ALASKA LEGISLATURE COMMITTEE FILES, 2003-2004 8672
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competitive carriers will not invest because they lack economic incentive to do so. The bottom line is that the Commission must make near term and substantial changes to its regulatory policies to conform to this legislative principle.

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

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

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The Nine Legislative Policy Initiatives

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Implications of R-03-X

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

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

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

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

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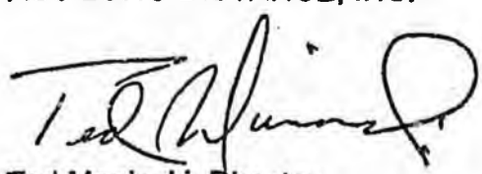
Again, ACS has not formed an opinion on the merits of the FCC forbearance petition, but looks forward to offering the Commission its opinion on the matter when the new docket is commenced. Like the many other important and related issues reserved for further consideration in R-02-6, the new NOI should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

Conclusion

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

Respectfully submitted this 16th day of July, 2003,

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



Ted Moninski, Director
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PROPOSED REGULATIONS

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

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

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

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

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

Authority: AS 42.05.141

AS 42.05.151

AS 42.05.221

AS 42.05.711

AS 42.05.990

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

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

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

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

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

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

---

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

EXHIBIT A

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(17) a tariff of rates and services; and

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

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

EXHIBIT A

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

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

Authority: AS 42.05.141

AS 42.05.151

AS 42.05.221

AS 42.05.241

AS 42.05.711

AS 42.05.990

3 AAC 53.220. DETERMINATION OF DOMINANT STATUS

3 AAC 53.220 is amended to read:

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

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

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

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

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

EXHIBIT A

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

Authority: AS 42.05.141

AS 42.05.151

AS 42.05.221

AS 42.05.711

AS 42.05.990

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

3 AAC 53.230 is amended to read:

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

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

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

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

EXHIBIT A

Authority: AS 42.05.141

AS 42.05.151

AS 42.05.221

AS 42.05.241

AS 42.05.711

AS 42.05.990

3 AAC 53.240. RETAIL RATES

3 AAC 53.240 is amended to read:

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

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

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

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

Authority: AS 42.05.141

AS 42.05.151

EXHIBIT A

AS 42.05.221

AS 42.05.241

AS 42.05.431

AS 42.05.711

AS 42.05.990

3 AAC 53.250. WHOLESALE SERVICE AND RATES.

3 AAC 53.250 is amended to read:

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

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

Authority: AS 42.05.141

AS 42.05.151

AS 42.05.221

AS 42.05.241

AS 42.05.431

AS 42.05.711

AS 42.05.990

3 AAC 53.260. CHANGES IN LOCAL EXCHANGE CARRIER

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

3 AAC 53.280 is added to read:

3 AAC 53.280. UNBUNDLED NETWORK ELEMENT PRICING

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

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

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

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

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

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

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

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

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

3 AAC 53.290. MISCELLANEOUS PROVISIONS

3 AAC 53.290 is amended to read:

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

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

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

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

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

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

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

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

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

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

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

3 AAC 53.299 is amended to read:

3 AAC 53.299. DEFINITIONS

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

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

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

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

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

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

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

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

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

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

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

Authority: AS 42.05.141

AS 42.05.151

AS 42.05.720

EXHIBIT A

STATE OF ALASKA

THE ALASKA PUBLIC UTILITIES COMMISSION

Before Commissioners:

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

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

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

I. BACKGROUND AND PURPOSE

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

EXHIBIT B

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

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

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

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

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

Table 1: Competition within New York and Alaska

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

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

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

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

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

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

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

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

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

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

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

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

EXHIBIT B

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

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

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

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[9] Joint Explanatory Statement at 1.

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

and

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

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

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

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

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

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

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

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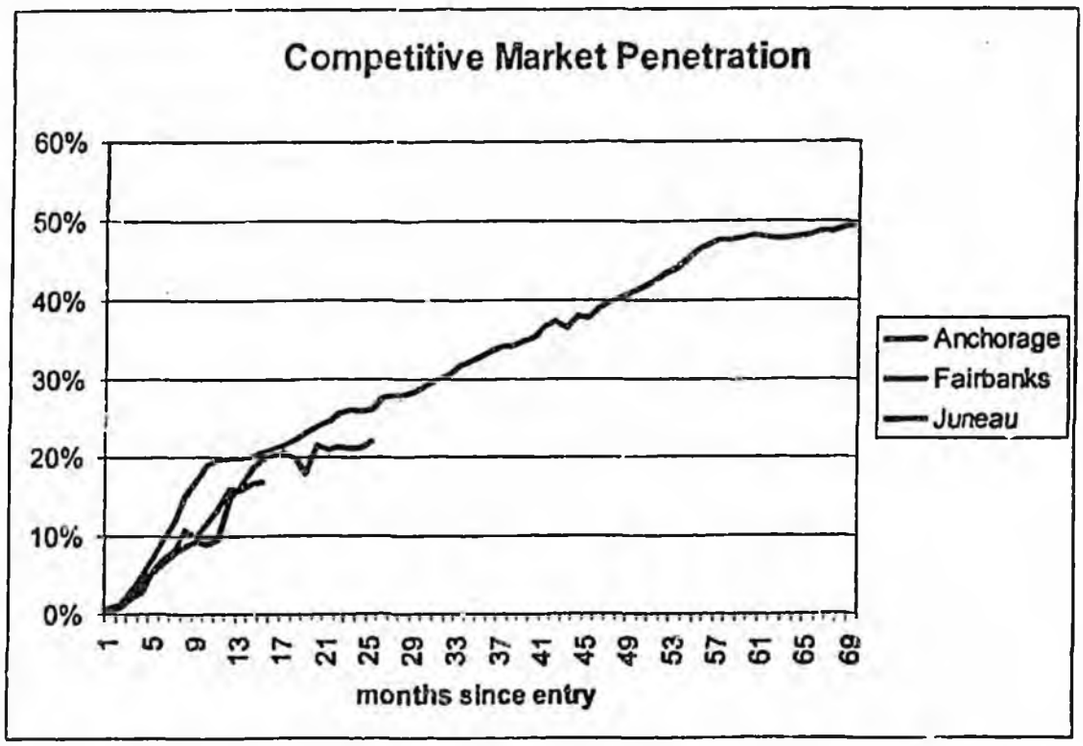
[13] This argument is enhanced by the fact that regulators do not solely set the price for the bottleneck facility – they also ensure it is equal in quality for the entrant as for the incumbent.

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

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



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

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

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

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

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

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

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

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

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

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

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

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

Table 3: State Deregulatory Developments[16]

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

32. This completes my affidavit.

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

Dale E. Lehman

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

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

Curriculum Vitae

DALE EDWARD LEHMAN

July, 2003

PERSONAL INFORMATION

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EDUCATION

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

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

BOOKS

The Telecommunications Act of 1996: The "Costs" of Managed Competition" with Dennis L. Weisman, Kluwer Academic Publishers (publication: September, 2000).

ATTACHMENT 1

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

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

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

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

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

EXPERIENCE

2002 Director, MBATM Program. Alaska Pacific University

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

1996- 1997 Senior Economist, Southwestern Bell Telephone Company

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

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

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

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

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

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

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

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

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

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

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

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

OTHER EXPERIENCE

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

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

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

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

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6

STATE OF ALASKA

THE REGULATORY COMMISSION OF ALASKA

Before Commissioners:

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

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

COMMENTS OF AT&T ALASCOM

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

BACKGROUND

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

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

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

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

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

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

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

AT&T ALASCOM'S PROPOSED REFORMS

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

Elimination Of Discriminatory Treatment Between Competitors

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Creation Of Incentives For Investment

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

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

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

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

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

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

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[4] Federal Subsidies were available, however, for certain long distance services to rural schools, libraries and health care providers.

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

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

Sharing of Carrier of Last Resort Responsibilities

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

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

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

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

(1) The public shall be protected.

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

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

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

(5) Competition among telecommunications companies shall be encouraged,

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

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

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

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

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

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

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

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

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

CONCLUSION

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

Dated: July 16, 2003

ASHBURN & MASON
Attorneys for AT&T Alascom

By _____
A. William Saupe

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STATE OF ALASKA

REGULATORY COMMISSION OF ALASKA

Before Commissioners:

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

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

Docket No. R-98-1

AFFIDAVIT OF MARK VASCONI

STATE OF ALASKA)
) ss:
THIRD JUDICIAL DISTRICT)

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

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

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

AT&T ALASCOM'S SUBSIDY PROPOSAL

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

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

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Exhibit A

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

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

THE SIZE OF THE BASIC SERVICE SUBSIDY

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

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

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

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

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Exhibit A

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

INTERNET SUBSIDY

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

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

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STATE OF ALASKA

THE REGULATORY COMMISSION OF ALASKA

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

COMMENTS OF GCI

Introduction

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

Discussion

A. Background and Overview

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

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

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

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

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

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

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

B. Discussion of Policies

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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(907) 265-5600

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

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

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

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

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(907) 265-5600

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

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

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

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

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

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

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

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Anchorage, AK 99503
(907) 265-5600

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

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

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

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

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

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

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

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

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

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

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

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