastate market at the more attractive larger communities.

Alascom has insisted that the small rural communities, on their own, are a money-losing operation. Under the concept of universal service, rates are averaged for all market areas; the high profit areas support the money losers — a fact of telephone service in many places including, for example, Nevada and Minnesota. The concept applies to just two long-distance companies in the United States — AT&T and Alascom,



Alaska State Museum

both of whom are classified as carriers of last resort. In other words, because these companies are the dominate carriers in their regions, they must provide service if no one else does and do it for the same averaged price. Other companies, like MCI, Sprint and GCI, can choose to serve virtually at will (given some oversight by the regulatory bodies).

Today, the Joint Board, Alascom, GCI and AT&T all agree that it is time for a change toward a market-driven, open and competitive arena. The Joint Board conceded that the AT&T/Alascom subsidy arrangement gives "Alascom little reason to control costs." And in a recent report it says, "There are few, if any, advocates for the current market structure's preservation."

The first serious proposition was brought to the table last year by Alascom and AT&T, who referred to their joint proposal as the "master agreement." Included in the complicated proposal were a number of sweeping changes in the way the market would be struc-

tured, as well as a buyout of Alascom's interstate side by AT&T for \$330 million. The plan met with considerable opposition and died.

The Joint Board itself then fostered an alternative plan that is today being reviewed and receiving comment. The complex plan would wean Alascom from the annual AT&T subsidy while still financially compensating Alascom for its sizable investment over the years. In theory, the plan would allow AT&T to enter the interstate market, leave Alascom with less investment to carry on the intrastate side of the books, and therefore help prevent any rise in intrastate rates to the consumer in a competitive market. In effect, open, unsubsidized competition would arrive while cushioning the blow to Alascom, which would remain the regulated carrier of last resort.

Compromise Cuts Competition

The Joint Board proposes a number of changes, all of which would be instituted and then phased out within the next 10 years. It calls for Alascom's interstate cost allocation to shrink from 86 percent to 75 percent, thereby reducing AT&T's annual subsidy. To help make up the difference to Alascom, the board has proposed the creation of a nationwide fund into which phone companies all over the country would pay. As the interstate allocation shrinks, Alascom's allowable intrastate cost allocation for key investments would nearly double, from 14 percent to 25 percent. To keep these intrastate costs from causing a rate increase for Alaskans, the proposal would require AT&T to "buy down" some of Alascom's investment, i.e., reimburse Alascom. In the meantime, AT&T would also be obliged to contract with Alascom for the use of its equipment for at least three years, providing another source of assured income for Alascom during a transition period.

Alascom seems willing to accept this deal as the best compromise package available. "We're prepared to go forward with exactly what the Joint Board is saying, as long as there is a reasonable transition period," says John Ayers, Alascom's executive vice president and general manager.

Even GCI, faced with the entry of

another formidable competitor, feels that the Joint Board proposal represents the best compromise available. "The solution to the Alaskan market structure is AT&T entry into the market," agrees Dana Tindall, vice president of GCI's legal and regulatory department. "It's always been our position that (AT&T's entry) is what needs to be done."

AT&T, however, thinks it has a better idea, which it recently proposed as an alternative to the Joint Board proposal. By comparison, their plan appears to be a remarkably simple and straight-forward approach in an arena strewn with complex timetables and calculations. AT&T proposes a complete and immediate elimination of the Alascom subsidy; it would enter direct competition with Alascom and GCI for interstate calling to and from the Lower 48 at comparable nationwide rates; it would be prepared to construct much of its own \$230 million network, including a new state-of-the-art fiber optic cable linking the Lower 48 and Alaska through Juneau and



Anchorage; and it would provide complete intrastate service across Alaska using either its own equipment or through facilities leased from Alascom or GCI at rates equal to or less than Alascom or GCI for at least five years, except to pass through APUC-approved increases in intrastate access charges.

Critics are not convinced. They point to that last clause about passing through increased access charges. What that means, critics say, is that if Alascom is granted increased intrastate rates to earn its current rate of return in a shrinking market, AT&T's and presumably GCI's rates will go up too, especially since both would be paying to use some of Alascom's rural network.

However, both GCI and AT&T contend they could make a respectable return at current prices regardless of where they might serve, even in the Bush, if given unrestricted access. They say that new, lower-cost technology plus current competitive market forces would give them an edge over Alascom, which must support an older, more expensive network.

Doug Wilcox, AT&T's Alaska business unit general manager, also tries to reassure critics by responding to a claim from John Ayers that Alascom's intrastate rates will rise under unbridled competition. "I tell John Ayers every time I see him, 'I love that story, John. I hope you do it because I'll get all of your customers!'"

After years of debate over the form and future of Alaskan telecommunication, change appears close at hand. The period of review and comment is well along, with a decision expected from the Joint Board by fall. Implementation is expected to begin on the first of the year. That said, it should also be noted that given the stakes and the complexity of the issue, any decision could be appealed, negotiated or litigated for some time.

But there does appear to be consensus on at least one point. Competition will likely cull the competition. Few people seem to think the Alaska market can support three major players the likes of Alascom, AT&T and an MCI-affiliated GCI.

And like Alascom's Ayers muses, "Anything is for sale at a price." □

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These are the traits Alaska's mine managers, engineers and equipment operators look for when they've got earth to move. It's why CMI built its reputation on quality product lines like Hitachi. We know that "Hitachi-made" means careful research and design that relies on nearly 80 years of field data. It means attention to engineering, from computer-aided design to ultrasonic structural tests to field engineers checking up on applications in the remotest of sites.

Hitachi-made means quality hydraulic systems in which motors, pumps and pipings are tested individually and then tested again in high-stress conditions, tougher than any you're likely to encounter.

At CMI we know Hitachi builds excellence into its excavators. In Alaska, where isolated worksites and extreme cold are part of the job, Hitachi excellence means less downtime and improved operating costs. That adds up to a job well done.



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