

ALASKA LEGISLATURE SPECIAL COMMITTEE/SUBJECT FILES 8672
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of providing local exchange access in low density areas are partially offset through higher access fees paid by intrastate carriers originating or terminating traffic in high density locations.

B. Competition, the AT&T Divestiture, and Joint Service Arrangement

The AT&T divestiture and growth of competition have eroded any rationale for the JSA. When in 1984 AT&T divested itself of its local exchange operations, the FCC created a system of local exchange access tariffs for long distance carriers' use of the local exchange carrier networks to originate and terminate their calls in the lower 48. This contrasts starkly with the "settlements" approach that is still embodied in the JSA 10 years later. Once equal access to the LEC networks was implemented and the interstate market became competitive, singling out AT&T to subsidize Alascom could no longer be justified.

There is now nearly unanimous agreement that the JSA must be terminated, because it is incompatible with competition and is no longer required to assure that other public interest goals are protected. Even Alascom's expert, Almarin Phillips agrees:

the State, Alascom and, I am sure, others have known for years 'that continuation of the Joint Services Arrangement is not viable in the long run, given the unanimous opposition to it by the relevant interexchange carriers.'¹²

¹² Prefiled Reply Testimony of Dr. Almarin Phillips, APUC Docket U-92-9, dated August 28, 1992, p. 5 (quoting Comments of the Continued on following page

But there has been no agreement about what should replace the JSA. A Joint Board of state and federal regulators formed in 1985 has set out five criteria by which any solution should be judged: universal service, rate integration, revenue requirement neutrality, competition, and efficiency.¹³ Previous efforts to find a solution that adequately meets these criteria have failed to gain regulatory approval.

C. AT&T's Consumer Benefit Plan

In March 1993 AT&T proposed a new solution, the Consumer Benefit Plan, under which AT&T would enter Alaska's interstate and intrastate market. AT&T would offer both northbound and southbound interstate service. It would (a) eliminate mileage bands 10 and 11 from its interstate MTS tariff, (b) set its intrastate rates at about 4% less than Alascom's current rates, and (c) not raise these initial intrastate rates for five years, except to pass through APUC-approved increases in intrastate access charges.

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State of Alaska). See also, Opposition of Alascom, Inc. to Proposal of General Communication, Inc., CC Docket No. 83-1376, RM 4436, October 23, 1992, Attachment No. 5, pp. 2-3.

¹³ While the goals of competition and efficiency are self-evident, the other goals require some explanation. The universal service goal requires that service remain available to all Alaskans at reasonable prices. Rate integration refers to the goal of extending the national geographically averaged rate policy to Alaska and Hawaii which was achieved in 1987. The goal of revenue requirement neutrality seeks to assure that Alaska's intrastate rates do not rise as a result of changes in the telecommunications regulatory structure.

As part of the CBP, AT&T would develop its own Alaska network including a state-of-the-art fiber optic undersea cable. AT&T estimates that the cost of constructing the cable would be about \$125 million. It also asks permission to invest up to \$95 million to build additional facilities in Alaska (\$40 million of which represents investment in terrestrial facilities that AT&T would prefer to take under tariff or lease from Alascom if available at reasonable rates). The implications of the CBP on service quality and innovation are considered more fully below, but the proposed cable itself is notable because it will be more capacious and easily upgraded than the existing cable serving Alaska. AT&T's entry would also make available many new services and pricing options.

AT&T makes the Consumer Benefit Plan contingent on three conditions: (1) the immediate termination of the JSA, (2) the approval of AT&T's Section 214 request to extend its network to Alaska, and (3) regulation to assure that Alascom provides transport service to Alaska's local exchange companies at cost-based prices. This latter condition is especially important, because Alascom currently enjoys a de jure facilities monopoly in many instances.

III. THE EFFECTS OF AT&T'S CONSUMER BENEFIT PLAN

A. Interstate Service

The Consumer Benefit Plan will significantly reduce the price of many interstate calls, more directly tie Alaska's interstate rates to the highly competitive environment in the lower 48, make new service options available to Alaska consumers, and provide service under conditions that are fair to competitors. The upshot is that Alaska's interstate customers will enjoy lower prices and better service from a more competitive interstate marketplace.

1. Many Interstate Calls Will Be Cheaper.

Under the Consumer Benefit Plan AT&T will eliminate mileage bands 10 and 11. Mileage bands 9, 10 and 11 cover calls spanning 1911-3000, 3001-4250, and 4250-5750 miles respectively. By eliminating mileage bands 10 and 11, the Consumer Benefit Plan will reduce the price of 25% of Alaska's originating interstate calls by 17% to 32%,¹⁴ resulting in direct customer savings on today's level of calling, and stimulate the growth of traffic. Callers from the more remote Bush communities will particularly benefit, because

¹⁴ AT&T's Petition to Terminate the Joint Service Arrangement, CC Docket No. 83-1376, March 31, 1993, pp. 6-7.

they tend to make calls over longer distances, they call more, and they have relatively low incomes.¹⁵

For example, in 1992 United Utilities, Inc. reported that its typical residential customer had an annual income of less than \$10,000 and lived in a community accessible only by air.¹⁶ This typical customer spent \$106.10 monthly or over 12% of his annual income on telephone service!¹⁷ Of this, \$15.00 monthly or \$180 a year is spent on interstate toll calls.¹⁸ Based on the conservative assumption that this typical customer makes the average number (25%) of calls to destinations more than 3000 miles away, he will save from \$7.65 to \$14.40 a year under the CBP.¹⁹

¹⁵ Bush customers will get the benefits of AT&T's interstate price cuts even if lack of equal access prevents AT&T from originating calls in the Bush. As discussed below, geographic averaged rate requirements and competitive market forces will compel Alascom to pass on these savings.

¹⁶ Ex Parte Presentation by United Utilities, Inc., CC Docket No. 83-1376, June 3, 1992, p. 9 (hereafter United Utilities Ex Parte). The table portraying the "Profile of a Typical United Utilities, Inc. Customer" gives demographic information and current monthly figures for local service, state toll, and interstate toll.

¹⁷ United Utilities Ex Parte. By way of comparison, in 1990 average household expenditures on basic and long distance telephone service for 17 metropolitan areas in Canada constituted only 2.5% of income for households with less than \$15,000. Stentor Resource Centre Inc., Review of Regulation Framework, Public Notice CRTC 92-78, April 13, 1993, p. 5-21.

¹⁸ United Utilities Ex Parte.

¹⁹ 25% of all calls multiplied by \$180 per year multiplied by 17% to 32% price reductions equals \$7.65 to \$14.40. The assumption that 25% of all calls will exceed 3000 miles is conservative, since many of the Bush communities served by United Utilities are over 500 miles west of Anchorage.

2. Integration of Rates and Competition in the Lower 48 States Will Assure Alaska Gets the Full Benefit of Competition.

Alaska's interstate rates are integrated into AT&T's long distance price schedule. By eliminating mileage bands 10 and 11, any call to or from Alaska made with AT&T would be priced the same as a call, spanning a comparable distance, within the lower 48. Thus, Alaskans would be guaranteed the same benefits from interstate competition as those customers in the rest of the market. This benefit is notable because of the intense degree of interstate competition, elaborated upon further below.

3. AT&T Will Offer New Services and Pricing Options.

With AT&T's full entry into Alaska's market, it will be able to extend to Alaska services that are offered in other states. The following examples illustrate the benefits that Alaskans will receive, particularly in facilitating business activities that will contribute to Alaskan economic growth and employment.

AT&T EasyReach Service - This is a custom network service which provides subscribers with a 700 telephone number in the format 700-xxx-xxx. This number is a portable long distance number that is theirs for as long as they remain AT&T EasyReach subscribers, no matter where on the U.S. mainland (but not yet Alaska) they may travel or move. It provides subscribers with a package of features that will allow them to choose which calls follow them to their new location and who will pay for the calls.

AT&T PRO WATS - To give businesses more flexibility and improved price/performance, AT&T has combined PRO WATS I, II and III Calling Plans into a single offering, AT&T PRO WATS, which began being phased in on a nationwide basis in 1989. Where billing of the service is available, this plan provides base discounts and volume discounts which vary by type of call. Currently, PRO WATS Service is available in approximately 95% of the country.

AT&T MEGACOM WATS is designed for high volume users -- 235 hours/month or more. It offers interstate, intrastate and international calling to over 177 dialable countries on the same direct access line. Volume discounts and Term Plans are offered and provide even greater discounts.

AT&T Multi-Location WATS is an outbound only, long distance pricing plan that provides significant savings for businesses with multiple locations. MLW gives the best price/performance on AT&T PRO WATS, AT&T WATS, or AT&T MEGACOM WATS at their various locations -- all at the lowest possible rate for each call.

AT&T One Line WATS Service enables customers to originate intrastate, interstate and international direct-dialed calls on the same dedicated access line. It responds to WATS customers' needs for a dedicated service to handle direct-dialed calls to multiple jurisdictions, i.e., intrastate, interstate and international. AT&T One Line WATS Service provides improved line efficiency for these users.

These examples illustrate the benefits from the dynamic workings of the competitive marketplace. In regulatory proceedings, it is all too easy for opponents of competitive entry to show that, under conditions of alleged natural monopoly, a single firm can serve the market at a lower unit cost than can two firms that share the market. Similarly, it can be argued that adding yet a third firm (here AT&T) would contribute to even greater inefficiency.

The problem with such analysis is that it conveys only a sterile, wooden concept of what competition is all about.²⁰ Experience has shown that firms' cost curves are affected by the incentives they face. For example, a competitive firm is more efficient, i.e., operates on a lower cost curve. Thus, competitive firms may produce at lower unit cost than would the single less-efficient monopoly firm. Moreover, competitive firms have greater incentives to offer more innovative services than does the monopoly firm.

4. AT&T's Entry Will Increase Competition in Alaska's Interstate Market.

While market forces would likely compel AT&T's competitors to match the significant price cuts embodied in the elimination of mileage bands 10 and 11, there is no plausible basis for believing that these price reductions could drive out competitors or allow AT&T to establish a monopoly from which it could reap gains that exceed upfront losses. Consider first the worst case scenario. Even if its competitors were to disappear, AT&T couldn't arbitrarily raise Alaska's interstate rates because they are already tied to the interstate rate structure in the lower 48. Thus AT&T could not effectively pursue a tail-wagging-the-dog strategy, that is, raise rates in the lower 48 simply as a way to raise rates for

²⁰ For a typical example of such wooden analysis see Almarin Phillips, Testimony, Attachment 3 to Response of Alascom, Inc. FCC CC Docket No. 83-1376, February 26, 1990.

Alaska traffic. Aside from the fact that the Alaskan market is a tiny part of the total, intense interstate competition could sharply erode AT&T's market share and revenues in the lower 48 if it were to hike its prices there.

The worst case scenario is, of course, unrealistic. AT&T would have to drive out two large, well-established competitors in order to gain a monopoly. (In this regard we note that MCI is now a 30% owner of GCI.) There is no a priori reason for believing that the competitors on the Alaska route are any more likely to fail than are long-distance competitors that serve the multitude of routes in the lower 48. Not only have we not seen any wholesale demise of competitors, their numbers have multiplied--with an increasing market share at AT&T's expense. For example, as of the 4th quarter of 1992, 81 carriers serve 4 or more states (this number has "stabilized at 81 for 2nd consecutive quarter after shooting up from 68 in December 1991 and from 26 five years ago") and 9 carriers serve 45 or more states (this number is "up from 6 [the] previous year, 3 in 1987").²¹

As a consequence, AT&T's market share in terms of total interstate minutes fell from 85% in 1984 to 60% in 1992.²² In terms of revenues of "long distance" carriers (both interstate and

²¹ Communications Daily, March 24, 1993, p. 6, referencing FCC, Summary of Long Distance Carriers, 1992.

²² FCC, Long Distance Market Shares: Fourth Quarter 1992, March 1993, p. 10.

intrastate), AT&T's market share fell from 90% in 1984 to 62% in 1991.²³ While its largest competitors, MCI and Sprint, enjoyed large increases, numerous other carriers as well saw their collective revenue market share rise from less than 3% to more than 13% during that same period.

In terms of capacity, AT&T's share has fallen even more dramatically. A Bell Labs study has found that AT&T's competitors have more than enough capacity to serve all of AT&T's customers.²⁴

Drawing from that and other analysis, the FCC concluded:

...AT&T's competitors have enough readily available supply capacity to constrain AT&T's market behavior and inhibit it from charging excessive rates.²⁵

Moreover, the long lives of these existing assets almost certainly assure that facilities will be held by competitors into the foreseeable future.

²³ Id., p. 12.

²⁴ See Appendix A, attached to AT&T Comments, Competition in the Interstate Interexchange Marketplace, No. 90-132 (FCC June 20, 1990)

²⁵ Competition in the Interstate Interexchange Marketplace, CC Docket No. 90-132, R&O, 6 FCC Rcd 5880 (para. 48), modified on recon, 7 FCC Rcd 2677 (1992).

B. Intrastate Service

1. Intrastate Prices Will Fall.

Under the Consumer Benefit Plan AT&T will reduce intrastate MTS prices, on average, by 4% as compared to Alascom.²⁶ For intrastate calls falling in relatively longer mileage bands--typically the case for calls made to or from the Bush--the CBP will decrease prices by over 7% as compared to Alascom.²⁷ Further, AT&T will not increase these prices for 5 years except to pass through APUC approved LEC access increases. We estimate that the upfront 4% price reduction will save Alaskan callers \$12.5 million over the first five years of the CBP. This figure is based on an estimate of Alascom's intrastate MTS revenue for 1992 of \$61.7 million,²⁸ with the assumption that Alascom would match AT&T's lower rates, but would keep its rates constant (in the absence of inflation which we consider below) if AT&T did not

²⁶ AT&T's Comments, CC Docket No. 83-1376, June 28, 1993, p. 23.

²⁷ Id., n. 35.

²⁸ Alascom reported to AT&T that in 1992 its intrastate switched services generated 231 million minutes. Using an average revenue of \$.32 per minute, we estimate Alascom's switched services to have been \$73.9 million. Assuming Alascom's intrastate MTS revenues were 83.4% of intrastate switched service revenues (based on AT&T's 1990 total long distance network data), Alascom's 1992 intrastate MTS revenues were \$61.7 million.

enter the Alaskan intrastate market.²⁹ This estimate of \$12.5 million in savings is conservative because (a) we do not take into account the savings that would accrue from traffic growth beyond the 1992 base, and (b) we ignore any savings that might accrue based on GCI's share (about 20%) of intrastate MTS traffic. Additional savings would accrue if GCI matched AT&T's rates, because AT&T's proposed rates are less than or equal to GCI's current intrastate rates.³⁰

Moreover, given continued general inflationary pressure, Alaskan consumers will also enjoy price reductions in real terms during the first five years of the CBP. To illustrate, suppose that general inflation as measured by the GNP Producer Price Index averages 4% annually over the 5-year period.³¹ Suppose further that (a) Alascom's rates, in the absence of AT&T entry, would rise by the amount of inflation, *i.e.*, they remain constant in real terms,³² and (b) AT&T's access costs (the amounts paid to LEC's) also rise by the rate of inflation. Because these access costs

²⁹ AT&T's 4% price reduction would produce savings of \$2.5 million annually or to \$12.5 over the 5-year period.

³⁰ AT&T's Comments, CC Docket No. 83-1376, June 28, 1993, p. 23, n. 35.

³¹ The plausibility of this assumption is suggested by the fact that the GNP-PPI index actually rose by an average of 3.67% during the period 1982-1992.

³² The assumption of an Alascom price rise is quite plausible because, as discussed below, Alascom has argued that under the Joint Board's Tentative Recommendation, its intrastate revenue requirements, and presumably rates, would rise. See Response to Request For Implementation Plan of Alascom, Inc., CC Docket No. 83-1376, June 7, 1993, p. 9.

will amount to about 44% of AT&T's total Alaskan intrastate costs, AT&T's rates would rise, in nominal terms, by about 10% over the 5-year period.³³ Since general prices will have risen by 22% (with the 4% annual price rise), AT&T's intrastate rates will have fallen by 9% in real terms by the end of the fifth year. Using the same revenue and competitive assumptions as above, the estimated annual real savings to Alaskan telephone ratepayers are \$16 million (Table 1). Adding these savings to the savings from the upfront 4% price cut (appropriately deflated), we estimate that the adoption of the CBP will lead to intrastate savings of about \$27 million over the first five years.³⁴

³³ Estimate of 44% is derived by dividing an estimated \$.14 per minute local access charge by an estimated average revenue per minute of \$.32. These access and revenue figures are the same as those used in AT&T's financial analysis contained in its July 12, 1993 Reply Comments.

³⁴ The \$12.5 million calculated above translates to \$11.3 million in real term savings. The sum of \$11.3 million and \$16 million rounds to \$27 million.

TABLE 1

REAL PRICE INTRASTATE TOLL SAVINGS UNDER CONSUMER BENEFIT PLAN
(Millions)

End of Year	Revenue Base	Revenue Base Less Access Costs	Mid-year Price Index	Deflated Revenues	Savings
1	61.7	34.6	102.0	33.9	0.7
2	61.7	34.6	106.1	32.6	2.0
3	61.7	34.6	110.3	31.3	3.2
4	61.7	34.6	114.7	30.1	4.4
5	61.7	34.6	119.8	28.8	5.7
				Total	16.0

The impact would be greater for those who are heavy intrastate callers. Again, consumers in the Bush communities would appear to benefit significantly. United Utilities' profile of its typical customer shows intrastate toll bills are \$65 a month or \$780 a year.³⁵ For each of the first five years of the CBP, this typical caller would save approximately 7% or \$54.60, for a total of

³⁵ United Utilities Ex Parte, p. 9. The table portraying monthly figures for state toll appears to be current as of June 1992. However, if these figures do not reflect intrastate rate cuts effective July 25, 1991 (as shown in Table 2 below), the estimated savings would have to be reduced by 6.1%.

\$273.³⁶ Assuming a 4% inflation rate and the above assumptions about AT&T's and Alascom's prices, we estimate that the typical United Utilities customer would save \$8, \$25, \$41, \$56, and \$71 for years 1 through 5. The total of \$201 plus the preceding \$273 (converted to inflation-adjusted savings of \$248) gives a total savings over the first five years of \$449.

Clearly, AT&T is making a unique commitment to Alaska: even if inflation were to heat up to 6%, 8%, or even double digit levels during the five years, AT&T would be committed to restrict any rate increases only to increases in its access costs. In these cases, the fall in rates in real terms would be even more dramatic than shown in Table 1.

In contrast, based on Alascom's analysis (using an illustrative write-down of \$150 million of investment), the Joint Board's Tentative Recommendation would increase Alascom's annual intrastate revenue requirement by more than \$18 million.³⁷ By itself, this increase would likely force an increase in intrastate rates unless traffic growth were rapid enough to provide additional needed revenue.

³⁶ For calls greater than 275 miles AT&T's rates are 7% less than Alascom's. The savings for the typical Bush customer estimated above assumes that all of these calls span distances greater than 275 miles.

³⁷ Response to Request For Implementation Plan of Alascom, Inc., CC Docket No. 83-1376, June 7, 1993, p. 9.

2. Intrastate Competition Would Be Strengthened.

Experience in Alaska has shown that competition produces lower prices for consumers than has regulation. This fact is vividly illustrated by Alascom's intrastate rate history since 1980 set out in Table 2. In 1980 Alascom raised rates 80% after a legal appeal and in the succeeding years it made relatively minor reductions. These reductions were largely targeted to the longer mileage bands or, in one case, when it could begin to charge for operator assisted calls.

Much larger and across-the-board cuts came in the period when GCI sought to enter the intrastate market. For years in the mid-1980's GCI attempted unsuccessfully to do so. It appeared to make a breakthrough when it sought to place the issue of intrastate competition on a voter initiative in Alaska. GCI filed its documentation supporting a state voter initiative on intrastate competition on June 5, 1989.³⁸ While Alascom fought the GCI initiative in the courts, it is illuminating that within days (June 15, 1989 as shown in Table 2) Alascom began markedly decreasing its rates. As the threat of intrastate competition became increasingly likely, Alascom made additional large rate cuts. In total, since mid-1989 Alascom has cut its intrastate rates by over 25%.

³⁸ Letter to Lieutenant Governor Stephen A. McAlpine from Ronald A. Duncan, President of GCI, Inc., June 5, 1989.

TABLE 2
CHRONOLOGY OF INTRASTATE RATE CHANGES³⁹

DATE	PERCENT CHANGE	COMMENT
JAN 1980	+83.4	Rate adjustment allowed by Supreme Court
APR 2, 1987	-4.5	Begins charging for operator assisted calls
JUN 17, 1987	-6.5	Only for longer mileage bands
OCT 1, 1987	-1.0	Only for longer mileage bands
JAN 1, 1989	-1.9	
JUN 5, 1989		GCI files documentation for voter initiative.
JUN 15, 1989	-12.0	
JAN 10, 1990		GCI files Bush expansion plan.
MAR 17, 1990	-12.8	
JUN 7, 1990		Intrastate competition legislation signed.
JUL 25, 1991	-6.1	

Entry by AT&T as a third competitor might well bring further price cuts by expanding competition beyond that of the Alascom and GCI-MCI duopoly. Using the Cournot model of pricing behavior by competitors--a model commonly used by economists--Kwerel and Williams calculate that the addition of a third firm in a domestic

³⁹ The dates and size of the price cuts are taken from a rate history prepared by Alascom and contained in Appendix B.

cellular telephone market would bring a price reduction of 25%.⁴⁰ Another study in five manufacturing industries showed entry of a sufficiently large third firm would reduce industry margins by 13 or 14 percentage points--which Kwerel and Williams translate to a 22% price reduction in their analysis of the cellular market.⁴¹

Of course, outcomes critically depend on the specific characteristics of each individual industry. Wireline service in Alaska is not the same as cellular in the lower 48. Nevertheless, the above studies suggest significant price effects of adding a third firm to the market.

As in the case of interstate services, there is no reason to believe that AT&T's intrastate competitors will be driven from the Alaskan market, leaving AT&T with a monopoly. Nor is it plausible that AT&T could use its "deep pockets" to invest large sums in Alaska, suffer large losses in the near term, and then reap the gains of monopoly in the long term sufficient to compensate for this loss.

These concerns are far-fetched for three reasons. First, deep pockets are indeed hard to find in AT&T's lines of business. Its interstate telephone business is fiercely competitive as discussed

⁴⁰ Kwerel and Williams, "Changing Channels: Voluntary Reallocation of UHF Television Spectrum," FCC (OPP) Working Paper 27, p. 82.

⁴¹ Id., p. 83.

previously. In addition to the rising market shares of its competitors in message toll, recent developments make a "deep pockets" strategy most improbable. To note just one example, full number portability recently became available in the rapidly growing and lucrative 800 number market and competition has greatly intensified.

On the global front, where AT&T is a major player, British Telecom has agreed to invest \$4.3 billion for a 20% stake in MCI. (Again, we note that MCI has purchased a 30% interest in GCI.) According to one report, the MCI Chairman and Chief Executive Officer has termed it the "telecommunications deal of the century" and has gone on to make "it clear that he expects to use that 'war chest' [the \$4.3 billion in cash] to finance moves into new U.S. domestic markets, including the nascent competitive access and other local distribution markets; cable TV/telephony system delivery of information and entertainment services; and emerging personal communications services."⁴² He might have added that these activities will go head-to-head with a multitude of AT&T ventures.

On top of these competitive pressures, AT&T must conform to the requirements of the FCC's price cap regime for many of its interstate services, particularly its consumer services. AT&T is permitted to raise average rates by the increase in the Producer

⁴² Telecommunications Reports, June 7, 1993, p.3

Price Index minus a 3.0% downward adjustment for "productivity" growth and for a "consumer dividend" (plus adjustments for exogenous factors such as access costs). In essence, it is forced to reduce average real interstate rates for regulated services by 3% annually. Such reductions encourage AT&T's utmost care in decisions about how best to utilize its financial resources.

Second, the possibilities of predatory pricing strategies are most commonly raised with respect to a large incumbent firm facing potential competitive entry. If the firm can threaten to reduce its prices to make entry unprofitable, entry may be deterred and the incumbent is left unscathed.⁴³ But here, it is AT&T that is the prospective entrant, starting with a zero market share. It is hard, indeed, to make the case that it would be willing to suffer such large losses that it could drive out the incumbents.

Third, little leeway would exist to reap monopoly profits in Alaska even if AT&T's competitors disappeared. Such an evolution would immediately bring demands for APUC regulation of AT&T's rates as the dominant or monopoly supplier. Attempts to raise rates from the then-current or historical levels would surely meet with negative public reaction and government action. Any hoped-

⁴³ See, for example, Ordover, J.A. and Saloner, G., "Predation, Monopolization and Antitrust" in Schmalensee and Willig [eds.], The Handbook of Industrial Organization, North Holland, Amsterdam, 1989, pp. 537-96.

for monopoly profits to offset earlier losses would almost certainly prove to be a mirage.

While dismissing the predatory pricing argument, one can reasonably ask why AT&T is willing to make the unique commitments embodied in the CBP. The answer is that (a) AT&T's financial calculations show that prompt entry in accordance with the CBP can be expected to be profitable, and (b) proceeding on the basis of the CBP allows AT&T to free itself of the financial drain imposed by the JSA. To be sure, Alaskans might assume that they benefit from the JSA through AT&T's large payments to Alascom. However, the JSA encourages wasteful, inefficient behavior by Alascom that translates into higher rates. Alaskans will get a better deal by working directly with AT&T in a competitive environment.

C. Preservation of Universal Service

1. Existing Regulation And Competition Will Assure Affordable Service.

Under the CBP, service can be expected to remain available to all Alaskans at affordable rates. A combination of exit (Section 214) regulation, competition, and the requirement that rates be geographically averaged will assure this result.

In both the interstate and intrastate markets, the largest ("dominant") carriers serve all locations and are required to

obtain regulatory approval before discontinuing service. In the interstate market, AT&T has stated that it is willing to accept a requirement that it obtain Section 214 approval before discontinuing southbound interstate service from Alaska. It makes this concession notwithstanding the competitive nature of the market and AT&T's new entrant status in Alaska. In the intrastate market, the largest carrier would be classified as the dominant carrier (initially this would be Alascom). Thus, another carrier would assume Alascom's current intrastate serving obligations, if it were to become the largest carrier.

At the interstate level all Alaskan callers will have the benefit of AT&T's geographically averaged rate schedule. Even if AT&T is unable immediately to originate traffic in Bush communities, its nationwide rate schedule, together with regulation, would provide a sufficient check on any attempt by Alascom to discriminate against interstate calls made from the Bush. As long as Alascom is the only carrier originating service in the Bush, the FCC can be expected to classify it as a dominant interstate carrier (at least for those locations) and require it to maintain geographically averaged interstate rates. In that event, competitive pressure would require Alascom to match AT&T's schedule for calls of any given distance, with callers in the Bush getting the same rate as those in Anchorage or in New York City.

A similar combination of competition and regulation would operate at the intrastate level. The APUC requires that retail intrastate

rates be geographically averaged--that is, calls of the same distance must be priced the same regardless of the points of origination and termination. Together with rivalrous competition on Alaska's high density routes which carry the bulk of the traffic, geographically averaged rates should give intrastate callers to and from low density areas the full benefits of competition.

2. The Consumer Benefit Plan Reasonably Accommodates Alascom's Financial Situation.

It is true that the Consumer Benefit Plan might preclude Alascom from pricing its service to cover its revenue requirement. Market forces will compel Alascom to match AT&T's initial rates over the first five years of the CBP regardless of what it would be permitted to charge under today's regulatory regime. Moreover, competitive pressures may force further rate cuts below those initially set by AT&T. To match these price cuts, Alascom might well be forced to write down plant and reduce expenses.

However, it is not likely that Alascom will be severely hurt. AT&T's cable will not be available until 1996 or later and therefore for at least three years, AT&T will necessarily lease capacity from Alascom. If Alascom prices its other (terrestrial) facilities reasonably, AT&T has stated that it would prefer to use them. Thus, the Consumer Benefit Plan affords an inherent transition period for Alascom to realign its costs.

Moreover, Alascom is substantially owned by a multi-billion dollar company that should give it sufficient access to the capital markets to weather whatever restructuring it must undergo.

Alascom is 100% owned by Pacific Telecom, which in turn is 87% owned by PacifiCorp. PacifiCorp is the third largest electric utility company west of the Rocky Mountains and serves 1.3 million customers through Pacific Power and Utah Power. PacifiCorp's 1992 revenues exceeded \$3 billion.⁴⁴

3. The Bush Communities Will Have Affordable Local Service.

Compelling evidence that universal service will not be threatened comes from recent experience in the Bush. Of all the areas in Alaska, the dozens of isolated small villages in the Bush are probably the most costly to serve. Under statewide averaged rates, the Bush routes are the most heavily subsidized. Yet, in 1990 GCI applied for permission to serve these communities by installing satellite ground stations side by side with those of Alascom. How could one possibly justify such an apparently wasteful expenditure? GCI's response was that Alascom's satellite service was so inefficient that GCI could install a system that would turn a profit even on routes that are allegedly heavily

⁴⁴ PacifiCorp Annual Report 1992, p. 1.

subsidized by Alascom.⁴⁵ Although the APUC has not approved GCI's application, we note that GCI was fully willing to back up its contentions with its money. This experience strongly suggests that the incremental cost of serving the Bush is far less than what one would conclude from Alascom's financial statements.

Any problems stemming from above-average costs of serving the Bush and other locations should be addressed by cost-based wholesale rates for transport charges and through pooling systems such as the APUC's bulk billing access system. The latter subsidizes calls made from or to low density locations (which presumably have higher than average local access costs). The APUC explains:

Weighting of bulk bill access charges partially levelizes the profitability of urban and rural toll routes. By maintaining profitability on low density, high cost rural toll routes...the weighting system protects universal service throughout the state without requiring payments between competing IXCs.⁴⁶

In any event, even if Alascom sought to leave the market, it is likely that other companies would seek to enter the market either by purchasing Alascom's facilities or, if permitted, by installing more efficient facilities. GCI has already expressed such an interest in serving the Bush. In the unlikely event that no other carrier is prepared to do so, AT&T has stated in its June 28, 1993

⁴⁵ Supplemental Filing of GCI, CC Docket No. 83-1376, RM 4436, January 10, 1990, pp. 4-6.

⁴⁶ APUC Order No. 6, p. 28.

Comments that it stands ready to serve the Bush by purchasing Alascom's Bush facilities at net book value.⁴⁷

IV. CONCLUDING REMARKS

In their promotional campaigns, economic development agencies around the world emphasize the particular advantages their regions have to offer. Commonly heading the list are proximity to transportation hubs, availability of adequate labor supply, and--notable here--access to the most modern telecommunications systems.

In contrast, we too frequently see descriptions of services "available in the United States, except in Alaska." To achieve its full economic potential, Alaska must be placed on full parity with the other states.

Given its climate, population density and distance from the lower 48, the importance of infrastructure is, if anything, greater in Alaska. The state covers more than one half million square miles or roughly one fifth of the total area of the lower 48. Fewer than 500,000 people (fewer than in Seattle) are spread over an area equivalent to California, Oregon, Washington, Nevada and Montana. The northern third of the state lies within the Arctic Zone. According to the Alaskan Telecommunications Association, "Many areas, including Juneau, are accessible only by water or air

⁴⁷ AT&T's Comments, CC Docket No. 83-1376, June 28, 1993, p. 15.

transportation. Weather extremes often prevent travel between cities, while the vast geographic distances between the Alaskan communities make traveling time consuming, difficult, and costly."⁴⁸ Its lack of other infrastructure ("only 8,700 miles of highways and only 2,517 of those miles are paved")⁴⁹ heighten the importance of Alaska's telecommunications infrastructure.

Today, we can easily imagine firms weighing the advantages and disadvantages of competing geographical sites in locating their activities. For example, a firm may place the bulk of its staff in Seattle, with smaller crews in Alaska, in part because of Seattle's easier access to worldwide communications services. On the other hand, with high capacity telecommunications links to Alaska, and new services offered at an attractive price, the firm may shift staff to Alaska where, with the telecommunications barrier removed, the firm could enjoy the other advantages offered by the state. Similarly, improved services may encourage small business development in the Bush, where, as we have seen, residents spend an extraordinary portion of their budgets on phone service.

Full Alaska telecommunications parity is within reach. AT&T's Consumer Benefit Plan is the critical link in attaining that goal.

⁴⁸ ATA Comments, CC Docket No. 83-1376, RM 4436, December 2, 1986, p. 10.

⁴⁹ Id.

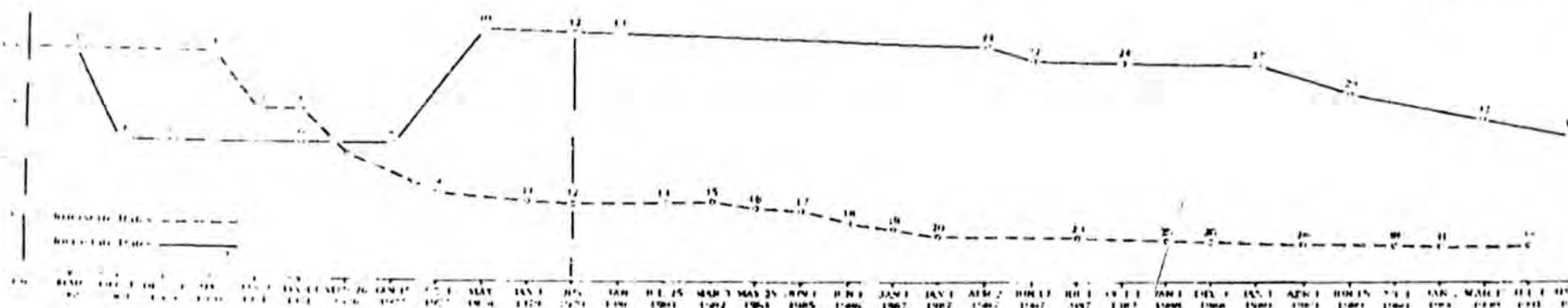
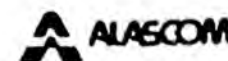
APPENDIX A

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APPENDIX B

Interstate and Intrastate Rate History



Event		Intrastate Effect	Interstate Effect
RCA	1. MAR 1969 RCA Alascom's offer to purchase ACS includes proposed 25% interstate and 10% intrastate rate reduction		
	2. DEC 1 1969 ACS implements RCA Alascom's proposed 10% intrastate rate reduction		
	3. DEC 31 1969 RCA Alascom awarded purchase of ACS		
	4. AUG 1970 RCA Alascom awarded long lines certificate		A \$10.00 call now costs \$6.00
	5. JAN 9 1971 ACS implements Alascom's proposed 25% interstate reduction		A \$10.00 call in 1969 now costs \$7.50
	6. JAN 10 1971 RCA Alascom assumes ownership and operation of ACS		
	7. MAR 26 1976 RCA Alascom implements 25.4% interstate rate reduction		A \$10.00 call in 1969 now costs \$5.51
	8. JAN 15 1977 RCA Alascom files with APRC for 87% interim intrastate rate increase		
	9. JUL 1 1977 RCA Alascom implements 30% interstate rate reduction		A \$10.00 call in 1969 now costs \$1.19
	10. MAY 1978 State Supreme Court allows 87% interim intrastate rate increase		A \$10.00 call in 1969 now costs \$11.22
PacifiCorp	11. JAN 1 1979 RCA Alascom implements 10% interstate rate reduction		A \$10.00 call in 1969 now costs \$15.
	12. JUN 1979 RCA Alascom is purchased by Pacific Power & Light		
	13. JAN 1980 Alascom implements 83.4% permanent intrastate rate increase		A \$10.00 call in 1969 now costs \$11.00
	14. JUL 25 1980 Alascom incorporated a minor interstate rate increase to mirror changes by AT&T		
	15. MAR 3 1982 Alascom incorporated a minor interstate rate increase to mirror changes by AT&T		
	16. MAY 25 1981 Alascom implements 5.1% interstate rate reduction		A \$10.00 call in 1969 now costs \$3.31
	17. JUN 1 1985 Alascom lowers interstate rates by 5.8%		A \$10.00 call in 1969 now costs \$3.12
	18. JUN 1 1986 Alascom lowers interstate rates by 14.1%		A \$10.00 call in 1969 now costs \$2.61
	19. JAN 1 1987 Alascom lowers interstate rates by 11.3%		A \$10.00 call in 1969 now costs \$2.32
	20. JAN 1 1987 Alascom lowers interstate rates by 10.9%		A \$10.00 call in 1969 now costs \$2.11
	21. APR 2 1987 Alascom lowers intrastate rates by an average of 4.5% and begins to charge for operator assisted calls		A \$10.00 call in 1969 now costs \$10.50
	22. JUN 17 1987 Alascom lowers intrastate rates by 6.5% for longer mileage bands		A \$10.00 call in 1969 now costs \$9.82
	23. JUL 1 1987 Alascom lowers interstate rates by 4.2%		A \$10.00 call in 1969 now costs \$2.02
	24. OCT 1 1987 Alascom lowers interstate rates by 1% for longer mileage bands		A \$10.00 call in 1969 now costs \$1.72
	25. JAN 1 1988 Alascom lowers interstate rates by 6.4%		A \$10.00 call in 1969 now costs \$1.89
	26. DEC 1 1988 Alascom lowers interstate rates by 3.9%		A \$10.00 call in 1969 now costs \$1.82
	27. JAN 1 1989 Alascom lowers intrastate rates by 4.9%		A \$10.00 call in 1969 now costs \$9.51
	28. APR 1 1989 Alascom lowers interstate rates by 6.4%		A \$10.00 call in 1969 now costs \$1.72
	29. JUL 1 1989 Alascom lowers intrastate rates by 1.2%		A \$10.00 call in 1969 now costs \$8.40
	30. JUL 1 1989 Alascom lowers interstate rates by .2%		A \$10.00 call in 1969 now costs \$1.62
	31. OCT 1 1989 Alascom lowers intrastate rates by 5.9%		A \$10.00 call in 1969 now costs \$1.59
	32. MAR 17 1990 Alascom lowers intrastate rates by 12.8%		A \$10.00 call in 1969 now costs \$7.41
	33. JUL 1 1990 Alascom lowers interstate rates by 10%		A \$10.00 call in 1969 now costs \$1.59
	34. JUL 25 1991 Alascom lowers intrastate rates by 6.1%		A \$10.00 call in 1969 now costs \$6.86

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SEP 28 1993

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

TOTAL P.02

LONG DISTANCE COMPETITORS IN SPARSELY POPULATED STATES

STATE	POPULATION** (000)	FACILITY BASED	COMPETITORS	
			CARRIERS CARRIER	RESELLERS & ALTERNATIVE OPERATOR SERVICES PROVIDERS
WYOMING	453	AT&T, MCI*, SPRINT WLTEL	WESTERN TELECOMMUNICATIONS COMPANY, INC.	35
NORTH DAKOTA	638	AT&T, MCI*, SPRINT*		78
SOUTH DAKOTA	698	AT&T, MCI*, SPRINT*, EXPRESS COMMUNICATIONS, POLARIS TELECOM		62

* Leases network form other carriers

** 1990 Census (Alaska Population 550,000)

912067054177 P.02

TO

10-13-1993 03:15PM FROM

SEP 27 '93 14:36 ATT CERTIFICATE ENT 908-231-5297

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Before the
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Washington, D.C. 20554

FCC 930-2

In the Matter of

Integration of Rates and Services for)
the Provision of Communications by) CC Docket No. 83-1376
Authorized Common Carriers between)
the Contiguous States and Alaska, Hawaii)
Puerto Rico and the Virgin Islands)

Final Recommended Decision

Adopted: October 26, 1993

Released: October 29, 1993

By the Federal-State Joint Board:

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I. Introduction

1. In this Final Recommended Decision we present a carefully integrated plan to accomplish the objectives, required of this Joint Board, for interstate telecommunications services between Alaska and the contiguous states ("Lower 48") and between Alaska and Hawaii. We believe that this recommendation achieves, and represents the best balancing of, the five objectives guiding resolution of this proceeding: preservation of universal service; continuation of rate integration; maintenance of revenue requirement neutrality; allowance of market-based competitive entry; and the encouragement of increased efficiency. Our recommendation is comprised of carefully balanced elements that are intended to be implemented as a whole. Elimination or significant modification of any one aspect of our overall recommendation could adversely impact achievement of our market structure objectives.

II. Executive Summary

2. The Alaska market structure has been under review by this Joint Board for over eight years. After collecting vast volumes of data, receiving extensive comments from interested parties, and reviewing numerous proposals on this subject, we have reached a final recommendation regarding the market structure for Alaska that we believe best balances our identified goals and advances the public interest.

3. We affirm the conclusion in the Tentative Recommendation that the Joint Service Arrangement ("JSA") should be terminated, subject to the adoption and implementation of suitable transition mechanisms.¹ We decline to recommend the market structure plans advanced by either Alascom or AT&T, but, instead, recommend an alternative market structure based on that set forth in the Tentative Recommendation.

4. Under our recommended market structure, American Telephone & Telegraph Co. ("AT&T") would provide interstate message telephone service and wide area telecommunications service (hereinafter collectively referred to as MTS) between Alaska and the Lower 48 (northbound and southbound) at integrated rates and under the terms and conditions applicable to AT&T's provision of services in the Lower 48. AT&T would also be obligated to furnish MTS between Alaska and Hawaii at integrated rates.

¹ Tentative Recommendation And Order Inviting Comments, CC Docket No. 83-1376, 8 FCC Rcd 3684, 3687 (1993) ("Tentative Recommendation").

5. After the JSA is terminated, Alascom could offer interstate MTS independently from AT&T under its own tariff and with no obligation to charge AT&T's integrated rates.

6. Services provided to interexchange carriers ("IXCs") by Alascom, Inc. ("Alascom") under tariff would be offered on a non-discriminatory basis at rates that reflect the costs of service. Alascom's tariff would have separate rate schedules for its operations in locations subject to facilities competition and in locations where Alascom has a facilities monopoly. The costs of service in each of these categories would be prepared pursuant to a cost allocation plan developed by Alascom and approved by the Commission.

7. Alascom would continue to provide interstate private line service upon reasonable request under its existing federal tariffing and Section 214 obligations. If AT&T elects to provide interstate private line service to or from Alaska, it would be required to do so under the same rate structures, terms, and conditions that apply to its provision of private line services between other states.

8. The final recommendation would maintain the current cost separations factor for the circuit equipment of Alascom and United Utilities, Inc. ("UUI"). Therefore, the Alaska Fund originally proposed in the Tentative Recommendation, would not be required.

9. During a four year transition period, beginning March 1, 1994, AT&T would be required to purchase services from Alascom to meet its MTS obligations. There would be two phases to the transition period with the first phase beginning on March 1, 1994, and the second phase beginning on September 1, 1995. During the first phase, AT&T would continue to obtain services from Alascom under the JSA that currently governs Alaska interstate MTS for one and one-half years. As of September 1, 1995, the JSA would terminate and Alascom's Common Carrier Services would be offered to carrier customers under tariff. During the second phase of the transition period, lasting two and one-half years, AT&T would be required to purchase a fixed amount of service from Alascom, defined as a percentage of a baseline revenue level. This obligation would decline to zero at the end of the second phase.

10. Finally, we recommend a \$150 million transition payment (to be made by AT&T in two installments of \$75 million each) be applied to reduce Alascom's total plant accounts. We conclude that this is necessary to ensure universal service, and to ensure revenue requirement neutrality.

III. Background

A. Rate Integration

11. In the early 1970's, the Commission authorized the private ownership and operation of domestic satellite and earth station facilities and concluded that the distance insensitive nature of satellite transmission costs required rate integration for services between the Lower 48 and certain noncontiguous points that included Alaska.² Rate integration for Alaska was accomplished in several steps that included the execution of the JSA between AT&T and Alascom in 1980.³ In the JSA, Alascom and AT&T entered into a contract to provide MTS services jointly, with Alascom responsible for MTS carriage to, from, and within Alaska, and AT&T responsible for carriage in the Lower 48. AT&T received all MTS revenues and paid all MTS costs of service, including those of Alascom.⁴ The JSA also required that the Lower 48 Separations

² "Rate integration" is the Commission policy that was adopted to describe service between the contiguous states and Alaska, Hawaii, Puerto Rico, and the Virgin Islands (noncontiguous points) at rates that are equivalent to those prevailing for comparable distances in the contiguous 48 states. Establishment of Domestic Communications Satellite Facilities, 35 FCC 2d 844, 856-57 (Domsat II), aff'd on recon., 38 FCC 2d 665 (1972), aff'd sub nom. Network Project v. FCC, 511 F.2d 786 (D.C. Cir. 1975). See also Integration of Rates and Services, 61 FCC 2d 380 (1976), recon. in part, 65 FCC 2d 324 (1977) (extending rate integration policy to the Virgin Islands).

³ The JSA was accepted and approved by the Commission in 1981. Memorandum Opinion and Order in W-P-C 649 et al., 87 FCC 2d 25 (1981). "The Commission has indicated its full support for the intercarrier settlement agreement submitted to the Federal-State Joint Board and the Commission to resolve separations questions for Alaska and Hawaii." FCC News Release, May 8, 1981, Report No. 16363. The FCC accepted the Joint Board's recommendation in a Report and Order, FCC 81 312, July 8, 1981, without qualification of the JSA as an "interim" measure. The Joint Board recommended adoption of the Motion of AT&T and Alascom regarding the JSA as filed. Confusion has arisen because the JSA included an "interim settlements procedure" to provide for the transitional supplement which would "terminate on January 1, 1985 at which time full rate integration will take place." See 87 FCC 2d 20, 21.

⁴ To implement the rate integration policy, AT&T develops its MTS rates for the total market and files tariffs covering the northbound service offerings to Alaska. Alascom mirrors the AT&T rates and files tariffs covering the southbound service offerings from Alaska. See Integration of Rates and Services, 2 FCC Rcd. 2447 (1987), aff'd sub nom. General Communication, Inc. ("GCI")

Manual would be applied to Alascom and that Alascom would receive annual, declining transitional supplement payments from AT&T during the transition to full rate integration.⁵

12. Several issues arose regarding the long-term relationship between the rate integration and competitive policies for MTS services between the noncontiguous points and the Lower 48. On December 22, 1983, in response to a petition for rulemaking filed by the State of Alaska and the Alaska Public Utilities Commission ("APUC"), the Commission adopted a Notice of Inquiry ("NOI").⁶ Comments in response to the NOI raised significant issues that required further analysis. On September 27, 1985, the Commission issued a Notice of Proposed Rulemaking ("NPRM") in CC Docket No. 83-1376 and referred those issues to this Joint Board pursuant to Section 410(c) of the Communications Act.⁷ In particular, this Joint Board was asked to consider questions concerning the appropriate market structure for the provision of Alaska MTS to harmonize the Commission's rate integration and competition policies and to recommend any separations changes that might be required to implement that market structure.

B. Joint Board Actions (1986 to 1992)

13. During the course of investigating the issues designated by the Commission, this Joint Board, on numerous occasions, solicited comments, data, and proposals regarding the Alaska interstate market structure. On May 9, 1986, we issued a

v. FCC, No. 87-1112 (D.C. Cir. 1987).

⁵ Memorandum Opinion and Order in W P-C 649 et al., 87 FCC 2d 25, 28-29 (1981). Originally, Alaska rate integration was to be achieved by 1985, but in 1984 the Commission extended the final implementation date for rate integration and continued the JSA and the transitional supplement payments at 1984 levels. Full rate integration became effective January 1, 1987, at which time AT&T's supplemental payments to Alascom terminated. Memorandum Opinion and Order, CC Docket No. 83-1376, RM 4436, FCC 86-602 (released January 2, 1987).

⁶ Notice of Inquiry, Integration of Rates and Services, CC Docket No. 83-1376, RM 4436, 96 FCC 2d 567 (1984).

⁷ Notice of Proposed Rulemaking, CC Docket No. 83-1376, RM 4436, FCC 85-520, 86-174 (released September 27, 1985) at para. 14. That Notice also terminated the inquiry with respect to non-contiguous points other than Alaska (i.e., Hawaii, Puerto Rico, and the Virgin Islands), finding that the comments did not raise any issues concerning the compatibility of rate integration and competition for service to and from those points.

data request on the costs of Alaska's interstate and intrastate telecommunications services, including a detailed description of then existing market and service arrangements, Alaskan demographic and economic data, and local exchange and interexchange carriers' financial, facilities, and statistical data (historical and projected). The order also asked commenters to address the question of the high cost of Alaska services and to submit market structure proposals.⁸ The comments and data filed in response to this order, as well as other documents submitted and issues raised relating to the market structure, were evaluated by the Joint Board.

14. As a result of this analysis the Joint Board issued a Supplemental Order on January 3, 1989.⁹ The Supplemental Order identified the following five objectives to guide resolution of the issues in this proceeding: continuation of rate integration; preservation of universal service; maintenance of jurisdictional revenue requirement neutrality; allowance for market-based competitive entry; and encouragement of increased efficiency. Two alternative conceptual market structure options, Plans A and B, were also identified by this order.

15. The Supplemental Order solicited comments on the objectives and the plans and also identified additional, updated data that were to be provided. Commenters were generally supportive of the Joint Board's objectives and were critical of one or both of the proposed plans. Alternative plans were also filed in response to Plans A and B: Alascom filed its Alaska Revenue Cap ("ARC") Plan; AT&T filed a modified Plan B; and the State of Alaska filed its "Cost Plus Incentive Fee Plan."¹⁰

⁸ Order Requesting Data and Inviting Comments, CC Docket No. 83-1376, RM 4436, FCC 86J 2 (released May 9, 1986); filing dates amended by Memorandum Opinion and Order, CC Docket No. 83-1376, (released August 20, 1986). On July 15, 1986, data were filed by Alascom, Alaska Telephone Association ("ATA"), AT&T, GCI, and the State of Alaska. Market structure proposals for Alaska and/or comments were filed by interested parties on December 2, 1986. Opposition comments and reply comments were filed on February 27 and March 27, 1987, respectively.

⁹ Supplemental Order Inviting Comments, CC Docket No. 83-1376, RM 4436 4 FCC Rcd 395 (1989).

¹⁰ Comments and/or data were filed by Alascom, ATA, AT&T, GCI, the Organization for the Protection and Advancement of Small Telephone Companies ("OPASTCO"), the State of Alaska, the State of Hawaii ("Hawaii"), the United States Telephone Association ("USTA"), and UUI between February 27, 1989, and April 13, 1989. Reply comments were filed by Alascom, ATA, AT&T, GCI, Hawaii, National Exchange Carrier Association, Inc. ("NECA"), the State of

16. During July 1991, AT&T and Alascom informed the members of the Joint Board that they were in the process of finalizing an agreement to replace the JSA and to resolve outstanding issues.¹¹ On January 29, 1992, a Joint Petition was filed by AT&T, Alascom, Pacific Telecom Inc., ("PTI") and Telephone Utilities of Alaska, Inc. ("TUA") seeking approval of a Master Agreement ("MA") for the provision of Alaska telecommunications services. On March 4, 1992, the Joint Board issued a Public Notice requesting comments and reply comments on the MA.¹² Pleadings were also invited on a petition by GCI, filed on January 29, 1992, that requested a new proceeding to resolve Alaska market structure issues.

17. In addition to comments and reply comments, the Joint Board received data concerning the MA through responses made to five data requests released between October 4, 1991, and June 25, 1992, by the State Members of the Joint Board. Overland Consulting, Inc. ("Overland"), a consultant hired to assist the Alaska Member of the Joint Board and staff, submitted a Briefing Paper on the MA on July 21, 1992.

18. On August 4, 1992, the State Members of the Joint Board issued a Memorandum of Understanding ("MOU") setting forth their concerns with the MA in light of the objectives set forth in the Supplemental Order. In response to the MOU, Alascom, AT&T, GCI, and the State of Alaska each offered modifications or alternatives to the MA. After studying the comments, pleadings, and proposals received in response to the MOU, the State Members, on November 5, 1992, released a document entitled: "Memorandum of Principles - Alaska Market Structure" ("The State Members' Plan"). The State Members' Plan identified those elements of the MA which they believed were not in the best interest of the public and recommended an alternative market structure.

Alaska, and UUI between May 5 and May 15, 1989.

¹¹ Pacific Telecom, Inc. Press Release (July 10, 1991).

¹² Comments were filed by Alascom, ATA, AT&T, Anchorage Telephone Utility ("ATU"), GCI, Hawaii, MCI Telecommunications Corporation ("MCI"), NECA, and Sprint Communications Company L. P. ("Sprint"), the State of Alaska, and UUI between April 16, 1992 and April 20, 1992. Reply Comments were filed by Alascom, ATA, AT&T, GCI, Hawaii, MCI, OFASTCO, and the State of Alaska on May 20, 1992.

19. On December 2, 1992, a Public Notice was issued inviting comments on the State Members' Plan.¹² In early 1993, we were notified by AT&T that the parties had elected not to extend the MA and would allow the agreement to expire after January 15, 1993. As a consequence, the MA became moot.¹⁴

C. Recent Procedural History (1993)

20. On March 31, 1993, AT&T petitioned for termination of the JSA and proposed an alternative Alaska market structure named the Consumer Benefit Plan ("CBP").¹⁵ On May 17, 1993, the Joint Board released the Tentative Recommendation.¹⁶ The Tentative Recommendation proposed a new market structure for Alaska interstate telecommunications services based on the extensive record that had been developed in this proceeding. The Tentative Recommendation required Alascom and AT&T to file plans to implement the Joint Board's recommendations. The Tentative Recommendation also invited comments and reply comments on its market structure proposal, the CBP filed by AT&T,¹⁷ and the requested implementation plans.

21. Both the Alascom and the AT&T responses to the requirement for implementation plan(s) were filed on June 7, 1993.¹⁸ Alascom's implementation plan included data regarding the estimated effects of the Tentative Recommendation market structure proposal at varying levels of accelerated cost recovery and its preliminary comments regarding the Tentative Recommendation. AT&T's filing did not present an implementation plan but, instead, argued that the

¹² Comments on the State Members' Plan were submitted by Alascom, APUC, ATA, AT&T, GCI, MCI, the State of Alaska, and UUI on December 18, 1992. Reply Comments were filed by Alascom, ATA, AT&T, GCI and the State of Alaska on January 15, 1993.

¹⁴ On September 18, 1992 Charles Naftman submitted an ex parte filing indicating that TUA had also filed a Notice of Withdrawal of its companion application pending before the APUC in APUC Docket U-92-9.

¹⁵ AT&T's Petition to Terminate the Joint Service Arrangement, March 31, 1993.

¹⁶ Tentative Recommendation, 8 FCC Rcd 3684 (1993).

¹⁷ Alascom had previously filed on April 15, 1993, its opposition to the AT&T proposal in its Initial Response of Alascom, Inc. to AT&T's Petition to Terminate the Joint Service Arrangement.

¹⁸ Response to Request for Implementation Plan of Alascom, Inc. (June 7, 1993); AT&T's Response to Request for an Implementation Plan (June 7, 1993).

Tentative Recommendation was inadequate and inferior to the CBP.

22. In response to the Tentative Recommendation, numerous entities filed comments, reply comments, and motions.¹⁹ In addition, a public hearing was convened on July 1, 1993, in Anchorage, Alaska, to receive testimony from the citizens of Alaska and other interested persons on the Tentative Recommendation, the CBP, and the implementation plan filings of Alascom and AT&T.²⁰ All Members of the Joint Board participated in person or via audio or video teleconference.²¹ Also on July 9, 1993, Alascom was requested by the State Members of the Joint Board to provide the underlying data supporting the financial analyses presented in its implementation plan.²²

23. The record in this proceeding also includes the taped record and a transcript of a hearing convened in Anchorage,

¹⁹ Comments dated June 23-28, 1993 were filed by Alascom, ATA, AT&T, ATU, GCI, Hawaii, MCI, NECA, Southwestern Bell Telephone Company ("SWBT"), Sprint, the State of Alaska, and UUT. Reply comments were filed by Alascom, ATA, AT&T, GCI, Hawaii, MCI, Sprint, the State of Alaska, USTA, and UUI between July 9 and 12, 1993. During June, July, and August numerous letters were filed by members of the public regarding the Alaska market structure issues. Motions made in this proceeding include Alascom's Request for Supplementation of Record (June 15, 1993); Motion of Alascom, Inc. (regarding Mr. Pitsch ex parte filing), (July 16, 1993); and AT&T's Reply to Motion of Alascom (July 22, 1993).

²⁰ Representatives of Alascom, the Alaska Federation of Natives, Inc., Anchorage Community Access TV, Inc., AT&T, the City of Anchorage, Cook Inlet Region, Inc., GCI, Teamsters Local 959, as well as other members of the public provided testimony.

²¹ An order released on July 9, 1993, provided an opportunity for interested parties to file written responses to the public hearing testimony in order to assure a complete record. Order, CC Docket No. 83-1376, DA 93 825 (released July 9, 1993). This Order was in part a response to a Motion of Alascom, Inc. to Schedule Reply Comments filed on June 28, 1993. Alascom's Motion was opposed by GCI on June 29, 1993. Alascom filed its reply to GCI's opposition on June 30, 1993. Alascom, AT&T, GCI, and numerous members of the public filed comments in response to the July 9, 1993, Order.

²² Letters regarding Data Request 6 and Data Request 7, from Lorraine Kenyon, Joint Board Staff, to Vernon Dunham, PTI dated July 9, 1993. A letter by Alascom in response to Requests 6 and 7 was received on July 14, 1993. Data Request 7 was withdrawn on July 19, 1993, after further consideration by the State Members of the Joint Board. Alascom filed Data Request 6 on July 23, 1993.

Alaska, on August 27, 1993, by members of the Alaska State Legislature's Telecommunications Task Force. The hearing provided an opportunity for a technical briefing and comment on the proposals currently pending before the Joint Board.²³ Alascom, ATA, AT&T, CCI, MCI, and the State of Alaska participated in that hearing.

IV. Market Structure

A. Joint Service Arrangement

1. Introduction

24. The JSA was signed before wide-spread interexchange competition had developed throughout the United States, and was based upon the pre-divestiture, pre-access charge settlement model that was then applied to independent telephone companies. As implemented, the JSA obligated AT&T to pay all of Alascom's interstate MTS related costs on the same pre-divestiture basis that applied to independent telephone companies including the earned rate of return on interstate investment.²⁴ Although the exact amount has been subject to dispute, AT&T's current costs of meeting its obligations to provide rate integrated MTS service through the JSA exceed the MTS and WATS revenues that AT&T receives from servicing the Alaska market by a significant amount.²⁵

25. In the Tentative Recommendation, we initially concluded "that the public interest would be better served by terminating the JSA and thereby restructuring the interstate telecommunications market in Alaska to promote competition, open entry, and improve efficiency incentives."²⁶ We also recognized,

²³ Commissioner Susan Knowles and staff member Lorraine Kenyon briefed the Telecommunications Task Force on the history of CC Docket 83-1376 and on the Tentative Recommendation.

²⁴ See generally, Joint Petition To Approve Master Agreement, Terminate Joint Service Arrangement, Continue NECA Participation, And For Limited Waiver Of Separations Rules And Resolution And Termination of Regulatory Proceedings, Attachment B at 4 (filed in CC Docket No. 83-1376 and RM 4436 by AT&T, Alascom, PTI, TUA on January 29, 1992).

²⁵ E.g., AT&T currently estimates that its obligation under the agreement exceeds the revenues that it receives under the agreement by approximately \$80 million. Ex parte letter, A.L. Tyree, AT&T to William F. Caton, FCC, Acting Secretary, FCC (September 18, 1993).

²⁶ Tentative Recommendation, 8 FCC Rcd at 3687, para. 27.

however, that an immediate termination of the JSA "could harm carriers and adversely impact the public by accomplishing the goals of competition and efficiency at the expense of the goals of universal service and revenue requirement neutrality."²⁷ Therefore, we proposed several transition mechanisms to accompany a phase-out of the JSA and requested comments on our plan.

2. Comments

26. In response to the Tentative Recommendation, Alascom recommended that the Joint Board continue the existing market structure and JSA, possibly under its previous ARC plan, modified by adoption of an accelerated cost recovery mechanism. AT&T continued to advance its CBP as the best solution to meet the five objectives identified in the Supplemental Order. Comments from other parties were generally supportive of the Tentative Recommendation, although some parties suggested changes in one or more of the basic elements. The only full support given the ARC Plan and CBP came from their respective sponsors.

3. Discussion

27. We have concluded that, in the current environment, the JSA is not a viable long term market structure and that it should be terminated pursuant to the transition plan described below.²⁸ We have reached this conclusion after carefully considering the extensive record that has been compiled in this proceeding in the context of our understanding of the competitive forces that operate in the Alaska MTS market and the costs of providing telecommunications services within, to, and from, the Alaska market.

28. As observed in the Tentative Recommendation, conditions have changed since the JSA was crafted and approved by the Commission on an interim basis. The JSA is no longer compatible with the development of a competitive, multi-carrier, interexchange market that serves Alaska. For example, the JSA tends to function as a "requirements contract," in which AT&T is required to satisfy all of its MTS service needs through the JSA. Such an arrangement does not facilitate the sale of Alascom services to other interexchange carriers or the purchase of services by AT&T from other carriers.

²⁷ Id.

²⁸ Most parties in this proceeding either currently or historically have advocated termination of the JSA. Tentative Recommendation, 8 FCC Rcd at 3687.

29. In addition, the JSA does not allow AT&T the same freedom that its competitors enjoy to build or lease facilities to serve Alaska; and the JSA does little to encourage efficiency since Alascom is guaranteed a customer base. As a consequence, we recommend that the FCC terminate the JSA as soon as reasonably possible, subject to the implementation of transition mechanisms that we identify in the order. Our recommendation will ensure that the five objectives guiding development of a revised interstate market structure for Alaska will not be compromised given termination of the JSA. The resulting plan will better serve the public interest than the JSA or any other plan proposed, or considered by, this Joint Board during the course of this extended proceeding.

B. ARC Plan: Retention of the Joint Service Arrangement

1. Introduction

30. The ARC Plan was first introduced by Alascom in its Comments filed April 13, 1989.²⁹ Alascom contends that its recommended market structure would continue the JSA but would incorporate amendments to resemble closely the price cap regulation of AT&T.³⁰ Under the ARC Plan, Alascom would develop a baseline revenue cap equal to the previous year's interstate MTS revenue requirements. The cap would be adjusted up or down by applying the same index that is applied to AT&T's capped rates. Thus, Alascom would receive more or less in payments from AT&T under the JSA according to the same productivity factor applied to AT&T and to the other factors in AT&T's index. Alascom would receive an increase or decrease to its cap based on 50% of the value of the annual increase or decrease in southbound traffic compared with the base year. The final adjustment to the previous year's revenue requirements would be to reduce those requirements by the total MTS payments made to Alascom by carriers other than AT&T.³¹

2. Comments

31. After the ARC Plan was proposed in April 1989, GCI and AT&T filed reply comments opposing the plan. It was criticized as insulating Alascom from competition and from incentives for economic efficiency; lacking an "automatic stabilizer" mechanism; failing to assign a portion of the Alaskan support burden to AT&T's competition; and grandfathering Alascom's costs which were

²⁹ Comments of Alascom, CC Docket No. 83-1376 (April 13, 1989).

³⁰ Price cap regulation is described in Policy and Rules Concerning Rates For Dominant Carriers, 4 FCC Rcd 2873 (1989).

³¹ A description of the ARC Plan may also be found in Comments of Alascom, Inc. (July 12, 1993) at Attachment 1.

perceived as being needlessly high.³² GCI opposed Alascom retaining a portion of the profits associated with southbound traffic.³³ The State of Alaska likewise opposed Alascom retaining any southbound traffic profits and expressed concern that service quality could suffer due to disincentives to invest and the lack of service quality monitoring under the ARC Plan.³⁴ As the ARC Plan did not resurface until Alascom filed its Comments on July 12, 1993, there have been no further comments on it in this proceeding.

3. Discussion

32. Alascom is the only party supporting the ARC Plan. The ARC Plan rests on continuing the JSA, and we are not persuaded that the decision to terminate the JSA should be abandoned. We have evaluated the JSA in light of our five objectives and find that the goals of enhancing competition in the Alaska market and increasing incentives for efficiency have not been furthered under the JSA. Indeed, the point of continuing this proceeding has been to devise a market structure that will permit the most balanced and complete achievement of our five objectives that is possible. Continuing the JSA even under the provisions of the ARC Plan simply will not allow that to occur.³⁵ Accordingly, we reject Alascom's latest proposal to resurrect the ARC Plan inasmuch as it fails to advance the objectives of this proceeding. Instead, we recommend moving forward with the adoption of the market structure proposed in the Tentative Recommendation as modified herein.

C. Consumer Benefit Plan

1. Introduction

33. AT&T filed a Petition on March 31, 1993, requesting the immediate termination of the JSA and adoption of its CBF proposal to allow for the entry of AT&T as a fully competitive interstate and intrastate toll provider in the Alaska market. Concurrently, AT&T filed an Application for Section 214(a)

³² Reply Comments of AT&T (May 15, 1989) at 28; Reply Comments of GCI (May 15, 1989) at 16.

³³ Reply Comments of GCI (May 15, 1989) at 16.

³⁴ State of Alaska Reply Comments (May 15, 1989) at 19-20.

³⁵ Alascom has not demonstrated that the ARC Plan is sufficiently different from the JSA to promote our competition and efficiency goals, especially given that, under the ARC Plan, Alascom continues to be guaranteed that AT&T would be a customer for virtually all of its interstate MTS.

authority to create and operate a network for interstate service to and from Alaska.³⁶

34. Under the CBP, AT&T would: (1) provide interstate MTS to and from Alaska at integrated rates; (2) eliminate its mileage bands 10 and 11, thus lowering rates for approximately 25% of the calls southbound from Alaska and 25% of the calls northbound to Alaska;³⁷ (3) offer Alaskan customers many of the AT&T services it claimed were not now available through Alascom; (4) build a new fiber optic submarine cable between Alaska and the Lower 48; and (5) enter into the intrastate MTS market in Alaska at rates equal to, or lower than, the lowest current rates of GCI or Alascom with a pledge not to raise those rates for five years, except to pass through any local exchange carrier ("LEC") access charge increases approved by the APUC.³⁸ AT&T conditioned its pledge to implement the CBP upon the occurrence of three events: (1) prompt termination of the JSA; (2) the granting of Section 214(a) authority; and (3) the issuance of an order directing Alascom to provide AT&T and other carriers with tariffed, cost-based services between their Alaskan points of presence ("POPs") and the networks of the Alaskan LECs.

2. Comments

35. In Alascom's Petition to Deny AT&T's Application³⁹ and in its Comments, Alascom asserted that the Application filed by AT&T was insufficient and contrary to the public interest.⁴⁰ Alascom stated that the CBP would duplicate facilities for no reasonable purpose and would result in an \$80 million increase in cost without appreciably increasing revenues.⁴¹ Alascom also contended that AT&T's arguments in support of the CBP were factually incorrect or contradicted by past filings.⁴² Lastly, Alascom characterized AT&T's promise that, for a period of five

³⁶ Application of AT&T (March 31, 1993), File No. W-P-C-6861.

³⁷ AT&T's Petition (March 31, 1993) at 6-7.

³⁸ AT&T stated that it would offer intrastate services at rates 4% lower than Alascom's standard rates. AT&T's Comments (June 28, 1993) at 23.

³⁹ Petition to Deny of Alascom, Inc. (June 25, 1993) FCC File No. W-P-C-6861.

⁴⁰ Comments of Alascom (July 12, 1993) at 18.

⁴¹ Alascom Implementation Plan (June 7, 1993) at 29; Comments of Alascom (July 12, 1993) at 19.

⁴² Comments of Alascom (July 12, 1993) at 23-26, 27-31.

years, it would charge intrastate rates that are lower than those of Alascom or GCI as "pricing without regard to cost" and destructive of the competitive marketplace.⁴³

36. Other parties criticized the Application as lacking sufficient detail and key information necessary to analyze the plan.⁴⁴ ATU criticized the CBP as providing no assurance that it would not lead to increases in intrastate access rates.⁴⁵ The State of Alaska, while acknowledging the possibility that the CBP could be in the public interest on a theoretical basis, required more information "to determine whether AT&T's plan would result in a market structure that would make universal service achievable, rate integration sustainable, and jurisdictional cost shifts avoidable in both the short and long terms."⁴⁶ The CBP was also criticized by the State of Alaska as not providing an orderly transition to a new market structure and not adequately recognizing the investment that Alascom had made in reliance on the JSA.⁴⁷ The State of Alaska questioned how AT&T would provide service to rural areas of Alaska if Alascom's existing services were not available, given that AT&T does not currently have a satellite that serves those areas.⁴⁸

3. Discussion

37. AT&T asserts that its CBP "satisfies all of the Joint Board's previously stated objectives for an Alaska telecommunications structure" and that it will "benefit consumers

⁴³ Id. at 34-35.

⁴⁴ For example, ATA maintained that AT&T's CBP and Section 214 Application failed to include "the details necessary to fully analyze the Plan's impact on Alaska's ratepayers and telecommunications market structure." ATA Comments (June 25, 1993) at 8. ATU contended that AT&T's CBP proposal was incomplete and that AT&T's associated request for Section 214 authority should be denied. ATU Petition to Defer or Deny (June 25, 1993) at 3. UUI asserted that there was insufficient detail to ensure that ratepayers were not saddled with duplicative and unnecessary facilities (UUI Comments (June 23, 1993) at 10) and that the CBP was not in the public interest (UUI Reply Comments (July 12, 1993) at 2).

⁴⁵ Comments of ATU (June 28, 1993) at 3.

⁴⁶ Comments of the State of Alaska (June 28, 1993) at 0-10.

⁴⁷ Reply Comments of the State of Alaska (July 12, 1993) at 4.

⁴⁸ State of Alaska Comments (June 28, 1993) at 10.

more than any other plan offered during this proceeding."⁴⁹ On the surface, it does appear that AT&T is making a service commitment in the CBP that will continue integrated interstate MTS rates to Alaska (at even lower than current rates) and will introduce another competitor in the intrastate market at rates that are as low as, or lower than, those identified on the lowest currently available rate schedules, while at the same time bringing a wider array of services to Alaskans and newer, more reliable, technology to provide those services.

38. AT&T, however, has not provided sufficient information and data to permit us to find that AT&T's proposed CBP will satisfy the five objectives for a new market structure we have identified in this proceeding. In fact, no party of record, outside of AT&T, has stated that sufficiently detailed information exists to allow the Joint Board to adopt the CBP in its current form. Moreover, we are concerned that the plan does not contain any transition mechanisms or mechanisms to ensure that there will not be significant intrastate cost shifts when the JSA is terminated and AT&T provides service independently or to ensure that there will be no service disruptions or reductions in service quality while the market is reforming to adapt to the CBP structure. The CBP does nothing to enable Alascom to shift smoothly from the JSA to a new market structure, and during the transition to the new market structure it is essential that Alascom continue to provide service.

39. In conclusion, the CBP lacks sufficient detail to demonstrate that it satisfactorily achieves the five objectives of the Joint Board and fails to incorporate transition mechanisms essential to introduction of a new market structure in Alaska at this time. Thus, while there are attractive elements in the CBP, we cannot recommend its adoption. We do not believe that it is appropriate to further delay the resolution of this proceeding by calling for data to support the CBP's projection of future occurrences or by attempting to develop modifications to the CBP to ensure that it does not compromise our goals.

D. Recommended Market Structure

1. Introduction

40. As noted above, we have developed a revised Alaska market structure recommendation that is based on the Tentative Recommendation as modified by the results of our analysis of the comments, data, and concepts advanced by the parties. We believe that our recommendation reasonably balances the five objectives set forth in the Supplemental Order. In particular, the revised

⁴⁹ AT&T's Petition to Terminate Joint Services Arrangement (March 31, 1993) at 6.

market structure we recommend is an improvement over the Tentative Recommendation in that it is simpler, provides greater assurance of revenue requirement neutrality, and at the same time produces a more rapid, yet controlled, transition to the new market structure. Therefore, we recommend that the Commission adopt our revised Alaska market structure plan. The following sections explain in detail the various aspects of our revised market structure recommendation, how it differs from the Tentative Recommendation, and why these changes and the overall arrangement serves the public interest.

2. Facilities Issues

a. Introduction

41. Under the market structure set forth in the Tentative Recommendation, Alascom and AT&T could each build or lease facilities individually in order to provide their services, subject, of course, to acquiring all necessary authorizations. The construction of facilities and provision of services by Alascom and AT&T would be governed by the same regulatory requirements applicable to dominant IXCs in the rest of the nation. The only exceptions are the current prohibition against construction of duplicate facilities in certain rural Alaska locations and the existing requirement that Alascom build facilities to allow provision of service to communities of 25 or more.⁵⁰

b. Comments

42. Few comments were filed on this aspect of the Tentative Recommendation except in regard to lifting the current prohibition against construction of duplicate earth stations in rural Alaska.⁵¹

c. Discussion

43. We continue to support the position regarding facilities issues originally articulated in the Tentative Recommendation. No party strongly objects to that recommendation. No arguments have been raised to persuade us that a change in this facet of our recommended market structure is needed. Accordingly, we recommend, as we originally proposed, that AT&T and Alascom be free to build or lease their own facilities, subject to the

⁵⁰ In this Final Recommended Decision, we further clarify that in the case where no LEC facilities exist, Alascom may, on a case-by-case basis, be required to provide interconnection to locations that are functionally similar or equivalent to LEC end offices.

⁵¹ This Final Recommended Decision does not address a lifting of that restriction.

requirements imposed generally outside Alaska on dominant IXCs and imposed on Alascom inside Alaska in the areas where Alascom has a facilities monopoly.⁵²

3. Service Issues

a. Message Telephone Services/Wide Area Telecommunications Services

i. Introduction

44. In the Tentative Recommendation we concluded that one or more carriers must be responsible for ensuring that interstate MTS is available at reasonable rates to all those requesting such service. We recommended that AT&T be responsible for providing Alaskan customers with interstate MTS at the same integrated rate levels and under the same terms and conditions available to other AT&T customers in the rest of the nation. This AT&T service requirement would apply to service between Alaska and the Lower 48 and between Alaska and Hawaii.

45. Under the Tentative Recommendation we also proposed that if Alascom chose not to provide interstate MTS under the new market structure, it must file under Section 214 of the Communications Act for authority to exit the market.⁵³ This filing also must include a plan for the smooth exit of Alascom from the MTS market to ensure that customers would not be faced with a service interruption.⁵⁴

ii. Comments

⁵² If a situation arose where customers in a community of 25 or more required interexchange service, but no facilities existed, Alascom would be required to build the facilities necessary to provide service or fully justify why such construction would not be in the public interest. The continuation under the Tentative Recommendation of this current obligation did not imply that Alascom was responsible for providing interstate MTS to those communities, but, rather, that it must make available and maintain the necessary facilities for IXCs desiring to provide MTS to gain access to customers in remote areas where duplicate facility construction is prohibited.

⁵³ The Tentative Recommendation also proposed that Alascom not be allowed to exit the market as long as the JSA was in effect.

⁵⁴ In addition, Alascom would be allowed to sell its customer list subsequent to the termination of the JSA, provided customers were properly notified of any change in carrier and subject to approval of Section 214 authority to exit the market.

46. AT&T stated that it had no authority to provide southbound interstate services and that the provision under the Tentative Recommendation to require AT&T to obtain Section 214 authority to provide such service was unenforceable.⁵⁵ In Reply Comments, GCI observed that the Commission has the clear authority to enforce AT&T's longstanding obligation to provide rate integrated service to the Alaska market. GCI maintained that whether AT&T chooses to comply with this responsibility by filing a Section 214 application to construct its own facilities to serve Alaska or chooses to use the facilities of other carriers is of no consequence. GCI also noted that Section 214(d) confers authority on the Commission to require a carrier to provide service to a particular locality or region. Thus, the operative legal standard is AT&T's pre existing service responsibility to Alaska.⁵⁶

Discussion

47. We are not persuaded that we should significantly modify our position on MTS as identified in the Tentative Recommendation.

48. First, AT&T recognized and undertook the responsibility to provide both northbound and southbound interstate MTS at integrated rates to Alaska when it signed the JSA. If the southbound customers were not a responsibility of AT&T, then AT&T would not have signed a settlement agreement to arrange for their service nor would AT&T have agreed to cover all of the costs of those services.

49. Second, no party contends that AT&T does not have the obligation to provide rate integration both in Alaska and throughout the nation. AT&T's obligations under the Commission's rate integration policy apply regardless of the route of the call and the location of the caller; otherwise, the policy would be without effect. The Commission has adequate authority under Sections 201(a) and 4(i) of the Communications Act to enforce this policy,⁵⁷ without utilizing its authority under Section 214 of the

⁵⁵ AT&T Comments (June 28, 1993) at 10-13.

⁵⁶ GCI Reply Comments (July 12, 1993) at 2-4.

⁵⁷ In pertinent part, Section 201(a) states: "it shall be the duty of every common carrier ... in cases where the Commission . . . finds such action necessary or desirable in the public interest, to establish physical connections with other carriers, to establish through routes and charges applicable thereto and the divisions of such charges, and to establish and provide facilities and regulations for operating such through routes." 47 U.S.C. § 201(a).

Act⁵⁸ and, in fact, has already required AT&T to provide service to southbound Alaska customers under the rate integration policy and through approval of the JSA. We see no public interest reason to reduce or otherwise limit AT&T's rate integration obligation to serve the Alaska market and, therefore, continue to support the provision of interstate MTS outlined in the Tentative Recommendation and further discussed in this recommended decision.⁵⁹

50. In light of the dissolution of the JSA as an integral part of the Alaska market structure, AT&T must continue to fulfill its pre-existing service obligation to Alaska. Any reduction in AT&T's obligation to serve could well leave Alaskans without service or without the benefits of rate integration. Such a situation would not be in the public interest and would be contrary to our previously identified goals. We accordingly recommend that the Commission explicitly recognize AT&T's obligation under Section 201(a) of the Communications Act to provide MTS service to and from Alaska on a nation-wide rate integrated basis.

51. We recommend that the Commission require AT&T to amend its Section 214 application consistent with the requirements of this order. We recommend that AT&T be given the flexibility under the recommended market structure to choose whether to lease facilities from another carrier or to build its own facilities, subject to the current prohibition against construction of duplicate facilities in rural Alaska. If AT&T chooses to build facilities, then it will be required to file a Section 214 application under standard procedures.⁶⁰

52. Finally, we continue to recommend that, in order to prevent abandonment of service to Alaskan customers under the new market structure and for the reasons set forth in the Tentative Recommendation, Alascom must file a transition plan and file for permission under Section 214 of the Communications Act prior to exiting the MTS market, if it chooses to exit that market.

b. Alascom Common Carrier Services

⁵⁸ 47 U.S.C. §214

⁵⁹ The public interest requires that AT&T continue to provide MTS at rate integrated levels to and from Alaska and between Alaska and Hawaii under the same terms, conditions, and rates as apply to provision of MTS elsewhere in the nation.

⁶⁰ AT&T must comply with all Section 214 requirements and has not requested any waiver of these provisions. AT&T would be required to make its facilities available to other carriers under tariff.

1. Introduction

53. The Tentative Recommendation recommended that upon termination of the JSA Alascom provide to IXCs all interstate transport and switching services ("Common Carrier Services") needed to complete the long distance services of IXCs up to the Alascom point of interconnection with each Alaskan local carrier.⁶¹ It was proposed that Alascom's Common Carrier Services would be provided by tariff on a non-discriminatory basis, with rates averaged statewide. The requirement to average geographically Alascom's Common Carrier Service rates was intended to assure that the costs associated with serving areas of the state where facilities competition is permitted were not assigned to the rural areas of the state where Alascom has a facilities monopoly.⁶²

11. Comments

54. The commenters focused on the conclusion in the Tentative Recommendation that Alascom's Common Carrier Service rates should be averaged statewide. Both GCI and MCI supported this conclusion stating that deaveraging Common Carrier Service rates was unjustified and would allow Alascom to assign excessive costs to services provided in those areas of the state where it had a facilities monopoly.⁶³ The Commission's tariff review process alone, without rate averaging, was not deemed sufficient by these parties to protect against the potential abuses of cross-subsidization. GCI further argued that rate averaging would protect rural customers and would reduce incentives for IXCs to deaverage their end-user rates or restrict service on rural routes.

55. In contrast, Alascom, AT&T, the State of Alaska, and UUI all either opposed a requirement that the Common Carrier Service rates be averaged, or raised concerns. It was argued that geographic averaging of the rates would encourage AT&T to abandon Alascom's facilities.⁶⁴ Alascom contended that under this provision

⁶¹ Tentative Recommendation, 8 FCC Rcd at 3688, para. 33.

⁶² These areas are hereinafter referred to as non-Bush and Bush respectively. See Earth Stations re Tentative Decision to Establish Joint Ownership, 92 FCC 2d 736 (1982); Policies Governing the Ownership of Domestic Satellite Earth Stations in the Bush Communities in Alaska, CC Docket 80 254, RM-3304, 96 FCC 2d 522, 541 (1984) at para. 40.

⁶³ GCI Comments (June 28, 1993) at 6; GCI Reply Comments (July 12, 1993) at 6-8; MCI Reply Comments (July 12, 1993) at 1-2.

⁶⁴ Alascom Implementation Plan (June 7, 1993) at 20; UUI Comments (June 23, 1993) at 4; AT&T Reply Comments (July 12, 1993) at 8; State of Alaska Comments (June 28, 1993) at 7; State of

of the Tentative Recommendation GCI would gain a competitive advantage because it was not obligated to average geographically its switching and transport service rates or to serve the high-cost rural areas of the state.⁶⁵

56. The State of Alaska also proposed the elimination of the geographic averaging requirement, claiming that costs of service were not equal statewide and imbalances between the average rates and the cost of service would likely lead to decreased traffic on the Alascom system, reduced efficiency, and upward pressure on intrastate rates.⁶⁶ It further argued that averaging was not needed since the tariffing process would ensure that rates were properly set. Sprint opposed statewide geographic rate averaging, claiming that such a policy was not justified.⁶⁷

57. AT&T suggested that creating a separate study area for Alascom's services to Bush locations was preferable to statewide averaging of the Common Carrier Service rates.⁶⁸ The State of Alaska stated that the separate study area concept had merit, while UUI opposed the concept as unworkable, stating that it would be difficult for Alascom to generate sufficient revenues to support its network infrastructure.⁶⁹

iii. Discussion

58. The provision of service in the Alaska market is unique. The satellite equipment necessary to provide communications to and from remote areas of the state has historically been high cost, and, as a consequence, there appears to be a large service cost disparity between the Bush and non-Bush areas of Alaska. For example, Alascom's intrastate dedicated transport rates for rural wholesale services are almost ten times

Alaska Reply Comments (July 12, 1993) at 3.

⁶⁵ Alascom Implementation Plan (June 7, 1993) at 21; Alascom Comments (July 12, 1993) at 15-17.

⁶⁶ State of Alaska Comments (June 28, 1993) at 7; State of Alaska Reply Comments (July 12, 1993) at 3.

⁶⁷ Sprint Comments (June 28, 1993) at 4-b.

⁶⁸ AT&T Comments (June 28, 1993) at 30.

⁶⁹ State of Alaska Reply Comments (July 12, 1993) at 3, n. 1; UUI Reply Comments (July 12, 1993) at 5.

higher than those for urban wholesale services.⁷⁰ Alascom has also claimed in this proceeding that its Bush costs are \$.406 per minute while non-Bush costs are only \$.106 per minute.⁷¹ Alascom attributes the high cost per minute in Bush locations in part to the low traffic volumes associated with those locations.⁷² Given the relationship between costs and traffic volumes (channels), it would be reasonable to assume that the low volume rural locations in Alaska would tend to have a higher cost of service than the high volume centers. After reviewing the record in this proceeding, we are persuaded that a significant disparity in the cost of service between the non-Bush and Bush areas of Alaska is highly likely.⁷³

59. We further note that Alaska will be moving from a market structure where Alascom is isolated from the full effects of competition, since it had a guaranteed customer (AT&T), to a market where Alascom will become one of multiple carriers that will compete on essentially equally footing. For instance, Alascom's principal competitor to date, GCI, has built extensive facilities throughout large portions of Alaska and is well positioned to compete in the Alaska common carrier service market.

60. Given the expected high cost disparities within the Alaska market and the expected level of LXC competition, we must carefully evaluate whether Alascom's Common Carrier Service rates should be averaged statewide. With the exception of GCI and MCI, most commenters in this proceeding oppose statewide rate averaging for Alascom's Common Carrier Services. On balance, we are persuaded by the arguments of Alascom, AT&T, the State of Alaska, and UUI that a mandatory statewide averaged rate structure will require Alascom to price its services above cost in non Bush areas and thus provide an artificial incentive for AT&T and other IXCs not to use Alascom's non-Bush network, even in cases where Alascom's underlying costs may be lower than those of its competitors. It is not our intent to handicap Alascom in the

⁷⁰ Alascom's intrastate wholesale services are services purchased by carrier customers for resale. APUC Alascom Tariff No. 98, 1st Revised Page 360.

⁷¹ Alascom Comments (July 12, 1993) at 50.

⁷² Id. at 48-52.

⁷³ Our final recommendation includes a provision that Alascom file a Cost Allocation Plan ("CAP") with the Commission. We expect that the conclusions reached in this order regarding the cost disparity between non-Bush and Bush Common Carrier Services will be supported by the cost study that Alascom will be required to prepare. If after analysis, however, the cost study does not reflect that disparity, then the tariff for Alascom's Common Carrier services can be modified to reflect that fact.

interexchange market. We are also concerned that our objective of revenue requirement neutrality will not be achieved if the Commission implements a mechanism (rate averaging) that most parties state would probably result in a shift in costs to the state jurisdiction as a result of lost interstate traffic.

61. We have also concluded that the advocates of statewide rate averaging have not demonstrated that deaveraging common carrier service rates will clearly lead to reduction in service availability or end use rate deaveraging. Our recommendation obligates the provision of interstate service statewide. Nor has the Commission given any indication that it would consider abandoning rate integration based on regional differences in the component costs of service. In conclusion, we are persuaded that allowing Alascom to file Common Carrier Service tariffs for two geographic rate zones will not lead to deaveraging of end user rates or to reducing the availability of service on facilities monopoly routes.⁷⁴

62. While we remain concerned that the potential exists for Alascom to assign costs from its facilities competitive areas to its monopoly areas, we believe that potential cross-subsidization can be addressed without requiring statewide rate averaging. Accordingly, we recommend that Alascom be required to establish certain accounting safeguards to address the potential for cross subsidization. Those accounting safeguards should take the form of a CAP that would be filed with, and approved by, the Commission.

63. We believe that the Computer III Remand Order contains accounting safeguards that will serve as a useful starting point for the development of a CAP.⁷⁵ Recognizing that Alascom is a monopoly provider of service to the Bush areas of Alaska, its unique position raises the question of potential discrimination or cross subsidization. For this reason, the cost accounting requirement for Alascom is based on the cost accounting rules contained in the Computer III proceedings adapted to apply to Alascom's provision of service in the bush areas. Alascom's

⁷⁴ Geographic rate zones should be viewed as the creation of different pricing schedules either by geographic region or group of locations. In this order we will generally refer to geographic rate zones as the difference in rate schedules for services associated with locations where Alascom holds a facilities monopoly (Bush) and services for all other locations (non-Bush).

⁷⁵ See Computer III Remand Proceedings: Bell Operating Company Safeguards and Tier 1 Local Exchange Company Safeguards, CC Docket No. 90-623, 6 FCC Rcd 7571 (1991) (Computer III Remand Order), pets. for recon. pending, pets. for rev. pending, California v. FCC, No. 92-70083 (9th Cir. filed Feb. 14, 1992).

submission must describe the accounting and cost allocation procedures that will be implemented to eliminate cross-subsidization.

64. The Alascom CAP shall be designed to segregate and identify separately, the costs, revenues, and investment for Alascom's monopoly Bush area operations, as distinct from those for its competitive, non-Bush operations. We recommend that the Commission require Alascom to divide its costs into three groups: those incurred solely to provide Bush service, those incurred solely to provide non-Bush service and those incurred to provide service to both the Bush and non-Bush areas.⁷⁶ The latter costs are referred to as joint and common costs. Further, we recommend that the Commission require Alascom to define its cost categories, to explain its procedures for assigning costs to these categories; and finally, for joint and common costs, to define its procedures for apportioning costs between the Bush and non-Bush areas. We recommend that the Commission closely examine Alascom's procedures for apportioning the operating lease expenses associated with the Aurora II satellite and Alascom's affiliated interest transactions.

65. We recommend that Alascom be required to file its CAP, including the categorization and allocation methodology described above, within three months of the release of a Commission Order adopting this recommendation.⁷⁷

66. Given the above, we recommend that the provision in the Tentative Recommendation requiring that Alascom's Common Carrier Service rates be averaged statewide be eliminated. We conclude instead that division of Alascom's operations into two major geographic rate zone cost categories as defined through a CAP be adopted: (1) to accommodate the concern that Alascom could assign excessive costs to its Bush services, and (2) to recognize the apparent difference in costs within Alascom's network between its Bush and non-Bush geographic rate zones. The proper development of the rates within these two cost categories would be a matter for the Commission tariff review process.

67. We have not recommended a separate study area approach, as suggested by AT&T, for a variety of reasons. First, study areas are generally "self-contained" in that the predominant equipment necessary to provide the utility's service to the study area is located in its entirety within the study area and not split between study areas. By comparison, AT&T's proposal would divide the equipment (e.g., satellite, earth stations, buildings)

⁷⁶ Bush services are defined as those interstate services that either originate or terminate in the Bush.

⁷⁷ We recommend that Alascom's CAP proposal be subject to notice and comment.

necessary for the provisioning of Alascom's service, between the study areas that have been proposed. This is not a typical application of the study area concept, would prove controversial, and could set a precedent regarding division of study areas that is beyond the scope of this Joint Board. Second, a study area approach has the potential to affect the intrastate jurisdiction, which could lead to further controversy that could prevent the speedy resolution of this proceeding without effectively adding any benefit.⁷⁸

68. In summary, we recommend that there be two geographic rate zones under Alascom's Common Carrier Service tariff: one zone for services associated with locations where facilities competition is allowed and another zone for services involving the locations where a facilities monopoly is prescribed. To accommodate concerns that costs will be properly allocated to the monopoly operations, Alascom should be required to file a CAP to appropriately assign costs between these two geographic rate zones. Issues arising with regard to Alascom's Common Carrier Services tariff would be resolved in accordance with the requirements of the Communications Act.

c. Private Line Services

i. Introduction

69. As proposed in the Tentative Recommendation, Alascom would be required to provide interstate private line services statewide, and if AT&T chooses to provide interstate private line services in Alaska, it must do so under Section 214 authority and make available its services statewide to the same extent as comparable AT&T private line services are available throughout the nation.

ii. Comments

70. AT&T rejects the notion that it could be compelled to obtain Section 214 authority to provide southbound interstate services although that is what it has proposed to do voluntarily under its CEP.⁷⁹ AT&T also states that while it would provide private line services pursuant to the Communications Act, it could not be assumed that its terms, conditions, and service area for

⁷⁸ We would not be prepared to recommend any change in Alaska's study areas without consulting with the APUC in conformance with the Commission's standard practice when study area changes are contemplated.

⁷⁹ AT&T's Comments (June 28, 1993) at 11; AT&T Application (March 31, 1993) at 3.

private line services would be the same as that for MTS.⁸⁰ Alascom implies that it should not be required to provide private line service and instead proposes that it provide "private line links" similar to special access.⁸¹

iii. Discussion

71. In this order we reaffirm the provisions of the Tentative Recommendation with respect to private line services. While we recognize Alascom is currently providing interstate private line service as a dominant carrier, we believe it is necessary for the market structure adopted by the Commission to be explicit in this matter to ensure uninterrupted and universal service in Alaska. Alascom must continue to provide statewide interstate private line service. It would appear neither practical nor reasonable for Alascom to function solely as a "special access" provider in the market and to abandon its private line service at this time. Otherwise, Alascom's private line customers would likely be stranded without service since Alascom has not identified which carrier, if any, would take over its responsibility in the private line market.

72. With respect to AT&T's private line services, we recommend that if AT&T chooses to provide interstate private line service to and from Alaska, it be required to do so under the same rate structures, terms, and conditions attendant to its provision of private line services among the Lower 48 states.⁸²

d. Dominant Carriers

73. The Tentative Recommendation proposed that both Alascom and AT&T retain their status as dominant carriers while the JSA existed. Upon JSA termination, AT&T would be considered dominant for the provision of both northbound and southbound MTS services. Additionally, AT&T would be considered dominant in the provision of service in the Alaska-Hawaii market. We proposed that in the post-JSA market, Alascom would initially continue to be

⁸⁰ AT&T's Comments (June 28, 1993) at 10.

⁸¹ Alascom Implementation Plan (June 7, 1993) at 26.

⁸² Hawaii maintains that rate integration applies to all telecommunications services, particularly MTS and private line service. Hawaii has also asked that the Commission clarify that rate integration applies to service between the contiguous states and Hawaii or Alaska and between Hawaii and Alaska. Hawaii Comments (June 28, 1993) at 20. We have specifically declined to address the issue of rate integration pertaining beyond the Alaska MTS market because the issue of rate integration applying to other interstate services is beyond the scope of this proceeding.

considered dominant for its provision of MTS, private line, and Alascom Common Carrier Services, with the proviso that Alascom's status could be reviewed after the recommended transition period. Alascom's dominant status was based upon its primary control over the Alaska Spur, its statewide network, and its service and facilities monopolies in those areas where duplicate earth station construction is prohibited.⁹³

i. AT&T's Dominant Status

1) Comments

74. AT&T challenged the proposal that it be designated as a dominant carrier for southbound Alaska MTS service.⁹⁴ Sprint's Reply Comments supported AT&T's dominant carrier status for provision of Alaska service. Sprint stated that the Commission has taken the position that there is a single national relevant geographic market (including Alaska, Hawaii, Puerto Rico, U.S. Virgin Islands, and other U.S. offshore points) for AT&T's interstate domestic, interexchange telecommunications service with no relevant submarkets. Although in the past the Commission has indicated that it might consider different markets for AT&T, Sprint argues that in later cases it has declined to do so. Sprint further observed that the record was insufficiently developed to warrant the treatment of Alaska as a separate geographic market or submarket for determining AT&T's market power. Hawaii also pointed out in Reply Comments that customer perception, the factor cited by AT&T to support its contention that it is non-dominant in the Alaska southbound market, is just one feature to consider when determining market dominance; the number and size distribution of competing firms, the nature of barriers to significant entry (including control of significant facilities), and the availability of reasonably substitutable services must also be evaluated.⁹⁵

2) Discussion

75. After considering the parties' comments, we find that the record is insufficient to justify that Alaska be deemed a separate relevant AT&T geographic market or submarket, nor would treatment of Alaska as a submarket be consistent with the Commission's rate integration policy. Since AT&T is classified as a dominant carrier for its provision of MTS in the Lower 48, this

⁹³ Tentative Recommendation, CC Docket No. 83-1376, 8 FCC Rcd at 3689, para. 39.

⁹⁴ AT&T Comments (June 28, 1993) at 10-14.

⁹⁵ Hawaii Reply Comments (July 12, 1993) at 2-3.

classification should be equally applicable to AT&T's provision of MTS to and from Alaska and between Alaska and Hawaii.

ii. Alascom's Dominant Status

76. No party, including Alascom, filed comments in response to the conclusions in the Tentative Recommendation regarding this issue. We continue to believe that Alascom should be classified as a dominant carrier.

4. Circuit Equipment Allocation Factor/Alaska Fund

a. Introduction

77. In the Tentative Recommendation we proposed to reduce the frozen allocation factor for Alascom circuit equipment from 86% to 75%. This change was recommended for several reasons, including enhanced interstate and intrastate competition as well as more accurate recognition of the character of Alascom's costs. In addition, the same separations factor would be applied to UUI's one-half interest in the earth stations owned and operated by Alascom.

78. The allocator proposed under the Tentative Recommendation would be implemented January 1, 1994, but the shift in circuit equipment costs from the interstate to the intrastate jurisdiction would be phased in over 10-years. The difference between the 75% factor and the factor in effect during each year of the phase-in would be paid from a special Alaska Fund. The Alaska Fund would be administered by NECA, which would file a tariff to collect the requisite funds from all interexchange carriers that contribute to the Universal Service Fund and would make payments from the Alaska Fund to Alascom and UUI. At the end of 10 years, the Alaska Fund would be terminated and the 75% interstate allocator would be fully in effect. We tentatively concluded that, in the context of the overall transition plan, 25% of Alascom's circuit equipment costs, but no more than 25%, could be assigned to the intrastate jurisdiction without causing an undue increase in intrastate rates. However, we specifically invited comments on this point.

b. Comments

79. In the Implementation Plan filed on June 7, 1993, Alascom presented financial data and commentary regarding the impact of the Tentative Recommendation on the Joint Board's goal of revenue requirement neutrality. Alascom assumed that the 75% circuit equipment allocation factor would be in effect at the end of the 10-year transition period and analyzed the impact of varying levels of accelerated cost recovery ("ACR") on intrastate rates. Based on its 1992 year-end financial statements and several

assumptions,⁸⁶ Alascom estimated that with ACR of \$150 million paid over three years, there was a net increase in annual intrastate operating expenses of \$23 million or 71% from 1993 to 2000 due to the change in the circuit equipment allocator. Alascom estimated that the intrastate revenue requirement shortfall would be \$10 million or \$0.0609 per minute in the year 2000.⁸⁷ Performing the same analysis using ACR of \$221 million paid over three years, Alascom contended that there would be a \$13.8 million revenue requirement shortfall in the year 2000.⁸⁸

80. Alascom argued that revenue requirement neutrality could not be assured simply by reducing plant; rather, it would be necessary to reduce expenses.⁸⁹ Alascom also stated that "any significant cost reduction must be sought from the labor force, the only material, residual cost category remaining."⁹⁰ Alascom stated that its ACR analyses already included a 10% reduction in the work force. However, Alascom stated that an additional 23% cut in positions would be required to meet the \$4 million intrastate revenue requirement shortfall projected for 1993 under the \$221 million ACR assumption.⁹¹ Alascom argued that the labor cuts necessary to achieve revenue requirement neutrality were unrealistic and, in any event, would severely harm its ability to deliver service. Alascom further asserted that technological change alone would not be adequate to address the issue of Alaska's high service costs.

81. In its July 12, 1993 Comments, Alascom proposed increasing ACR by a prepaid expense of \$72 million, which it described as a "Transitional Credit Facility" or "TCF". Alascom stated that the TCF was designed to moderate AT&T's abandonment of the Alascom network and any intrastate cost shifts that would result. The TCF would be amortized over a four-year transition

⁸⁶ The major assumptions are listed on pages 11 and 12 of Alascom's Implementation Plan (June 7, 1993).

⁸⁷ Id. at 13-14, Exhibit H.

⁸⁸ Id. Exhibit J.

⁸⁹ "Reliance solely upon an ACR program cannot achieve the revenue requirement neutrality goals established in 1989 by the Joint Board and reaffirmed in the Tentative Recommendation. This is part of the 'intractability' of the Alaska service problem. Therefore, to the extent the problem cannot be solved by addressing the plant part of the equation, the expense side of the issue must come into question." Id. at 16.

⁹⁰ Id. at 16-17.

⁹¹ Id.

period after termination of the JSA; the more AT&T used Alascom to carry traffic, the more of the TCF AT&T would recover. Using the same underlying financial data it relied on for its Implementation Plan, Alascom argued that a \$221 million ACK plus a \$72 million TCF would result in an intrastate rate decrease of 3% in 1997 and thereafter.⁹²

82. Alascom filed Reply Comments on July 22, 1993, in which it maintained that AT&T did not care about intrastate cost increases because it would not base its prices on costs. Alascom stated that AT&T's data demonstrated that its intrastate costs would exceed revenues every year, which raised concerns about predatory, anticompetitive behavior.⁹³

83. AT&T's June 7, 1993 Response did not address the change in circuit equipment allocation factor. However, in its June 28, 1993, Comments AT&T stated that on the basis of Alascom's figures, implementing the Tentative Recommendation was likely to lead to increases in Alascom's intrastate revenue requirements in both the short and long term.⁹⁴ AT&T then suggested that revenue requirements and by implication, revenue requirement neutrality were not the appropriate standard in a competitive environment.⁹⁵ While endorsing the rationale in the Tentative Recommendation for changing the existing allocation factor, AT&T stated that the issue of separations changes would be irrelevant under the CBP.⁹⁶ Finally, AT&T was critical of the complex transition mechanisms proposed in the Tentative Recommendation, including the establishment of the Alaska Fund.

84. AT&T's July 12, 1993 Reply Comments stated that the Tentative Recommendation failed to provide reasonable assurance that intrastate rates would not be increased with the introduction of a competitive market structure.⁹⁷ AT&T reiterated its position that, while the existing allocator is inappropriate and unfair, no change was necessary under the CBP; and, without a change in the separations factor, no Alaska Fund was required.⁹⁸ AT&T concurred in changing the frozen allocator if the Tentative Recommendation

⁹² Comments of Alascom (July 12, 1993) at 12-14.

⁹³ Alascom Reply Comments (July 22, 1993) at 7-8.

⁹⁴ AT&T Comments (June 28, 1993) at 17.

⁹⁵ Id. at 19.

⁹⁶ Id. at 22.

⁹⁷ AT&T Reply Comments (July 12, 1993) at 3.

⁹⁸ Id. at 5.

were adopted and, therefore, opposed the State of Alaska's suggestion that ACR be dedicated totally to interstate plant because that would negate the use of ACR to offset jurisdictional cost shifts.⁹⁹ AT&T maintained that, ultimately, the forces of competition could be relied on to keep intrastate rates at or below their current levels. In response to Alascom's claims of possible predation, AT&T projected that, under the CBP, its intrastate revenues would exceed intrastate revenue requirements for the period 1999 - 2003.¹⁰⁰

85. The State of Alaska's June 28, 1993 Comments raised concerns regarding the extent of the jurisdictional cost shift created by the change in allocation factor proposed in the Tentative Recommendation. Based on the size of the Alaska Fund in years 1994 - 1997 and other anticipated increases in intrastate cost allocations, the State of Alaska estimated that intrastate costs would increase by more than \$10 million or \$40 per year per access line.¹⁰¹ The State of Alaska suggested that the intended purpose of the change in allocation factor, i.e. reducing Alascom's interstate costs, could be accomplished instead by targeting the ACR to interstate plant. In addition, according to the State of Alaska, retention of the existing separations factor would negate the necessity for an Alaska Fund and would be more consistent with policies and procedures for achieving rate integration and universal service in the rest of the country.¹⁰²

86. In its June 23, 1993 Comments, UUI endorsed the use of a frozen allocator for separating circuit equipment costs and the consistent application of this factor regardless of ownership of the facilities.¹⁰³ UUI also recommended that the Alaska Fund be administered on the same basis as state access charges (i.e., no "true-up") rather than on the basis of other NECA funds.¹⁰⁴ UUI's July 17, 1993 Reply Comments challenged AT&T to state clearly its

⁹⁹ Id. at 6.

¹⁰⁰ Id. at 7.

¹⁰¹ State of Alaska Comments (June 28, 1993) at 4-5.

¹⁰² In Reply Comments, dated July 12, 1993, the State of Alaska reiterated its position that the Tentative Recommendation should be modified to retain the existing circuit equipment allocator in order to avoid intrastate cost shifts and rate increases.

¹⁰³ UUI Comments (June 23, 1993) at 2-3.

¹⁰⁴ Id. at 3.

position on the use of a frozen allocator and what separations factor it is endorsing for Alaska.¹⁰⁶

87. In other comments filed, ATA generally supported the phased-in change in allocation factor.¹⁰⁶ ATU expressed concern with the potential impact of the Tentative Recommendation on access costs and rates and local rates of LECs based on changes in demand resulting from increased intrastate interexchange rates.¹⁰⁷ USTA did not object to the phasing down of the separations factor for Alascom and UII but suggested that the full impact of any resultant increase in local rates needed to be considered so as not to jeopardize universal service.¹⁰⁸ MCI opposed requiring all interexchange carriers to contribute to the Alaska Fund.¹⁰⁹ Sprint questioned the need for the Alaska Fund and why such costs could not be recovered from the intrastate jurisdiction rather than from interstate interexchange carriers that do not use Alascom's services.¹¹⁰ In its reply comments Sprint reiterated its objection to the Alaska Fund generally and expressed its opposition to AT&T's suggestion that contributions to such a fund be based on minutes of use.¹¹¹ NECA expressed its willingness and ability to administer an Alaska Fund, if it were created, and offered suggestions regarding the structure of the fund and the provision of data to NECA.¹¹²

c. Discussion

88. We initially proposed a reduction in the interstate circuit equipment allocator in conjunction with an overall plan for a transition to a more competitive environment, with the expectation that this plan would enhance the development of competition in Alaska with minimal intrastate cost shifts at the conclusion of a 10-year phase-in period. Based on the comments in response to this proposal, we are changing significant aspects of the proposed overall plan for achieving our five objectives in this proceeding. With these modifications, which include the

¹⁰⁶ Reply Comments of UII (July 12, 1993) at 3-4.

¹⁰⁶ ATA Comments (June 24, 1993) at 4.

¹⁰⁷ ATU Comments (June 28, 1993) at 1-2.

¹⁰⁸ Reply Comments of USTA (July 12, 1993) at 2-3.

¹⁰⁹ MCI Comments (June 28, 1993) at 1.

¹¹⁰ Comments of Sprint (June 28, 1993) at 3-4.

¹¹¹ Reply Comments of Sprint (July 12, 1993) at 2.

¹¹² NECA Comments (June 28, 1993) at 1-4.

termination of the JSA after one and one-half years and the shortening of the subsequent transition period to two and one-half years, we conclude that the change in cost separations factor set forth in the Tentative Recommendation is neither necessary nor desirable as a transition mechanism for the new market structure.

89. The cost analysis presented by parties have persuaded us that the change in cost separations factor set forth in the Tentative Recommendation would violate the revenue requirement neutrality objective we established in the Supplemental Order, and therefore, the 86% interstate allocator should be retained for Alascom's equipment.

90. The retention of the current separations factor would significantly simplify the transition. There would be no need for the Alaska Fund, eliminating both the need to resolve the issues raised with respect to its policy premises and operation and the administrative costs of establishing and operating this separate fund for a limited time period.

91. Another reason for reaffirming the current frozen allocation factor is recognition that the market structure contemplated under this order eventually will reduce the importance of cost separations rules on rates for services. The price cap regime which currently governs AT&T's interstate rates reinforces this supposition. We believe that the revised transition time frames we recommend are sufficiently short to make it on the one hand, unnecessary to consider a change in the allocation factor at this time and, on the other hand, necessary to provide the intrastate ratepayers with adequate assurance against more rapid, unforeseen revenue requirement shifts that may occur.

92. In addition, we recognize that the factor at issue applies both to AT&T and Alascom and that it may be preferable for any modifications to the factor to be based on broader considerations than were contemplated in this proceeding. While the current mileage-based factor may not be applicable for all components of circuit equipment, it was approved by another joint board and is presumptively appropriate until modified.

93. Accordingly, we recommend that the frozen 86% interstate allocator be retained for Alascom's and UUI's circuit equipment.¹¹³

V. Transition Mechanisms

¹¹³ Since the circuit equipment allocation factor proposed for UUI mirrored that for Alascom, it also will remain at the 86% interstate level.

94. A number of transition mechanisms will be required as a condition of adoption and successful implementation of the market structure which is recommended in this order. We believe that the Commission can modify the status quo and place conditions on JSA termination to achieve the five objectives and the public interest under Sections 1, 4(i)-(j), 201, and 202 of the Communications Act.¹¹⁴ Consequently, the Commission has the authority to require implementation of the transition mechanisms that we recommend in this section, even after the JSA is terminated.

A. Transition Periods for JSA Termination and AT&T's Use of Alascom Facilities

1. Introduction

95. Under the Tentative Recommendation we proposed that the JSA be eliminated after three years. This transition period was chosen to allow for Alascom's adjustment to the competitive conditions under the market structure, to develop and to approve the required Alascom tariffs, and to implement certain transition mechanisms.

96. The Tentative Recommendation further proposed that, after the JSA was eliminated, AT&T would be required to purchase Common Carrier Services from Alascom for four years. Under the Tentative Recommendation, AT&T's purchase obligation would be reduced in equal annual increments until it was zero at the end of the fourth year.¹¹⁵ As proposed, those increments would be based on a percentage of AT&T's MTS traffic carried by Alascom during the last year of the JSA. The Tentative Recommendation stated that the purchase requirement was necessary to reduce the potential for unforeseen jurisdictional revenue requirement shifts if AT&T immediately stopped using Alascom's facilities.

2. Comments

97. Alascom contended that the JSA should not be eliminated, but that if termination were required, that termination should occur no sooner than the timetable set forth in the Tentative Recommendation.¹¹⁶ Alascom argued that the JSA was lawful, that it had successfully achieved universal service, and

¹¹⁴ 47 U.S.C. §§ 151, 154(i)-(j), 201, 202.

¹¹⁵ The Tentative Recommendation also allowed Alascom and AT&T to propose an alternative schedule for reduction of AT&T's purchase obligation, subject to the Commission's approval. Tentative Recommendation, 8 FCC Red at 3696, para. 84.

¹¹⁶ Alascom Implementation Plan (June 7, 1993) at 23.

that it did not harm competition.¹¹⁷ Alascom stated that allowing AT&T into the market would lead to harmful effects.¹¹⁸

98. ATA stated that delaying AT&T's ability to build its own facilities in Alaska would reduce AT&T's incentives to invest in the Alaska market.¹¹⁹ ATA also stated that the Tentative Recommendation eliminated Alascom's incentive to upgrade its equipment or to prepare for replacement of the Aurora II satellite, whose estimated life would terminate in 2001.¹²⁰

99. Similarly, AT&T stated that continuing the JSA until 1997 would force it to delay entering the market at which time AT&T might no longer have an economic incentive to construct the network proposed under the CBP.¹²¹ AT&T further argued that parties supporting the Tentative Recommendation would benefit from the delay created under that plan.¹²² With regard to the Tentative Recommendation's transition mechanisms, AT&T stated that there was no legal basis for requiring it to purchase services from Alascom after the JSA was terminated.¹²³

100. GCI supported termination of the JSA and stated that the Tentative Recommendation provided a workable compromise for the JSA's replacement that should be implemented no later than the beginning of 1994.¹²⁴

101. The State of Alaska argued that the transition timetable set forth in the Tentative Recommendation did not promote quick delivery of new and improved services to Alaska.¹²⁵ The State of Alaska's recommended solution to this perceived shortcoming was to reduce the period that AT&T must place traffic on the Alascom network from four to two years.¹²⁶ The State of

¹¹⁷ Comments of Alascom (July 12, 1993) at 42-55.

¹¹⁸ Id. at 44.

¹¹⁹ ATA Comments (June 25, 1993) at 5.

¹²⁰ Id. at 5-6.

¹²¹ AT&T Comments (June 28, 1993) at 26.

¹²² AT&T Reply Comments (July 12, 1993) at 2.

¹²³ AT&T Comments (June 28, 1993) at 20.

¹²⁴ GCI Comments (June 28, 1993) at 1-2.

¹²⁵ State of Alaska Reply Comments (July 12, 1993) at 2-3.

¹²⁶ Id. at 3.

Alaska did not propose any change in the three years that were proposed for retention of the JSA.

102. UUI stated that the JSA should remain in effect until AT&T presents an adequate implementation plan for the ACR issue it was requested to address in the Tentative Recommendation.¹²⁷ UUI indicated that the transition time under the Tentative Recommendation appeared adequate but continued to question Alascom's viability as a transport carrier if AT&T were allowed to construct its own facilities in Alaska.¹²⁸

3. Discussion

103. Based on the comments filed, and in light of the other changes recommended in this order, we have reconsidered the schedule proposed for termination of the JSA and for AT&T's obligation to purchase services from Alascom. We now recommend that both of these transition mechanisms should be shorter in duration than originally proposed.¹²⁹

104. The comments present strong reasons to believe that, overall, the transition timetable under the Tentative Recommendation is too long. First, concerns have been raised by parties, including the State of Alaska, that a long transition period disadvantages Alaskans because it discourages carriers from investing in new technologies and new equipment and from entering this market. No party has suggested that these concerns regarding investment and entry are immaterial or inconsequential.¹³⁰

105. Second, several parties have noted that the useful life of the Aurora II satellite is expected to end by 2001 and that significant lead time is required for planning and launching its

¹²⁷ UUI Reply Comments (July 12, 1993) at 3.

¹²⁸ UUI Comments (June 23, 1993) at 4.

¹²⁹ This recommendation assumes that all major aspects of this recommendation will be placed in effect. Our recommendation incorporates provisions that are designed to balance many factors; the elimination of any of these provisions would upset that carefully crafted balance.

¹³⁰ At hearings held before an Alaska Telecommunications Task Force on August 27, 1993, Alascom and the State of Alaska stated separately that uncertainties in the Alaska market structure would inhibit investment in that market.

successor.¹³¹ It is critical for universal service that a satellite be available to provide transport services to remote rural Alaskan locations. We conclude that, to the extent reasonably possible, our transition mechanisms should be shortened so as not to interfere with the orderly replacement of Aurora II capacity. A shorter transition should reduce uncertainties as to service requirements applicable to this market and as to the financial issues involved. Third, AT&T states that it may be at a competitive disadvantage in the future if it is not now given the freedom enjoyed by its competitors to build facilities as necessary in Alaska. Surveys conducted by AT&T also suggest that Alaskans would welcome the opportunity for AT&T to enter the market.¹³²

106. Last, we believe that other changes in our proposed market structure adequately address the concerns underlying Alascom's opposition to any shortening of our proposed transition. That opposition reflected Alascom's view that our originally proposed transition period was the minimum period required for it to adapt to the proposed market structure because of the substantial revenue requirement shifts to the intrastate jurisdiction that it projected. As explained supra, this final recommendation retains the existing cost separations factor for Alascom's circuit equipment. This modification in conjunction with our other recommendations significantly reduces, if not eliminates, the intrastate cost shift that Alascom could have experienced under the Tentative Recommendation.¹³³ Because of this and because retention of the frozen separations allocator simplifies the transition, this final recommendation also substantially decreases the uncertainty associated with the transition. In sum, without a change in the separations factor, the differences between the STATUS QUO and the new market structure are reduced. This, in

¹³¹ In particular, UUI has indicated that it takes approximately four years to negotiate an RFP and to build and launch a replacement satellite. UUI further stated that in order to assure adequate satellite coverage of Alaska, by 1997 "someone will need to step forward to spend approximately \$100 million to replace Aurora II." UUI Comments (June 28, 1993) at 8.

¹³² AT&T Supplemental Reply Comments (July 12, 1993) at Exhibit A. There are also letters from members of the public filed in the record of this proceeding that oppose AT&T's entry primarily because of concerns about degradation in universal service and service quality. We believe that our recommendation mitigates these concerns by imposing service requirements on AT&T and Alascom.

¹³³ The change in separations factor in conjunction with our other changes proposed under the Tentative Recommendation was one of the key motivating factors that led us to recommend the seven and ten year transition periods.

turn, permits a shortening of the transition mechanisms previously proposed.

107. We have thus concluded that the transition to the new market structure can and should be completed by March 1, 1998. We recommend that the implementation of the revised market structure should begin March 1, 1994. This would allow four years for the transition from the status quo to a fully competitive market structure. We affirm our proposal in the Tentative Recommendation that there should be two phases to the transition, a phase during which the JSA would be in effect and a phase after termination of the JSA during which AT&T would be obligated to purchase declining levels of Alascom's Common Carrier Services under tariff. We also recommend that the duration of each of these phases should be one and one-half years for continuation of the JSA and a period of two and one-half years for the phase down of AT&T's obligation to purchase Alascom's Common Carrier Services under tariff.¹³⁴ The second time period is consistent with the recommendation of the State of Alaska, which proposed that AT&T's "must purchase" obligation should be reduced from four to two years and that our entire proposal is consistent with the idea that the majority of key market changes occur so as not to interfere with the satellite replacement. At the Telecommunications Task Force hearing conducted on August 27, 1993 (see para. 23, supra), GCI and MCI stated that reduction in the timeframe, as proposed by the State of Alaska, would be acceptable, and AT&T generally supported a shorter transition period.

B. Transition Payments, Accounting Issues, and AT&T's Use of Alascom Facilities

1. Introduction

108. Under the Tentative Recommendation we concluded that it was necessary to reduce Alascom's costs through an ACR mechanism to ameliorate potential cost shifts to the intrastate jurisdiction and to allow Alascom to better adapt to the new market structure. We were concerned that cost shifts could occur as a result of our proposed change to the separations factor for circuit equipment and as a result of possible AT&T reduction in use of the Alascom network. The Tentative Recommendation did not identify the exact form of ACR that was to be adopted and, instead, requested Alascom and AT&T to file implementation plans to suggest an appropriate mechanism. One option suggested under the Tentative Recommendation was that the ACR be provided through accelerated depreciation of assets funded by lump sum payments made by AT&T to Alascom.

¹³⁴ AT&T's comments regarding the legal basis to establish transition mechanisms are addressed in supra paras. 49-50, 94 and infra paras. 122-127.

2. Comments

a. Accelerated Cost Recovery

109. Alascom generally supported the ACR mechanism proposed in the Tentative Recommendation. Alascom expressed concern, however, that the amount paid be sufficient to achieve the Joint Board's goals, particularly jurisdictional revenue requirement neutrality.¹³⁵ Alascom stated that a total ACR payment of \$150 million was too low and that the figure should be \$221 million with an additional TCF payment of \$72 million to offset operating expenses.¹³⁶ Alascom argued that significant jurisdictional cost shifts would occur absent adequate ACR payments.¹³⁷

110. In its response to the Joint Board's request for implementation plans, AT&T failed to present a proposed ACR mechanism; rather, it objected to the entire concept for several reasons. First, AT&T characterized ACR as an inefficient way to reduce Alascom's costs inasmuch as Alascom's costs were perceived to be driven primarily by its high operating expenses. Second, AT&T believed it would not recoup as much as it would pay under the ACR mechanism.¹³⁸ Third, AT&T objected to having the responsibility to fund cost reductions for its competitor.¹³⁹ Fourth, AT&T argued that the Commission has no legal authority to compel AT&T to enter into a voluntary agreement under which it would bear sole responsibility for this obligation to Alascom.¹⁴⁰ Fifth, AT&T questioned the need for an ACR, stating that Alascom had not demonstrated that it could not function profitably in a competitive market without subsidy.¹⁴¹

¹³⁵ Alascom had previously opposed any form of ACR, but in its recent comments it has stated that such a mechanism was essential. Alascom Implementation Plan (June 7, 1993), passim.

¹³⁶ Alascom Implementation Plan (June 7, 1993) at 9-16, Exh. H; Alascom Comments (July 12, 1993) at 8-15.

¹³⁷ Alascom Comments (July 12, 1993) at 8.

¹³⁸ AT&T stated: "on a net present value basis, AT&T would not recoup through lower Alascom charges about 14 cents for each dollar paid to reduce Alascom's asset base." AT&T Implementation Plan (June 7, 1993) at 4.

¹³⁹ AT&T Implementation Plan (June 7, 1993) at 3-6.

¹⁴⁰ AT&T Comments (June 28, 1993) at 20.

¹⁴¹ Id. at 18-19.

111. ATA concurred with AT&T that the key to achieving revenue requirement neutrality under the Tentative Recommendation would be reducing what it believed to be Alascom's high operating costs.¹⁴² ATA also raised the concern that the ACR proposal would be ineffective if Alascom were to continue to install plant during the transition period.¹⁴³

112. The other parties that filed comments in response to the Tentative Recommendation were nearly unanimous in their endorsement of some form of ACR for Alascom.¹⁴⁴

b. Application of Payment

113. AT&T proposed that any plant write-down under an ACR mechanism be limited to plant employed to provide services to other carriers.¹⁴⁵ Alascom stated that the ACR should be applied as broadly as possible.¹⁴⁶ GCI and the State of Alaska contended that any ACR-funded plant write-down should apply only to interstate MTS plant.¹⁴⁷ They raised concerns regarding potential litigation and the dilution of the effects of the ACR if it were applied to the entire Alascom rate base as opposed to just the interstate portion. AT&T stated that it would be inappropriate to apply ACR payments solely to Alascom's interstate plant; to do so would limit the effectiveness of the ACR in meeting its purposes of offsetting the jurisdictional cost shifts and minimizing the upward pressures on intrastate rates that would result from the separations change proposed under the Tentative Recommendation.¹⁴⁸ GCI also suggested that for each year of the transition, Alascom should file a proposed accounting treatment for any write-down with the Commission's Common Carrier Bureau. UUI recommended that the

¹⁴² ATA Comments (June 25, 1993) at 6.

¹⁴³ ATA testimony, Telecommunications Task Force Hearing (August 27, 1993).

¹⁴⁴ UUI Comments (June 23, 1993) at 2; Comments of GCI (June 28, 1993) at 4; Comments of the State of Alaska (June 28, 1993) at 4; Comments of SWBT (June 28, 1993) at 4.

¹⁴⁵ AT&T Implementation Plan (June 7, 1993) at 5.

¹⁴⁶ Alascom Implementation Plan (June 7, 1993) at 37.

¹⁴⁷ GCI Comments (June 28, 1993) at 5; State of Alaska Comments, (June 28, 1993) at 5.

¹⁴⁸ AT&T Reply Comments (July 12, 1993) at 6.

JSA remain in place until AT&T adequately addressed the ACR problem.¹⁴⁷

3. Discussion

a. Transition Payment

1. Legal Issues

114. AT&T has argued that the Commission does not have the legal authority to force it into a voluntary agreement nor can the Commission compel AT&T alone to make the transition payment.¹⁵⁰ We have concluded that neither argument prevents the Commission from requiring a transition payment as a condition for implementing a new market structure that achieves the proper balancing of Joint Board objectives that are derived directly from the Communications Act. We also note that this accomplishes AT&T's long sought-after goal of terminating the JSA, under which it estimates that it loses \$80 million per year.

115. We conclude that a payment is essential to a successful transition to a post-JSA Alaska market structure, in particular to prevent a reduction, or impairment, in universal service during the transition from the unique market structure under the JSA to a more open competitive market structure comparable to that prevailing in the Lower 48. We recommend that Alascom be directed to use that transition payment to reduce its investment which, in turn, will lower its costs of operation as new technologies and more cost efficient, competitive equipment are introduced into the Alaska market. This is necessary to address, and balance, three of the Joint Board's goals: revenue requirement neutrality, rate integration, and universal service.¹⁵¹

116. The JSA is styled after the pre-divestiture settlements contracts that governed payments among carriers for

¹⁴⁸ UUI Reply Comments (July 12, 1993) at 2.

¹⁵⁰ AT&T Comments (June 28, 1993) at 19-20; AT&T Comments On The Proposal of The State Members Of The Federal-State Joint Board (Dec. 18, 1992) at 6.

¹⁵¹ The availability of telecommunications services over the great distances and under the disruptive climatic conditions in Alaska is essential to the safety of life and property as well as the health and well being of Alaskans. In our judgment, the transition payment recommended herein is essential to making "available, so far as possible, to all the people of the United States a rapid, efficient, Nation-wide, and world-wide wire and radio communications service with adequate facilities at reasonable charges," as required by the Communications Act, 47 U.S.C. § 151.

jointly provided interstate services. "From the mid-1940s until the advent of access charges, most LECs recovered the bulk of their interstate revenue requirement through a 'pooling' process administered by AT&T known as settlements and division of revenues. This process was sometimes referred to as a 'partnership' because it permitted LECs to achieve a uniform, rate of return on their investment. It also helped AT&T maintain a nationwide average toll rate schedule."¹⁵² As previously noted, the JSA was a similar pooling vehicle that Alascom and AT&T elected to use to achieve the rate integration requirement for the Alaska interstate market.

117. The Commission has ample authority under Sections 1, 4(i), and 201 of the Communications Act, *inter alia*, to require a transition payment to avoid the potentially harmful consequences of "depooling" that will result from terminating the JSA. There is clear precedent for using transitional inter-carrier payments to achieve valid Commission policy objectives. For example, the FCC mandated carrier common line ("CCL") pooling in creating the post-divestiture access charge structure.¹⁵³ The mandate was needed because the Commission believed that LEC-specific CCL rates might generate significant pressures upon IXCs to deaverage interstate toll rates. CCL pooling was identified as a mechanism to forestall this eventuality.

118. The Commission recognized, however, that not all consequences of CCL pooling were beneficial, as it was found that pooling limited LEC cost recovery flexibility, established economically inefficient cost/price distortions, and reduced LEC incentives to contain costs.¹⁵⁴ In light of those concerns, the Commission directed the CC Docket 80-286 (Separations) Joint Board to study those issues and sought comments and recommendations on possible modifications to the mandatory CCL pooling of costs and revenues. In response, that Joint Board found that several features had been implemented to mitigate the concern for toll rate deaveraging.¹⁵⁵ The Separations Joint Board found that the mandatory CCL pooling was broader than necessary to achieve the

¹⁵² In the Matter of MTS and WATS Market Structure, 2 FCC Rcd 2324, para. 112 (1987). See also *id.* at para. 112 n. 171.

¹⁵³ Third Report and Order, MTS and WATS Market Structure, CC Docket No. 78-72, 933 FCC 2d 241 (1983) (hereinafter "Access Charge Order").

¹⁵⁴ In the Matter of MTS and WATS Market Structure, CC Docket No. 78-72, 2 FCC Rcd 2324, para. 115 (1987); In the Matter of MTS and WATS Market Structure, CC Docket No. 78-72, 2 FCC Rcd 2953, para. 23 (May 19, 1987).

¹⁵⁵ In the Matter of MTS and WATS Market Structure, 2 FCC Rcd 2324, paras. 117-120 (1987).

intended public interest benefits and was a hindrance to achieving two goals of access charges: enhanced incentives to contain costs and the elimination of economically inefficient cost/price distortions.¹⁵⁶

119. In reducing the mandatory aspects of CCL pooling, the Joint Board recommended transitional mechanisms to forestall the possibility that "depooling, particularly precipitous depooling, could adversely affect the telecommunications marketplace and cause hardship in many areas of the country for ratepayers and LECs alike."¹⁵⁷ Carriers electing to withdraw from the CCL pool would be required as a pre-condition of withdrawal to pay a four year transitional support into the pool, which would be used to provide transitional support payments to LECs that traditionally were net receivers under the mandatory pooling program, but were projected to withdraw from the revised, "voluntary" pool.¹⁵⁸ In addition, a mandatory long term support fund was established to enable those LECs remaining in the pool to charge IXCs the equivalent of what would have been the nationwide average CCL rate had the mandatory CCL pool been maintained.¹⁵⁹ This long term support feature was needed to assure the forestalling of pressures to deaverage toll rates.¹⁶⁰

120. The Commission adopted the Separations Joint Board's recommendations concerning the revisions to the mandatory CCL pool, concluding:

The Joint Board has recommended a carefully integrated plan of action for resolving a variety of issues concerning common line cost recovery. These recommendations are designed to further all four of the long standing goals of this proceeding -- preserving universal service, promoting economic efficiency, eliminating service pricing discrimination, and deterring uneconomic bypass -- and to achieve a proper balance among these goals.¹⁶¹

¹⁵⁶ Id. at para. 120.

¹⁵⁷ Id. at para. 121.

¹⁵⁸ Id. at para. 98.

¹⁵⁹ Id.

¹⁶⁰ Id. at para. 127.

¹⁶¹ Id. at para. 27.

121. On reconsideration, the Commission affirmed its earlier conclusion and observed that the long term support arrangement among all LECs was needed to ensure that small, unaffiliated LECs with high nontraffic sensitive costs would not be forced to impose inordinately high nontraffic sensitive cost recovery burdens on their subscribers.¹⁶²

122. The transition payment we are recommending as part of the Alaska market recommendation closely parallels the transitional support payments required pursuant to the CCL pooling revisions discussed above. First, both payments are transitional in nature. The courts have recognized that the Commission has the authority to prescribe transitional policy mechanisms to assure the preservation of universal service and to avoid service disruptions.¹⁶³ Second, there is significant similarity between the goals underlying the CCL pooling revisions -- universal service and economic efficiency -- and the Joint Board's goals. Third, both the required AT&T payment under the Alaska market transition mechanism and the transitional support payments under the CCL pooling revisions concern inter-carrier payments. Fourth, the payments pursuant to each proceeding were an integral part of an overall plan to achieve a proper balancing of competing policy considerations.

123. The Commission's authority to order pooling arrangements such as the recommended payment has been affirmed upon judicial review. In Rural Telephone Coalition v. FCC, 838 F.2d 1307 (D.C. Cir. 1988), the United States Court of Appeals for the District of Columbia Circuit ruled that the Commission had the authority to create the mandatory pooling arrangement known as the Universal Service Fund to assist certain high cost local companies to maintain universal service. The creation of the fund was challenged on appeal as a subsidy prohibited under the Communications Act. The Court viewed the allocation of costs underlying the fund as "a step on the road towards an efficient national telephone rate structure based primarily on access charges levied directly on customers."¹⁶⁴ The FCC's statutory authority pursuant to Sections 1 and 4 of the Communications Act, 47 U.S.C. §§ 151 and 154, was approved as the basis for mandating the Fund. Additional challenges to the specific features of the Fund were raised, with the principal objection that the Fund would not necessarily achieve its intended purposes. The Court dismissed these challenges, noting:

¹⁶² In the Matter of MTS and WATS Market Structure, CC Docket No. 78-72, 3 FCC Rcd 4543 (1988).

¹⁶³ NARUC v. FCC, 737 F.2d 1095, 1135 n.35 (D.C. Cir. 1984).

¹⁶⁴ Rural Telephone Coalition v. FCC, 838 F.2d 1307, 1314-15 (D.C. Cir. 1988).

The fund as proposed may well produce anomalous results, and there may be 'better' means of aiding the truly needy. [citation omitted.] Our task, however, is not to determine the best means, but only to decide whether the means selected by the Commission are lawful, supported by substantial evidence after consideration of relevant factors, and rationally connected to the facts. The Commission determined that the Fund would serve the statutory objective of universal service at reasonable charges. 47 U.S.C. Section 151 (1982). The Fund was not proposed as a welfare scheme; if it were, the Commission would have exceeded its authority. Rather, the Commission seeks to moderate excessive NTS local exchange plant costs in order to ensure that rates are within the means of the average subscriber. As an interim measure, this decision was within the Commission's discretion.¹⁶⁵

124. The transition payment is an integral part of our recommendation that is designed to preserve universal service and revenue requirement neutrality by permitting Alascom to continue to provide service throughout Alaska during a period of rapidly accelerating, but selective, competition that would drain Alascom revenues where Alascom is most vulnerable competitively, thereby impairing its continued ability to provide interconnecting services throughout the state.¹⁶⁶ We thus conclude that the Commission has the requisite authority to require the transition payment from AT&T to Alascom.

125. The obligation to provide the intercarrier transition payment rests with AT&T. AT&T was initially required to provide rate integrated services and to serve the Alaska interstate market jointly with Alascom in connection with the Commission's provision of satellite acquisition and operation authority to AT&T. That requirement was imposed solely on AT&T prior to the advent of competition in the interstate MTS market. However, as discussed above, AT&T and Alascom jointly negotiated and implemented the USA during a period when competition had been authorized and had begun to be implemented for the interstate MTS market in the Lower 48. Nevertheless, AT&T did not object to its responsibility for this obligation when it was initially imposed,

¹⁶⁵ Id. at 1316.

¹⁶⁶ At present, only Alascom provides universal connectivity throughout the State of Alaska.

despite the existence of, and the real potential for, competitors in the market in light of competitive policies that were then being adopted by the Commission. While objections to the continuation of the JSA were raised later by AT&T, they did not go to the sole service responsibility issue.

126. When imposing rate integration responsibility for the interstate Alaska market on AT&T, the Commission acknowledged AT&T's dominance in the interstate MTS market.¹⁶⁷ This classification continues today. In addition to preserving universal service, maintaining revenue requirement neutrality, and encouraging economic efficiency, the transition payment is necessary to maintain the rate integration goal that has been a guiding policy for structuring the Alaska interstate MTS market since 1972 and is one of the Joint Board's goals.¹⁶⁸

127. We have thus concluded that the transition payment, and phased reduction in AT&T's required use of Alascom facilities, together with our recommendation that the Commission maintain the current frozen allocator, will maintain our goals of universal service and revenue neutrality.

11. Amount of Payment

128. Rather than an ACR mechanism that would involve accelerated depreciation, we have decided to recommend that a reduction in Alascom's plant balances be funded by a transition payment to Alascom of \$150 million in two installments (\$75 million on March 1, 1994; and \$75 million upon termination of the JSA).¹⁶⁹

¹⁶⁷ See, e.g., In the Matter of Establishment of Domestic Communications-Satellite Facilities by Non-Governmental Entities, Docket No. 16495, 35 FCC 2d 844, paras. 5, 9 (1972).

¹⁶⁸ Without an acceptable transition payment mechanism the Joint Board would be unlikely to recommend termination of the JSA.

¹⁶⁹ This recommendation is a variation on the proposal we identified in the Tentative Recommendation that recommended reducing net plant balances by accelerating depreciation. We now achieve the same end result by simply crediting the plant accounts without accelerating the depreciation rate. We have reviewed the comments suggesting various ways to construct and target an appropriate ACR mechanism. Alascom's costs are primarily a combination of plant costs and operating (i.e., non plant related) expenses. Unquestionably, Alascom has greater control over its operating expenses than its plant costs which are largely a function of the existing equipment in service (e.g., network configuration, switch size). While a few commenters have suggested a need to consider an ACR for Alascom's expenses, no proposal, with the exception of Alascom's proposed TCR, has been

We have concluded that this payment will meet the goal of revenue requirement neutrality.¹⁷⁰ Support for this conclusion is contained in the data underlying the intrastate revenue requirement increases that were predicted and filed by the principal parties to this proceeding.

129. Specifically, we note first that in the Master Agreement filed jointly by AT&T and Alascom in January, 1992, those

presented for our consideration. We are reluctant to propose a cost support mechanism for Alascom's operating expenses for several reasons: Alascom has control over a substantial portion of these costs and may reduce them at its discretion; it is not known what operating expenses, if any, might truly merit support under the new market conditions; and any subsidy to offset operating expenses would have no lasting effect on costs in that it would not eliminate costs, but merely change who pays the costs during the period payments are made. Consequently, we do not recommend adoption of an ACK that includes as a component the TCF proposed by Alascom or any similar payment mechanism to offset operating expenses. Furthermore, absent a change in the cost separations factor for circuit equipment, there are no data on the record to support the necessity of an operating expense subsidy for Alascom.

¹⁷⁰ We have assumed that the \$150 million transition payment (to be paid in two installments of \$75 million each, the first installment on March 1, 1994, and the second installment, when the JSA terminates, on September 1, 1995) from AT&T to Alascom is taxable income to Alascom. However, we recommend that the parties be required to file, within 60 days of the effective date of the Commission's order, requests with the United States Internal Revenue Service ("IRS") and with the State of Alaska for expedited rulings on whether the transition payment is, in whole or in part, taxable income. If the IRS and/or the State of Alaska conclude(s) that the transition payment is not taxable income to Alascom, then AT&T may request that the Commission reduce the second installment by the amount of the tax payment(s) that Alascom is not required to make. If reduction in the second installment is thus warranted, we recommend that the Commission adjust the second installment to reflect the results of the requested rulings.