

ALASKA LEGISLATURE COMMITTEE FILES, 1989-1990 8672

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Alascom generally must connect with local telephone companies for both origination and termination of each call within Alaska. Alascom pays the telephone companies for this access through a pooling mechanism whereby each telephone company determines its cost of originating and terminating in-state long distance calls and Alascom, as the pooling manager, settles with individual companies, covering each company's costs.

The total cost of providing in-state long distance service (about \$82.9 million in 1985) is made up of the cost of the exchange company settlements paid by Alascom (\$52.1 million) and Alascom's own network costs (\$30.8 million).^{1/} Under the present system, customers, in some instances, pay rates that are higher than the cost of completing their call and, in other instances, pay rates that are lower than the cost of completing their call. The result is a form of subsidy from one group of telephone consumers to another. While it is often assumed that a large subsidy of this kind flows from urban areas to rural areas, as is shown below, the reality of the Alaska industry appears to be quite different.

Historically, Alascom has relied in part upon the assumption that this rural subsidy exists as a reason to keep competition out of Alaska. Eight years ago, Alascom attempted and failed to exclude competition from the Alaska interstate market by making dire predictions before the FCC that rural service would be jeopardized, rates would go up, and technological innovation would come to a halt.^{2/} Likewise, Alascom has argued before the Legislature, the Alaska Public Utilities Commission, and elsewhere that competition is not in the public interest in Alaska because rural rates will go up as the funds available to subsidize rural areas are reduced through competition.

Recently, Alascom has taken this argument one step further by assuming that in the face of competition it will not attempt to lower its costs and that it will be allowed to make up any losses it incurs on competitive routes through increased rural rates. Over time, Alascom argues, rural rates will go up higher and higher as competition expands further and further. In the end, Alascom argues, it will be left with its last customer paying for the entire network.^{3/}

^{1/} See Appendix A.

^{2/} See for example: Rebuttal Comments of Alascom in CC Docket No. 78-72, June, 1981, pp. 16-21; Supplemental Comments of Alascom CC Docket 78-72, January, 1980, pp. 94-100.

^{3/} Alascom Response to Order # 14 and Pre-filed Testimony, APUC Docket U-87-25, August 26, 1988, pp. 11-12.

Alascom's argument is incorrect for a number of reasons: First, the actual subsidy flowing from the urban to the rural areas is quite small, if it exists at all, and can easily be funded through a universal service fund in which all carriers participate; second, Alascom's arguments assume it will be allowed to cross-subsidize any decreases in revenue due to competition by increasing the rates on its monopoly services - a notion that is contrary to the purpose of competition and which is expressly prohibited in the proposed legislation; and third, Alascom assumes that unlike carriers elsewhere, which have been faced with competition, it will not bring down its costs over time to meet the competitive challenge.

THE URBAN-RURAL SUBSIDY IS QUITE SMALL

According to data that Alascom presented to the APUC in April, 1987, calling between the cities of Anchorage, Fairbanks, and Juneau generates \$10.9 million more in revenue than it costs to provide the service. The excess revenue from these routes is said to be the source of the subsidy for rural calling. However, according to the Alascom data, \$7.3 million (or 67%) of the subsidy is used to support near-urban calling around the Anchorage market, leaving only \$3.6 million for the remainder of Alaska.^{4/} In short, based upon Alascom data, urban callers are paying a large cross subsidy to themselves and the subsidy which flows from urban Alaska to rural Alaska is no more than \$3.6 million. (See Appendix A).

In fact, the rural subsidy is far smaller than this \$3.6 million figure, if it exists at all. It is likely that a portion of this \$3.6 million is used to support calling around other urban areas. The areas around cities other than Anchorage were not separately identified in the Alascom April, 1987, data but they likely have the same short haul pricing characteristic as the Anchorage market does. Thus, a portion of the remaining \$3.6 million is certainly absorbed in these urban markets.

In addition, much, if not all, of the remaining subsidy is absorbed in urban areas through the exchange company settlements process. In Alaska, certain urban telephone companies have higher intrastate long distance settlement costs than do most rural Alaska exchange carriers. (See Appendix B) Since the \$3.6 million subsidy figure was calculated by averaging urban and rural settlement costs, it masks these higher urban costs. Using the averaging approach in Alascom's April, 1987, data, the subsidy flowing from low-cost rural telephone companies to high-cost urban telephone companies through the settlements process is not accounted for. If the subsidy were to be

^{4/} See Alascom's "Analysis of GCI Scenarios 1 and 2", presented at public hearing, APUC Docket No. R-86-2, April 8, 1987.

calculated using company-specific settlements costs, most, if not all, of the remaining subsidy would be absorbed by higher cost urban calling. (See Appendix C) Therefore, it is even possible that rural callers are in small measure subsidizing urban callers - a result that is totally contrary to the claims which have been made and accepted for years.

Even if rural callers were the recipients of a \$3.6 million subsidy, which they apparently are not, this is a relatively small figure - \$3.6 million is only 4.3% of Alascom's intrastate gross revenues and 1.3% of its total revenues.^{5/} This money (equivalent to 1.7 cents per intrastate minute) could easily be funded through a universal service fund in which all long distance carriers participate.

SB 206 proposes such a fund whereby each long distance carrier pays a surcharge on access charges paid to the exchange companies. This fund would be administered by the industry and would make money available to local telephone companies in rural, high-cost areas. The local telephone companies will use this money to lower the amount of money interexchange carriers pay to originate and terminate long distance calls, thereby lowering the total cost of a long distance call and preventing rates from rising.

This type of pool is not new. After the Federal Communications Commission opened the interstate market to competition, it developed an access charge system and a fund similar to the one described above, known as the High Cost Fund. The federal subsidies flowing through these mechanisms as well as the cost separation process and the averaging of access charges through the National Exchange Carrier Association have been successful in keeping exchange and long distance rates down throughout rural America.^{6/} In fact, in Alaska some rural

^{5/} According to the Alascom data submitted to the APUC, Alascom 1985 intrastate toll revenues were \$83 million. Alascom's total revenues reported on its 1985 FCC Form M were \$291 million. (See Appendix C.)

^{6/} The subsidies resulting from the exchange cost separations process, access charge averaging and the high-cost fund are available to all areas of the U.S., including Alaska. They are not the same as the subsidy flowing from AT&T to Alascom in the Alaska interstate market. The present FCC Joint Board proceeding dealing with the Alaska interstate market may alter the AT&T to Alascom subsidy but it is not concerned with and will not affect the nationwide exchange subsidies which are discussed here. In addition, the FCC Joint Board recently announced that it will not entertain proposals that would have the effect of shifting costs to the Alaska in-state market. Supplemental Order Inviting Comments in CC Docket 83-1376, FCC 88J-4, released January 3, 1989.

telephone companies receive so much money from federal subsidies that they charge Alascom little or no money to originate and terminate intrastate calls.^{7/} This is one reason why many rural Alaska exchange companies have costs that are lower than the corresponding urban Alaska exchange company costs.

ALASCOM CANNOT RECOVER COMPETITIVE LOSSES FROM RURAL CUSTOMERS

Alascom argues that when competition enters the market, it will be forced to lower its rates on competitive routes thus incurring a loss. Alascom then argues that it will make up any decline in revenue by raising the rates charged to customers on monopoly routes. This argument assumes that Alascom would be allowed to engage in such cross-subsidization free from regulatory oversight. Alascom would attempt to use its monopoly power against the very groups of consumers that regulation was designed to protect from the use of monopoly power.^{8/}

SB 206 proposes to foreclose this use of Alascom's monopoly power by requiring Alascom to allocate its costs between regulated and deregulated market areas. Should Alascom incur any decrease in revenue in its deregulated service, it could not raise rural rates to recover those revenues. SB 206 states that following deregulation of a service, the cost of any remaining regulated service may be increased only if the direct costs of such service increase.

Through this type of legislation, Alascom cannot raise rates in the rural areas to cover any decline in revenue on competitive routes. Rural rates can only go up if the direct costs on rural routes go up. In addition, to ensure that rural rates remain reasonable, the APUC may, if necessary, permit any increased costs to be recovered from the universal service fund.

COMPETITION WILL LOWER COSTS

Finally, the argument that competition is not in the public interest, due to the inherent subsidies in the Alaska telephone system, is flawed because it ignores the dynamic benefits of competition. Alascom assumes that when competition enters the

^{7/} Testimony of Alascom in public hearing, APUC Docket No. R-86-2, April 8-9, 1987, p. 442.

^{8/} ACAP pre-filed testimony of Dr. Michael Sheehan, October 28, 1988, pp. 37-38.

market it will continue to incur costs in the same way it would if it were still a monopoly. This kind of behavior would be totally inconsistent, not only with the behavior of business entities generally in the economy, but also with the experience in the telephone industry over the last decade as competition has been introduced throughout the country. The advent of competition led AT&T and other carriers to lower their costs and improve their service. Alascom would certainly do the same.

Alascom's reaction is not unprecedented. Every monopolist confronted with the possibility of competition attempts to forestall the inevitable beginning of competitive entry by making dire predictions that universal service will be destroyed. AT&T certainly made these arguments in profusion. So long as these arguments succeed the monopolist never changes its thinking or its behavior - it merely assumes that it will be impossible to reduce costs. When decision-makers reject these arguments and introduce competition, the monopolist immediately begins behaving as a competitor by reducing its costs and improving service. This is what happened when AT&T had to compete and what happened when Alascom had to compete in Alaska interstate services.

COMPETITION WILL BRING FASTER TECHNOLOGICAL ADVANCES TO RURAL ALASKA

The choice between monopoly and competition is not simply one of lower or higher telecommunications costs. In recent years, there has been a literal revolution in communications and computer technology. These technologies have not only led to cheaper and higher quality communications service, but they have spawned an entire generation of new information and technology - related industries. These industries have provided jobs and diversification for the economies of many areas throughout the U.S.

In the interstate market, competition is responsible for many of the technological advances that have been introduced in Alaska. For example, competition brought digital transmission to Juneau and Fairbanks as well as new private line services that are now available to consumers. New entrepreneurial companies, such as Meteor Data, Inc., have appeared on the scene to pioneer the provision of specialized service. And, mobile satellite technology (which competition will bring to Alaska by 1992) will lower costs and improve service in remote areas of Alaska. This technology will bring reasonably priced telephone service to each resident, even those who are not in villages having at least 25 people (see testimony of Ronald A. Duncan, House Special Committee on Telecommunications, January 1986).

CONCLUSION

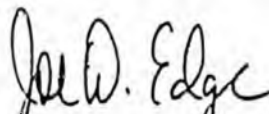
Alaska can benefit from the telecommunications revolution through the introduction of competition without jeopardizing the service which Alaska's rural residents have come to enjoy. Through careful legislation, rural ratepayers may be assured that their telephone rates will not go up as a result of competition.

SB 206 proposes such legislation through a universal service fund and the unbundling of competitive and non-competitive costs. Not only will rural rates not go up, it is very likely that they will decrease as competition leads to use of improved technology and more efficient ways to serve both rural and urban Alaska.

Intrastate competition will also help provide a path for competitive expansion to rural areas. Currently, competitive services are offered in Anchorage, the Matanuska Valley, the Kenai Peninsula, Juneau, Fairbanks, North Pole, and Adak. With intrastate competition, other regions of the state will soon see competition as well.

Competition in the telephone industry is not a new idea. The FCC and forty-five other states have permitted competition in long distance service. The result is predictable: where there is competition, rates go down, where there is no competition they do not.^{9/} It is time for Alaska to reap the benefits of competition as well.

Respectfully,



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JDE:jml
Enclosures

^{9/} Federal Trade Commission, Bureau of Economics, "The Impact of State Price and Entry Regulation on Intrastate Long Distance Telephone Rates." November 1988, p. vii. The Federal Trade Commission analysis indicated that states that permit competitive entry into the toll services market experience prices approximately 7 to 10 percent lower than states that do not allow entry.

ALASCOM 1985 INTRASTATE MTS REVENUE DATA

	<u>Dollars Per Year</u>			
	(millions)			
	<u>ANC-FBX JNU ROUTES</u>	<u>ANC-MAT VALLEY KENAI ROUTES</u>	<u>REST OF STATE</u>	<u>TOTAL STATE LONG DISTANCE REVENUES</u>
Alascom revenues	22.5	10.2	50.2	82.9
Alascom cost	(2.5)	(3.1)	(25.2)	(30.8)
Average local Telephone Co. Settlements	(9.2)	(14.3)	(28.6)	(52.1)
Surplus or * (Subsidy)	10.9	(7.3)	(3.6)	(0.0)

* A total of \$10.9 million in surplus revenue is earned on the Anchorage-Fairbanks-Juneau route. Of this amount, \$7.3 million is used to subsidize the Anchorage-Mat Valley-Kenai Routes. The remaining \$3.6 million is available to subsidize service in the remainder of Alaska. See "Analysis of GCI Scenarios 1 and 2" presented by Alascom at public hearing, APUC Docket No. R-86-2, April 8, 1987.

Above Average Cost Companies (Pool "Takers")*

<u>Company</u>	<u>from average ¢/min.</u>	<u>Minutes (millions)</u>	<u>\$ (millions)</u>
ATU	(.127 - .119)	132.3	1.06
Bush Tel	(.213 - .119)	1.9	.18
FMUS	(.181 - .119)	33.2	2.06
MTA	(.135 - .119)	62.1	.99
Mukluk	(.309 - .119)	2.0	.38
OTZ	(.153 - .119)	5.8	.20
United	(.267 - .119)	10.4	1.54
Yukon	(.128 - .119)	<u>1.4</u>	<u>.01</u>
		249	<u>\$6.4</u>

Below Average Cost Companies (Pool "Donors")*

<u>Company</u>	<u>from average ¢/min.</u>	<u>Minutes (millions)</u>	<u>\$ (millions)</u>
ASTAC	(.119 - .054)	11.9	.78
Bristol Bay	(.119 - .063)	2.7	.15
Copper Valley	(.119 - .100)	6.6	.13
Cordova	(.119 - .037)	2.5	.21
Gen Tel	(.119 - .075)	28.7	1.26
GSTC	(.119 - .084)	51.8	1.81
Interior	(.119 - .067)	5.9	.31
JDTC	(.119 - .083)	25.1	.90
Ketchikan	(.119 - .108)	8.3	.09
Nushagak	(.119 - .114)	3.3	.02
Sitka	(.119 - .086)	19.3	.64
TUA	(.119 - .042)	<u>1.4</u>	<u>.11</u>
		167	<u>\$6.4</u>

* Data are for 1986. See Appendix C to APUC staff comments in Docket R-87-1, filed October 12, 1988 (attached).

MCS: POOL
September 30, 1988

Appendix C

Telecom Toll Settlements by Exchange Carrier and Estimation of Per Minute Access Charges Given Mandatory and Optional Pooling by Urban LECs

Utility	1986			1986 Settlements				Calculated Rate/Minute			
	Term. Minutes	Orig. Minutes	Total Minutes	NTS	TS	B&C	Total	NTS	TS	B&C	Total
ARI	70,380,190	61,960,195	132,340,385	12,659,043	724,376	3,405,870	16,789,289	0.096 *	0.005	0.026 *	0.127 *
ASTAC	4,154,883	7,888,728	11,943,611	0	505,215	135,281	640,496	0.000	0.042 *	0.011	0.054
BRISTOL BAY	1,185,415	1,586,141	2,771,556	0	46,723	127,255	173,978	0.000	0.017 *	0.046 *	0.063
IN-TEL	906,382	1,064,738	1,971,120	251,652	132,075	34,527	420,254	0.128 *	0.067 *	0.019	0.213 *
JTC	3,006,780	3,652,489	6,659,269	458,419	140,987	43,341	642,747	0.069	0.021 *	0.018	0.100
CORONA	1,170,671	1,384,350	2,555,021	0	31,513	64,306	95,819	0.000	0.012	0.025 *	0.037
FRS	17,400,698	15,858,706	33,259,404	5,158,792	384,596	475,180	6,018,568	0.155 *	0.012	0.014	0.181 *
GEX-TEL	13,728,397	15,801,625	28,730,022	1,349,512	416,612	378,294	2,144,418	0.047	0.015	0.013	0.075
GTTC	25,950,485	25,895,852	51,846,337	3,050,506	527,114	779,611	4,365,231	0.059	0.010	0.015	0.084
INTERIOR	2,552,438	3,429,884	5,982,322	0	317,548	82,258	399,806	0.000	0.053 *	0.014	0.067
JOTC	13,097,238	12,017,424	25,114,662	1,582,475	174,567	399,088	2,076,050	0.060	0.007	0.016	0.083
KETCHIKAN	4,406,369	3,974,868	8,381,237	630,216	143,827	128,466	902,509	0.075	0.017 *	0.015	0.108
MTA	32,837,717	30,891,899	62,128,816	6,919,853	682,627	759,832	8,361,512	0.111 *	0.011	0.012	0.135 *
MUKLUK	364,178	1,158,956	2,023,134	356,579	186,622	82,827	625,228	0.176 *	0.092 *	0.041 *	0.309 *
NRISNAGAK	1,528,497	1,820,108	3,348,605	214,004	83,323	85,202	382,529	0.064	0.025 *	0.025 *	0.114
OTZ	2,696,914	3,139,596	5,836,510	612,291	149,733	131,345	893,369	0.105 *	0.026 *	0.023 *	0.153 *
SITKA	8,394,173	10,914,675	19,308,848	801,689	648,136	221,039	1,662,864	0.042	0.033 *	0.011	0.086
TUA	625,465	778,459	1,403,924	0	8,514	50,183	58,617	0.000	0.006	0.036 *	0.042
UNITED **	4,681,349	5,728,298	10,409,647	1,755,330	741,270	287,655	2,784,255	0.169 *	0.071 *	0.028 *	0.267 *
YUKON	432,160	855,566	1,487,726	0	124,738	65,218	189,956	0.000	0.084 *	0.044 *	0.128 *
State Total:	209,400,579	208,123,757	417,524,336	35,728,361	6,162,116	7,757,010	49,647,495				

Average Rate/Minute for LECs
Revide:

0.086 0.015 0.019 0.119

- * - Per Minute Rates are Above Average - LEC in a Pool Receiver
- NTS - Non-Traffic Sensitive
- TS - Traffic Sensitive
- B&C - Billing and Collection

** UNITED 1986 Information was not available, 1985 data was employed.

Absorption of Subsidy by Alaska
Urban Exchange Carriers

Three major urban carriers are subsidy recipients:

ATU	\$1.06 million
FMUS	2.06 million
MTA	<u>.99</u> million
	\$4.11 million

On the other hand the TU companies (JDTC & GSTC) are overall subsidy donors. TU has both urban and rural operations so the subsidy donation must be split into urban and rural components. TU is 71% urban (see p. 2 of this appendix) so;

GSTC	\$1.81 million
JDTC	<u>.90</u> million
	\$2.71 million

Urban portion is:

$\$2.71 \text{ million} \times .71 = \1.92 million

Overall net subsidy from rural to urban exchanges arising through exchange settlements:

$\$4.11 \text{ million} - \$1.92 \text{ million} = \underline{\$2.19 \text{ million}}$

Derivation of Urban Component of JDTC/GSTC

JDTC, GSTC & Sitka are now TUA & TUNI which together have both rural and urban components.

JDTC, GSTC & Sitka are subsidy contributors and so their "urban" operations will offset the drain caused by ATU, FMUS & MTA thereby reducing the net rural to urban subsidy flowing through exchange settlements.

To derive the urban and rural components one possible approach is to divide the companies by line counts.*

Since TUA is almost all "urban," 100% of its lines (and thereby its subsidy donation) should be counted as urban.

Within TUNI, North Pole, Kenai, North Kenai and Soldotna are urban and Sitka should be excluded because it is listed separately in the exchange company data we are using.

Thus:

<u>Company</u>	<u>Urban Lines</u>	<u>Rural Lines</u>
TUA	16,342	- 0 -
TUNI		
N. Pole	5,961	
Kenai	3,894	
N. Kenai	1,423	
Soldotna	5,369	
All Other**		<u>13,458</u>
	32,989	13,458

Total Lines** = 46,447

Percent Urban = 71%

Percent Rural = 29%

TU Urban Subsidy "Donation"***

\$2.71 mil X .71 = \$1.92 mil.

* Using line counts may distort reality somewhat. However, if the rural to urban exchange subsidy existing generally in the Alaska market also exists within the urban/rural operations of TU, then using line counts overstates the TU urban "donation" and understates the rural to urban subsidy.

** Sitka excluded.

Net Rural Subsidy

In a presentation to the APUC in Docket No. R-86-2, Alascom indicated that calling among Anchorage, Fairbanks, and Juneau generates surplus revenues of \$10.9 million which are available to subsidize calling in the remainder of Alaska. Of this amount, \$7.3 million is absorbed in short haul calling to points near Anchorage leaving \$3.6 million for the remainder of the state. Short haul calling around other cites absorbs an additional amount which was not shown in the Alascom analysis. Finally, since the Alascom analysis was predicated upon average rather than company-specific exchange settlements data and since exchange settlements represent over 60% of Alascom's cost of service, the use of company-specific settlements data will more precisely pinpoint the magnitude of subsidy flows between urban and rural areas of the state. The maximum available subsidy for rural areas is less than 1.4 million.

Total available subsidy	\$10.9 million
Less Anchorage area subsidy	(7.3) million
Less other urban area subsidy	(?) million
Less rural to urban exchange subsidy	<u>(2.19) million</u>
Maximum available subsidy	1.41 million
Maximum available subsidy*	0.68¢ per minute
State MTS average revenue**	39.8¢ minute
Maximum available subsidy as a percentage of State MTS revenue per minute	1.7%

* Assumes 208 million intrastate minutes.

** Assumes intrastate MTS revenues of \$82.9 million.

LONG DISTANCE TELEPHONE COMPETITION

QUESTIONS AND ANSWERS

Q: Why is competition allowed for out-of-state long distance calls but not for in-state calls?

A: Out-of-state calls are regulated by the federal government (Federal Communications Commission), which has permitted competition since the early 1970's. In-state calls are regulated by the state (Alaska Public Utilities Commission) which has not yet permitted competition.

Q: Do other states allow in-state long distance telephone competition?

A: Yes. Forty-five other states allow some form of in-state competition.

Q: What will be the result of in-state competition?

A: We can expect a result similar to what has happened with out-of-state competition. Telephone rates will come down on each route where competition occurs.

Q: If rates come down on some long distance telephone routes, will they go up in other areas as a result?

A: No. Senator Frank's bill would prohibit transferring costs from competitive routes to noncompetitive routes. Further, a "universal service fund" would be created to prevent rate increases on noncompetitive routes as a result of competition.

Q: Is it true that rural Alaska calls are heavily subsidized by urban calls?

A: No. According to Alascom data filed with the Alaska Public Utilities Commission, the net flow of subsidy from urban to rural Alaska is less than \$3 million out of \$83 million in revenue for in-state long distance calling.

Q: Why should the legislature make a decision to allow competition, rather than APUC?

A: The legislature established the overall policies for the APUC to carry out. While the APUC has the legal right to authorize competition, the issue is sufficiently important to consumers that it merits clear legislative direction.

Q: What changes have taken place in telephone technology that make competition possible?

A: Telephone technology is rapidly advancing. Improved satellites, microwave systems, fiber optic cables, exchange switches, and computer programs are making long distance service more efficient and less expensive.

Q: Why doesn't the APUC simply force the existing monopoly carrier to lower its rates?

A: There is no financial incentive for a monopoly carrier to reduce its rates, as it makes a profit based on its investment. The higher its costs, the more money it makes. It is difficult for a public utilities commission to have enough resources to prove that rates and costs are too high. Private competition is a simpler, more effective way to bring down rates.

Q: Does Senator Frank's bill limit which companies may compete in providing in-state long distance calls?

A: No. Any company may offer competitive services subject to a bonding requirement which assures payment to local telephone exchange companies for initiating or completing a call.

Q: Where will competition likely occur?

A: It is likely that competition will begin on routes which are currently competitive for out-of-state calls: Fairbanks, Anchorage, Juneau, Matanuska Valley, Kenai Peninsula, North Pole, and Adak. Other routes which are likely to be competitive are Ketchikan, Kodiak, Sitka and regional centers such as Bethel, Dillingham, and Nome.

Q: Won't competition create an inefficient duplication of facilities?

A: No. Competition will allow more companies to better serve consumers' needs. Competition in long distance services is similar to the grocery business. If one grocery store does not carry the brand you like, you can go to the other store.

THE IMPACT OF INTRA-STATE COMPETITION ON
UNIVERSAL SERVICE IN RURAL ALASKA

A SUMMARY

The following summarizes a detailed analysis of the effects of Senate Bill 182 on intrastate long distance service in rural Alaska.

The analysis was conducted by Joe Dixon "Dick" Edge, a partner in the Washington, D.C. law firm of Hopkins, Sutter, Hamel & Park.

Mr. Edge began his legal career in 1974 as a trial lawyer for the Federal Communications Commission (FCC) in Washington D.C., where, for two years he represented the FCC in litigation involving competition in the telephone industry. For the ten years following, Mr. Edge worked in the firm of Hamel & Park, where he was initially recruited to represent the State of Alaska in the development of rural telecommunications. During his ten years at Hamel & Park Mr. Edge concentrated in telecommunications and antitrust law, with such clients as the State of Alaska, National Bank of Alaska, Northern Television, the Commonwealth of Puerto Rico, Wang Laboratories, Tandy Corporation, General Communication, Inc. (GCI) and others. Three years ago Mr. Edge moved to Anchorage and became Vice President and General Counsel for GCI representing them in their antitrust and regulatory litigation. Last September he returned to private practice in Washington, D.C. at his previous law firm of Hamel & Park which had merged with the Chicago firm of Hopkins & Sutter in July. In addition to his law degree, Mr. Edge holds a bachelors degree in Electrical Engineering and a masters degree in Law with an emphasis in economics and public utilities regulation.

Competition in intrastate telephone service is consistent with universal service in rural Alaska at affordable rates. SB permits such competition while establishing safeguards for use on noncompetitive routes.

Alascom is now the monopoly in-state long distance carrier. It uses local telephone companies to originate and terminate these calls, and pays an access charge for this service. Under the present system, some customers pay more than the actual cost of completing the call, and others pay less. The result is a form of subsidy from one group of telephone customers to another.

While it is commonly assumed that this subsidy flows heavily from urban to rural Alaska, data presented to the APUC by Alascom indicates that this subsidy is quite small: less than \$3.6 million out of total revenues of \$82.9 million. Most of the subsidy actually flows from urban to suburban routes.

To assure that rural telephone customers do not lose whatever small subsidy they receive, SB established a universal service fund. All long distance carriers would contribute to the fund which would be used to cover any shortfalls on high cost (noncompetitive) routes. The bill also prohibits Alascom from recovering any competitive losses from rural customers.

Competition will lower the cost of telephone service throughout the State and bring new technology to rural as well as urban Alaska.

HISTORY OF TELECOMMUNICATIONS COMPETITION IN ALASKA

In 1969, RCA Alascom bought the Alaska Communications System from the military. As part of Alascom's bid proposal to the military, it agreed to provide service to all areas of 25 people or more.

By 1974, when Alascom had not expanded its system to rural Alaska, Congress and the FCC became concerned and requested a proposal for bush service from Alascom. In response, Alascom proposed a system consisting of large satellites in regional centers with terrestrial cable linking the regional centers.

Following an analysis of Alascom's proposal, the State of Alaska informed Alascom that its proposed system was inefficient and unreliable, asking Alascom to accept a proposal consisting of small earth stations in each village instead.

When Alascom refused to accept the state's alternative proposal, the state filed its own application in 1975 for 120 small earth stations to serve rural Alaska. In response, Alascom filed parallel applications with the FCC for the same small earth stations. Since the applications were overlapping, this created an impasse that could have lasted

several years. In an effort to avoid further delays in rural telephone service, the State of Alaska and the Alaska Legislature agreed to fund the small earth station program if Alascom installed and operated the earth stations.

The State of Alaska's application to the FCC was the first sign of competition and its resulting beneficial effect in Alaska.

In 1980, GCI filed an application with the FCC to provide communication service between Alaska and the Lower 48. Alascom opposed GCI's application even though competition had been accepted and was in full force in the lower 48 since the early 70's. Alascom argued to the FCC that competition in Alaska would destroy rural service, increase rates, and limit technological innovation. ¹

In November 1982, GCI began long distance service in Anchorage under continuing protests by Alascom. The issue of whether or not Alaska should have competition in the provision of long distance service to and from Alaska was not fully put

¹ See for example: Rebuttal Comments of Alascom in CC Docket No. 78-72, June 1981, pp. 16-21, Supplemental Comments of Alascom CC Docket 78-72, January, 1980, pp. 94-100.

to rest until 1984 when the FCC released a final order denying Alascom's applications for review - stating that Alascom's claims had been addressed and rejected on several occasions. 2

Since competition began in the interstate market, Alascom's rates have gone down by over 50% in urban as well as rural areas. Technological innovation has occurred bringing in more reliable and cost efficient digital service as well as new expanded private line services. Meanwhile rates within the state, where there is no competition, have increased since 1982.

The issue of competition within the State of Alaska was first addressed when the Alaska Public Utilities Commission (APUC) began a proceeding to determine whether or not Alaska should have competition within the state in August, 1983. The telephone industry and other participants filed several rounds of comments and attended two public hearings on the issue of intrastate competition. In addition, GCI filed proposed regulations which would establish the rules under which competitive services would be provided. Alascom opposed GCI's

2 See, Memorandum Opinion and Order, in Re Applications of GCI, File Nos. W-P-C-3345 et al., FCC 84-168 (April 24, 1984).

regulations making many of the arguments that it made in delaying interstate competition before the FCC.

In 1986, the APUC closed the proceeding on competition within Alaska without taking action. In response, GCI filed a formal application to provide service within Alaska as well as a new proposal for regulations.

Since 1986, the APUC has held two public hearings on the competitive question and has asked for comments from the industry on several occasions. Alascom continues to oppose competition and to this date the APUC has taken no action.

HOPKINS, SUTTER, HAMEL & PARK

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MEMORANDUM

TO: The Honorable Steve Frank
P.O. Box V
Juneau, Alaska 99811

FROM: Joe D. Edge
Hopkins, Sutter, Hamel & Park

DATE: February 21, 1989

RE: Senate Bill 206 and the Impact of Intrastate
Competition on Universal Service in Rural Alaska

You have asked me to examine the impact of SB 206 ; "An Act relating to intrastate competition in telecommunications" . . . , on the provision of intrastate long distance service at reasonable rates throughout Alaska. In discussing this issue, I will also address a number of questions which have been raised from time-to-time regarding the introduction of competition in Alaska long distance services.

In looking at this question, I have assumed that the central objective of the bill is to provide for a flourishing competitive intrastate long distance market while ensuring the availability of universal service at reasonable rates. I believe the bill will accomplish these objectives. SB 206 removes existing regulatory and structural barriers to competition in the Alaska market. At the same time, the bill provides for continuing regulation by the Alaska Public Utilities Commission ("APUC") in those areas where competition is not yet fully effective thus ensuring universal service at reasonable rates. Finally, the bill provides for a system of access charges and a Universal Service Fund administered by the Alaska telecommunications industry, under APUC supervision, which will ensure nondiscriminatory access to local exchange facilities and provide

support, where necessary, to ensure the provision of universal service at reasonable rates.

INTRODUCTION

Today competition in long distance service is permitted nationwide in the interstate market and in forty-five of the states. Interstate long distance competition began over a decade ago in the lower 48 and has been a reality in Alaska since 1982.

Since the FCC opened the national interstate market to competition, long distance rates have declined by over 50% and many new services have been introduced. AT&T, which had a monopoly before the advent of competition, has lost some of its market share to competition but its traffic volumes have increased and it is a healthy and thriving company.

These same competitive benefits have been realized even in lower-48 rural interstate markets not yet reached by the networks of competing carriers such as MCI and Sprint. When competition appeared in interstate markets over a decade ago, AT&T vigorously opposed it arguing, among other things, that competition could lead to "deaveraging" of AT&T's toll rates with calls between urban areas priced lower than calls in rural areas. In more than ten years of competition in interstate markets, this has never happened. Not only has AT&T continued to "average" its rates throughout the country but so have MCI and Sprint even though the latter companies' rates are not regulated. Rural long distance rates have declined by over 50% just as urban rates have.

Alaska has also experienced the benefits of interstate competition. Although Alaska interstate competition was opposed with the same arguments made in the lower-48, none of the predicted harms have occurred. Interstate rates have declined by over 50% throughout Alaska. Today, Alascom, while losing market share to GCI, is carrying more traffic than when GCI entered the market. An enormous increase in calling has occurred as a result of lower rates and the stimulation resulting from the intensive marketing efforts of GCI and Alascom. And service has been improved as well. SB 206 will extend these benefits to the Alaska intrastate market.

The Structure of the Alaska Market

Under the existing noncompetitive structure, the in-state long distance telephone market is served by a monopoly long distance carrier (Alascom) connecting with over two dozen local telephone companies. In order to provide long distance service,

Alascom generally must connect with local telephone companies for both origination and termination of each call within Alaska. Alascom pays the telephone companies for this access through a pooling mechanism whereby each telephone company determines its cost of originating and terminating in-state long distance calls and Alascom, as the pooling manager, settles with individual companies, covering each company's costs.

The total cost of providing in-state long distance service (about \$82.9 million in 1985) is made up of the cost of the exchange company settlements paid by Alascom (\$52.1 million) and Alascom's own network costs (\$30.8 million).^{1/} Under the present system, customers, in some instances, pay rates that are higher than the cost of completing their call and, in other instances, pay rates that are lower than the cost of completing their call. The result is a form of subsidy from one group of telephone consumers to another. While it is often assumed that a large subsidy of this kind flows from urban areas to rural areas, as is shown below, the reality of the Alaska industry appears to be quite different.

Historically, Alascom has relied in part upon the assumption that this rural subsidy exists as a reason to keep competition out of Alaska. Eight years ago, Alascom attempted and failed to exclude competition from the Alaska interstate market by making dire predictions before the FCC that rural service would be jeopardized, rates would go up, and technological innovation would come to a halt.^{2/} Likewise, Alascom has argued before the Legislature, the Alaska Public Utilities Commission, and elsewhere that competition is not in the public interest in Alaska because rural rates will go up as the funds available to subsidize rural areas are reduced through competition.

Recently, Alascom has taken this argument one step further by assuming that in the face of competition it will not attempt to lower its costs and that it will be allowed to make up any losses it incurs on competitive routes through increased rural rates. Over time, Alascom argues, rural rates will go up higher and higher as competition expands further and further. In the end, Alascom argues, it will be left with its last customer paying for the entire network.^{3/}

^{1/} See Appendix A.

^{2/} See for example: Rebuttal Comments of Alascom in CC Docket No. 78-72, June, 1981, pp. 16-21; Supplemental Comments of Alascom CC Docket 78-72, January, 1980, pp. 94-100.

^{3/} Alascom Response to Order # 14 and Pre-filed Testimony, APUC Docket U-87-25, August 26, 1988, pp. 11-12.

Alascom's argument is incorrect for a number of reasons: First, the actual subsidy flowing from the urban to the rural areas is quite small, if it exists at all, and can easily be funded through a universal service fund in which all carriers participate; second, Alascom's arguments assume it will be allowed to cross-subsidize any decreases in revenue due to competition by increasing the rates on its monopoly services - a notion that is contrary to the purpose of competition and which is expressly prohibited in the proposed legislation; and third, Alascom assumes that unlike carriers elsewhere, which have been faced with competition, it will not bring down its costs over time to meet the competitive challenge.

THE URBAN-RURAL SUBSIDY IS QUITE SMALL

According to data that Alascom presented to the APUC in April, 1987, calling between the cities of Anchorage, Fairbanks, and Juneau generates \$10.9 million more in revenue than it costs to provide the service. The excess revenue from these routes is said to be the source of the subsidy for rural calling. However, according to the Alascom data, \$7.3 million (or 67%) of the subsidy is used to support near-urban calling around the Anchorage market, leaving only \$3.6 million for the remainder of Alaska.^{4/} In short, based upon Alascom data, urban callers are paying a large cross subsidy to themselves and the subsidy which flows from urban Alaska to rural Alaska is no more than \$3.6 million. (See Appendix A).

In fact, the rural subsidy is far smaller than this \$3.6 million figure, if it exists at all. It is likely that a portion of this \$3.6 million is used to support calling around other urban areas. The areas around cities other than Anchorage were not separately identified in the Alascom April, 1987, data but they likely have the same short haul pricing characteristic as the Anchorage market does. Thus, a portion of the remaining \$3.6 million is certainly absorbed in these urban markets.

In addition, much, if not all, of the remaining subsidy is absorbed in urban areas through the exchange company settlements process. In Alaska, certain urban telephone companies have higher intrastate long distance settlement costs than do most rural Alaska exchange carriers. (See Appendix B) Since the \$3.6 million subsidy figure was calculated by averaging urban and rural settlement costs, it masks these higher urban costs. Using the averaging approach in Alascom's April, 1987, data, the subsidy flowing from low-cost rural telephone companies to high-cost urban telephone companies through the settlements process is not accounted for. If the subsidy were to be

^{4/} See Alascom's "Analysis of GCI Scenarios 1 and 2", presented at public hearing, APUC Docket No. R-86-2, April 8, 1987.

calculated using company-specific settlements costs, most, if not all, of the remaining subsidy would be absorbed by higher cost urban calling. (See Appendix C) Therefore, it is even possible that rural callers are in small measure subsidizing urban callers - a result that is totally contrary to the claims which have been made and accepted for years.

Even if rural callers were the recipients of a \$3.6 million subsidy, which they apparently are not, this is a relatively small figure - \$3.6 million is only 4.3% of Alascom's intrastate gross revenues and 1.3% of its total revenues.^{5/} This money (equivalent to 1.7 cents per intrastate minute) could easily be funded through a universal service fund in which all long distance carriers participate.

SB 206 proposes such a fund whereby each long distance carrier pays a surcharge on access charges paid to the exchange companies. This fund would be administered by the industry and would make money available to local telephone companies in rural, high-cost areas. The local telephone companies will use this money to lower the amount of money interexchange carriers pay to originate and terminate long distance calls, thereby lowering the total cost of a long distance call and preventing rates from rising.

This type of pool is not new. After the Federal Communications Commission opened the interstate market to competition, it developed an access charge system and a fund similar to the one described above, known as the High Cost Fund. The federal subsidies flowing through these mechanisms as well as the cost separation process and the averaging of access charges through the National Exchange Carrier Association have been successful in keeping exchange and long distance rates down throughout rural America.^{6/} In fact, in Alaska some rural

^{5/} According to the Alascom data submitted to the APUC, Alascom 1985 intrastate toll revenues were \$83 million. Alascom's total revenues reported on its 1985 FCC Form M were \$291 million. (See Appendix C.)

^{6/} The subsidies resulting from the exchange cost separations process, access charge averaging and the high-cost fund are available to all areas of the U.S., including Alaska. They are not the same as the subsidy flowing from AT&T to Alascom in the Alaska interstate market. The present FCC Joint Board proceeding dealing with the Alaska interstate market may alter the AT&T to Alascom subsidy but it is not concerned with and will not affect the nationwide exchange subsidies which are discussed here. In addition, the FCC Joint Board recently announced that it will not entertain proposals that would have the effect of shifting costs to the Alaska in-state market. Supplemental Order Inviting Comments in CC Docket 83-1376, FCC 88J-4, released January 3, 1989.

telephone companies receive so much money from federal subsidies that they charge Alascom little or no money to originate and terminate intrastate calls.^{7/} This is one reason why many rural Alaska exchange companies have costs that are lower than the corresponding urban Alaska exchange company costs.

ALASCOM CANNOT RECOVER COMPETITIVE LOSSES FROM RURAL CUSTOMERS

Alascom argues that when competition enters the market, it will be forced to lower its rates on competitive routes thus incurring a loss. Alascom then argues that it will make up any decline in revenue by raising the rates charged to customers on monopoly routes. This argument assumes that Alascom would be allowed to engage in such cross-subsidization free from regulatory oversight. Alascom would attempt to use its monopoly power against the very groups of consumers that regulation was designed to protect from the use of monopoly power.^{8/}

SB 206 proposes to foreclose this use of Alascom's monopoly power by requiring Alascom to allocate its costs between regulated and deregulated market areas. Should Alascom incur any decrease in revenue in its deregulated service, it could not raise rural rates to recover those revenues. SB 206 states that following deregulation of a service, the cost of any remaining regulated service may be increased only if the direct costs of such service increase.

Through this type of legislation, Alascom cannot raise rates in the rural areas to cover any decline in revenue on competitive routes. Rural rates can only go up if the direct costs on rural routes go up. In addition, to ensure that rural rates remain reasonable, the APUC may, if necessary, permit any increased costs to be recovered from the universal service fund.

COMPETITION WILL LOWER COSTS

Finally, the argument that competition is not in the public interest, due to the inherent subsidies in the Alaska telephone system, is flawed because it ignores the dynamic benefits of competition. Alascom assumes that when competition enters the

^{7/} Testimony of Alascom in public hearing, APUC Docket No. R-86-2, April 8-9, 1987, p. 442.

^{8/} ACAP pre-filed testimony of Dr. Michael Sheehan, October 28, 1988, pp. 37-38.

market it will continue to incur costs in the same way it would if it were still a monopoly. This kind of behavior would be totally inconsistent, not only with the behavior of business entities generally in the economy, but also with the experience in the telephone industry over the last decade as competition has been introduced throughout the country. The advent of competition led AT&T and other carriers to lower their costs and improve their service. Alascom would certainly do the same.

Alascom's reaction is not unprecedented. Every monopolist confronted with the possibility of competition attempts to forestall the inevitable beginning of competitive entry by making dire predictions that universal service will be destroyed. AT&T certainly made these arguments in profusion. So long as these arguments succeed the monopolist never changes its thinking or its behavior - it merely assumes that it will be impossible to reduce costs. When decision-makers reject these arguments and introduce competition, the monopolist immediately begins behaving as a competitor by reducing its costs and improving service. This is what happened when AT&T had to compete and what happened when Alascom had to compete in Alaska interstate services.

COMPETITION WILL BRING FASTER TECHNOLOGICAL ADVANCES TO RURAL ALASKA

The choice between monopoly and competition is not simply one of lower or higher telecommunications costs. In recent years, there has been a literal revolution in communications and computer technology. These technologies have not only led to cheaper and higher quality communications service, but they have spawned an entire generation of new information and technology-related industries. These industries have provided jobs and diversification for the economies of many areas throughout the U.S.

In the interstate market, competition is responsible for many of the technological advances that have been introduced in Alaska. For example, competition brought digital transmission to Juneau and Fairbanks as well as new private line services that are now available to consumers. New entrepreneurial companies, such as Meteor Data, Inc., have appeared on the scene to pioneer the provision of specialized service. And, mobile satellite technology (which competition will bring to Alaska by 1992) will lower costs and improve service in remote areas of Alaska. This technology will bring reasonably priced telephone service to each resident, even those who are not in villages having at least 25 people (see testimony of Ronald A. Duncan, House Special Committee on Telecommunications, January 1986).

CONCLUSION

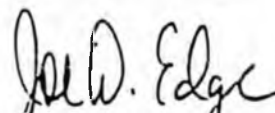
Alaska can benefit from the telecommunications revolution through the introduction of competition without jeopardizing the service which Alaska's rural residents have come to enjoy. Through careful legislation, rural ratepayers may be assured that their telephone rates will not go up as a result of competition.

SB 206 proposes such legislation through a universal service fund and the unbundling of competitive and non-competitive costs. Not only will rural rates not go up, it is very likely that they will decrease as competition leads to use of improved technology and more efficient ways to serve both rural and urban Alaska.

Intrastate competition will also help provide a path for competitive expansion to rural areas. Currently, competitive services are offered in Anchorage, the Matanuska Valley, the Kenai Peninsula, Juneau, Fairbanks, North Pole, and Adak. With intrastate competition, other regions of the state will soon see competition as well.

Competition in the telephone industry is not a new idea. The FCC and forty-five other states have permitted competition in long distance service. The result is predictable: where there is competition, rates go down, where there is no competition they do not.^{9/} It is time for Alaska to reap the benefits of competition as well.

Respectfully,



Joe D. Edge
Counsel for
General Communication Inc.

JDE:jml
Enclosures

^{9/} Federal Trade Commission, Bureau of Economics, "The Impact of State Price and Entry Regulation on Intrastate Long Distance Telephone Rates." November 1988, p. vii. The Federal Trade Commission analysis indicated that states that permit competitive entry into the toll services market experience prices approximately 7 to 10 percent lower than states that do not allow entry.

ALASCOM 1985 INTRASTATE MTS REVENUE DATA

	<u>Dollars Per Year</u>			
	(millions)			
	<u>ANC-FBX JNU ROUTES</u>	<u>ANC-MAT VALLEY KENAI ROUTES</u>	<u>REST OF STATE</u>	<u>TOTAL STATE LONG DISTANCE REVENUES</u>
Alascom revenues	22.5	10.2	50.2	82.9
Alascom cost	(2.5)	(3.1)	(25.2)	(30.8)
Average local Telephone Co. Settlements	(9.2)	(14.3)	(28.6)	(52.1)
Surplus or * (Subsidy)	10.9	(7.3)	(3.6)	(0.0)

* A total of \$10.9 million in surplus revenue is earned on the Anchorage-Fairbanks-Juneau route. Of this amount, \$7.3 million is used to subsidize the Anchorage-Mat Valley-Kenai Routes. The remaining \$3.6 million is available to subsidize service in the remainder of Alaska. See "Analysis of GCI Scenarios 1 and 2" presented by Alascom at public hearing, APUC Docket No. R-86-2, April 8, 1987.

Above Average Cost Companies (Pool "Takers")*

<u>Company</u>	<u>from average ¢/min.</u>	<u>Minutes (millions)</u>	<u>\$ (millions)</u>
ATU	(.127 - .119)	137.3	1.06
Bush Tel	(.213 - .119)	1.9	.18
FMUS	(.181 - .119)	33.2	2.06
MTA	(.135 - .119)	62.1	.99
Mukluk	(.309 - .119)	2.0	.38
OTZ	(.153 - .119)	5.8	.20
United	(.267 - .119)	10.4	1.54
Yukon	(.128 - .119)	<u>1.4</u>	<u>.01</u>
		249	<u>\$6.4</u>

Below Average Cost Companies (Pool "Donors")*

<u>Company</u>	<u>from average ¢/min.</u>	<u>Minutes (millions)</u>	<u>\$ (millions)</u>
ASTAC	(.119 - .054)	11.9	.78
Bristol Bay	(.119 - .063)	2.7	.15
Copper Valley	(.119 - .100)	6.6	.13
Cordova	(.119 - .037)	2.5	.21
Gen Tel	(.119 - .075)	28.7	1.26
GSTC	(.119 - .084)	51.8	1.81
Interior	(.119 - .067)	5.9	.31
JDTC	(.119 - .083)	25.1	.90
Ketchikan	(.119 - .108)	8.3	.09
Nushagak	(.119 - .114)	3.3	.02
Sitka	(.119 - .086)	19.3	.64
TUA	(.119 - .042)	<u>1.4</u>	<u>.11</u>
		167	<u>\$6.4</u>

* Data are for 1986. See Appendix C to APUC staff comments in Docket R-87-1, filed October 12, 1988 (attached).

LECs: POOL?
September 30, 1988

Alascom Toll Settlements by Exchange Carrier and Estimation of Per Minute Access
Charges Given Mandatory and Optional Pooling by Urban LECs

Utility	1986 Term. Minutes	1986 Orig. Minutes	1986 Total Minutes	1986 Settlements				Calculated Rate/Minute			
				NTS	TS	B&C	Total	NTS	TS	B&C	Total
AIN	70,380,190	61,960,195	132,340,385	12,659,043	724,376	3,405,870	16,789,289	0.096 *	0.005	0.026 *	0.127 *
ASTAC	6,156,883	7,888,728	11,943,611	0	505,215	135,281	640,496	0.000	0.042 *	0.031	0.054
BRISTOL BAY	1,185,415	1,586,141	2,771,556	0	46,723	127,255	173,978	0.000	0.017 *	0.044 *	0.063
IN-TEL	486,382	1,064,738	1,971,120	251,652	132,075	34,527	420,254	0.128 *	0.067 *	0.019	0.213 *
JTC	3,006,760	3,652,489	6,659,249	458,419	140,987	63,341	662,747	0.069	0.021 *	0.010	0.100
CORBOVA	1,178,671	1,386,350	2,557,021	0	31,513	64,306	95,819	0.000	0.012	0.025 *	0.037
FINS	17,400,690	15,858,786	33,259,484	5,158,792	384,596	475,180	6,018,568	0.155 *	0.012	0.014	0.181 *
GEN-TEL	13,728,397	15,001,625	28,730,022	1,349,512	416,612	378,294	2,144,418	0.047	0.015	0.013	0.075
GTC	25,950,485	25,095,852	51,046,337	3,058,506	527,114	779,611	4,365,231	0.059	0.010	0.015	0.084
INTERIOR	2,552,438	3,429,884	5,982,322	0	317,548	82,258	399,806	0.000	0.053 *	0.014	0.067
JOTC	13,097,238	12,017,424	25,114,662	1,502,475	174,567	399,008	2,076,050	0.060	0.007	0.016	0.083
KETCHIKAN	4,406,369	3,974,868	8,381,237	630,216	143,827	128,466	902,509	0.075	0.017 *	0.015	0.108
MTA	32,837,717	30,091,099	62,128,816	6,919,853	682,627	759,032	8,361,512	0.111 *	0.011	0.012	0.135 *
MUKLUK	864,178	1,158,956	2,023,134	356,579	185,622	82,027	625,228	0.176 *	0.092 *	0.041 *	0.309 *
MUSKOGEE	1,528,497	1,820,108	3,348,605	214,004	83,323	55,202	382,529	0.064	0.025 *	0.025 *	0.114
OTZ	2,696,914	3,139,596	5,836,510	612,291	149,733	131,345	893,369	0.105 *	0.026 *	0.023 *	0.153 *
SIKA	8,394,173	10,914,675	19,308,848	801,689	648,136	221,039	1,662,864	0.042	0.033 *	0.011	0.086
TUA	625,465	778,459	1,403,924	0	8,514	50,183	58,617	0.000	0.006	0.036 *	0.042
UNITED **	4,681,349	5,728,298	10,409,647	1,755,330	741,270	287,655	2,784,255	0.169 *	0.071 *	0.028 *	0.267 *
YUKON	632,160	855,566	1,487,726	0	124,738	65,218	189,956	0.000	0.084 *	0.044 *	0.128 *
State Total:	209,408,379	208,123,757	417,526,136	35,728,361	6,162,116	7,757,018	49,647,495				

Average Rate/Minute for LECs
Revised:

0.086 0.015 0.019 0.119

- * - Per Minute Rates are Above Average - LEC is a Pool Receiver
- NTS - Non-Traffic Sensitive
- TS - Traffic Sensitive
- B&C - Billing and Collection

** UNITED 1986 information was not available, 1985 data was employed.

Absorption of Subsidy by Alaska
Urban Exchange Carriers

Three major urban carriers are subsidy recipients:

ATU	\$1.06 million
FMUS	2.06 million
MTA	<u>.99 million</u>
	\$4.11 million

On the other hand the TU companies (JDTC & GSTC) are overall subsidy donors. TU has both urban and rural operations so the subsidy donation must be split into urban and rural components. TU is 71% urban (see p. 2 of this appendix) so;

GSTC	\$1.81 million
JDTC	<u>.90 million</u>
	\$2.71 million

Urban portion is:

$\$2.71 \text{ million} \times .71 = \1.92 million

Overall net subsidy from rural to urban exchanges arising through exchange settlements:

$\$4.11 \text{ million} - \$1.92 \text{ million} = \underline{\$2.19 \text{ million}}$

Derivation of Urban Component of JDTC/GSTC

JDTC, GSTC & Sitka are now TUA & TUNI which together have both rural and urban components.

JDTC, GSTC & Sitka are subsidy contributors and so their "urban" operations will offset the drain caused by ATU, FMUS & MTA thereby reducing the net rural to urban subsidy flowing through exchange settlements.

To derive the urban and rural components one possible approach is to divide the companies by line counts.*

Since TUA is almost all "urban," 100% of its lines (and thereby its subsidy donation) should be counted as urban.

Within TUNI, North Pole, Kenai, North Kenai and Soldotna are urban and Sitka should be excluded because it is listed separately in the exchange company data we are using.

Thus:

<u>Company</u>	<u>Urban Lines</u>	<u>Rural Lines</u>
TUA	16,342	- 0 -
TUNI		
N. Pole	5,961	
Kenai	3,894	
N. Kenai	1,423	
Soldotna	5,369	
All Other**	<u> </u>	<u>13,458</u>
	32,989	13,458

Total Lines** = 46,447

Percent Urban = 71%

Percent Rural = 29%

TU Urban Subsidy "Donation"***

\$2.71 mil X .71 = \$1.92 mil.

* Using line counts may distort reality somewhat. However, if the rural to urban exchange subsidy existing generally in the Alaska market also exists within the urban/rural operations of TU, then using line counts overstates the TU urban "donation" and understates the rural to urban subsidy.

** Sitka excluded.

Net Rural Subsidy

In a presentation to the APUC in Docket No. R-86-2, Alascom indicated that calling among Anchorage, Fairbanks, and Juneau generates surplus revenues of \$10.9 million which are available to subsidize calling in the remainder of Alaska. Of this amount, \$7.3 million is absorbed in short haul calling to points near Anchorage leaving \$3.6 million for the remainder of the state. Short haul calling around other cites absorbs an additional amount which was not shown in the Alascom analysis. Finally, since the Alascom analysis was predicated upon average rather than company-specific exchange settlements data and since exchange settlements represent over 60% of Alascom's cost of service, the use of company-specific settlements data will more precisely pinpoint the magnitude of subsidy flows between urban and rural areas of the state. The maximum available subsidy for rural areas is less than 1.4 million.

Total available subsidy	\$10.9 million
Less Anchorage area subsidy	(7.3) million
Less other urban area subsidy	(?) million
Less rural to urban exchange subsidy	<u>(2.19) million</u>
Maximum available subsidy	1.41 million
Maximum available subsidy*	0.68¢ per minute
State MTS average revenue**	39.8¢ minute
Maximum available subsidy as a percentage of State MTS revenue per minute	1.7%

* Assumes 208 million intrastate minutes.

** Assumes intrastate MTS revenues of \$82.9 million.

LONG DISTANCE TELEPHONE COMPETITION

QUESTIONS AND ANSWERS

Q: Why is competition allowed for out-of-state long distance calls but not for in-state calls?

A: Out-of-state calls are regulated by the federal government (Federal Communications Commission), which has permitted competition since the early 1970's. In-state calls are regulated by the state (Alaska Public Utilities Commission) which has not yet permitted competition.

Q: Do other states allow in-state long distance telephone competition?

A: Yes. Forty-five other states allow some form of in-state competition.

Q: What will be the result of in-state competition?

A: We can expect a result similar to what has happened with out-of-state competition. Telephone rates will come down on each route where competition occurs.

Q: If rates come down on some long distance telephone routes, will they go up in other areas as a result?

A: No. Senator Frank's bill would prohibit transferring costs from competitive routes to noncompetitive routes. Further, a "universal service fund" would be created to prevent rate increases on noncompetitive routes as a result of competition.

Q: Is it true that rural Alaska calls are heavily subsidized by urban calls?

A: No. According to Alascom data filed with the Alaska Public Utilities Commission, the net flow of subsidy from urban to rural Alaska is less than \$3 million out of \$83 million in revenue for in-state long distance calling.

Q: Why should the legislature make a decision to allow competition, rather than APUC?

A: The legislature established the overall policies for the APUC to carry out. While the APUC has the legal right to authorize competition, the issue is sufficiently important to consumers that it merits clear legislative direction.

Q: What changes have taken place in telephone technology that make competition possible?

A: Telephone technology is rapidly advancing. Improved satellites, microwave systems, fiber optic cables, exchange switches, and computer programs are making long distance service more efficient and less expensive.

Q: Why doesn't the APUC simply force the existing monopoly carrier to lower its rates?

A: There is no financial incentive for a monopoly carrier to reduce its rates, as it makes a profit based on its investment. The higher its costs, the more money it makes. It is difficult for a public utilities commission to have enough resources to prove that rates and costs are too high. Private competition is a simpler, more effective way to bring down rates.

Q: Does Senator Frank's bill limit which companies may compete in providing in-state long distance calls?

A: No. Any company may offer competitive services subject to a bonding requirement which assures payment to local telephone exchange companies for initiating or completing a call.

Q: Where will competition likely occur?

A: It is likely that competition will begin on routes which are currently competitive for out-of-state calls: Fairbanks, Anchorage, Juneau, Matanuska Valley, Kenai Peninsula, North Pole, and Adak. Other routes which are likely to be competitive are Ketchikan, Kodiak, Sitka and regional centers such as Bethel, Dillingham, and Nome.

Q: Won't competition create an inefficient duplication of facilities?

A: No. Competition will allow more companies to better serve consumers' needs. Competition in long distance services is similar to the grocery business. If one grocery store does not carry the brand you like, you can go to the other store.

THE IMPACT OF INTRA-STATE COMPETITION ON
UNIVERSAL SERVICE IN RURAL ALASKA

A SUMMARY

The following summarizes a detailed analysis of the effects of Senate Bill 182 on intrastate long distance service in rural Alaska.

The analysis was conducted by Joe Dixon "Dick" Edge, a partner in the Washington, D.C. law firm of Hopkins, Sutter, Hamel & Park.

Mr. Edge began his legal career in 1974 as a trial lawyer for the Federal Communications Commission (FCC) in Washington D.C., where, for two years he represented the FCC in litigation involving competition in the telephone industry. For the ten years following, Mr. Edge worked in the firm of Hamel & Park, where he was initially recruited to represent the State of Alaska in the development of rural telecommunications. During his ten years at Hamel & Park Mr. Edge concentrated in telecommunications and antitrust law, with such clients as the State of Alaska, National Bank of Alaska, Northern Television, the Commonwealth of Puerto Rico, Wang Laboratories, Tandy Corporation, General Communication, Inc. (GCI) and others. Three years ago Mr. Edge moved to Anchorage and became Vice President and General Counsel for GCI representing them in their antitrust and regulatory litigation. Last September he returned to private practice in Washington, D.C. at his previous law firm of Hamel & Park which had merged with the Chicago firm of Hopkins & Sutter in July. In addition to his law degree, Mr. Edge holds a bachelors degree in Electrical Engineering and a masters degree in Law with an emphasis in economics and public utilities regulation.

Competition in intrastate telephone service is consistent with universal service in rural Alaska at affordable rates. SB permits such competition while establishing safeguards for use on noncompetitive routes.

Alascom is now the monopoly in-state long distance carrier. It uses local telephone companies to originate and terminate these calls, and pays an access charge for this service. Under the present system, some customers pay more than the actual cost of completing the call, and others pay less. The result is a form of subsidy from one group of telephone customers to another.

While it is commonly assumed that this subsidy flows heavily from urban to rural Alaska, data presented to the APUC by Alascom indicates that this subsidy is quite small: less than \$3.6 million out of total revenues of \$82.9 million. Most of the subsidy actually flows from urban to suburban routes.

To assure that rural telephone customers do not lose whatever small subsidy they receive, SB established a universal service fund. All long distance carriers would contribute to the fund which would be used to cover any shortfalls on high cost (noncompetitive) routes. The bill also prohibits Alascom from recovering any competitive losses from rural customers.

Competition will lower the cost of telephone service throughout the State and bring new technology to rural as well as urban Alaska.

EXHIBIT 2

1986

Per Minute State Toll Revenue Requirement

costs they recover from Alascom

<u>Utility</u>	<u>A</u> 1986 Intrastate Minutes 1/	<u>B</u> 1986 NTS-State Est. 2/	<u>C</u> 1983 TS-State Toll Alloc 2/	<u>(B + C)</u> Total State Toll Alloc	<u>(B + C)</u> A Cost/Min
ASTAC	8,925,770	0	361,590	361,590	.0405
ATU	56,114,162	3,937,415	2,074,592	6,012,007	.1071
BBTC	1,483,229	0	35,222	35,222	.0237
BUSH-TEL	804,866	113,581	78,943	192,524	.2392
Cordova	1,276,266	0	4,985	4,985	.0039
CVTC	1,467,050	282,607	93,057	375,664	.2560
FMUS	15,229,716	2,868,480	467,519	3,335,999	.2190
Gen-Tel	13,751,379	481,594	407,191	888,785	.0646
GSTC	24,382,945	2,520,335	206,648	2,726,983	.1118
ITC	3,263,797	0	287,819	287,819	.0881
JDTC	11,078,355	921,206	129,647	1,050,853	.0948
Ketchikan	3,523,305	442,992	85,754	528,746	.1500
MTA	17,178,537	5,054,153	296,791	5,350,944	.3114
Mukluk	974,033	256,164	147,954	404,118	.4148
Nushagak	1,545,858	135,813	18,336	154,149	.0997
OTZ	2,749,553	306,346	319,486	625,832	.2276
Sitka	6,968,697	539,618	421,990	961,608	.1379
TUA	760,002	0	21,254	21,254	.0279
United	5,141,736	1,008,521	768,829	1,777,350	.3456
Yukon	399,764	0	64,985	64,985	.1625
All other Company's	<u>20,935,981</u>	<u>0</u>	<u>315,496</u>	<u>315,496</u>	<u>.0151</u>
Total	197,955,001	18,868,825	6,608,088	25,476,913	.1287

1/ Alascom Response to Order Requesting Data, CC Docket 83-1376, July 15, 1986.

2/ Staff exhibit, Hearing on Subscriber Line Charges, Docket R-87-1, October 3, 1988.

APUC SUBCOMMITTEE'S

HOUSE LABOR AND COMMERCE

1. TELEPHONE: Rep. Gruenberg, Rep. Boucher, Rep. Collins
2. ELECTRIC: Rep. Boyer, Rep. Spohnholz, Rep. Leman
3. SOLID WASTE: Rep. Boucher, Rep. Leman
4. APUC ISSUES: Rep. Donley, Rep. Boyer
5. MISC. ISSUES: Rep. Donley, Rep. Gruenberg

Alaska State Legislature

REPRESENTATIVE
MARK BOYER

VICE-CHAIRMAN, HOUSE
HEALTH, EDUCATION AND
SOCIAL SERVICES COMMITTEE

MEMBER, HOUSE LABOR AND
COMMERCE COMMITTEE

CHAIR, CHILDREN'S CAUCUS



House of Representatives

FAIRBANKS

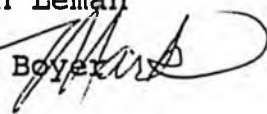
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JUNEAU

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JUNEAU, ALASKA 99811
(907) 465-3466

MEMORANDUM

TO: ✓ Representative Dave Donley
Representative Ann Spohnholz
Representative Loren Leman

FROM: Representative Mark Boyer 

DATE: April 3, 1989

SUBJECT: PROPOSED HOUSE BILL

Attached for your review is a proposed bill containing the amendments suggested by Dave Hutchens, Executive Director of the Alaska Rural Electric Cooperative Association. It will be brought before the committee for discussion tomorrow, Tuesday, April 4. Mr. Hutchens will be available for comments and questions.

Thank you.

MB/NJG/bhn

FAIRBANKS 20B

1 IN THE HOUSE

BY BOYER

2 HOUSE BILL NO.

3 IN THE LEGISLATURE OF THE STATE OF ALASKA

4 SIXTEENTH LEGISLATURE - FIRST SESSION

5 A BILL

6 For an Act entitled: "An Act relating to public utility regulation."

7 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

8 * Section 1. AS 42.05.381 is amended by adding a new subsection to
9 read:

10 (f) Dues or fees paid by a public utility to a trade association
11 that is tax exempt under 26 U.S.C. 501(c)(6) (Internal Revenue Code)
12 may not be disallowed as a business expense on the grounds that the
13 trade association is engaged in lobbying.

14 * Sec. 2. AS 42.05.461 is amended to read:

15 Sec. 42.05.461. CONTINUING PROPERTY RECORDS. The commission may
16 require a public utility to establish, provide, and maintain as a part
17 of its system of accounts, continuing property records segregated by
18 the year of placement in service, including a list or inventory of all
19 the units of tangible property used or useful in the public service,
20 identifying the property by location or project [SHOWING THE CURRENT
21 LOCATION OF THE PROPERTY UNITS BY DEFINITE REFERENCE TO THE SPECIFIC
22 LAND PARCELS UPON WHICH THE UNITS ARE LOCATED OR STORED]. The commis-
23 sion may require a public utility to keep accounts and records in
24 [SUCH] a manner that shows [AS TO SHOW], currently, the original cost
25 of the property when first devoted to the public service, and the
26 related reserve for depreciation. Each public utility with annual
27 revenues exceeding \$100,000 shall keep continuing property records.

28 * Sec. 3. AS 42.05.720(3) is amended to read:

29 (3) "public" or "general public" means

1 (A) a [ANY] group of 10 or more customers that pur-
2 chase the service or commodity furnished by a public utility and
3 that is located outside or makes the purchase outside the certif-
4 icated service area of the public utility; [AS DEFINED IN (4) OF
5 THIS SECTION; AND]

6 (B) a person who purchases a utility service or prod-
7 uct from a public utility and who is located in or makes the
8 purchase in the certificated service area of the public utility;
9 and

10 (C) a [ANY] utility purchasing the product or service
11 or paying for the transmission of electric energy, natural or
12 manufactured gas, or petroleum products that [WHICH] are re-sold
13 to a person or group included in (A) or (B) of this paragraph or
14 that [WHICH] are used to produce the service or commodity sold to
15 the public by the utility;

STAFF: G. Baum

BILL #: HB 72
DATE: 4/27/89

BILL TRACKING/HOUSE FLOOR FILE
Representative Dave Donley

TITLE: AN ACT CONTINUING THE A.P.U.C.

SPONSOR/S: Governor

WHAT BILL DOES: Continues APUC until June 30, 1993 (1989)

COMMITTEE REFERRALS/BILL HISTORY

COMMITTEE	VOTE (DP, DNP, NR)	CS?
<u>L+E</u>	<u>7 DO PASS</u>	<u>NO</u>
	<u>7 DO PASS (SHULTZ ABSENT)</u>	
<u>FINANCE</u>	<u>3 NO VC (GILL, DAVIS, HOFFMAN, BEIGER, WALLIS)</u>	<u>NO</u>

EXPLAIN DIFFERENCE/S IN CS: NO CS

FISCAL IMPACT: ZERO

FLOOR MANAGER: DONLEY STAFF: G. Baum PHONE: 4954

SUPPORTERS: ALL
OPPOSITION: none

FLOOR FIGHT? (WHO AND WHY) MAYBE QUESTIONS ABOUT LB+A RECOMMENDATIONS
AMENDMENTS?:
YES/NO/MAYBE NO

COMMENTS:

JANUARY 10, 1989, HOUSE JOURNAL

HOUSE BILL NO. 72 by the Rules Committee by request of the Governor, entitled:

"An Act continuing the existence of the Alaska Public Utilities Commission; and providing for an effective date."

was read the first time and referred to the Labor & Commerce and Finance Committees.

A zero fiscal note was published January 9, 1989.

The Governor's transmittal letter, dated January 9, 1989, appears below:

HB 72

"Dear Representative Cotten:

Under the authority of art. III, sec. 18, of the Alaska Constitution, I am transmitting a bill to continue the existence of the Alaska Public Utilities Commission for four years (AS 44.66.010(c)). Under current law, the commission is scheduled to "sunset" June 30, 1989 (AS 44.66.010(a)), and will go into its "wind-down" year under AS 44.66.010(b).

The purpose of the commission is to protect the public; its continuation is fundamental to the welfare of the people of our state. This protection involves overseeing the availability, cost, and quality of the utility services that are essential to daily life and of the pipeline services that are essential to the state's economy. Furthermore, the presence of a vigilant, competent regulatory commission is especially critical given the adverse economic conditions currently facing so many of our citizens, businesses, and public institutions.

I urge your early and favorable consideration of this bill so that the commission can continue to serve the public interest.

Sincerely,

/s/

Steve Cowper
Governor"

APRIL 12, 1989, HOUSE JOURNAL

The Labor & Commerce Committee has considered:

HOUSE BILL NO. 72

"An Act continuing the existence of the Alaska Public Utilities Commission; and providing for an effective date."

Recommending do pass (7): Donley (Chairman), Spohnholz, Collins, Leman, Boucher, Boyer, Gruenberg

A previous zero fiscal note by the Department of Commerce & Economic Development, published January 9, 1989, applies.

HB 72 was referred to the Finance Committee.

APRIL 25, 1989, HOUSE JOURNAL

The Finance Committee has considered:

HOUSE BILL NO. 72

"An Act continuing the existence of the Alaska Public Utilities Commission; and providing for an effective date."

Recommending do pass (7): Larson (Co-chairman), Swackhammer, Brown, Koponen, Phillips, Barnes, Ulmer
No recommendation (3): Hoffman (Co-chairman), Rieger, Wallis

A previous zero fiscal note by the Department of Commerce & Economic Development, published January 9, 1989, applies.
HB 72 was referred to the Rules Committee for placement on the calendar.

FISCAL NOTE

REQUEST:

Revision Date: _____
Title: An Act continuing the existence
of APUC
Sponsor: Rules Committee
Requestor: Governor

Agency Affected: Commerce & Econ. Dev.
BRU: APUC
Components: Operations

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 89	FY 90	FY 91	FY 92	FY 93	FY 94
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	0	0	0	0	0	0
CAPITAL	0	0	0	0	0	0
REVENUE	0	0	0	0	0	0

FUNDING: (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER						
TOTAL	0	0	0	0	0	0

POSITIONS:

FULL-TIME	0	0	0	0	0	0
PART-TIME						
TEMPORARY						

ANALYSIS : (Attach a separate page if necessary)

The proposed legislation referenced above continues the APUC as it is currently configured for an additional four years. As such, the bill has no direct incremental or decremental effect on the agency's operating budget.

Prepared by: T.S. Moninski II, Executive Director
Division: Alaska Public Utilities Commission

Phone: 276-6222

Date: _____

Approved by Commissioner: 
Agency: Commerce & Economic Development

Date: 1/2/88

Distribution (by preparer):

Legislative Finance
Legislative Sponsor
Requestor
Office of Management and Budget
Impacted Agency(ies)

HOUSE COMMITTEE ACTION - HB 72:

JANUARY 20, 1989, LABOR AND COMMERCE COMMITTEE MEETING

SUSAN KNOWLES, COMMISSIONER, ALASKA PUBLIC UTILITIES COMMISSION (APUC), reported that the commission was a public protection agency which regulates public utilities and pipelines. The primary duty of the commission was to issue certificates of public convenience and necessity for utility service areas and pipeline routes to applicants who prove they are qualified to go into business. For certificated entities, the APUC performs economic regulations in the areas of rates charged, terms and conditions of service to the public, and oversees the practices, services and facilities of the enterprises that are regulated. An additional responsibility was to compute the cost and assistance amount that are allowed to electric utilities under the power cost equalization program. Commissioner Knowles then explained that the jurisdiction of the APUC extends to cable television, electric, gas, radio common carriers, garbage, sewer, telephones, water and oil and gas pipelines. The extent of the jurisdiction depends on the type of entity, the ownership of the entity, and the size of the entity.

Additionally, Commissioner Knowles noted, consumers of these public utilities can choose an option allowable under the law to conduct elections to become deregulated from the commission.

Commissioner Knowles then explained the simplified procedures for rate-making as set forth in the statutes. At this point Commissioner Knowles passed out copies of the APUC's annual report, with explanations of each section. Commissioner Knowles ended her statements with support of HB 72, and urged the committee to pass the bill as quickly as possible.

Number 270

Rep. Leman asked Commissioner Knowles where, if any place, could the APUC reduce the budget and still provide the service that they are mandated to provide. He also inquired as to the cost reduction in areas of preparing rate cases.

Number 295

Commissioner Knowles referred to the FY 1989 plan section of the annual report, page number 80. The section regarding small utilities rate-making has been identified by the APUC as one of their objectives during the current year.

In answer to Rep. Leman's first question, Commissioner Knowles felt there could not be a reduction in the present budget and keep the standard of competency that is required.

Number 336

Rep. Leman stated that the legislators are in a position of having to make reductions, and perhaps changes will have to be made in what is now being required of different

commissions to accommodate those reductions.

Number 345

Commissioner Knowles spoke of local entities that could control and oversee some areas now under the APUC's authority. She felt that the bottom line was establishing the areas of greatest needs and using the existing resources to meet those needs.

Number 395

Rep. Leman asked Commissioner Knowles if she would be willing to work with the legislature in determining where savings could be made within the APUC budget. She answered in the affirmative.

Number 410

Rep. Collins spoke of her concern with the telecommunication expenditures, and asked for clarification from Commissioner Knowles on the impact of this issue to the consumer.

Number 425

Chairman Donley informed Commissioner Knowles that the committee had requested additional hearings to be held to investigate, in depth, cost saving measures. He then asked the commissioner if there were any additional materials that could be supplied to committee members on the issue of budget reduction. Chairman Donley also asked the APUC to prioritize their responsibilities on the basis of the constitutional mandates, the statutory mandates, and the things they are doing that are not required by law. He requested information on areas that the APUC was required to do, but felt they could not, because of insufficient resources.

Number 481

Commissioner Knowles stated that she would like to see HB 72 pass as a sunset bill.

Number 513

Rep. Leman inquired if Commissioner Knowles had information that the committee could refer to on the telecommunication case the APUC has been working on. He felt that a decision of that magnitude should be decided by policy makers of the legislature rather than the APUC.

Number 521

Commissioner Knowles felt that the issue of intrastate long distance competition was properly delegated to the expertise of the commission.

Number 575

DR. DAVID KNUTSON, ALASKA CONSUMER ADVOCACY PROGRAM (ACAP), gave support of the continuation of the APUC. He stated six points in which the ACAP offered their support.

Dr. Knudson stated he felt that only with regulation could consumers be protected from utility monopolization.

TAPE FIVE, SIDE B

Number 000

Dr. Knudson gave further testimony in support of the APUC. He suggested several books for the committee to read that dealt with the area of monopolies.

Number 238

Chairman Donley told members of the commission that he felt the key issue was program receipts versus general funds. He requested that information on this issue be given to the committee for review if it has already been gathered by the commission.

Number 275

JEFF BOHMAN, ALASKA PUBLIC INTEREST RESEARCH GROUP (AkPIRG), spoke in support of HB 72 and the APUC. He felt there were three areas for the committee to look at.

1. Consideration of the extension of the APUC.
2. The range of responsibilities of the APUC.
3. Where the funds come from for the APUC to operate.

Mr. Bohman also spoke of the need for the APUC to have additional staffing and greater computer capabilities.

Number 364

LEE NUNN, representing the MUNICIPALITY of ANCHORAGE, told Chairman Donley they would like to work with the legislature very closely in regards to HB 72. He explained that there are four municipalities within Anchorage that come under the control of the APUC:

1. Municipal Light and Power
2. Anchorage Water and Waste Water
3. Solid Waste Water
4. Anchorage Telephone Utilities

Mr. Nunn objected to the funding to the APUC for the rate case costs of Anchorage Telephone Utilities. He felt that a large portion of the reason for those costs was due to the liberal interpretation clause in the existing legislation. He stated that the APUC's charter needs to be more precisely defined so as to have narrower bounds on the rate cases that come before it.

Mr. Nunn stated he felt that precise language was needed to allow municipalities to become deregulated and that the Anchorage Borough Assembly could oversee these entities.

Number 445

Rep. Leman asked for clarification on the APUC statute in regards to deregulations. He then asked Commissioner Knowles the differences between private utility regulation and municipality regulation.

Number 507

Mr. Nunn stated that he supported the philosophy of the APUC, but for private utilities only.

Number 570

Chairman Donley asked for clarification on the APUC statutes that place the ML&P (Municipal Light & Power) under APUC regulation. He then inquired of Commissioner Knowles as to the language involved for a utility to deregulate.

TAPE SIX, SIDE A

Number 000

CAROLYN GUESS, member of the APUC, spoke in support of HB 72 as sunset legislation.

Ms. Guess asked the committee to explore avenues of

rate-payer concepts and utility-payer concepts. She volunteered information that the APUC had gathered on these items for committee review.

Number 099

Chairman Donley explained dedicated funds versus general funding, with the understanding that both types have to go through the budget process.

Number 161

KATHLEEN WHITAKER, MEMBER OF THE APUC, spoke in support of HB 72. She felt that regardless of the decision to allow competition in long distance communication, someone will have to manage those areas. Ms. Whitaker commented that the best manager was the existing one, the APUC.

Number 210

JACK HUGES, VICE PRESIDENT OF GCI, urged the committee to accept competition in telecommunications for the state of Alaska.

Mr. Huges stated that the legislature needed to set forth appropriate policy guidelines with regards to the regulation of telecommunication within the state of Alaska. Mr. Hughes preferred that the committee address the broader issues in regards to continuation of the APUC at this time, rather than just the sunset issue.

Number 288

Rep. Leman inquired if Mr. Hughes had seen any records comparing Alascom's profit and loss since the arrival of GCI.

Mr. Hughes responded that GCI had originally stated that Alascom would not suffer a profit loss with competition and felt that the last six years proved there was a market for telecommunication competition within the state of Alaska.

Number 341

Chairman Donley adjourned the teleconference at 11:40 a.m.

FEBRUARY 2, 1989, LABOR AND COMMERCE COMMITTEE MEETING

Chairman Donley called the House Labor and Commerce Committee meeting to order at 3:00 p.m. He announced the meeting was a WORK SESSION for HB 48 and HB 72. WORK SESSION tapes of the meeting can be found at the House Labor and Commerce Committee Room, Capitol Building #17, or the Legislative Reference Library. Chairman Donley adjourned the meeting at 4:00 p.m.

FEBRUARY 14, 1989, LABOR AND COMMERCE COMMITTEE MEETING

Chairman Donley established subcommittees for HB 72, the Alaska Public Utilities Commission (APUC) bill. The breakdown was as follows:

1. Telephone: Rep. Gruenberg, Rep. Boucher, Rep. Collins
2. Electric: Rep. Boyer, Rep. Spohnholz, Rep. Leman
3. Solid Waste: Rep. Boucher, Rep. Leman
4. APUC Issues: Rep. Donley, Rep. Boyer
5. Misc. Issues: Rep. Donley, Rep. Gruenberg

Donley

A PERFORMANCE REPORT ON THE
DEPARTMENT OF COMMERCE AND
ECONOMIC DEVELOPMENT
ALASKA PUBLIC UTILITIES COMMISSION

February 14, 1989

Audit Control Number

08-1354-89-R

Commissioner, Department of
Commerce and Economic Development Larry Mercurieff

Deputy Commissioner, Department of
Commerce and Economic Development Jeffrey W. Bush

Members of the
Alaska Public Utilities Commission

Chairperson	Susan M. Knowles
Member	Carolyn S. Guess
Member	Peter Sokolov
Member	Louis E. Agi
Member	Kathleen L. Whiteaker

STATE OF ALASKA

AUDIT DIVISION
P.O. BOX W
JUNEAU, ALASKA 99811-3300

THE LEGISLATURE

BUDGET AND AUDIT COMMITTEE

February 21, 1989

Members of the Legislative Budget
and Audit Committee:

In accordance with the provisions of Titles 24 and 44 of the Alaska Statutes, the attached report is submitted for your review.

A PERFORMANCE REPORT ON THE
DEPARTMENT OF COMMERCE AND
ECONOMIC DEVELOPMENT
ALASKA PUBLIC UTILITIES COMMISSION

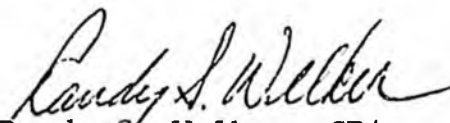
February 14, 1989

Audit Control Number

08-1354-89-R

The objectives of this audit were to examine the activities of the Alaska Public Utilities Commission to determine if there is a demonstrated public need for its continued existence and if the commission has been operating in an efficient and effective manner.

The audit was conducted in accordance with generally accepted governmental performance auditing standards. Audit scope and methodology are discussed in the Report Objectives, Scope, and Methodology section of this report. Audit results may be found in the Report Conclusions, Findings and Recommendations, and in the Analysis of Public Need sections of this report.



Randy S. Welker, CPA
Legislative Auditor
Division of Legislative Audit

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REPORT OBJECTIVES, SCOPE, AND METHODOLOGY

In accordance with the intent of Titles 24 and 44 of the Alaska Statutes, we have examined the activities of the Alaska Public Utilities Commission (hereinafter referred to as APUC or the commission) to determine if there is a demonstrated public need for its continued existence and if the commission has operated in an efficient and effective manner.

Legislative intent requires consideration of this report during the legislative oversight hearings to determine whether APUC should be reestablished. The law now specifies that the commission will terminate June 30, 1989 and have one year from that date to conclude its affairs.

The policy and audit approach utilized by the Division of Legislative Audit for performance reports can best be described as "audit by exception." This methodology focuses audit effort on areas of an auditee's operations that have been identified by a preliminary survey as having a high degree of probability for needing improvements.

Therefore, by design, finite audit resources are used to identify where and how improvement can be made, and little time is devoted to reviewing well-run operations or programs. Consequently, this report highlights those areas needing improvement and does not emphasize those operations and programs that are properly functioning.

Discussion of the objectives, scope, and methodology of our review follows.

Objectives

APUC was created to regulate public utilities so that citizens could enjoy adequate service at the lowest reasonable rates. The primary objective of this audit, therefore, was to determine whether the public need for the commission continues to exist.

The secondary objective was to review the commission's major functions, namely certification of utilities, tariff actions, investigations, and complaint follow-up for effectiveness in meeting the public need. The tertiary objective was to evaluate these functions in particular, and the APUC's operations in general, for economy and efficiency of operation.

Our analysis of public need, findings and recommendations, and our conclusions have been summarized in the appropriate sections of this report.

Scope and Methodology

The primary emphasis of our audit was on the factors outlined in the Analysis of Public Need section of this report. Alaska Statute 44.66.050 requires that these factors be considered in the determination of the commission's continued existence. To address these areas, we analyzed the need for regulation of the various industries, reviewed pertinent academic literature, considered the regulatory status and trends nationwide, interviewed commissioners and staff, reviewed APUC's statutes and regulations, contacted the State Ombudsman and the Equal Employment Opportunity offices, analyzed consumer complaints against utilities filed with the commission, and reviewed decisions made by the commission.

The effectiveness and efficiency of the commission was addressed through the above procedures and also by contacting and requesting assistance from all certificated utilities and by reviewing individual files.

Our review of decisions, complaints, tariff actions, hearings, investigations, and certifications was performed primarily on a sample of FY 88 items. These were selected on a judgmental basis to allow us to focus on certain activities and industries.

ORGANIZATION AND FUNCTION

Public utility regulation in Alaska has evolved substantially since the creation of the Public Services Commission (PSC) in 1959. That three-member body had jurisdiction over electric power, heat, water, gas, oil or other petroleum products (except by pipeline), telephone or telegraph communications, and community sewer services. In 1960 PSC gained responsibility for transportation utilities which it regulated until the creation of the Alaska Transportation Commission in 1966.

PSC was replaced by a three-member Alaska Public Utilities Commission in 1970. Regulated industries then included electrical, telecommunications, water, steam, sewer, gas, and petroleum when no competition existed. A 1973 amendment added garbage, refuse, trash or other waste to the list. Amendments passed in 1980 provided exemptions from economic regulation for cable television services and other utilities with low annual gross revenues as well as establishing a provision allowing economic deregulation by consumer vote for certain utility groups. With abolition of the Alaska Pipeline Commission in 1981, jurisdiction over pipelines passed to APUC.

In addition to jurisdictional changes, composition of APUC also changed. Alaska Statute 42.05.040 originally required one member to be a law school graduate, one to be a university graduate with a major in engineering, and one to be a university graduate with a major in finance, accounting, or business administration. Two additional positions were added to the commission in 1975 for which no special qualifications were established. All members are appointed by the Governor and confirmed by the Legislature for six-year terms.

Under AS 42.05 and AS 42.06, APUC is charged with the responsibility to ensure the furnishing of adequate service to all public utility patrons, without discrimination, and at the lowest reasonable rates consistent with the interests of both the public and the utility. Statutory provisions direct the commission, after determining an applicant is fit, willing, and able to provide utility service, to issue that applicant a Certificate of Public Convenience and Necessity. After issuance of this certificate the commission then regulates the rates, classifications, rules, regulations, practices, services, and facilities of a public utility, unless it is exempted or deregulated. The commission has the authority to adopt regulations and to hold formal, quasi-judicial hearings to accomplish these purposes.

The staff of APUC is divided into six major functions: administration, engineering, communications carriers, consumer protection, finance, and tariffs. In total, APUC employs 40 people with an operating budget for FY 89 of \$3,884,100. A brief description of the services provided by those functions follows:

Administration. An executive director, hired by the commission, is responsible for directing all staff functions and acts as a liaison between staff and commissioners and between the commission and legislature. He is responsible for records and document management, fiscal and personnel administration, and budget preparation and is assisted in these duties by an administrative assistant, document processing personnel, and other clerical support staff.

Engineering. This section is responsible for the investigation of utility procedures and practices affecting quality of service, review of legal descriptions for service areas, plans for plant expansion, and plant-in-service and depreciation schedules. Their evaluations are presented in proceedings before the commission.

Communications Carriers. This section was established by 1976 legislation to develop, recommend, and administer policies and programs with respect to the regulation of rates, services, accounting, and facilities of communications common carriers within the State involving the use of wire, cables, radio and space satellites.

Consumer Protection and Information. Major responsibilities for this section include investigation and resolution of consumer complaints, public relations, and information dissemination.

Finance. Activities carried out by this section include the examination, analysis, and evaluation of financial statements submitted for rate cases, audits of financial records of utilities, examination of financial information comprising historical operating year and pro forma adjustments, and the presentation of these analyses at proceedings before the commission.

Tariff. This section examines, analyzes, and investigates tariff filings and presents recommendations to the commission at biweekly tariff action meetings. Administrative functions include organizing those meetings, as well as meeting all public notice requirements on tariff filings and maintenance of current master tariffs for all utilities.

REPORT CONCLUSIONS

Policy Issues

This review contains policy issues raised as a result of our evaluation of various commission practices. The final policy decisions affecting those practices are not within the scope of this review but require legislative consideration. In debating these decisions the legislative oversight committees should take into consideration the findings and recommendations presented in this report to assist them in evaluating the potential impact of any policy changes.

Report Conclusions

In our opinion, the Alaska Public Utilities Commission is operating in an efficient and effective manner and should continue to regulate public utilities and pipelines. We believe that the public interest is being served by requiring public utilities and pipelines to be certificated by APUC. This process stabilizes demand for the utility service by eliminating competition and thereby allowing economies of scale to operate. Economic regulation by the commission, in place of that competition, ensures that the utilities provide adequate service at the lowest reasonable rates.

Although this economic justification is valid for the majority of utilities regulated by APUC, we evaluated their jurisdiction for potential areas of deregulation for several major reasons: (1) to comply with the intent of sunset legislation which attributed public disenchantment with state government to a proliferation of that government; (2) in recognition of the fact that the cost of regulation may exceed its benefits; (3) the increased demands being placed on commission resources; and (4) the State's ability to provide those resources.

Our analyses revealed several industries where regulation could be eliminated with minimum negative public impact. Our initial criteria was whether the service was essential for modern living to the average Alaskan and, if so, whether the industry operated as a natural monopoly. Although it is uncertain whether rates under deregulation would be higher or lower, deregulation should provide benefits such as competitive alternatives to existing services and more innovative services and rate designs. Additionally, services may be provided in areas not previously served as a result of eliminating the barrier to entry into the marketplace that has been erected by certification and the cost of regulation. While refuse collection services may be considered essential by many, this industry is not a natural

monopoly and should not be regulated (See Recommendation No. 1A). Radio communication carriers do not provide an essential service and also should not be regulated (See Recommendation No. 1B). Cable television may be considered essential by many and may also be a natural monopoly in the small and medium size towns. However, the statutes have created state sanctioned monopolies without the companion public protection against unreasonable and discriminatory rates and services. Further, federal law prohibits full economic regulation. The State should cease cable certification (See Recommendation No. 1C).

We are also convinced that small utilities should be exempted from economic regulation on the basis that the cost of regulation likely exceeds its benefits to consumers. We further recommend that the consumers of these exempted utilities be allowed a reasonable opportunity to elect economic regulation (See Recommendation No. 1D).

We recommend that the utilities owned by the Municipality of Anchorage be exempted from economic regulation. This exemption and the companion opportunity to elect economic regulation should be available to Anchorage as it is to all other municipal governments in the State (See Recommendation No. 1E).

We believe that the commission's costs should be fully allocated to consumers, but only to those consumers of utilities who continue to be regulated. We consider this regulatory funding approach to be most equitable to all the State's citizens. It should also encourage the elimination of any unwarranted economic regulation when combined with consumer regulatory elections (See Recommendation No. 2).

We recommend that APUC develop a topical reference system for commission orders and court decisions (See Recommendation No. 3).

A review of commissioner appointments showed that appointment terms expire on the same date for the two consumer members. As this situation could cause a significant disruption of commission activity, we recommend that the statute be changed to require the staggering of these appointments (See Recommendation No. 4).

FINDINGS AND RECOMMENDATIONS

Recommendation No. 1

Alaska Statute 42.05 should be amended to eliminate certain unnecessary regulatory functions of APUC.

Public convenience and necessity require certain services to be provided. Such services have traditionally included electric, telephone, gas, water, and sewer. The nature of these businesses do not lend themselves to competition; they are capital intensive and have permanent physical connections to their customers. The economies of scale of these industries are such that one company may be able to serve an entire market at a lower cost than could two or more companies; therefore, competition could not decrease prices to consumers in the long run and would only result in wasted capital resources through duplicate facilities. Note that this "natural monopoly" relates not only to the relationship between fixed and variable costs but also to the characteristics of the market. As these services are considered essential and as the long-run cost is lowest if only one company is allowed to serve, a monopoly is awarded in the form of a Certificate of Public Convenience and Necessity to a company that is determined to be fit, willing, and able.

As these services are essential, the demand for them is relatively inelastic in terms of service price or available funds. A monopoly coupled with inelastic demand can result in excessively high prices as well as price and service discrimination between consumers. Uncontrolled economic power has been considered economically, politically, and socially unacceptable in a democratic society. The alternatives are to nationalize the utilities or to regulate their services as a substitute for effective competition, with regulation being the preferred method. Regulated public utilities are required to make specified service levels available at approved rates to all consumers in their designated service areas.

In addition to the concerns over economic power, the public interest may also serve to extend regulation into situations where competition would have significant undesirable side effects on the quality of life in the area. For example, competition could create a black forest of utility poles or the continual digging to bury cables or pipe.

However, it may not be appropriate to economically regulate all certificated utility companies. For example, the cost of regulation may outweigh its potential benefits or the consumer's control over service and rates that already theoretically exists in that the company is a member-owned cooperative or it is owned by a political subdivision.

Further, overriding all the above considerations, the public interest being addressed must represent a substantial portion of the State's population; unique situations should be addressed at the local level.

While we acknowledge that not everyone will subscribe to this theory of regulation, we believe it to be fundamentally sound. Utilizing these principles, we analyzed APUC's jurisdiction and determined that governmental control in the following areas was unwarranted.

- A. Alaska Statute 42.05 should be amended to cease certification and regulation of companies furnishing collection and disposal service of garbage, refuse, trash, or other waste material.

Whether an individual considers refuse collection to be an essential service for modern living depends primarily on where they reside in the State. However, even essential services should generally not be regulated unless they are natural monopolies. For example, we do not believe that essentials such as food and clothing should be regulated.

Refuse collection, as with most enterprises, has certain economies of scale that affect its operations. However, these economies of scale are not such that one company can obviously provide the area-wide services for a significantly lower total cost than could several competitors. Relative to traditionally-regulated industries, refuse collection requires less capital, and thus they have a higher percentage of variable costs and less significant economies of scale. Further, the competition within service areas in several locations defeats the natural monopoly premise in the larger markets. We believe that a natural monopoly could occur in this industry in only the very small markets and that these do not warrant regulation due to the cost to benefit relationship.

Therefore, refuse collection should not be regulated unless there are overwhelming negative side effects present under competition in this industry. We acknowledge the possible negative effects of increased truck traffic, refuse pickup scheduled throughout the week in individual neighborhoods, and consistency problems as companies adjust to the economic realities of competition. However, these problems did not overwhelm the residents of the Mat-Su Borough as a result of the residential competition which began in 1985. Further, the Alaska Municipal League has adopted a resolution asking that refuse collection be de-regulated.

In response to our previous sunset audit recommendations to deregulate this industry, APUC expressed concern over the health and sanitation problems that could occur if these companies were removed from their jurisdiction. These health and sanitation issues are presently under the jurisdiction of local communities and also the Department of Environmental Conservation.

There are presently forty-three certificated refuse companies; nine of these are economically regulated under AS 42.05.711, as they have annual gross revenues of greater than \$200,000. Although APUC has no time sheet data upon which to estimate the cost to regulate these forty-three companies, the commission states in their FY 88 Annual Report that the time dedicated to refuse is excessive relative to agency resources and the resultant public benefit, and they recommend that this industry be deregulated.

B. Alaska Statute 42.05 should be amended to cease certification and regulation of radio common carriers.

There are currently ten certificated radio common carriers in Alaska. Radio Common Carrier (RCC) services include radio paging, mobile radiotelephone, and improved mobile telephone public utility services.

The commission opened an investigative docket on the subject of deregulation of RCCs in 1981 which resulted in a 1982 decision to cease economic regulation of this industry. The commission cited as justification, among other things, that RCC service was not an essential service. As RCC service is not essential to the average Alaskan, we concur with the commission that it should not be economically regulated. We further contend that services that are not essential should not be certificated.

In that 1982 decision, APUC stated that the certification process should be continued to monitor the interconnection to the telecommunications network and to prevent cross-subsidization of non-monopoly RCC services by monopoly local exchange telephone services. However, both these concerns can be monitored through the continuing processes of certification and economic regulation of local exchange services.

Cellular phones are relatively new to Alaska, and APUC has not yet decided if or how they should be regulated. We understand these phones provide a higher sound quality at a higher cost than conventional radio phones and over a shorter range; as such, they may be even less of an essential service to the average Alaskan.

Alaska Statute 42.05.711(d) reads as follows: "The commission, on a finding that no legitimate public interest will be served, may exempt a utility from all or any portion of this chapter." [Emphasis added.] As the 1982 decision categorically deregulated an entire industry, not an individual utility, this order may be illegal. We are not recommending that this statute be amended to allow categorical deregulation, as this power should be retained by the Legislature. Rather, we are recommending that the statute be amended to specifically deregulate RCC services; this would incidentally resolve the question.

C. Alaska Statute 42.05 should be amended to cease certification of cable television.

We do not consider cable television an essential service, particularly in view of the large number of Alaskans who receive off-the-air network television or broadcasts from the Rural Alaska Television Network. The premise of "essential" is also defeated by a review of the cable television service in Anchorage in which large sections of the service area are not yet cabled 9 years after the certification was awarded. The 1988 service expansion added only 1 mile of cable for 83 homes and businesses. While we acknowledge that it takes years for a new utility to cover a service area, we submit that this standstill, even in consideration of the economic decline, indicates that this service has a higher elasticity of demand than would an "essential" service.

As it is not an essential service, it should not be regulated as a public utility. Although the statutes do not allow economic regulation, they do require certification of the companies. APUC has responded by issuing certifications for exclusive service areas. This has created state-sanctioned monopolies with legally protected service areas, yet the statutes do not provide the companion public protection against unreasonable and discriminatory rates and services. The statute should, therefore, be amended to remove the certification requirement.

However, there are many who believe that cable television is essential to modern living or that it is essential so that we may fully realize our First Amendment right of freedom of speech. If it is first decided that cable television is essential, then the natural monopoly issue must also be considered in the regulatory determination.

We believe that cable television may be a natural monopoly in the small and medium-sized towns. As such, these may be candidates for economic regulation. However, the cost of regulation may outweigh the benefits for these small markets. The economic regulation that is available is also limited to basic services, as the federal Cable Communications Policy Act of 1984 prohibits price regulation of the premium packages. In the largest cities, the competitive environment indicates that there is not a natural monopoly present for cable television, thus certification and economic regulation is inappropriate.

The federal Cable Act was designed to promote the expansion of cable television systems by promoting local franchising and limiting rate regulation. This law would not allow any rate regulation in Anchorage or Fairbanks but would allow basic service rates to be regulated in other areas such as Juneau or Homer. It does, however, appear to allow us control over the possible competitive side effect of duplicate cabling. By statute we could require the segregation of cable distribution companies and these could be fully regulated. The cable programming could then be opened to competition.

In summary, regardless as to whether or not cable television is viewed as essential, we recommended that the present certification requirement be deleted from the statute. To the extent that this service is deemed essential, municipal franchising or certification and regulation of distribution-only companies should be considered.

We also must point out a potential liability to the State under the Cable Act if this recommendation is implemented. The Cable Act outlines specific criteria which must be shown to deny a franchise and the proposed statute amendment would categorically retract the certificates (franchise) without this showing. However, the Attorney General's Office indicated to us that the State would prevail in court. We recommend that a formal opinion on this potential liability be obtained from the Attorney General before this statute is amended.

- D. Alaska Statute 42.05 should be amended to exempt the smaller utilities from economic regulation.

Electric, telephone, gas, water, and sewer utilities have traditionally been considered essential services and are often natural monopolies. Nevertheless, we should refrain from economic regulation if its cost

exceeds the benefits. However, this information is not available nor can it be reasonably generated. "Cost" would include incremental APUC and utility time and materials as well as the effect of project delays on long-term rates; this component of the equation could be studied and estimated. The "benefits" of regulation include a financially stable utility providing consistent service uniformly to customers who are assured of equitable rates and services now and in the future; this cannot be quantified.

Nevertheless, in consideration of the State's dwindling resources and the public's disenchantment with the proliferation of state government, we believe that it is appropriate for us to presume that the cost of regulation presently exceeds its benefits for many smaller utilities and that the gross revenue exemption levels provided in the statutes should be raised.

Alaska Statute 42.05.711 exempts electric and telephone utilities with gross revenues under \$50,000 from certification and economic regulation. It also allows a utility's consumers to elect economic deregulation for cooperatives, electric or telephone utilities with less than \$325,000 in annual gross revenues, and for any utility which does not gross \$100,000 annually. We propose that an across-the-board gross revenue-based exemption from economic regulation be established. Three options are presented in the following table. It was prepared based upon APUC's FY 88 Annual Report and represents all utilities that are currently economically regulated with the exclusion of the industries we have recommended for categorical deregulation.

Number of affected utilities and customers, based upon gross revenues:

Type	Under \$500,000		Under \$750,000		Under \$1,000,000	
	Util.	Customers	Util.	Customers	Util.	Customers
Electric	10	819	15	1,990	18	2,691
Telephone	-0-	-0-	1	343	2	863
Gas	-0-	-0-	-0-	-0-	1	908
Water	22	3,715	22	3,715	22	3,715
Sewer	2	15	3	382	3	382
<u>Total</u>	<u>34</u>	<u>4,549</u>	<u>41</u>	<u>6,430</u>	<u>46</u>	<u>8,559</u>
<u>Percent</u>	<u>40.5%</u>	<u>.8%</u>	<u>48.8%</u>	<u>1.1%</u>	<u>54.8%</u>	<u>1.5%</u>

The above percent calculations represent the reduction in the coverage of economic regulation under each revenue scenario; however, we caution the inference from the table that APUC's workload would decrease

proportionate to the decrease in the number of utilities. While there certainly should be some relationship, the commission has no time sheet data available to correlate these factors.

In concert with an amendment to exempt these smaller utilities, the following areas should also be addressed:

1. The petition provision which allows customers to request economic regulation of exempted utilities should be amended. Alaska Statute 42.05.711 presently requires 25% of an exempted utility's subscribers to sign the petition. We believe that this is much too great an obstacle to overcome and recommend that an election be called if APUC receives a petition demonstrating significant consumer interest. For example, the petition requirement could be set at the lesser of 5% or 500 customers.
2. This proposed gross revenue exemption statute should not take effect for 6 months to allow utility customers who wish to retain regulation to do so without interruption.
3. The results of past deregulation elections should be honored, thus not requiring a new vote on failed deregulation elections.
4. The customers who continue the benefits of APUC's economic regulatory oversight should be expected to pay for this service (See Recommendation No. 2).

E. Alaska Statute 42.05 should be amended to cease mandatory economic regulation of certain utilities owned by political subdivisions.

Alaska Statute 42.05.711(b) generally exempts utilities owned by political subdivisions from economic regulation, unless they so elect. However, it also provides that if any of a subdivision's utilities directly competes with any other certificated utility then all the subdivision's utilities shall be economically regulated. We presume the intent of this provision was to eliminate the wasting of resources from facility duplication resulting from the then ongoing electric service area dispute as well as preventing the cross-subsidization of rates which might accompany such a dispute. The only utilities falling under this provision, at present, are owned by the Municipality of Anchorage.

The Anchorage service area dispute has been resolved and the present day competition is in the form of economy energy sales of electricity and perhaps telephone communication systems. This type of competition does not encourage the massive facility duplication or the cross-subsidization of rates that a service area dispute might. Service area concerns can be adequately addressed through the certification process without economic regulation.

In conjunction with an amendment to delete this mandatory economic regulation, the following areas should also be addressed:

1. The utilities previously regulated by APUC due to competition should continue to be so regulated unless rejected by the governing body.
2. A governing body should be allowed to withdraw a previous election.
3. The consumers who, through their local government, have chosen to continue the benefits of APUC's economic regulatory oversight should be expected to pay for this service. Specifically, the Municipality of Anchorage Assembly should decide whether their utilities should be regulated locally or by APUC. If they choose to "hire" APUC to perform this regulatory function in their behalf, citizens from all across the State should not be forced to pay for that service with General Funds (See Recommendation No. 2).

Recommendation No. 2

Alaska Statute 42.05 and Alaska Statute 42.06 should be amended to more fully allocate the costs of regulation.

APUC is currently being funded primarily by General Funds with a program receipts supplement from partial direct allocations of cost. The statutes require the cost of investigations and hearings to be allocated among the parties, including the commission, as is just under the circumstances. The commission has traditionally not allocated costs to itself and has allocated only the hired consultant fees, attorney general services, and other incremental out-of-pocket costs. In a 1988 decision, the Alaska Supreme Court interpreted the present statutes on cost allocations to disallow attorney general services. The court also remanded the case back to the commission to determine what portion of the cost allocation they should absorb.

Basic fairness prescribes that only the consumers who benefit from the regulatory services provided by APUC should pay the cost of this service. This is the "user fee" concept of funding. A funding method should also be designed to allow responsive adjustments to be made in the level of regulation as desired by consumers. With these criteria in mind, we have briefly commented on three predominate alternatives.

To the extent of its general funding, any approach fails to equitably match the regulatory cost to the consumers who benefit. General funding may be viewed as a payment by all citizens all across the State, while the benefit may accrue primarily to consumers in Anchorage. The utilities owned by the Municipality of Anchorage have contributed greatly to the commission's workload, yet a significant portion of the total cost of the proceedings is paid out of General Funds.

General funding is also less responsive to appropriate regulatory levels; in fact, it probably wastes some of the State's dwindling resources. Given that there is a regulatory cost/benefit break-even point and that certain consumers are given the opportunity to elect full economic regulation, general funding will likely be perceived as payment by "someone else" with the result that regulation will always be extended past this break-even point. Thus, government is providing an unnecessary service.

Funding of APUC through a gross receipts tax levied against the utilities and pipelines that is passed through to consumers could provide a reasonable matching of costs to beneficiaries. This assumes tax rates were established by utility size, by industry, and by level of regulation. However, there would always be inequities.

This tax approach would be responsive to regulatory needs only to the extent that the matching is accurate. However, taxation has traditionally focused on ability to bear rather than resource utilization and, thus, such a funding approach may not be responsive. For example, if a tax was designed which levied 100% of the commission's costs against the pipeline companies and none to the utilities, this approach would do nothing to reduce unnecessary regulation of the utilities.

Full and direct allocation of the commission's costs provides the most accurate and defensible matching among the three alternatives. As such, it would not only be an effective method in eliminating unwarranted government regulation but it could also make the regulatory process more efficient by encouraging adequate and appropriate filings.

To administer this full allocation program would require time sheets for commission staff and attorney general

services, and the use of account codes to share docket proceeding costs among the parties and to allow recovery of general overhead. The administrative cost of this program should be less than with the tax approach but, of course, greater than with the General Fund design. These costs could potentially be offset by increased staff efficiency through time sheet accountability. We believe the benefits of a full-cost allocation program would far outweigh a slightly higher administrative cost.

Based upon the above, we recommend that the statutes be amended to establish a full-cost allocation funding approach for APUC. In conjunction with this shift toward program receipts funding, AS 42.05.651 and AS 42.06.610 should be amended, as follows:

1. These statutes should be amended to specify that all costs of the commission may be allocated.
2. Alaska Statute 42.05.651 should be changed to require interim allocation, rather than awaiting completion of a proceeding. The commission has estimated their unbilled utility allocations at \$1.6 million with an average age of 3.0 years. We note that the related pipeline statute, at AS 42.06.610, already requires interim billings. However, APUC does not appear to be in compliance, with their estimated unbilled pipeline allocations at \$2.1 million with an average of 4.7 years. Further, APUC should amend their regulation at 3 AAC 48.157 which provides for cost allocations after pipeline hearings rather than on the required interim basis.
3. These statutes presently require allocation to the parties of a proceeding including the commission; these should be modified to exclude the commission. However, the provisions allowing the commission to allocate among the parties as is reasonable and just should be retained, thus the commission may occasionally absorb some costs indirectly and have a need for minimal General Fund monies.
4. For economically regulated companies, on a case-by-case basis, the commission should be allowed to determine whether the costs being allocated are to be passed through to the consumers.

Recommendation No. 3

APUC should develop a topical reference system for commission orders and court decisions.

The commission is a quasi-judicial agency which issues decisions based upon finding of fact and conclusions of law.

These decisions are in the form of written orders that have the effect of law and are subject to judicial review.

The commission's orders are filed chronologically and also within the docket (case) files. Decisions from the courts on appeals of commission orders are filed with the related docket. However, no topical cross-reference system is maintained.

At present, the best catalog of prior actions is institutional memory. Obviously, such a memory-based system cannot provide true access to precedent when needed by commissioners, staff, utilities, consultants, and attorneys. A cross-reference system would allow analysis by staff and decisions by the commission to be made consistently from case to case and in accordance with relevant court decisions. It would also aid utilities and their consultants and attorneys to adequately prepare for filings and hearings.

The Legislature, in conjunction with their FY 89 appropriation to APUC, provided the following: "It is the intent of the Legislature that the commission use the additional permanent part-time position to develop a keyword index filing system for all future commission orders and that prior year orders be incorporated into the system as possible." However, the part-time position was not actually authorized and the system has not yet been designed.

Recommendation No. 4

Alaska Statute 42.05.030 should be amended to stagger the appointments of the two consumer members of the commission.

In 1975 the commission was expanded from three to five commissioners. Appointments were made to both the new positions for the standard six-year terms with both terminating on the same date. All other APUC commissioner terms have been appropriately staggered. Because the potential for disruption of commission activity would be high with two new commissioners coming on at the same time, we recommend the terms of the consumer members be staggered.

Currently, the terms are scheduled to end as follows:

Consumer seats (2):	November 1, 1993
Engineering seat:	October 31, 1990
Finance seat:	October 31, 1992
Legal seat:	October 31, 1994

The statute required the governor to stagger the initial appointments. However, as this was not done for the consumer members, we recommend the statute be amended to also require the necessary staggering of subsequent appointments.

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ANALYSIS OF PUBLIC NEED

Limited Analysis

The following analyses of commission activities indicate both positive and negative factors as they relate to the public need factors defined in AS 44.66.050. These analyses were not intended to be all-inclusive, but address those areas we were able to cover within the scope of our review.

1. The extent to which the board, commission, or program has operated in the public interest.

The commission has conscientiously attempted to allow only qualified applicants to provide utility services and to regulate them in such a manner as to ensure adequate service at the lowest reasonable rates. In finding that no public interest would be served through regulation, APUC administratively exempted some utilities through the discretionary power granted at AS 42.05.711(d).

2. The extent to which the operation of the board, commission, or agency program has been impeded or enhanced by existing statutes, procedures, and practices which it has adopted, and any other matter, including budgetary, resource, and personnel matters.

The Alaska Public Utilities Act (AS 42.05) and Pipeline Act (AS 42.06) provide broad discretionary power to the commission to carry out its mandated responsibilities. The jurisdiction provided under these statutes should be limited to require regulation only of industries where the greatest public interest may be served (See Recommendation No. 1).

The budgeting approach and the statutes should be modified to fully allocate the commission's costs to consumers, but only to those consumers of utilities who continue to be regulated. We consider this regulatory funding approach to be most equitable to all the State's citizens. It should also encourage the elimination of any unwarranted economic regulation when combined with consumer regulatory elections (See Recommendation No. 2).

The commission has not developed a topical reference system for commission orders and court decisions (See Recommendation No. 3). APUC has not been successful in obtaining additional personnel or funding for this task.

3. The extent to which the board, commission or agency has recommended statutory changes which are generally of benefit to the public interest.

In their FY 88 Annual Report, APUC highlighted certain problems they perceive with the current statutes and also outlined options and recommended solutions.

APUC broached the question of who should pay the cost of regulation and also presented several options on a public policy level. However, they placed the emphasis on agency funding, rather than on equity to the State's citizens or on the potential elimination of unwarranted regulation (See Recommendation No. 2).

The commission recommended that the statutes be amended to allow interim billing of cost allocations for utilities, similar to that allowed for pipelines. We concur, however, we believe that these billings should be required, and we assert that they are in fact already required for pipeline cases (See Recommendation No. 2).

The commission recommended a statute change to allow them to increase certificate application fees to fully reflect the cost of processing these filings. We would concur if it were not for our recommendation which would effectively allocate these costs on a comprehensive basis (See Recommendation No. 2).

APUC also recommended that the exemption scheme at AS 42.05.711 be reviewed and revised. We agree and have outlined our suggestions at Recommendation No. 1. The commission specifically recommended the deregulation of refuse collection.

They requested clarification of AS 42.05.431 which establishes the power of the commission to fix rates. APUC is uncertain how the dispute resolution procedures under subsection (b) could be used to renegotiate wholesale power contract rates if the commission finds them to be unjust and unreasonable.

The commission suggested that, if the Legislature intended for utilities who are not economically regulated to pay interest on customer deposits, AS 42.05.711 should be amended to reflect this intent. They further recommended that unclaimed deposits not be escheated to the State. We disagree with this second recommendation, as it may provide a disincentive to locate the true owners of these funds.

4. The extent to which the board, commission, or agency has encouraged interested persons to report to it concerning the effect of its regulations and decisions on the effectiveness of service, economy of service, and availability of service which it has provided.

Formal proceedings are properly and timely noticed and are open to the public. The commission has held public hearings and formal proceedings within the service areas of the utilities before them to facilitate public attendance and participation. APUC also staffs a Consumer Protection and Information Section to resolve complaints and disseminate information.

5. The extent to which the board, commission, or agency has encouraged public participation in the making of its regulations and decisions.

All formal proceedings, including hearings on proposed regulations, are noticed and open to the public. Any interested person or party may intervene in a formal proceeding if that intervention will benefit, but not unduly delay the proceeding. The commission has also held informal workshops with attorneys and utility representatives in an attempt to be more responsive to the needs and concerns of those groups.

6. The efficiency with which public inquiries or complaints regarding the activities of the board, commission, or agency filed with it, to the department to which a board or commission is administratively assigned, or with the Office of the Ombudsman have been processed and resolved.

The commission has adopted regulations for informal and formal complaint procedures. Procedures include a requirement that the complaint be made first with the utility before being filed with the commission. If the complaint cannot be resolved informally, formal procedures, including an investigation, may be initiated. The Office of the Ombudsman also occasionally handles utility or APUC-related complaints. We found the complaint resolution process to be operating satisfactorily.

7. The extent to which a board or commission which regulates entry into an occupation or profession has presented qualified applicants to serve the public.

The commission, prior to granting a Certificate of Public Convenience and Necessity to a public utility, is required to determine that the applicant is fit, willing, and able to provide the service. APUC employs

utility financial analysts and utility engineers to perform the necessary analyses to make this determination.

8. The extent to which state personnel practices, including affirmative action requirements, have been complied with by the board, commission, or agency to its own activities and the area of activity or interest.

We found no evidence of hiring practices or commission appointments that are contrary to state personnel practices. No complaints have been filed with the Human Rights Commission or the Division of Equal Employment Opportunity.

9. The extent to which statutory, regulatory, budgeting, or other changes are necessary to enable the agency board or commission to better serve the interests of the public and to comply with the factors.

Please refer to the previous section, Findings and Recommendations.

APPENDIX

DEPARTMENT OF COMMERCE AND ECONOMIC DEVELOPMENT
ALASKA PUBLIC UTILITIES COMMISSION
SUMMARY OF APPROPRIATIONS AND EXPENDITURES
For Fiscal Years 1988 and 1989
(UNAUDITED)

<u>Category</u>	<u>1988</u> <u>Authorized</u>	<u>1988</u> <u>Expenses and</u> <u>Encumbrances</u>	<u>1989</u> <u>Authorized</u>
Personal Services	\$2,113,600	\$2,103,406	\$2,113,600
Travel	28,660	27,423	57,100
Other Services	1,592,330	1,224,346	1,688,500
Supplies	21,000	20,800	22,000
Capital Outlay	<u>3,910</u>	<u>3,910</u>	<u>2,900</u>
<u>Total</u>	<u>\$3.759.500</u>	<u>\$3.379.885</u>	<u>\$3.884.100</u>

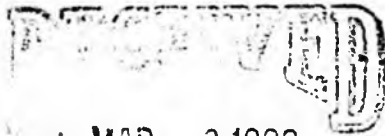
Note: The information included in this summary was obtained from APUC records and the state accounting system. This information has not been audited by us and, accordingly, we express no opinion on it.

STATE OF ALASKA

STEVE COWPER, GOVERNOR

ALASKA PUBLIC UTILITIES COMMISSION DEPARTMENT OF COMMERCE AND ECONOMIC DEVELOPMENT

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MAR - 9 1989

March 7, 1989

LEGISLATIVE
AUDIT

Mr. Randy Welker
Legislative Auditor
Division of Legislative Audit
State of Alaska
P. O. Box W
Juneau, Alaska 99811-3300

Re. Response to Preliminary Audit Report

Dear Mr. Welker:

The following is the response of the Commission to the preliminary audit report and recommendations submitted by the Division of Legislative Audit on February 14, 1989, as a result of its performance review of the Commission.

The Commission concurs with the fundamental conclusion of the report that the

Alaska Public Utilities Commission is operating in an efficient and effective manner and should continue to regulate public utilities and pipelines. (Page 5.)

The Commission does not agree with all of the statements of regulatory theory and philosophy in the preliminary audit report but has focused its comments on the actual recommendations.

Recommendation No. 1A

Alaska Statute 42.05 should be amended to cease certification and regulation of companies furnishing collection and disposal service of garbage, refuse, trash, or other waste material.

The Commission supports this recommendation as it did the identical recommendation made in the 1979 and 1985 Sunset Audits. The auditor's statement that the public health and sanitation aspects of this service are monitored by local governments and the Department of Environmental Conservation addresses the Commission's previous reservation on deregulation.

Recommendation No. 1B

Alaska Statute 42.05 should be amended to cease certification and regulation of radio common carriers.

The Commission concurs with this recommendation based on the character of radio common carrier (RCC) services and the current regulatory status of RCCs operating in the state. However, as noted in the Commission's response to the same recommendation in the 1985 Sunset Audit, future developments in the telecommunications industry may require reimposition of RCC regulation at some later time.

The Commission also believes that its authority to partially or fully deregulate a particular utility industry in response to current circumstances is a desirable and appropriate supplement to the legislative action advocated by the auditor. Accordingly, the Commission requests legislative guidance on the validity of its decision to economically deregulate the RCC industry in the event this recommendation is not implemented by statute.

Recommendation No. 1C

Alaska Statute 42.05 should be amended to cease certification of cable television.

The Commission concurs with this recommendation with some qualifications, as it did with the same recommendation in the 1985 Sunset Audit. The recommendation appropriately eliminates the anomaly in the current regulatory scheme for cable television (CATV) service whereby CATV providers hold monopoly certificates but are economically deregulated. However, the Commission would encourage the Legislature to use its legal and research staffs to examine the implications of the following on full CATV deregulation: (1) the Cable Communications Policy Act of 1984, (2) the Federal Communications Commission's recent initiatives to eliminate the existing ban on cross-ownership of CATV and telephone companies, (3) the availability and status of local government oversight, (4) shared use of rights-of-way, (5) community access and institutional network use of CATV systems, and (6) disposition of certificates held by existing CATV providers. In any event, as noted in response to the 1985 Sunset Audit recommendation, CATV certification is not a large element of the Commission's workload.

Recommendation No. 1D

Alaska Statute 42.05 should be amended to exempt smaller utilities from economic regulation.

The Commission opposes this recommendation because it disagrees with the auditor's unsupported presumption that the cost of economic regulation presently exceeds its benefits for smaller utilities. Rather, the Commission concludes from its experience

that regulation of small utilities is at the core of its public protection function, especially given the geographic and demographic characteristics of Alaska. The Commission also believes that the burden and cost of regulation on smaller utilities can and should be reduced administratively, and it is currently addressing this issue.

As the auditor points out, it is extremely difficult to quantify the cost of regulation, both to the regulated and to the regulator. At the same time, it is relatively easy to inflate or deflate cost figures to support a given predisposition for or against regulation. Regardless of amount, costs are relatively meaningless unless they are compared to benefits.

The Commission agrees with the auditor that the primary benefits of regulation are a financially stable utility which provides reliable, safe service to all customers at reasonable, non-discriminatory rates. With the exception of 22 water companies, the utilities affected by this recommendation are providing service in rural Alaska and are predominantly electric utilities. It has been the Commission's experience that the need for regulation and the potential benefits provided by regulation are frequently greater for smaller utilities than for larger utilities for many reasons, including, the logistical challenge of operating in remote locations; inexperienced personnel; unsafe facilities as a result of non-compliance with the National Electric Safety Code; lack of familiarity with utility management, maintenance, and accounting procedures; discriminatory actions by utility management; failure to request rate increases when needed; and procurement of wrong equipment. In addition, it can be argued that the consumers in rural Alaska are even more captive than those in the urban areas, and, therefore, are particularly dependent on a high level of protection.

Although the reduction in workload would be approximately commensurate with the loss of Commission staff over the past three years if this recommendation were enacted, and from that standpoint may be appealing, the Commission does not believe that the public interest would be served by wholesale deregulation of utilities serving perhaps the most (or one of the more) vulnerable segment(s) of the ratepaying public.

The Commission believes that the concern about the cost of regulation that has been voiced by the auditor as well as others, for the most part, is directed at the expense (both in time and dollars) associated with regulatory requirements when a utility desires or needs to change its rates. The Commission has recognized for some time that the regulatory scheme that exists and has been applied to both large and small utilities should be examined. To that end, on February 3, 1989, the Commission has issued a Notice of Inquiry. The purpose of the Inquiry is to receive information which would assist the Commission in proposing regulations to simplify rate and other regulatory proceedings for smaller utilities. A copy of this order is attached. (See Appendix A.)

In summary, the Commission believes that the issue of the cost of regulation as it relates to the smaller-sized utilities can be substantially mitigated through administrative procedures rather than legislation which would eliminate the important public protection function today provided by economic regulation.

However, if the Legislature believes public policy is better served by deregulating smaller utilities, the Commission would propose, as it did in response to the 1985 Sunset Audit, the following amendment to AS 42.05.711 to expand the deregulation election process found in AS 42.05.712 which would replace the provisions of AS 42.05.711(e), (f), (g), and (i):

All utilities which have gross revenues of \$500,000 or less may elect to be exempt from the provisions of AS 42.05, other than AS 42.05.221-42.05.281, under the procedures described in AS 42.05.712.

This approach conforms with the Commission's position that regulation for utilities that heretofore have been regulated should be continued unless the people most affected, the consumers, vote to become deregulated.

The Commission also concurs with the auditor's suggestion that consideration be given to reducing the number of customers required to petition for regulation under AS 42.05.711.

Recommendation No. 1E

Alaska Statute 42.05 should be amended to cease mandatory economic regulation of certain utilities owned by political subdivisions.

The Commission supports the philosophy underlying this recommendation. However, the Commission does not believe that elimination of AS 42.05.711(b)(2) is necessary to achieve the auditor's objective and has proposed an alternative legislative approach and language.

It is reasonable that if regulation is elected at one time by a governing body as currently provided under AS 42.05.711(b)(1), then a future governing body should have similar authority to vote to revoke that election. If such revocation is exercised, it is presumed that the public protection function provided by the Commission will be assumed by the governing body of the

political subdivision, thus giving affected consumers a forum and recourse for concerns and complaints.

The Commission recognizes that this recommendation presently affects only the Municipality of Anchorage. It is pertinent to consideration of this recommendation that, at the present time, there are a number of outstanding issues before, and outstanding requirements by, the Commission for the Anchorage Water and Wastewater Utility (sewer), the Anchorage Telephone Utility, and the Anchorage Municipal Light and Power Department.¹ It is reasonable to assume that the Anchorage Assembly would take into consideration the status and results of proceedings before the Commission at such time as it considers any decision to end economic regulation by the Commission.

¹Docket U-87-47 is an investigation into the general management practices of Anchorage's sewer utility. In Dockets U-88-18 and U-87-61 the Anchorage Telephone Utility is before the Commission requesting a 54.83% rate increase and responding to an investigation into the general and financial management practices of the utility. Commission decisions are currently pending in these sewer and telephone cases. At the present time, the Municipal Light and Power Department is required to provide an equity management plan and obtain Commission approval before further debt refunding is issued because of its poor financial condition.