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STATE OF ALASKA

THE ALASKA PUBLIC UTILITIES COMMISSION

Before Commissioners:

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

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

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

I. Scope and Summary

1. My name is Dale E. Lehman and I filed an affidavit on behalf of Alaska Communications Systems in the Comment phase of R-03-03. My comments addressed the appropriate triggers and scope of deregulation in retail telecommunications markets as a result of the pro-competitive provisions of the Telecommunications Act. I now respond to the initial comments filed by GCI, the Alaska Telephone Association, the Rural Coalition, and AT&T Alascom on these same issues.

2. All parties recognize that markets should be deregulated when no carrier has sufficient market power to raise prices above competitive levels. This determination should be made on a market by market basis, both geographical and by service (wholesale/retail). The parties differ, however, concerning what circumstances are

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appropriate for triggering deregulation, as well as the extent to which deregulation should provide equal treatment of competitors. GCI proposes retaining dominant/non-dominant carrier distinctions and proposes market share tests for moving carriers from dominant status to non-dominant status. ATA proposes a trigger of the "advent of competition" for deregulation and argues that deregulation should impose the same restrictions on incumbents and entrants alike. Similarly, the Rural Coalition proposes that designation of a second eligible telecommunications carrier (ETC) as the trigger for treating incumbent and entrant retail services alike. AT&T Alascom addresses regulatory parity in a different market, the interexchange market, and calls for regulatory parity based on this market's competitiveness.

3. I will reiterate, and expand upon, my original position that the wholesale provisions[1] of the Telecommunications Act require modification of the way that retail telecommunications markets are regulated. Indeed, the need for retail regulation is eliminated by the establishment of markets for unbundled network elements (UNEs), the designation of multiple ETCs in an area, or the availability of alternative facilities required for provision of local services. There can be no middle ground – attempts by this Commission to "manage" the transition to competition will actually prevent competition from working and will harm consumers. Additional consumer protection is better provided by direct price constraints than by continuation of an outdated regulatory paradigm.

[1] By "wholesale" I mean the establishment and pricing of unbundled network elements - the wholesale inputs to the provision of retail service. Wholesale services, purchased at a wholesale discount for offer on a total service resale basis, are different. I do not address the latter as it generally does not eliminate the incumbent's retail market power in the same way that UNEs do.

II. The parties all agree that retail market (de)regulation should reflect the pro-competitive wholesale provisions of the Telecommunications Act, but the parties diverge concerning both the timing and the extent of retail deregulation.

4. The comments filed by GCI, ATA, the Rural Coalition, and ACS all reflect the fact that regulation of retail markets is impacted by provisions in the Act.[2] All parties recommend deregulation of retail services when market power is not present. The basis for determining whether market power exists differs, however. GCI calls for a market-specific investigation by the Commission that would consider a number of factors. In addition, it proposes a market share test: rate increases would only be permitted when an ILEC's market share falls below 80%. They distinguish between freedom to reduce rates and freedom to increase rates on a perceived legislative distinction between markets that have competition and those that have "significant" competition.[3]

5. ATA calls for complete parity in regulation of ILECs and CLECs "in areas where the commission has determined there is competition among carriers."[4] The Rural Coalition goes further in calling for regulatory parity in "any service areas where multiple carriers have been designated as eligible telecommunications carriers."[5] AT&T Alascom claims that the interexchange market in Alaska is already competitive and that regulatory parity should be in place, specifically regarding reporting and retail tariff requirements. In my initial comments on behalf of ACS, I called for retail deregulation in local markets "when UNEs are available and being purchased."[6]

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[2] AT&T Alascom makes similar proposals for the interexchange market, though the changes it cites preceded the passage of the Act.
[3] See the discussion in the GCI Comments, at pages 20-22.
[4] ATA Comments, at page 3.
[5] Rural Coalition Comments, at page 7.
[6] Affidavit of Dale E. Lehman, at page 7.

6. The issue is: when does a carrier cease to have the ability to raise rates above competitive levels, i.e., when do they no longer have market power? As I explained in my direct comments, the availability of UNEs mitigates the retail market power of the incumbent. For carriers that have rural exemptions, either the removal of those exemptions or the designation of multiple ETCs has the same effect. The incumbent carrier cannot raise prices above competitive levels – it will provoke a bona fide request for UNEs and/or facilities-based entry by competitors. Any of these conditions should be sufficient for complete retail regulatory parity. Anything less will harm the process of competition and will harm consumers. Market share tests are inappropriate, as I will now discuss.

III. The dominance/non-dominance regulatory regime is outdated and likely to cause more damage than benefit to consumer interests. In particular, market share tests to trigger deregulation are inappropriate and backward-looking. The proper course is deregulation of retail markets as soon as UNEs are available and/or multiple ETCs have been designated in a market.

7. GCI cites "the clear rationale for continuing differential regulation of dominant and non-dominant carriers based on market power, but elimination of the regulation initially defining the incumbent carrier as dominant."[7] It is correct to focus on market power and it is correct to drop the presumption that the incumbent has such power. GCI's continued reliance on the dominant/non-dominant distinction is misplaced, however. GCI cites the lengthy history of FCC regulations based on this dominance distinction. It is misguided to rely on a regulatory history that evolved in a market that did not have the extensive requirements for interconnection and unbundling of essential facilities that are contained in the Telecom Act. Market dominance is a backward-looking concept and one

prone to misuse. If the Commission is careful to remember that a carrier may be dominant in a particular geographical wholesale market *but non-dominant in the same geographical retail market*, then little harm is caused (GCI recognizes this specific situation at page 13 of their comments). Dominance in the market for unbundled network elements is an unnecessary concept, as the provision of UNEs is governed by Federal law. It is precisely the availability of UNEs or alternative facilities that makes a carrier non-dominant in the retail market, so dominance in a market for UNEs generally implies non-dominance in the same geographical retail market. The dominance label does nothing to help with determining whether a carrier can raise prices above competitive levels, but it does risk asymmetrically imposing regulatory burdens on one competitor in the market.

8. The FCC history with dominance points in the direction of removing such labels. The FCC ordered detariffing of interexchange services in 1996 but it was not until 2000 that the court challenges finally ended.[8] The industry resisted detariffing. Tariffs were actually harming consumers by protecting competitors from the intensity of competition that results from more direct competitive pressures between carriers. The FCC had to fight for detariffing within the outdated dominance paradigm.

9. The FCC's treatment of local markets is markedly different than for interexchange markets. Section 271 of the Act provides a "competitive checklist" that must be complied with before the Regional Bell Operating Companies (RBOCs) are permitted to offer interLATA services. The purpose of the checklist is to ensure that the

[7] GCI Comments, at page 12, lines 6-9.

[8] See Charles H. Kennedy, *An Introduction to U.S. Telecommunications Law*, Artech House, 2001, pages 109-110. Detailed discussion of the potential anticompetitive effects of tariffing can be found in Paul W. MacAvoy, *The Failure of Antitrust and Regulation to Establish Competition in Long-Distance Telephone Services*, MIT Press, 1996. AT&T Alascom also cites the FCC detariffing of long-distance services in its comments.

local markets are open to competition – no particular degree of competitive entry is required. Rather, the checklist focuses on the conditions required to open the market to competition – availability of interconnection, UNEs, and resold services, at cost based prices.

10. As of May 1, 2003, the FCC has found that this checklist has been met in 42 jurisdictions. In only three (3) of these jurisdictions has the CLEC market share been 20% or greater and the lowest reported market share in which the FCC has approved RBOC Section 271 authority is 4% (in Kentucky).[9] Clearly, the FCC has found that determining whether an incumbent has market power is not tied to any particular competitive market share. It is the unbundling and interconnection requirements of the Act that make such market share data irrelevant to the determination of whether or not market power exists.

11. It is not just that market share data is irrelevant to the determination of market power – use of market share triggers will only harm competition and consumer interests. This is because consumers are best served by having two or more viable competitors and not by handicapping one competitor in the market. The evidence in Alaska suggests that once competitive entry occurs, it rises to 20% (GCI's suggested trigger) and then beyond. There is no magical threshold required for competition to be sustainable and the Commission should not (and cannot) manage market shares. Regulators should be in different between competitive market shares of 60% or 10%.

[9] The Section 271 data is from *Statistics of the Long Distance Telecommunications Industry*, May 2003, and the local competition data is from *Local Telephone Competition Report*, June 2003 (data as of December 31, 2002), Federal Communications Commission reports. The CLEC market share data is only reported for states where there are more than two CLECs so a number of states are not included in the above statements regarding CLEC shares.

provided that they result fr. ' fair and unfettered competition. The point is that the market should decide the eventual market shares, not regulators. This means that regulators should treat competitors equally, and also, that the regulation of competitive markets should be kept to a minimum. The regulatory role in the unbundled environment is to ensure that UNEs and interconnection are available at cost-based prices. Continued asymmetric retail regulation of carriers is not appropriate.

12. Market share tests can be particularly damaging to small ILECs. The loss of 20% of the lines may entail a revenue loss of far more than 20% and can threaten financial viability. Fine-tuning the market share measures and conducting proceedings to determine whether a particular market has become sufficiently competitive only prolongs the necessary deregulatory process By the time that sufficient evidence has been collected and sufficient market share lost, the damage (to both the ILEC and eventually consumers) is done. The Telecom Act rewrote the rules of the market and this, in turn, calls for more tangible changes in retail regulatory structures. The triggers for regulatory parity should be concrete and easily monitored. Availability and use of UNEs, removal of the rural exemption, and designation of multiple ETCs are such triggers.

IV. If additional consumer protection against rate increases is desired, it is better achieved through constraints on retail rate increases than continued reliance on an outdated regulatory regime.

13. To the extent that the Commission is wary of moving this quickly, additional consumer protection can be provided with minimal distortion of the competitive process. Maximum permitted price increases for basic residential service are simple to administer and safeguard consumers against abuse of regulatory freedom. ILECs will

worry about competition rather than spend their resources trying to work within regulatory constraints that their retail competitors don't face.[10] Consumers face enhanced choice and will benefit as a result. The dominant/non-dominant regime simply has no place in this environment, other than to thwart the workings of competition.

14. The Commission's recent decision in consolidated Dockets U-01-34, U-01-83, U-01-85, U-01-87 provides an example of the dangers of continuing the dominant carrier regime. Among the Commission's findings concerning the waiving of tariff requirements:

> *"The waivers sought by the ACS Companies are not supported by the record in this proceeding nor is this the appropriate forum to implement such substantive changes to our competitive policies."*
>
> *"we do not find that ACS-AN is no longer dominant in its market."*
>
> *"provides an opportunity for us to observe the market and consumer reactions to ACS-AN being on an equal tariff procedural treatment with its major competitor."*
>
> *"we do not extent our interim waiver to the ACS-F, ACS-AK or ACS-N markets. Competition in those markets is not developed as well as in Anchorage. Further review of the status of competition outside of Anchorage is necessary before we relax regulations in other markets."*[11]

15. While these investigations continue, competition happens. It is not the unfettered competition that most benefits consumers, however. It is competition where one competitor is limited in its ability to deaverage its prices, restrained from rapidly changing prices, and restricted in its ability to offer promotions, new services, and new bundles. As

[10] Regulatory parity is in consumers' interests, as is reduced regulation in a competitive market. Restrictions like public notice for price changes should be equally applied to competitors, and the requirements for such notice should be kept to a minimum, consistent with the need for consumers to be informed and be able to exercise choice.

[11] At pages 21-22.

a result, the competitive pressure it presents to others is less intense. In the name of consumer protection, consumers face more limited choices than they should in a competitive market. Such a situation may have been appropriate in the pre-Telecom Act environment. It does not reflect the sweeping changes that the Act presents. Consumers are protected by the interconnection, unbundling, and resale provisions of the Act. These provisions obviate the need for much of the retail regulatory apparatus that was constructed during the monopoly era. It is time for regulation to become as forward-looking as the cost models.

16. This completes my Affidavit.

DATED this 8 day of August, 2003, at Anchorage Alaska.

Dale E. Lehman

SUBSCRIBED AND SWORN to or affirmed before me this 8th day of August, 2003, at Anchorage Alaska.

Notary Public in and for Alaska
My Commission Expires 11-3-06

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

AFFIDAVIT OF HOWARD A. SHELANSKI
ON BEHALF OF
ALASKA COMMUNICATIONS SYSTEMS

I. Qualifications

1. My name is Howard A. Shelanski. I am a professor of law at the University of California at Berkeley. My address is School of Law, Boalt Hall, University of California, Berkeley, CA 94720.

2. I received my B.A. from Haverford College in 1986, my J.D. from the University of California at Berkeley in 1992, and my Ph.D. in economics from the University of California at Berkeley in 1993. I have been a member of the Berkeley faculty since 1997. In 1998-2000 I was on leave from my faculty position to serve as a Senior Economist to the President's Council of Economic Advisers (1998-99) and then as Chief Economist of the Federal Communications Commission (1999-2000). I rejoined the Berkeley faculty on a full time basis in July 2000. I formerly practiced law in Washington,

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D.C. with the firm of Kellogg, Huber, Hansen, Todd and Evans and served as a law clerk to Justice Antonin Scalia of the United States Supreme Court.

3. I teach and conduct research in the areas of telecommunications regulation, antitrust, and applied microeconomics. My recent publications include articles in the *Journal of Law, Economics and Organization*, the *Yale Journal on Regulation*, the *University of Chicago Law Review*, the *Journal of Law and Economics*, the *University of Chicago Legal Forum*, the *Columbia Law Review*, and *Telecommunications Policy*. I am co-author of the legal textbook *TELECOMMUNICATIONS LAW AND POLICY* (Carolina Academic Press, 2001). My Curriculum Vitae is attached to my testimony as Exhibit 1.

II. Purpose of Declaration

4. The purpose of this declaration is to explain why local exchange competition and regulation of retail telephone rates are inconsistent with each other and why continuing with such regulation could interfere with the very competition that is the goal of RCA and legislative policy. I will also comment on the relevance of wholesale and UNE rate regulation to retail rate regulation and on how the question of ACS' market share should factor into retail rate policy.

III. Rate regulation is an imperfect Solution Even in the Best of Circumstances

5. Rate regulation is a tool that, in the absence of competition, can limit a firm's ability to extract monopoly profits from consumers. Courts, policy makers, and commentators recognize, however, that rate regulation is extremely difficult to implement effectively. Regulators often have difficulty obtaining the information they need to set prices—whether under a rate-of-return or price cap regime—efficiently. Even if the

regulated firm fully complies in good faith with the regulatory process, it is hard for regulators to know what levels of return are fair for carriers or what levels are necessary to sustain forward-looking investment and technological change in an industry. The challenges for regulation are particularly tricky to navigate during periods of change in an industry, such as the current transition to competition and increasingly advanced networks in local telecommunications.

6. Because of the difficulties of rate regulation, and because of the unintended consequences rate regulation may have for competition and market performance, regulators have generally retreated from such intervention when competition develops or is predicted to develop in a market. Telecommunications, in particular, provides several instructive examples of such caution and conservatism in regulating prices. Consider the de-tariffing of "dominant" long-distance carriers (i.e., AT&T) in 1991. In that proceeding, the FCC determined that even though competition in long-distance telephone service was not perfect, the increase in competition and the growth of competitive capacity made deregulation preferable to continued scrutiny of AT&T's filed tariffs.[1] The Commission concluded that in light of potential competitive pressure from MCI and Sprint, the costs of continued rate regulation would outweigh its benefits for consumers.[2]

7. The Commission exercised similar forbearance in the context of wireless telephony. When the Commission first licensed cellular spectrum beginning in the early 1980s, it assigned two licenses in each geographic area; a "B block" license to an affiliate

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[1] 1991 Report on Interexchange Competition, 6 F.C.C. Rcc. 5880, 5881-5882 ¶¶8-9 (1991).
[2] Id. at ¶9.

of the incumbent ILEC and an "A block" license to a new entrant.[3] Because there would be two competing providers in each market, the Commission did not regulate cellular prices, instead letting the market develop competitively. To be sure, a two-firm market is unlikely to be perfectly competitive, but the vigorous rivalry between the A and B block carriers to attract customers to the then-new wireless market kept prices falling and the prospect of grabbing any profits that remained in the market was sufficient to induce the development of superior digital technologies and the entry in the mid-1990s of numerous PCS carriers. Instead of a rate-regulated market of two cellular carriers, we now have a vigorously competitive market in which over 80 percent of Americans have a choice of at least five competing wireless providers, with all the ensuing benefits of lower prices and more innovative services.[4]

8. A final example of refraining from rate regulation in the face of emerging competition comes from the cable sector. The FCC and local governments had joint authority under the Cable Act of 1992 to regulate cable rates in the absence of effective competition. In 1993 the Commission established definitions of "effective competition" in cable markets that demonstrated caution about engaging in rate regulation and showed a decided preference for relying on competition rather than agency rules. Notably, the FCC determined that where an incumbent cable operator faces a competitor that (1) offers comparable service to 50% of the households in the franchise area, and (2) provides service to at least 15% of the households in the franchise area, the incumbent faces sufficiently

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[3] See Peter W. Huber, et al., Federal Telecommunications Law (1999) §10.4.2.
[4] FCC, Eight Annual Report and Analysis of Competitive Market Conditions with Respect to Commercial Mobile Services (July 14, 2003) at ¶18.

"effective competition" that rate regulation is unwarranted.[5] In adopting the above standard, the Commission made the judgment that competition can be effective and superior to rate regulation even where it is not ubiquitous and even when market shares remain greatly uneven as between incumbents and entrants.

9. The above examples demonstrate a consistent pattern at the FCC of reluctance to continue rate regulation in the face of emerging competition in a variety of telecommunications markets. That reluctance is anchored in both an appreciation of the difficulty and costs of regulation and an understanding of the benefits that can result when competition is allowed to run its course. The recent growth of competition in local exchange markets, which has been particularly strong in key areas of Alaska, suggests that the retail rate regulation that has to date been applied in Alaska may no longer be necessary and, more urgently, may interfere with the continued growth and expansion of local telephone competition in the State. The next section discusses in more detail why retail price regulation and competition are ultimately incompatible.

IV. How Rate Regulation Can Interfere With Competition

10. Firms enter markets when they see opportunities to under-price incumbents and take market share while still earning positive returns. The higher the prevailing prices in a market, the more likely entry is to occur. It is thus not surprising, for example, that local exchange entry has been most vigorous in the densely populated markets where entry costs are lowest and where retail rates tend most to exceed costs. Regulations that limit

[5] Rate Regulation of Cable Services, 8 F.C.C. Rec. 5631 at ¶8 (1993).

retail rates can have the effect of depressing the margins that make entry attractive, ultimately deterring the competition that could make the regulation unnecessary. Such substitution of regulation for competition is undesirable for two reasons. First, the regulation itself is costly, both for the regulator and for the firm under scrutiny. Second, while regulation may succeed in pushing prices for consumers down, it does not provide non-price benefits of competition such as innovation.

11. Retail rate regulation—and in particular increases in such regulation—can have particularly harmful effects where competitive entry into a market is already underway. Pushing an incumbent carrier's rates down when there is a competitor in the market might undermine the investment calculations that the entrant has made and slow the pace of the competitor's growth. Such regulation might also have the effect of chilling the entry of yet additional competitors whose presence in the market would provide vigorous and beneficial competition. This picture is particularly salient in Alaska. At present, ACS faces very substantial competition from GCI, with market share loss ranging from 20 to 40 percent in ACS' major markets of Juneau, Fairbanks, and Anchorage. But other providers, notably AT&T, have also begun to make inroads. AT&T's market share currently hovers around 6 percent in Anchorage—small by comparison to GCI but non-trivial. One need only ask the question of now downward regulation of ACS' retail rates would affect AT&T's entry incentives, not only in Anchorage but also in Fairbanks and Juneau, to see how such regulation can reduce competition. Entry follows profit opportunities, and as those opportunities diminish as regulation pushes down the incumbent's rates, which rates an entrant will have to beat or match to gain customers, entry and competition diminish as well. Customers may receive lower rates in the very short run, but they lose the more

robust price efficiency that results from true competition, they lose the innovations that result from true competitive incentives and, if regulated prices fail to capture the margins necessary to sustain dynamic network investment, they may lose on the level and variety of service they receive from the incumbent.

12. Other dimensions of rate regulation also li nit competition. If the incumbent firm alone must face regulatory review, the unregulated entrant may be spared the need to respond to rapid price cuts or changes in service offerings. Similarly, the competitor might gain valuable information during the regulatory process about the incumbent's cost structure or business strategies. Where one firm (the incumbent) is hampered in its ability to compete in a quick and aggressive manner, the competitive process becomes is less beneficial for consumers.

13. The hazards discussed above are particularly salient in a market, such as local exchange service, in which cross-subsidies are built into rates and where rates often do not correspond meaningfully to costs. Under a regulatory program in which rates for some customers do not cover costs, *economically efficient* entry will occur only in markets where retail prices exceed the costs of providing service and will focus on markets in which those margins are largest. To be sure, entrants might serve otherwise unprofitable customers if they do not have to bear the true costs of doing so. Thus, if rates for unbundled network elements (UNEs) are averaged across service areas, then UNE prices in high cost areas will be lower than the ILEC's actual service costs and entry that is profitable for the CLEC, but that is socially inefficient because it is not covering its costs, may occur. Under such a regime, however, new entrants need not compete as vigorously as they would in an unregulated regime. The ILEC is in no position to cut retail rates in

competitive response because to do so would only increase its losses. Moreover, in no such case of subsidized entry will a CLEC have any incentive to make the transition from UNEs to its own network and provide true, facilities-based, competition. For such competition to occur, both UNE prices and retail rates must reflect the true incremental costs of providing the service or element at issue. Because the incumbent must meet its overall revenue requirements from customers in its low-cost markets, it will not have either the incentive or ability to engage in a price war in profitable markets either. To do so would leave the incumbent with reduced profits from its low-cost markets but bearing the same losses in its high-cost markets. Eventually, of course, prices in the profitable market will erode with entry but the economic viability of the incumbent network will have been compromised. The result is a poorer network of last resort for consumers and a weakened incumbent competitor in major markets. Unless rates are deregulated to the extent that they at least reflect costs, both of the problems identified above—selective entry by CLECs and a weakened, competitively constrained ILEC—will persist.

14. Implicit in the discussion above is that some rates, those that are below cost, will rise as rate regulation is removed. To the extent such cost-based pricing is contrary to state universal service objectives, the high-cost problem can be alleviated in part through more neutral and targeted subsidy mechanisms that do not depend on a carrier's revenues from profitable markets. But two things must be kept in mind: first, the rates that would rise are rising to more efficient, *i.e.*, cost-covering levels; and second, the higher rates are more likely to attract competitive entry that will over time provide firms with incentives to reduce costs and once again lower prices. The CLECs themselves have recognized that letting prices rise to efficient levels is likely to benefit competition and consumers. For

example, Dr. John Mayo, AT&T's expert economist in a recent Massachusetts retail rate proceeding, stated that:

> *Prices that do not--at a minimum--recover the incremental cost of providing a service will simply fail to encourage any other parties to consider entry into the market. In this case, while consumers are nominally "protected" from monopoly through a policy of low prices, such a policy actually acts to prevent the introduction and growth of competition. ... A necessary (but not sufficient) condition for the emergence and growth of competitors is the removal of regulatory barriers to entry, and there can be no more effective barrier to entry than prices that are lower than the incremental cost of providing a service.*[6]

15. Dr. Mayo further advocated letting retail rates rise when entry has occurred and allowing competition to provide the necessary discipline, noting that "despite the larger *potential* price increases permitted, competitors and competition will provide a meaningful check on [the ILEC's] upward pricing."[7]

16. The discussion above demonstrates that where competition has developed sufficiently to prevent the incumbent from exercising market power, rate regulation is unnecessary and will do more harm than good. I turn next to an explanation of market power and of why the evidence shows an absence of such power for ACS.

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[6] Pre-filed Direct Testimony of John W. Mayo on Behalf of AT&T Communications of New England, Sept. 4, 2002, at p.15. Mass. Dept. of Telecommunications and Energy, DTE 01-31 (Phase 2).

[7] Id. at p.21.

V. ACS Does Not Today Possess Market Power in Local Exchange Services

17. Market power is a firm's ability profitably to raise prices above the competitive level for a significant period of time, or to otherwise dictate the terms of trade in a market through the firm's decisions on quality or level of output of the good or service at issue. Accepted economic theory holds that two conditions are necessary for a firm to exercise market power. First, there must not be competition from existing firms producing substitute products in the relevant market. If competitors have sufficient capacity, they can step in and meet any demand for alternative sources of supply that would accompany an increase in price (or decrease in output or quality) by the firm attempting to exercise market power. When such competitive capacity is available, it is not long profitable for an incumbent firm to raise prices above the competitive level. A firm might decide to raise prices, but if in so doing it loses market share to competitors then the firm lacks market power. ACS has in fact rapidly lost market share to GCI. The fact that GCI has been able to take customers from ACS so effectively refutes the notion that ACS retains market power.

18. Second, for a firm to be able to exercise market power, entry into a market by firms not currently in the market must be relatively difficult. Where barriers to entry are low, even where there are few current competitors or substitutable products/services, any attempt to increase price above the competitive level would stimulate entry by new firms offering competitive products at a competitive price, and the attempt to increase price would not be sustainable. When a market is susceptible to such entry, it is sometimes referred to as being "contestable." It is important to recognize that in local telephone service, contestability is being achieved over multiple platforms. Use of UNEs and resale is perhaps the competitive path that is most often mentioned. But alternative platforms

such as wireless and cable networks also provide important avenues for entry through which ILEC can be challenged competitively. Such entry paths are not speculative, but real. For example, GCI recently told financial analysts that it intends to roll out telephone service on its monopoly cable network to as many as 60,000 customers over the next three years.[8] Given the competitive results GCI has already achieved against ACS and given its ability to enter at an even greater rate over its proprietary cable networks, there is no question that GCI has rendered ACS' markets fully contestable.

19. Unless the above two conditions—absence of competition and barriers to entry—hold, a firm cannot exercise market power. Neither of those necessary conditions for market power holds for ACS. The company unquestionably faces competition in is core markets, most strongly from GCI but also from AT&T and others. Moreover, the wholesale and unbundled network element (UNE) regimes ensure that there is "elastic" supply for increased competitive service, so there is no difficulty of entry or expansion of supply by existing competitors. Accordingly, ACS will not be able to control prices in its markets even if rate regulation is eliminated.

VI. Regulation at the Wholesale Level Undermines the Case for Regulation at the Retail Level

20. The point made in the previous paragraph about entry through resale or use of UNEs bears emphasis. Because CLECs can purchase the inputs they need to provide competing service at regulated wholesale prices, ACS would face a strong constraint on its

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[8] General Communications (GNCMA) –Q2 2003 Financial Release Conference Call, Thursday, July 31, 2003 2 PM, Transcript Produced by Fair Disclosure Financial Network Inc, at p.12.

ability to raise retail prices to consumers. As soon as ACS' profits rose to attractive levels, new firms would enter or existing CLECs would expand their operations. This result is not speculative. In those markets where rates contain a margin over cost, GCI and other CLECs have already availed themselves of the opportunity to purchase UNEs from ACS or to resell ACS' own service and to take customers away through lower-priced services than those offered by ACS. In this way, the existence of wholesale price regulation for service inputs undermines the need for retail price regulation on service outputs. There is, moreover, something of a contradiction between retail and wholesale price regulation in local telecommunications. As explained above and as corroborated in the cited testimony of AT&T witness John Mayo, retail price regulation acts as a deterrent to competitive entry and thus renders the regulatory program for incumbent provision of wholesale inputs less effective. Therefore, not only does the competition that has emerged from the UNE and resale regimes diminish the need for retail rate regulation, but elimination of such regulation is likely to increase the incentives of competitors to take advantage of UNEs and resale to enter and further improve market performance for consumers.

VII. High Market Share is a Poor Proxy for Market Power in Local Telecommunications

21. Some parties might still object that, despite competitive entry, ACS retains the majority share of its service markets, and in some places still faces no competition. Yet these facts do not support the conclusion that ACS has market power or that rate regulation should persist. Indeed, high market share does not in itself suffice to show market power. Market share measures are backward looking. They reflect the point to which a firm has come, perhaps because of past competitive behavior or, as in the case of local telephony, a

history of being a regulated monopoly. Market share fails, however, to show the extent of current competition and how that competition will proceed from this point forward. This is a particularly critical shortcoming of relying on market shares to set policy in a regulated industry making the transition to competition. The fact that ACS has been the regulated provider of telecommunications services in the territory it covers, with the legacy of a large market share in that market, is of little help in understanding the competition that ACS faces right now or the competitive prospects in the market from today forward.

22. To take just one example of how static market share can misrepresent market power, consider local exchange service nationwide. In December 1999, CLECs reported serving just over eight (8) million switched access lines, or about 4.3% of the market. Only 18 months later, in June 2001, the CLECs had more than doubled their lines to over 17 million, or about 9% of the market.[9] Clearly, CLECs have been able to enter the local exchange market, to increase their supply of services, and provide substitutes for consumers of local telephone services. An analysis of the local market that equated ILEC market share with ILEC market power in 1999 would clearly have proven erroneous by 2001. The case is even more compelling in Alaska, where the competitive market shares are far, far higher than the nationwide average. Competition is not a mere prospect in Alaska's major markets, it is a clear reality.

23. In the face of such market evidence, it is particularly inappropriate to rely on market share as evidence of an incumbent's market power. Where the change in that market share has been sharply negative, as it has for ACS, market power simply cannot be

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[9] FCC, Industry Analysis Division, Local Telephone Competition: Status as of June 30, 2001 (Feb. 2002), Table 1.

inferred from the share that remains at any given point in time. Nor can market power be inferred from the fact that ACS has not faced significant, if any, competitive entry in some of the territories it serves. The economic literature makes this point forcefully:

> *To the extent that regulation is effective, its effect is to sever market power from market share...This is obviously so when the effect of regulation is to limit a monopolist's price to the competitive price level. A subtler effect should also be noted, however.* ***Regulation may increase a firm's market share in circumstances where only the appearance and not the reality of monopoly power is created thereby.*** *For example, ... price may be above marginal cost in some markets and below market cost in others. In the latter group of markets, the regulated firm is apt to have 100% market share. The reason is not that it has market power but that the market is so unattractive to sellers that the only firm that will serve it is one that is either forbidden by regulatory fiat to leave the market or that is induced to remain in it by the opportunity to recoup its losses in its other markets. .... In these circumstances, a 100% market share is a symptom of a lack, rather than the possession, of market power.*
>
> *Notice in this case that the causality between market share and price is reversed. Instead of a large market share leading to a high price, a low price leads to a large market share; and it would be improper to infer market power from observing the large market share.*[10]

24. The U.S. Federal Trade Commission/Department of Justice Horizontal Merger Guidelines similarly state that in changing markets current market share may be an inaccurate measure of a firm's forward-looking competitive significance. (Section 1.521). Given the shortcomings inherent in a market share analysis, there is strong consensus

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[10] William M. Landes and Richard A. Posner, "Market Power in Antitrust Cases," *Harvard Law Review*, Vol. 95, pp. 975-76 (1981) (footnotes omitted).

among economists that capacity to enter and expand in a market is of much greater significance when assessing competition than the percentage of total customers the incumbent has lost to date. It is thus especially imperative that in this case the focus be on supply and demand conditions and not on a static snapshot of market share data.

25. Emphasis on market share or the adoption of any market share threshold for retail rate deregulation can lead to strategic behavior by an entrant that ultimately diminishes competition. Thus, in the FCC Non-Dominance Proceeding, AT&T's experts argued against a policy of delaying regulatory relief until the achievement of a threshold level of market share loss by making the following point:

> *AT&T would, under such a policy, be encouraged to refrain from aggressive competition in order to allow its market share to fall below a threshold level. ... At the same time, the firms attempting to prolong regulation of AT&T would face an incentive not to capture too much market share... A contest is created to see who can turn in the worst performance.*[11]

26. If ACS' competitors gain somehow from retail regulation of ACS—perhaps by being spared rapid competitive responses by the incumbent or by obtaining informational advantages—then the possibility of such strategic behavior as the threshold level of competitive market share is being reached cannot be ignored.

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[11] *"Is AT&T Dominant?" An Assessment of the Evidence*, by David Kaserman and John Mayo: June 1995, Attachment to AT&T Ex Parte Letter from Charles L. Ward to William C. Caton. Re Ex Parte CC Docket 79-252.

VIII. Entry by Even a Single Strong Competitor Erodes the Case for Rate Regulation

27. An additional argument that might be made is that competition between two firms is not enough to protect consumers from high prices. It is true that a market with two competing firms—a "duopoly"—may not yield the same degree of price-reducing rivalry that a market with multiple competitors produces. Yet it is important to recognize that the relevant economic comparison for retail rate policy is not between duopoly and perfect competition, but between duopoly and a market with retail rate regulation. Once the direct and indirect costs of rate regulation are factored in, consumers will often be better off under an unregulated duopoly than under a duopoly in which one of the firms faces retail price regulation. Part of the reason for this has already been discussed above: market processes avoid the inefficiencies that regulated rates may entail and also send more accurate economic signals to new entrants. But another reason is that duopoly, particularly in markets newly opened to competition, my entail aggressive rivalry that immediately constrains rates, improves services, and benefits consumers. The rapid loss of market share experienced by ACS is strong evidence for how effective a single competitive entrant can be in improving market performance for consumers.

28. Precedent strongly supports retail rate deregulation when a second firm begins successfully competing in a telecommunications market. Consider the examples I discussed at the beginning of this declaration. In the cases of both cellular telephony and cable television, the FCC declined to impose retail rate regulation in a duopoly setting. In the cellular context, the market began as a duopoly and retail rates were never regulated. In the cable context, rate regulation was permitted in absence of competition but the FCC determined that once a single new competitor entered the market, even if it had capacity to serve only half the market and even if it had only a 15 percent market share, rate regulation

should cease. The case for deregulation is even stronger in Alaska than in either of the above cases. Not only is there more than one CLEC in the state's major markets, but the leading CLEC has shown itself capable of rapidly taking customers and eliminating any market advantage that the incumbent ACS might once have had.

IX. Conclusions

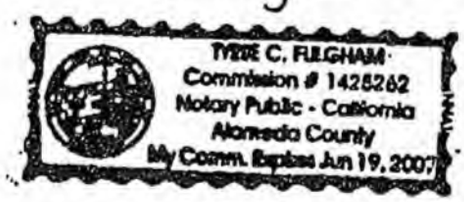
29. For the reasons discussed above, I conclude that competition in ACS' local exchange markets has reached the point where continued retail rate regulation raises substantial concerns. Such regulation is likely to impede the growth of competition in markets where entry has occurred and will perpetuate conditions that make entry uneconomic in areas where regulated rates do not cover the incremental costs of service. The long-run interests of consumers will be better served by relying on competition to discipline prices and send efficient signals to competitors. Should the market fail to perform as needed to protect consumers, regulation could then be re-imposed.

30. This completes my Affidavit.

DATED this 9th day of August, 2003.

Howard A. Shelanski
Howard A. Shelanski

SUBSCRIBED AND SWORN to or affirmed before me this 9 day of August, 2003, at Berkeley, California.



Tere C. Filgham
Notary Public in and for California
My Commission Expires 6/19/2007

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STATE OF ALASKA

THE ALASKA PUBLIC UTILITIES COMMISSION

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

In the Matter of the Commission Review of Rules and Regulations Governing Telecommunications Rates, Charges Between Competing Telecommunications Companies, and Competition in Telecommunications	R-03-3

NOTICE OF ERRATA

ACS of Anchorage, Inc. ("ACS-ANC"), ACS of Fairbanks, Inc. ("ACS-F"); ACS of Alaska, Inc. ("ACS-AK"), ACS of the Northland, Inc. ("ACS-N"), and ACS Long Distance, Inc. ("ACS-LD"), hereinafter collectively referred to as ACS, file an errata to their Reply Comments filed on August 13, 2003. The errata filing submits the curriculum vitae of Howard A. Shelanski and is Attachment 1 to Exhibit B of the Reply Comments.

Respectfully submitted this 13th day of August, 2003,

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

Ted Moninski, Director
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HOWARD A. SHELANSKI
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Current Position

University of California at Berkeley, School of Law
Professor of Law, and Director, Berkeley Center for Law and Technology. Teaching areas include antitrust law, telecommunications law, regulated industries, and contract law.

Experience

Federal Communications Commission, Washington, D.C.
Chief Economist, 1999-2000.

President's Council of Economic Advisers, Washington, D.C.
Senior Economist, responsible for issues of industrial organization, competition policy, regulation, and trade, 1998-99.

Kellogg, Huber, Hansen, Todd & Evans, Washington, D.C.
Associate, telecommunications and general litigation practice, 1995-97.

Law Clerk to Justice Antonin Scalia, United States Supreme Court, 1994–95.

Law Clerk to Judge Louis H. Pollak, U.S. District Court, Eastern District of Pennsylvania, 1993-94.

Law Clerk to Judge Stephen F. Williams, United States Court of Appeals, D.C. Circuit, 1992-93.

Education

University of California at Berkeley, Economics Department
Ph.D. 1993; M.A. 1989
Dissertation: "Transfer Pricing and the Organization of Intrafirm Exchange."

University of California at Berkeley, School of Law (Boalt Hall)
J.D. 1992; Order of the Coif
Senior Articles Editor, *California Law Review*

Haverford College, Pennsylvania
B.A. (history) with high honors, 1986
Phi Beta Kappa; varsity track and cross country

Other

Speak French and Spanish;
Enjoy brewing beer, outdoor sports, travel, and jazz;
Admitted to the Bar in the District of Columbia and in Pennsylvania.

Selected Research & Publications

(With Peter Klein) "Empirical Research in Transaction Cost Economics: A Review and Assessment," 11 *Journal of Law, Economics, & Organization* 335 (1995).

"Transaction-Level Determinants of Transfer Pricing Policy: Evidence From the High Technology Sector," working paper, U.C. Berkeley School of Law, (1997, revised May 2002). Under review at the *Journal of Industrial and Corporate Change*.

"The Bending Line Between Conventional Broadcast and Wireless Carriage," 97 *Columbia Law Review* 1048 (1997).

"Video Competition and the Public Interest Debate," Mackie-Mason and Waterman (eds.), Telephony, the Internet, and the Media: Selected Papers, 25th Annual Telecommunications Policy Research Conference (1998).

(With Peter Huber) "Administrative Creation of Property Rights to Radio Spectrum," XLI(2) *Journal of Law and Economics* 581 (October 1998).

(With Jerry Hausman) "Economic Welfare and Telecommunications Regulation: The E-Rate Policy for Universal-Service Subsidies," 16 *Yale J. Reg.* 19 (1999).

"The Speed Gap: Broadband Infrastructure and Electronic Commerce," 14 *Berkeley Tech. L. J.* 721 (1999).

"A Comment on Competition and Controversy in Local Telecommunications," 50 *Hastings L. J.* 1617 (2000).

"Competition and Deployment of New Technology in U.S. Telecommunications," 2000 *The U. Chicago Legal Forum* 85 (2000).

(With Greg Sidak) "Antitrust Divestiture in Network Industries," 68 *U. Chicago L. Rev.* 1 (winter 2001).

(With Stuart Benjamin and Douglas Lichtman) TELECOMMUNICATIONS LAW AND POLICY, Carolina Academic Press (2001).

"From Sector-Specific Regulation to Antitrust Law for U.S. Telecommunications: The Prospects for Transition," 26 *Telecommunications Policy* 335 (2002).

"Competition and Regulation in Broadband Communications," in Crandall and Alleman (eds.) BROADBAND: SHOULD WE REGULATE HIGH-SPEED INTERNET ACCESS?, Brookings Institution (2002).

"Regulated Competition and Regulatory Takings: The Law and Economics of *Verizon* v. *FCC*", working paper (2003).

14

STATE OF ALASKA

THE ALASKA PUBLIC UTILITIES COMMISSION

Before Commissioners:

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

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

AFFIDAVIT OF HUGH MCKENNA
ON BEHALF OF
ALASKA COMMUNICATIONS SYSTEMS

Impact Analysis of Tariff Reviews in a Competitive Telecommunications Environment

I. Qualifications

1. My name is Hugh E. McKenna. I am Managing Director of Mountainside Enterprises, Inc., which is my own independent management consulting company. My address is 6 Mountainside Drive, Morristown, New Jersey 07960.

2. I received my B.A. from the University of Notre Dame in 1970, and my M.B.A. from Cornell University in 1972. I joined AT&T in 1972 immediately following graduate school, and during the next twenty-six years completed assignments with successively higher levels of responsibility in a wide range of functional areas. One primary set of activities while at AT&T related to helping the company create new

products and enter new markets. This was accomplished through helping to develop new market entry plans for Lucent products for thirty international target countries in the early 1980s, and through promoting the development of enhanced service offers for Business Communications Services, helping to establish AT&T's new Solutions business unit, and preparing new product and service offers for AT&T's Local Services market during the early and mid-1990s. While at AT&T I also held various other positions within Strategic Planning, Finance, and in Operations Planning and Engineering.

3. I established Mountainside Enterprises, Inc. in 1998, and it has operated successfully during the past five years. I have completed numerous assignments related to the telecommunications, Information Technology and the emerging Electronic Business areas. Selected highlights include publishing a major market research report on wireless data applications for Enterprise customers, acting as Program Manager for an ISP/CLEC startup in Buenos Aires, Argentina, and helping AT&T Laboratories assess the commercial viability of new Web-based technologies. My Curriculum Vitae is attached to my testimony.

II. Purpose of Declaration

4. This analysis addresses the impact of continuing the traditional tariff review process for Incumbent LECs (ILECs) within a competitive telecommunications environment. In his analysis, Professor Howard Shelanski notes that the ongoing application of retail regulation can artificially depress prices and, as such, acts as a disincentive for new market entrants.[1] In addition to this observation, my conclusion is that continuing traditional tariff reviews not only serves no evident purpose, but also acts to

[1] R-03-3, Affidavit of Howard A. Shelanski, August 11, 2003, Section IV, beginning at p.5.

increase the time and cost needed for an ILEC to introduce new services. Further, it provides unfair advantages to other competitive telecom entities that have already entered a particular market.

5. The first relevant point to consider is whether genuine competition does exist in Alaska for local telecommunications services, and how one would measure the degree of competition that does exist. Relatively simple examples should suffice here. Since underlying competitive conditions have been established following the Telecommunications Act of 1996, ACS' market share for local services in Anchorage has been reduced from 100% share to somewhere around half of that amount at the present time. Significant but less severe reductions in market share have also been experienced in both Fairbanks and Juneau. While I do not endorse the use of market share tests for determining the point at which relaxed regulation is appropriate, it is evident from these simple facts alone that consumers not only have a choice of competing telecommunications offers, they are also actively selecting them in many cases.

6. A relevant measure of competitiveness suggested by ACS in its July 16 comments does have considerable merit, and I suggest that the commission give it serious consideration. It states that competitive conditions exist in a market where 75% of consumers can currently be served by more than one facilities-based carrier, where facilities-based is understood to mean either using its own facilities or those it procures on a UNE basis from another carrier. It is the availability of attractive, alternative offers that truly characterizes a competitive marketplace, and this is more important than the relative mix of services that are currently procured from any single one of the competitive entities.

7. To illustrate, many types of consumer goods are currently available to be purchased at the local supermarket. Even though one may continue to purchase the same brand of goods as in the past, it is an awareness of viable alternatives where changes may be made in price and other conditions that characterize a competitive market situation. With a sufficient change in one of the offer conditions relevant to the consumer, he or she will choose to change their supplier, and this is precisely what disciplines the market leader to change its offer only after careful consideration. Where viable alternatives exist that the consumer is sufficiently aware of, competitive conditions have been achieved, and the market leader must always act in the context of potential competitive response to its actions. It is recommended that the commission give serious consideration to using the 75% consumer coverage rule, as noted above, as a benchmark for determining when competitive conditions have been achieved in local telecommunications markets.

8. Where competitive market conditions can be shown to exist, a second relevant point relates to the value and role of ongoing tariff reviews by a regulatory commission, and whether rules relating to these reviews should differ among market participants. If competitive market conditions have been achieved, it is not clear what value remains in regulatory review and oversight, other than assurance that some implicit collusion among participants is not taking place, and that safety net and carrier of the last resort requirements will be satisfied. Safety net and related conditions should be examined before new market offers are introduced in cases where it is apparent that these requirements could be impacted, while potential collusion is probably best addressed by observing the market behavior of competitors over some period of time. Beyond these two areas, regulatory review of new product and service offers only serves to slow the

increase the time and cost needed for an ILEC to introduce new services. Further, it provides unfair advantages to other competitive telecom entities that have already entered a particular market.

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introduction of these offers by the time it takes to review them, adds a cost burden for the company that must submit them, and it adds to the workload of the commission that must review them. The efficient working of the marketplace will truly take care of disciplining the offers and the behavior of the market participants completely aside from regulatory review. It is certainly not in the public interest to continue such regulatory review unless clear benefit can be demonstrated.

9. It logically follows that if such a review is unwarranted for an individual carrier in a competitive market, then the need to apply different forms of regulatory review for different participants in that market is also not clear. If review is not needed for any individual carrier in a competitive market, the need to differentiate among them for review purposes ceases to be relevant.

10. Most important in examining the impact of the tariff review process in competitive markets are cases where harm may be done to both competitive markets and to individual competitors as part of the process. Such harm does indeed appear to result from continuing the tariff review process in competitive markets, and this provides the strongest argument yet for moving to the new paradigm of detariffing local services in these cases. In addition to slowing new market offers and adding to the cost basis for providing them, in order to fulfill review requirements, the current process also provides competing carriers with an unreasonable opportunity to review competitive market plans in advance of introduction, and it reduces a carrier's ability to fully capitalize upon its own creative marketing efforts as a consequence. Finally, potential disclosure of confidential cost information to competitors is fundamentally inconsistent with the basic tenets of competitive markets, as companies need to safeguard the right to keep such information

about their own internal efficiency completely confidential. The harm caused to an ILEC by disclosing information within the tariff review process will be covered in greater detail below, under the separate topics of time-to-market advantages, product and service differentiation, and implications of disclosing underlying cost information.

III. Time to Market

11. The ability to correctly perceive market needs and to rapidly introduce products that meet them are fundamental elements of a successful competitive enterprise. Market studies demonstrate repeatedly that companies that perceive market needs quickly, and respond rapidly, become market leaders. This ability is often called a time-to-market advantage, and superior skills in this area are increasingly separating the winners from the losers in the market. While time-to-market advantages may seem somewhat apparent, some illustrations and supporting information may serve to highlight appropriate insights in this area.

12. A recent article in the Wall Street Journal observed that Motorola was increasingly lagging behind market leader Nokia in cell phone development and sales, due to inability to rapidly bring new products to market. It noted that while Nokia was able to field on the order of twenty-five new phone designs in the market each year, Motorola was averaging only five or six. In its analysis of the situation, the article went on to note that Nokia had developed an underlying product design that made maximum reuse of common components among models, while Motorola had designed each product uniquely, and shared little or no synergies among products. Two fundamental consequences result from Nokia's superior approach. It has the advantage of testing many more product concepts in the market than its competitor, and as a result to continue to "recycle" more rapidly those

introduction of these offers by the time it takes to review them, adds a cost burden for the company that must submit them, and it adds to the workload of the commission that must review them. The efficient working of the marketplace will truly take care of disciplining the offers and the behavior of the market participants completely aside from regulatory review. It is certainly not in the public interest to continue such regulatory review unless clear benefit can be demonstrated.

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designs that fail to successfully meet customer needs. And second, it is able to make much more efficient use of development resource by effectively sharing among designs, fueling the engine that produces many more numerous new designs per year than Motorola. It is interesting to note that this is precisely the strategy now being undertaken by Daimler Chrysler to improve the joint success of its Mercedes and Chrysler car divisions. Nokia's ability to correctly perceive needs and rapidly deliver on them has solidified its place for the time being as market leader in cell phone sales. We should consider whether it would enjoy comparable success if its competitors had the ability to review its new product offers before their introduction, in some cases including the underlying cost estimates for the latest models. Nokia is not required to do so, and it is free to enjoy the benefits of its superior approach through superior market and financial results.

13. A second example will be familiar to those who have actively followed long distance market developments in the "Lower 48" states over the past decade. MCI has repeatedly bested its archrival AT&T with new marketing ideas and superior time-to-market delivery. For collect calls, it determined that the 800 numbers were available that corresponded to 1-800-COLLECT on the dial pad, and it rapidly moved this offer to market. AT&T appeared to be completely caught off guard, and with the numbers for the "COLLECT" offer now owned by MCI, it came up with a competing offer of 1-800-OPERATOR, which had considerably less cachet and probably was less easy for a consumer to recall. Based upon innovation and rapid delivery, MCI clearly won the time-to-market game, and it was rewarded appropriately in the marketplace. It is not clear who would have won this market skirmish if MCI had been required to share its plans with AT&T before market introduction.

14. Another MCI example that is relevant relates to its calling plan "Friends and Family", which leveraged flexibility in its new billing platform to permit discounted service to other MCI customers (i.e., friends and family). After introduction it took AT&T several years to produce a comparable offer, due to the greater challenge it experienced in making needed changes in its own billing platform. In this case MCI was amply rewarded in the market by excellence in time-to-market skills as well, and secrecy in preparing this market offer clearly worked to its advantage.

15 A third example deals specifically with the period of time a new consumer-related idea remains new and novel in the market, and thus the time an innovative company has available to recoup its investment in resources in this new offering. Even genuinely new product ideas may have a very short "shelf life" in which they retain special appeal in the market, and are either promptly imitated or rapidly go from fame to fad. Think of new consumer ideas such as Pet Rocks, Scooters, Hoola Hoops and Tickle-Me-Elmo dolls. Each had rapid market introduction and a single season of success, with a very limited time to recoup its investment in the new product. In all likelihood, the companies introducing these new products were more than adequately rewarded for their marketing flair with these products, although one wonders whether they would have been willing to share their ideas in advance with a set of key competitors before product introduction, or to bring these products to market if they had been required to do so. Even if they had chosen to proceed with market introduction following disclosure of their plans, the limited time they would have to recoup their investment with serious market competition would have been measurably diminished.

16. Finally, certain major companies make conscious choices about where to position themselves in the innovation and time-to-market game, and not all choose to be the "first mover". Certain companies have concluded that there is generally too much risk in being first to market with a new idea, and that a wiser choice is to let someone else spend the resource and do a market test of new ideas before they will spend significant resources on those concepts on their own. Microsoft and IBM are two prime examples here. Little of what either company introduces is first to market, but generally is inspired by efforts made by smaller competitors that are subsequently imitated after they first test the waters. Both have chosen to be "fast follower" instead of "first movers", and due to market force and sufficiently rapid response have won more than their share of battles over time. Again in this case the innovating company has the opportunity to bring a fresh approach to the marketplace and to have a corresponding head start in the race, without first reviewing its plans with its primary competitors.

17. Each of these cases above shows a different aspect of how time-to-market considerations contribute strongly to a company's competitive strategy, and in no case is a company normally required to share its market plans and strategy with its primary competitors before introduction of a new product and service. Companies that are successful in the time-to-market dimension take either calculated or more significant risk, but in every case they are free to earn the appropriate reward for risk-taking in the marketplace without sharing of critical market plan information.

IV. Product Differentiation

18. The second significant dimension of competitiveness relates to whether a company is able to develop and sell products and services that are different from those of

its competitors in meaningful ways. If all products and services within a specific category are fundamentally the same, then all that is left to differentiate them is price, and marketing people typically seek many additional ways in which to demonstrate the specific appeal of their products. This dimension of competitiveness is generally called product and service differentiation. We'll examine several ways in which differentiation is sought wit.. varying degrees of success within the telecommunications industry today.

19. Despite the fact that telecommunications providers offer very similar services, product differentiation is still possible. The specific way in which a service is packaged, offered and supported in the market does serve to differentiate it in the eyes of the typical consumer, and marketing groups for the service providers make every effort to make best use of this "product mix". Although price does remain the primary element of differentiation for most consumers, other attributes do play a role in the product mix. Some companies think of the total customer experience with a vendor as the real service that they are selling. In this case, attributes such as billing accuracy, speed of repair service efforts and courtesy and competence of customer service representatives are stressed as part of the total package.

20. Other approaches may attempt to stress the quality of the service itself. Consider the efforts of Sprint during the last decade to stress its superior voice quality, touting its "all fiber network" and asserting that "you can hear a pin drop". AT&T once claimed superiority of service based upon the shortest call setup time, which addresses the time between completion of dialing and connection to the called party. AT&T also makes a generalized claim to greater reliability of service, although data to support this claim are seldom offered. Innovative approaches to determining the product mix can also stress

inclusion of additional "external" benefits such as frequent flier miles, or selection of some special gift every quarter based upon the volume of service usage. Finally, innovative service providers have discovered that bundling of various telecommunications services into attractive packages has strong appeal to consumers, and bundled offers of local and long distance services have now become standard practice among leading service providers in the "Lower 48" states.

21. Although these are genuinely creative efforts to achieve product and service differentiation, there are generally no real barriers to adopting a competitors' chosen approach if it appears to be winning in the marketplace. Consider developments related to offering cellular telecommunications service in the "Lower 48" states as a useful example. Beyond selection of underlying CDMA versus GSM cellular network technologies, the service offered by all service providers is fundamentally similar. Efforts to differentiate individual service offers include the following. Cingular Wireless has adopted a plan where unused minutes from one month are "rolled over", to be used in subsequent months and never paid for and lost. Verizon Wireless has adopted a scheme where calls among family members signed up under the same collective family offer are not included within the total number of minutes permitted on a monthly basis, effectively making them free in cases where they would have exceeded the limit otherwise. Verizon has also claimed superiority in effective coverage within its service area, and Sprint has recently echoed this claim as well, although there is no apparent mechanism to validate or disprove either one's claim.

22. Various service providers make distinctions regarding night and weekend minutes versus "anytime minutes", and it is now becoming the norm to include "free" long

distance service as part of the premium cellular service offers. All major service providers claim to offer a service that is national in scope, accomplished by using their own facilities where they are available and reselling a competitors' service where they have none. Services related to the new third generation (3G) cellular networks are also evolving in similar fashions, including photo service, games, PDA functionality and internet access in addition to basic voice services.

23. The messages to be drawn from the intense competitive efforts of these cellular service providers are clear. Creative marketing will play a significant role in determining the ultimate victors in the marketplace, and new approaches such as bundling and creative connections to other services will be required. However, most marketing approaches could also be promptly replicated if they appeared to be winning efforts. Telecommunications service providers will continue to have every incentive to achieve product and service differentiation in ways that are most meaningful to their customers. In the case of cellular services in the "Lower 48", it would be regarded as an unnecessary burden and an impediment to open competition if these service providers were required to share their marketing plans with their competitors before introducing new services. They would rightfully ask what would be gained from such disclosure, other than valuable advanced notice to their competitors, and limits to their ability to achieve differentiation.

V. Efficiency

24. A third key dimension of competitiveness relates to the fundamental efficiency achieved in delivering the product or service that the company offers. In addition to the attributes of speed and agility noted above, another key measure of efficiency relates to the cost levels incurred by a company in providing these products and

services. A company's underlying cost structure is a prime determinant of both profitability and its competitive position in the marketplace. Clearly, companies with higher costs per unit of product sold either need to charge their customers more for the product, or to accept lower margins on the resulting sale. Accordingly, companies place intense focus on minimizing their underlying cost structure compared to their competitors in order to achieve competitive advantage.

25. Because of the central nature of costs to a company's competitive position, information regarding costs is typically closely held and seldom shared with anyone without an absolute need to know them. A company will publish its overall financial results in its annual reports and related financial statements, but it exercises considerable discretion about making statements of cost or profitability below aggregate levels. It may opt to break out financial results according to company division or product groups, in order to highlight superior performance in specific areas, but most major corporations choose to only make these statements at the aggregate level in order to protect this highly valuable, proprietary information.

26. In fact, greater degrees of disaggregation in available cost data offer increasingly greater potential value to a competitor. Such detail starts to provide intelligence on whether this competitor will be able to match a company's offer on a sustained basis in the marketplace, and on how a company needs to position its own products on a relative basis in the market. For instance, if you were aware that your costs for a specific product were 10% less than those of your competitor, you would know the precise price point at which it would be losing money by matching your own product offer.

27. Alternatively, if you knew that your competitor was pricing below its own average cost for some special product promotion, it would in all likelihood limit the time of this promotion in order to minimize the financial consequences. In another case, if you knew that your own costs were 10% higher than your competitor's on a unit cost basis, you would need to either accept lower margins by matching its price levels, or to convince your own customers that your product is justifiably priced at a premium over theirs due to effective differentiation. It is due to the significant value of cost information about a competitor's products that such significant efforts are directed toward reverse engineering them, as well as toward outright industrial espionage in some cases.

28. Accurate perceptions about costs will also drive significant business decisions and strategies for a company, and misperceptions about costs can also be highly damaging. AT&T for years undertook successive rounds of cost cutting in attempting to achieve the cost levels being publicly reported by Worldcom (now MCI). None of AT&T's business analysts or accountants could determine how it was possible for MCI to continue to make money with the service rates it was charging in the market, and the costs reported on its financial statements. It has now been fully reported how true costs were not disclosed by MCI for several years, although during this period AT&T undertook significant efforts to achieve cost parity based upon its best available intelligence at the time.

29. Without a doubt, companies in a competitive environment make significant efforts to both protect their own proprietary cost information, and to seek such information about competitors using available legal and sometimes other less wholesome methods. Accordingly, maintaining an appropriate competitive environment suggests the important

need to safeguard such proprietary information with all required diligence. If cost information continues to be an important topic of regulatory review, considerable efforts should be directed toward ensuring that it is not inadvertently shared with competitors.

VI. Conclusion

30. In summary, a significant degree of competition has now been introduced in the telecommunications market in Alaska and, to a lesser degree, throughout the U.S. As a consequence, consumers are beginning to reap the benefits of a considerably wider range of choices, resulting from an increased set of competitors constantly seeking better ways to serve them. The underlying dynamic of competitive markets will in most instances yield the desired results of increased choices at lower costs. In order to achieve this goal, however, it is imperative that companies be treated fairly and equitably, and they should also able to reap the rewards of creative marketing and innovation.

31. Where a competitive environment has been achieved, which has occurred in significant portions of Alaska, it is not clear what benefits a continued tariff review process would offer. Where tariff reviews are no longer needed, the distinction in treatment among different competitors loses relevance. As currently conducted, this review process only appears to slow the service introduction process, add associated costs, increase the workload of the commission, and raise the risks for seriously damaging information disclosure regarding the creative market plans and underlying cost structures of specific participants, especially ACS. Adopting the new paradigm of a detariffed environment where competitive conditions exist would be the most promising approach to achieving the desired benefits of competition, while at the same time permitting competitive parties to reap appropriate rewards for their innovative efforts.

32. This completes my Affidavit.

DATED this 11th day of August, 2003, at Morristown, New Jersey.

Hugh McKenna, Managing Director
Mountainside Enterprises

SUBSCRIBED AND SWORN to or affirmed before me this 11 day of August, 2003, at Morristown, New Jersey.

Notary Public in and for New Jersey
My Commission Expires Dec 20, 05

FARRAH J. BAUM
NOTARY PUBLIC OF NEW JERSEY
My Commission Expires Dec. 20, 2005

HUGH E. McKENNA
6 Mountainside Drive
Morristown, NJ 07960
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SUMMARY

Versatile telecommunications and IT industry professional, seeks new consulting engagements and specialized contract work. Combines creativity with strong analytical skills, to address strategic, technical and operations analysis and management. Offers broad industry expertise with significant strength and proven track record in:

- New business development and technology assessment
- Operations and business process analysis
- Customer Relationship Management and effective customer service
- Wireless technologies and applications
- E-business software and services
- Professional market research

PROFESSIONAL EXPERIENCE

Mountainside Enterprises, Inc., Management Consulting (1998-Present)

- Prepared assessment of AT&T Laboratories software tool used to access information from targeted websites, to support competitive analysis, monitoring and surveillance purposes. Conducted market scan to determine capabilities of tools and techniques used for similar purposes, examined range of associated analytics needed to support advanced usage, and specified development program needed to support competitive market entry in 2003.
- Prepared Expert Witness testimony for use in class action suit in Alaska, related to bundling long distance and local telecommunications services offers into integrated offerings. Participated in development of litigation defense strategy. Will serve as Expert Witness during jury trial anticipated in 2003.
- Prepared strategic overview of emerging market and technical developments in the Customer Relationship Management (CRM) area, to support development of service offers for a new consulting practice for a rapidly growing telecommunications-based consultancy.
- Co-author of wireless industry analysis and market research report entitled *Wireless Applications: Strategies for Capturing the Business Market*, published in July, 2001 in collaboration with Phillips Infotech, Inc. Conducted interviews with fifteen leading industry services suppliers, and analyzed over eighty structured survey responses from corporate wireless customers. This report provides in-depth analysis of current wireless industry issues and trends, and identifies key success factors for major market participants.
- Developed detailed recommendations for SprintPCS to improve current approach to supporting Enterprise customers, related to integration of wireless and wireline offerings, targeting high value added Enterprise applications, and use of partners to support sales channel and systems integration requirements.
- Developed Local Access strategy to enable Teleglobe to enter new U.S. and European markets for wholesale and commercial IP and hosting services. Examined current marketing and operational processes supporting new market entry, including partnership strategy for obtaining leased fiber capacity. Assessed significant business development and partnership options to accelerate market entry and to augment existing Teleglobe capabilities.

- Program Manager for commercial services launch of iPlan Networks, a new ISP/CLEC in Buenos Aires, Argentina. Led team of seven Subject Matter Experts in defining information requirements and process flows for key operational areas. Issued and analyzed RFP's for operations and financial systems support, and assisted in refining product offers to ensure integration with operations support capabilities. Provided advice in key strategic areas. Instituted overall program management planning and tracking systems to ensure effective transition of capabilities to iPlan Networks management team.
- Provided technology and market assessment of various Korean products identified by government-sponsored export development agency (KIPA) for potential distribution in the US market. Identified appropriate market entry strategies for selected wireless and CRM products, and identified target US companies to approach for use as potential distribution channels.
- Developed comprehensive process model of Frame Relay and Private Line maintenance Call Centers, addressing incoming call handling, diagnostic and repair activities and expert systems software, to optimize overall center effectiveness. Placed special emphasis upon migrating customers to greater use of web-based self-servicing capabilities.
- Project Manager of AT&T and BellSouth assessment team, evaluating customized software supporting T-1 maintenance in future network environments.
- Engagement Leader for Call Center optimization project, addressing AT&T Metro Markets billing inquiry and trouble resolution processes. Directed extensive process work flow and systems analysis, stakeholder interviews, direct timing observations, structured workgroup sessions and Interactive Voice Response (IVR) assessment to identify recommended improvements in overall center management processes. Placed special emphasis on migrating customers to greater use of IVR and web-based self-servicing capabilities.
- Prepared detailed assessment of AT&T Metro Markets Local Fulfillment activities, supporting effective creation and validation of new customer orders for local service. Examined current process, systems and management decision rules to identify critical areas for immediate improvement. Supervised preparation of Microsoft Access database architecture to address key information needs for a streamlined Local Fulfillment process.
- Conducted overall assessment of Enterprise-level data integrity for a rapidly growing CLEC (McLeodUSA). Participated with team of analysts to address current data inconsistencies among network, customer provisioning and billing systems, and provided longer-term process-based improvements to ensure superior data integrity levels in the future.

AT&T Corporation

Business Development Director-Local Service Organization (1996-1998)

- Successfully negotiated operations and technical serving arrangements with numerous Competitive Local Access Providers, to supply dedicated and switched access in support of local market entry.
- Led operations and technical assessment of 38 GHz, LMDS and MMDS wireless technologies for use within local services. Prepared overall assessment of wireless options to replace RBOC resale arrangements (Total Services Resale and Unbundled Network Elements), or to use in place of other key technologies (Hybrid Fiber-Coax, Digital Subscriber Line). Established approved technology road map for use of key wireless technologies.
- Led in-depth analysis of strategic business development options in local markets. Addressed preferred partnering arrangements with cable companies, utilities and new wireless entities, including the full range of contractual, franchising, equity-based and acquisition options.
- Managed group with primary business development and service contract negotiation responsibilities for Western U.S., and also included responsibilities for numerous national service suppliers (MCI, WinStar, Time Warner Cable).

Product Development Manager-AT&T Solutions (1994-1996)

- Directed comprehensive customer needs assessment for new Managed Network Services and Outsourcing offers. Identified required technical and feature/function improvements beyond existing offers. Developed and introduced specialized MNS and Outsourcing offers for middle-market customers.
- Defined overall capability requirements for AT&T Solutions' new Network Management and Outsourcing practice. Performed detailed benchmarking of targeted capabilities compared to key strategic competitors. Introduced initial service offers to Global 2000 target customers.
- Identified Merger and Acquisition requirements to support Network Management and Outsourcing practice. Directed financial and operational assessments of partnering options and service deployment scenarios. Conducted initial M&A discussions with potential partners (Accenture, CompuCom, Vanstar).
- Identified Supply Chain Management solutions for Logistics and Transportation industries, utilizing emerging Internet and AT&T-internal capabilities.

Market Development Manger-Business Communications Services (1991-1994)

- Conducted primary market research addressing Health Care and Insurance industry information technology applications. Prepared integrated product/service offers for leading industry customers (Blue Cross/Blue Shield, Travelers Insurance)
- Managed strategic, financial and technical assessment of $250M Electronic Claims Processing joint venture with leading Health Care systems group (Shared Medical Systems). Presented joint venture plans and obtained approvals up through Vice-Chairman level.
- Prepared specialized value-added data communications services for the Health Care and Insurance industries. Defined market and technical requirements, and managed related Bell Labs development.
- Examined the full range of partnership proposals received by AT&T to create business development partnerships in the services area. Prepared detailed analysis of potential partnership with The New York Times, to create an electronic information service to be deployed on a national basis.

Strategic Planning Manager-Corporate Strategy & Development (1987-1991)

- Identified requirements to increase corporate emphasis on Data Networking capabilities, and to make a major computer industry acquisition.
- Guided development of AT&T's international market development strategy.
- Assessed joint venture and acquisition options in Far East. Supported discussions with potential key alliance partner (Fujitsu).
- Created and deployed interactive, high-tech executive decision support system (Situation Room)
- Conducted numerous in-depth strategic analyses (Data Networking Strategy, PBX spin-off options, HDTV implications and requirements). Resulted in AT&T retention of $6B PBX business and intensified focus on corporate HDTV initiatives.

Additional experiences include:

- Developed and taught Financial Analysis courses.
- Prepared business case analyses related to international product development and market entry.
- Prepared organizational design recommendations for significant Bell System reorganization.
- Completed various operations planning and engineering assessments, evaluating operational and economic impact of proposed network and software upgrades.
- Created overall data model to address Business Marketing information requirements.

EDUCATION

M.B.A. Cornell University, Ithaca, New York. Finance concentration, *With Distinction (top 10%)*
B.A. University of Notre Dame, South Bend, Indiana. Double major in Economics and French, *Cum Laude (top 15%)*

Additional Honors Programs:

L'Universite Catholique de l'Ouest, Angers, France. Completed one-year honors program conducted entirely in French language.
Clarkson College of Technology, Potsdam, New York. National Science Foundation advanced mathematics and science program.

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STATE OF ALASKA

THE REGULATORY COMMISSION OF ALASKA

Before Commissioners:

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

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

AT&T ALASCOM'S REPLY COMMENTS

I. INTRODUCTION

AT&T Alascom has reviewed the comments filed by other parties and will focus its written reply comments on a few issues that are most important to it in its dual capacity as a long distance carrier (or inter-exchange carrier "IXC") and a competitive local exchange carrier. As the incumbent long distance carrier, AT&T Alascom is most directly concerned with Legislative Policy No. 2 (determination of dominance and non-dominance) and Legislative Principle No. 3 (prohibition on placing incumbent at unfair competitive disadvantage) and Principle No. 6 (encouragement of infrastructure development). AT&T Alascom's reply comments as an IXC argue in favor of a new regulation on dominance, creation of a competitively neutral fund to support facilities-

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based Bush service, and, in appropriate circumstances, shared Carrier of Last Resort ("COLR") responsibilities.

As a competitive local exchange carrier, AT&T Alascom is primarily concerned with Policy No. 1 (mandating fair payment for use of another carrier's facilities) and Policy No. 4 (considering the existence of actual competition before relaxing regulations). AT&T Alascom's reply comments on the local exchange rules argue in favor of maintaining the availability of unbundled network elements ("UNEs") from the incumbent local exchange carrier ("ILEC") at a fair and reasonable price in accordance with the Telecommunications Act of 1996.

II. IXC ISSUES

A. A New Approach To Dominance Is Necessary

In Policy No. 2, the Legislature clearly states that the fact that a carrier in a competitive market is the incumbent carrier is not relevant in determining whether or not it is dominant. Yet, today in contravention to Policy No. 2, AT&T Alascom is regulated as dominant just for being the incumbent IXC. *See* 52.363(b). Overwhelmingly, the facts do not support AT&T Alascom's classification as a dominant carrier. Over 10 years after intrastate competition began, and eight years after AT&T Alascom was considered by the FCC to be non-dominant for most interstate services, there is no other basis on which AT&T Alascom could be considered to possess market power or to require regulation as the dominant carrier.

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In 2002, AT&T Alascom's statewide total IXC market share had dropped to 42 percent.[1] In 1995, when the FCC reclassified AT&T Corp. as non-dominant, AT&T had a market share of 60 percent. *See*, In Re Motion Of AT&T Corp. To Be Reclassified As A Non-Dominant Carrier, Order dated October 12, 1995 ("Reclassification Order"), at ¶ 67.

Changing circumstances make AT&T Alascom no longer a dominant carrier even for transport. In 1991 AT&T Alascom was designated as dominant. Since then, however, AT&T Alascom's share of the transport capacity in the state has declined dramatically. In addition to the high capacity GCI and WCI undersea cables, there has been substantial new development of fiber optic capacity since 1995 within Alaska. Fiber optic cable systems have been built by Alaska Fiberstar ("AFS"), which is part of the WCI system, and KANAS, Inc., a consortium of Alaska Native Corporation, and MFS, Inc. The AFS facility, controlled by ACS, connects Anchorage and Fairbanks, as well as Eagle River, Wasilla, Talkeetna, Cantwell, Healy, Clear, and Nenana, and through WCI, provides direct interconnection among these Alaska locations, Seattle, Washington and Portland, Oregon. The KANAS facility, which is now owned and operated by GCI, runs along the 800-mile TransAlaska Pipeline connecting Valdez with Prudhoe Bay and providing interconnection at numerous places along that route. Additional fiber optic cable systems have been installed or are being installed between Klawock and Craig and Hollis; Fairbanks and Ft. Graham, Gilmore Creek, and the Delta Junction / Poker Flats area; Homer and Soldotna and Moose Pass; and Anchorage and

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[1] Bearing Point Study, page 17.

Wasilla. These projects are examples of entirely new fiber optic deployment since 1995. In addition, GCI has recently announced plans to build a new fiber link to the Lower 48, to be completed by summer, 2004.

Also, AT&T Alascom is not the only company that has deployed a satellite to serve Alaska. Although AT&T Alascom has taken the (expensive) steps necessary to ensure the continuity of satellite service to Alaska, other satellites now also provide service coverage to Alaska, separate from Alascom. For example, in January 2000, Galaxy-10 was launched, a satellite that provides GCI with both C-band and Ku-band capacity. Generally speaking, all geostationary satellites located west of 199 degrees west longitude have the capability to serve Alaska. Presently, the domestic satellites permanently in these positions include: Galaxy-9, Galaxy-5, Satcom C-3, Galaxy-1R, Satcom C-4, Satcom C-1, and Aurora II (also known as Satcom C-5). Certain international satellites could provide service to Alaska, at least in part, and most or all non-geostationary satellite systems which offer world-wide coverage also provide the potential for service to Alaska. Therefore, there are numerous alternative satellite facilities potentially available to entities seeking to compete in Alaska. The deployed satellites are able to offer Alaska consumer services such as email, voice over IP calls, and mobile phones.

As an IXC, AT&T Alascom provides three general categories of service: Message Toll Service (MTS), private line dedicated service, and wholesale service.

Message Toll Service. While it is true that there are multiple Bush locations where AT&T Alascom has the only MTS facilities, those locations combined represent a

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mere 10 percent of the access lines in Alaska.[2] Moreover, equal access is available and functional for the vast majority of access lines in the state, and is available, should a carrier request it, everywhere in Alaska, permitting GCI and other IXCs to offer competitive MTS service in Bush locations. In addition, a significant change in the treatment of MTS service in Bush areas has occurred. In 2000, the RCA lifted the intrastate "facilities restriction" in Bush Alaska that had prevented other carriers from building facilities. *See*, R-98-1(6). Now, the FCC has done the same for interstate. *See* FCC Press Release, attached as Exhibit A. The FCC's written order to this effect was issued August 12, 2003, and is attached to these comments as Exhibit B. As a result, AT&T Alascom no longer has a legal monopoly on MTS facilities in Bush Alaska. Should a carrier wish to build there it will be fully able to do so. This action by the FCC eliminates the last remaining justification for maintaining the anticompetitive, discriminatory treatment of one carrier over another in the interexchange market in Alaska.

Even more importantly, if no other carrier ever builds MTS facilities in these locations, AT&T Alascom cannot exploit these Bush facilities to raise MTS rates *because of the legal requirement that all MTS rates must be geographically averaged.* Customers calling to and from Bush locations pay the same rates as customers living in urban Alaska and calling on high-density routes. If AT&T Alascom tried to raise its rates to exploit its alleged facilities bottleneck, its urban market share would erode still further. AT&T

[2] By comparison, incumbent LECs have control of bottleneck facilities – local loops – that affect competitive access to 100 percent of the market.

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Alascom has zero ability to exercise market power by virtue of its ownership of Bush facilities. On the contrary, the expense of maintaining these facilities actually impedes AT&T Alascom's ability to compete statewide and to earn a profit. They detract from market power; they do not enhance it.

Private Line. It has been argued in the past that private line rates are not geographically averaged, therefore AT&T Alascom must have market power in the private line product market in those Bush locations where it has the only facilities. That is untrue or irrelevant for a variety of reasons. First, there are not now, nor have there been, legal barriers to entering the private line market. The fact that GCI has done so with great success illustrates the benefits of a fully competitive marketplace. The federal Bush facilities restriction (which AT&T Alascom has actively sought to eliminate at the FCC) never has prohibited GCI from installing private line facilities in the Bush. GCI has exploited this fact by skillfully and aggressively pursuing the largest private line customers, the rural health care providers, which it serves with its Ku-Band Satellite facilities. Second, AT&T Alascom has repeatedly committed in Docket R-98-1 and in public testimony, and hereby recommits, to cap its private line rates at current levels, preventing it from exercising any market power it might be perceived to have. Finally, it is important that the Commission not let the proverbial "tail wag the dog." There is only a small number of private line customers in the tiny villages where AT&T Alascom has the only facilities, and these limited number of customers do not give AT&T Alascom overall market power.

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Wholesale. In the wholesale market, AT&T Alascom offers its retail business services to carriers for resale statewide (even in the extraordinarily high-cost Bush communities where it has the only MTS facilities) at pennies above *access* costs. Moreover, AT&T Alascom has pledged, and hereby recommits, to cap its wholesale rates at existing levels, thereby eliminating any conceivable concern that it could somehow use its control of any perceived "bottleneck" or "essential facilities" it might have to raise prices to its wholesale carrier customers.[3]

By mentioning these facts, AT&T Alascom does not intend to argue in this regulatory docket its case whether it, as an individual carrier, should or should not be deemed dominant. It believes, however, that these background circumstances are important for the Commission to understand when it considers the need for, and structure of, a new regulation on interexchange dominance. The abstract economic concepts in the proposed regulation have more meaning when considered in the context of real markets.

GCI's proposed dominance regulation, set forth on page 14 of its initial comments, is not a bad first effort. As proposed by GCI, however, the test of market power is overly simplistic, inconsistent with the FCC's approach, and could cause AT&T Alascom to continue to be regulated as dominant in the long distance market for improper reasons. For many years now, GCI has thrived in the telecommunications market in Alaska, where it enjoys non-dominant status and competes against carriers that are

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[3] Wholesale rates are almost exclusively used by carriers who do not wish an end-to-end service such that CustomNet-type services offer, but instead wish the call to be carried either at the originating or terminating leg on their network.

burdened with onerous dominant carrier obligations that GCI does not have. Adoption of GCI's modification of 3 AAC 52.363, as proposed, could perpetuate that imbalance.

AT&T Alascom believes strongly that any rewrite of 3 AAC 52.363 must expressly recognize critical factors that can mitigate or eliminate altogether market power that a carrier might otherwise possess. Geographic rate averaging is a prime example. In the AT&T Reclassification Order at ¶¶ 107-115, 146, the FCC expressly acknowledged the relationship between geographic rate averaging and non-dominant status. Any dominance regulation adopted by this Commission must necessarily recognize geographic averaging as a key factor in the market power analysis. GCI's proposal would perpetuate dominance regulation for an incumbent controlling even a single "bottleneck" facility, but absolutely no ability to exercise market power. For that reason, the Commission should look towards *market power* as the test for dominance, and not historical incumbency or control of a single bottleneck facility.

AT&T suggests that one way the Commission may use this market power test is by examining, on a confidential basis, the *market share* of each competitor in a segment of telecommunications industry. The FCC has also taken a practical and balanced approach to dominance issues. It looks at markets in their entirety and does not impose burdensome dominant carrier regulation where some *de minimus* or discrete market segment may not be completely competitive. *See* AT&T Reclassification Order, ¶¶ 20-21, 26 (noting in ¶ 26 that "addressing AT&T Alascom's market power by an "all-services" standard (i.e., requiring AT&T Alascom to establish that it lacks the ability to

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control price in all service segments), would result in a situation where the economic costs of regulation outweighs its public benefits.

The FCC does not insist on perfection either. In its decision to classify the Bell operating companies ("BOCs") as non-dominant in the provision of both in-region and out-of-region long distance services, the FCC stated:

> The actions we take in this proceeding will further the pro-competitive, deregulatory objectives of the 1996 Act by eliminating unnecessary regulation that is currently imposed on interexchange carriers affiliated with BOCs and independent LECs. Although we are classifying these carriers as non-dominant with respect to their provision of in-region and out-of-region long distance services, as summarized above, we recognize that as long as these carriers retain market power in providing local exchange and exchange access services, they will have some incentive and ability to misallocate costs to local exchange and exchange access services, they will have some incentive and ability to discriminate against their long distance competitors, and to engage in other anticompetitive conduct. We conclude, however, the regulatory structure we adopt today will continue the process of enhancing competition in all telecommunications markets as envisioned by the 1996 Act.[4]

In revising GCI's draft regulation, AT&T Alascom has attempted to make it more accurately reflect the analytical process that the FCC uses in its dominance and market power analyses. AT&T Alascom's improvements include:

(1) reversal of the presumption in subsection 363(c) that the incumbent remains dominant until proven otherwise, which conflicts with Legislative Policy No. 2;

(2) the explicit mention of mitigating factors like geographic averaging and price caps[5]

(3) consideration of the capabilities of the competing firms;

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[4] In Re Regulatory Treatment Of LEC Provision Of Interexchange Services Originating In The LEC's Local Exchange Area, 2d Report & Order CC Doc. 96-149; Third Report & Order CC Doc. 96-61, ¶ 10.

[5] *See*, AT&T Alascom Reclassification Order, at ¶¶ 10, .

(4) reference to the interexchange "market as a whole" to avoid the problem of the tail wagging the dog, which we confront today;

(5) consideration of the magnitude of the impact of any bottleneck facilities (e.g., an ILEC's 100 percent vs. AT&T Alascom's 10 percent);

(6) deletion of GCI's all or nothing idea that owning a single bottleneck facility, however, insignificant, constitutes prima facie evidence of market power; and

(7) addition of a mandatory cost-benefit analysis.

AT&T Alascom suggests that the GCI proposal to add three subsections to 3 AAC 52.363 should be modified to read as follows:

> (b) When the commission grants a certificate of public convenience and necessity to provide intrastate interexchange service, the commission shall determine whether or not the carrier should be classified as dominant or non-dominant.
>
> (c) Within 180 days after the adoption of this regulation, the commission will determine whether or not any carrier holding a previously issued certificate for intrastate interexchange service should be designated as dominant.
>
> (d) In its determination of whether or not a carrier should be designated as dominant or non-dominant, the commission must first determine whether the carrier possesses market power. In making that determination, the commission shall determine the relevant product market and the relevant geographic market and shall consider the following factors in the relevant product and geographic market: the market share of the carrier; the number, size distribution and capability of competing firms; the existence and nature of barriers to entry in the market as a whole; the availability of reasonably substitutable service; whether the carrier controls any bottleneck or essential facilities affecting participation in a substantial component of the relevant market; and the presence or absence of factors that restrain the exercise of market power, such as geographic rate averaging, voluntary or mandatory rate caps, and similar safeguards.
>
> (e) If the commission determines that a carrier possesses market power, before designating the carrier as dominant, the commission must

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> consider whether the threat of harm from such market power is sufficiently great to justify the costs that dominant carrier regulation would impose on the carrier.

AT&T Alascom believes that this proposed regulation more accurately captures the analytical method used by the FCC. It also recognizes the complexity of the market power analysis and the need to balance the benefits of regulation against its costs. AT&T Alascom urges the Commission to give AT&T's proposal its careful consideration.

B. A Bush IXC Subsidy Would Be The Best Way To Encourage Infrastructure Development

In its initial comments, AT&T Alascom advocated adopting new regulations creating the competitively neutral Bush IXC subsidy that is authorized by AS 42.05.840.[6] AT&T Alascom argued that the creation of such a fund would be the best response to the Legislature's *imprecation* to the RCA to encourage development of a modern telecommunications infrastructure.

AT&T Alascom was pleased to find support for is proposal in Professor Dale Lehman's Affidavit. Exhibit B to ACS Comments. Dr. Lehman states:

> In the past this "carrier-of-last-resort" (COLR) responsibility has resided with the "dominant" or incumbent provider. In a competitive market, COLR cannot rest with one provider that is trying to compete with providers that do not have these costly obligations. The COLR responsibility requires a competitively neutral funding mechanism.

As AT&T Alascom's earlier comments illustrate, the COLR obligation to serve roughly 150 high-cost, low-revenue Bush communities is not a bottleneck to be exploited

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[6] AS 42.05.840 provides: The commission may establish a universal service fund or other mechanism to be used to ensure the provision *of long distance telephone* service at reasonable rates throughout the state and to otherwise preserve universal service. [Emphasis added.]

by AT&T Alascom, it is an old regulatory loophole that is exploited by AT&T Alascom's competitors. When they have finished cherry-picking the most lucrative, federally subsidized customers in these locations (*e.g.*, schools, libraries and health care facilities), GCI and other IXCs have no incentive to construct long distance MTS facilities. As the COLR, AT&T Alascom is required to incur the disproportionate cost of serving these locations and, as its reward, it is regulated as dominant, which imposes still greater costs.[7] It is a cycle with no balance or logic. Under these circumstances, AT&T Alascom has no financial incentive to invest in modern infrastructure. Current regulations are completely at odds with the *Legislative principles.*

A competitively neutral funding mechanism—based on forward-looking costs and equally available to all IXCs that construct Bush facilities—is the only feasible way to encourage rural infrastructure development. The APUC's well-intended Bulk Bill weighting scheme was not an effective compensation for AT&T Alascom's COLR obligations. Now that it has been repealed, a new, more effective solution is required.

AT&T Alascom recognizes the complexities involved in creating such a mechanism. There are several ways to go about it and AT&T Alascom is not wedded to the methods it has suggested in the past. AT&T Alascom would be satisfied if one result of this docket were an Order from the Commission clearly stating its intention to create such a fund as part of the Alaska Universal Service Fund, describing the goal of such a fund, and directing the Commission Staff to convene an industry workshop to develop a workable proposal within a specified deadline.

[7] AT&T Alascom estimates that the accounting and reporting costs caused by its dominant carrier status,

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C. Sharing Of COLR Responsibilities

In addition to the Bush IXC fund, another method of encouraging Bush infrastructure development could be the sharing of COLR obligations in certain circumstances. As AT&T Alascom has repeatedly stated, it has no intention of abandoning Bush Alaska. It does believe, however, that a competitively neutral sharing of the burden could be beneficial. If the responsibility for serving the smallest communities were borne proportionately by GCI and the other IXCs, for example, AT&T Alascom would be able to free up resources to better serve those areas allocated to it. Additionally, communities in the Bush would receive the benefit of relying on multiple carriers.

III. LOCAL EXCHANGE ISSUES

A. Implementation of Legislative Policy No. 1

Legislative Policy No. 1 provides that,

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

"Fair payment" is assured through compliance with federal costing standards. Indeed, federal law requires nothing less.

The Telecommunications Act of 1996 provides that.

> Determinations by a State commission of the just and reasonable rate for the interconnection of facilities and equipment for purposes of subsection (c)(2) of section 251, and the just and reasonable rate for network elements for purposes of subsection (c)(3) of such section--

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not borne by any of its competitors, are from $3 – 5 million per year.

(A) shall be—

(i) based on the cost (determined without reference to a rate-of-return or other rate-based proceeding) of providing the interconnection network element (whichever is applicable), and

(ii) nondiscriminatory, and

(B) may include a reasonable profit.[8]

In its August 8, 1996 *First Report and Order*,[9] often referred to as the "Local Competition Order," the Federal Communications Commission ("FCC") established the applicable costing standard to implement Congress' "pro-competition" goal in passing the Telecommunications Act of 1996.[10] Pursuant to this standard, state public utility commissions may not set prices lower than the forward-looking incremental costs directly attributable to provision of a given element, and may not set prices higher than that cost plus "a reasonable share of forward-looking joint and common costs of network elements."[11]

Specifically, federal regulations provide that the UNE rates of incumbent carriers *shall* comply with the FCC's "forward-looking economic cost-based pricing methodology."[12] The FCC explained that this methodology,

> best replicates, to the extent possible, the conditions of a competitive market. In addition, a forward-looking cost methodology reduces the

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[8] 47 U.S.C. § 252(d)(1).
[9] First Report and Order, *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996 (CC Docket No. 96-98); Interconnection between Local Exchange Carriers and Commercial Mobile Radio Service Providers (CC Docket No. 95-185)*, FCC No. 96-325 (rel. Aug. 8, 1996) (hereinafter "Local Competition Order").
[10] Local Competition Order ¶ 618.
[11] Local Competition Order ¶ 620.
[12] 47 C.F.R. § 51.503(b)(1).

> ability of an incumbent LEC [local exchange carrier] to engage in anti-competitive behavior. Congress recognized in the 1996 Act that access to the incumbent LECs' bottleneck facilities is critical to making meaningful competition possible. As a result of the availability to competitors of the incumbent LEC's unbundled elements at their economic cost, consumers will be able to reap the benefits of the incumbent LECs' economies of scale and scope, as well as the benefits of competition. Because a pricing methodology based on forward-looking costs simulates the conditions in a competitive marketplace, it allows the requesting carrier to produce efficiently and to compete effectively, which should drive retail prices to their competitive levels. We believe that our adoption of a forward-looking cost-based pricing methodology should facilitate competition on a reasonable and efficient basis by all firms in the industry by establishing prices for interconnection and unbundled elements based on costs similar to those incurred by the incumbents, which may be expected to reduce the regulatory burdens and economic impact of our decision for many parties, *including both small entities seeking to enter the local exchange markets* and small incumbent LECs.[13]

Generally, the FCC's forward-looking economic cost of an element equals the sum of (1) the Total Element Long run Incremental Cost (TELRIC) of the element, and (2) a reasonable allocation of forward-looking common costs.[14] The TELRIC of an element is "the forward-looking cost over the long run of the total quantity of the facilities and functions that are directly attributable to, or reasonably identifiable as incremental to, such element, calculated taking as a given the incumbent LEC's [local exchange carrier's] provision of other elements."[15]

Critically, the TELRIC of an element "should be measured based on the use of *the most efficient telecommunications technology currently available* and *the lowest cost network configuration*, given the existing location of the incumbent LEC's wire

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[13] Local Competition Order ¶ 679 (footnote omitted).
[14] 47 C.F.R. § 51.505(a).
[15] 47 C.F. R. § 51.505(b).

centers."[16] In other words, UNE prices should be "based on costs that assume that wire centers will be placed at the incumbent LEC's current wire center locations, but that *the reconstructed local network* will employ *the most efficient technology* for reasonably foreseeable capacity requirements."[17]

FCC regulations specify that "embedded costs" and "retail costs" "shall not be considered in a calculation of the forward-looking economic cost of an element...."[18] "Embedded costs" are defined as "the costs that the incumbent LEC incurred in the past that are recorded in the incumbent LEC's books of accounts."[19] "Retail costs include the costs of marketing, billing, collection, and other costs associated with offering retail telecommunications services to subscribers who are not telecommunications carriers...."[20]

Incumbent carriers immediately and repeatedly challenged the FCC's cost standard. The incumbents argued that the FCC's standard resulted in costs that are too low because it is based on a "hypothetical" "most efficient" network, not the incumbents' "actual" network. The United States Supreme Court resoundingly rejected this argument:

> As for an embedded-cost methodology, the problem with a method that relies *in any part* on historical cost, *the cost the incumbents say they actually incur in leasing network elements*, is that it will pass on to lessees the difference between most-efficient cost and embedded cost. *Any such cost difference is an inefficiency*, whether caused by poor management resulting in higher operating costs or poor investment strategies that have inflated capital and depreciation. *If leased elements were priced according to embedded costs, the incumbents could pass these*

[16] 47 C.F.R. § 51.505(b)(1) (emphasis added).
[17] Local Competition Order ¶ 685 (emphasis added).
[18] 47 C.F.R. § 51.505(d).
[19] 47 C.F.R. § 51.505(d)(1).
[20] 47 C.F.R. § 51.505(d)(2).

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> *inefficiencies to competitors in need of their wholesale elements, and to that extent defeat the competitive purpose of forcing efficient choices on all carriers whether incumbents or entrants. The upshot would be higher retail prices consumers would have to pay.*
>
> There are, of course, objections other than inefficiency to any method of ratemaking that relies on embedded costs as allegedly reflected in incumbents' book-cost data, with the possibilities for manipulation this presents. Even if incumbents have built and are operating leased elements at economically efficient costs, the temptation would remain to overstate book costs to ratemaking commissions and so perpetuate the intractable problems that led to the price-cap innovation.[21]

The United States Supreme Court explained that the Act establishes a "novel ratesetting *designed to give aspiring competitors every possible incentive to enter local retail telephone markets*, short of confiscating the incumbents' property."[22] The Court observed that "Congress called for ratemaking different from any historical practice, to achieve the entirely new objective of *uprooting the monopolies that traditional rate-based methods had perpetuated.*"[23] "For the first time, Congress passed a ratesetting statute *with the aim* not just to balance interests between sellers and buyers, but *to reorganize markets by rendering regulated utilities' monopolies vulnerable to interlopers*, even if that meant swallowing the traditional federal reluctance to intrude into local telephone markets."[24]

This remarkable departure was described by one leading Senate supporter as follows:

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[21] Verizon Comm. Inc. v. FCC, 122 S.Ct. 1646, 1673 (2002) (emphasis added; citations and footnote omitted).
[22] Verizon, 122 S.Ct. at 1661 (emphasis added).
[23] Verizon, 122 S.Ct. at 1660 (*citing* H.R. Conf. Rep. No. 104-230, p. 113 (1996)) (emphasis added).
[24] Verizon, 122 S.Ct. at 1661 (emphasis added).

> This is extraordinary in the sense of telling private industry that this is what they have to do in order to let the competitors come in and *try to beat your economic brains out*.... [¶] It is kind of almost a *jump-start... I will do everything I have to let you into my business*, because we used to be a bottleneck; we used to be a monopoly; we used to control everything. [¶] Now, this legislation says you will not control much of anything....[25]

To achieve these purposes, Congress established "a hybrid jurisdictional scheme with the FCC setting a basic, default methodology for use in setting rates when carriers fail to agree, but leaving it to state utility commissions to set the actual rates."[26] The RCA is required by federal law to adopt UNE prices that comply with these mandates.

Despite these clear mandates of federal law, ACS requests that the RCA reject forward-looking cost models and instead "begin with a rebuttable presumption of ILEC efficiency."[27] Such an approach would be a clear violation of the FCC's TELRIC rules which, as described above, require the TELRIC of an element "be measured based on the use of *the most efficient telecommunications technology currently available* and *the lowest cost network configuration*, given the existing location of the incumbent LEC's wire centers."[28] In other words, UNE prices cannot be based on the ILEC's embedded network and practices, but instead must be "based on costs that assume that wire centers will be placed at the incumbent LEC's current wire center locations, but that *the reconstructed local network* will employ *the most efficient technology* for reasonably foreseeable capacity requirements."[29]

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[25] Verizon, 122 S.Ct. at 1661 (*quoting* 141 Cong. Rec. 15572 (1995), Remarks of Sen. Breaux (La.) on Pub.L. 104-104 (1995)).
[26] Verizon, 122 S.Ct. at 1661.
[27] ACS Comments, p. 20.
[28] 47 C.F.R. § 51.505(b)(1) (emphasis added).
[29] Local Competition Order ¶ 685 (emphasis added).

ACS' request turns TELRIC on its head. Creating a rebuttable presumption that ILECs are efficient would in effect create a rebuttable presumption that the ILECs' embedded costs are efficient. But this is expressly forbidden by the FCC's rules, which list embedded costs as a "factor" that "*shall not be considered*" in applying TELRIC.[30]

Incredibly, ACS claims that "[t]he ILEC's embedded cost is not a precluded consideration," and that "[e]mbedded cost is the 'actual cost' of service."[31] But, in reality, embedded cost *is* a precluded consideration. Again, the FCC's regulations plainly state that "embedded costs" "*shall not be considered* in a calculation of the forward-looking cost of an element...."[32] The FCC could not have made it clearer.

ACS again requests the RCA to violate federal law when it asks that costs be based only on technology "actually deployed by the provider."[33] As indicated above, the FCC's TELRIC rules require costs to be based on the "use of the most efficient telecommunications technology *currently available*."[34]

AT&T Alascom respectfully requests that the RCA reject the regulations proposed by ACS on this issue in their entirety because they are based on a gross misinterpretation of, and would be clearly contrary to, federal law. Indeed, the regulations proposed by ACS are similar to legislation recently advocated by SBC Communications, Inc. in Illinois. Upon review, that legislation was found by the Federal District Court to conflict with federal law. The District Court noted that "incumbent

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[30] 47 C.F.R. § 51.505(d)(1).
[31] ACS Comments, p. 20.
[32] 47 C.F.R. § 51.505(d)(1) (emphasis added).
[33] ACS Comments, p. 20.
[34] 47 C.F.R. § 51.505(b)(1) (emphasis added).

LECS can only recover costs that an efficient provider would incur in providing the network elements irrespective of the costs of their actual practices."[35] It elaborated,

> The Illinois legislation conflicts with federal law in several respects. The legislation orders the ICC [Illinois Commerce Commission] to determine fill factor and depreciation costs based on SBC's actual fill and depreciation as accounted to the SEC. FCC Rule 51.505 clearly bars any such emphasis on the incumbent's actual practices. 47 C.F.R. § 51.505. Under TELRIC, element costs can only be based on a hypothetical efficient provider's costs determined on a forward-looking basis. *Id.* The FCC rule instructs the ICC to look at a hypothetical efficient provider's costs rather than SBC's actual costs. 47 C.F.R. § 51.505. The Illinois legislature then tells the ICC to use SBC's actual costs as the most reasonable projection of a hypothetical efficient provider's costs. 220 ILCS 5/13-408(a)-(b). Thus section 408 [of the legislation] completely reads out the hypothetical efficient provider standard from TELRIC. The Illinois legislation has, by fiat, rendered TELRIC irrelevant with respect to two key factors in the rate setting exercise.[36]

In sum, the District Court held that the Illinois legislation conflicted with federal law because "[t]he methodology to be used in federal rate determinations is eviscerated – TELRIC is effectively repealed."[37] ACS' proposed regulations would achieve the same result.

AT&T Alascom intends to provide further comment on this issue in subsequent phases of this proceeding.

B. Implementation of Legislative Policy No. 5

Legislative Policy No. 5 provides,

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

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[35] Voices for Choices v. Illinois Bell Telephone Co., Inc. (03 C 3290). *slip opinion*, p. 5 (N. Dist. Ill.) (June 9, 2003) (attached as Exhibit C).
[36] Voices for Choices, p. 9.
[37] Voices for Choices, p. 14.

ACS appears to suggest that the RCA use some form of financial depreciation lives based on ACS' actual practices - either lives reported to the Internal Revenue Service ("IRS") or the Securities and Exchange Commission ("SEC"). Either approach would violate federal law.

Again, a similar tactic was attempted by SBC Communications in Illinois. The Illinois legislation advocated by SBC mandated the use of the depreciation costs SBC reports to the SEC. The District Court held this was contrary to federal law because depreciation "must be based on a hypothetical efficient incumbent LEC's practices rather than SBC's actual practices."[38] In striking down the Illinois legislation, the District Court noted that "FCC Rule 51.505 clearly bars any such emphasis on the incumbent's actual practices."[39] Similarly, basing depreciation on ACS' actual practices with either the IRS or the SEC would contravene federal law.

AT&T Alascom intends to provide further comment on this issue in subsequent phases of this proceeding.

C. Implementation of Legislative Policy No. 7

Legislative Policy No. 7 provides:

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

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[38] Voices for Choices, p. 7.
[39] Voices for Choices, p. 9.

ACS proposes that fill factors represent "a reasonable projection of actual total usage of the elements in question."[40] This, again, would reflect embedded costs and thus violate federal law.

SBC tried this approach in Illinois, as well. The Illinois legislation required that fill factors be based on "SBC's actual fill, rather than on the fill of an efficient incumbent LEC."[41] This too was struck down by the Federal District Court, which again held that "FCC Rule 51.505 clearly bars any such emphasis on the incumbent's actual practices."[42] ACS' similar attempt to require the use of actual fill levels plainly contravenes federal law.

D. Miscellaneous

ACS has proposed 3 AAC 53.250 Wholesale Service and Rate. The regulations proposed by ACS would allow ACS to offer services for resale at retail rates, with no discount.[43] AT&T Alascom objects to ACS's proposed language for several reasons. First, like the suggestions discussed above, this proposal is plainly contrary to federal law, which provides that,

> The wholesale rate that an incumbent LEC may charge for a telecommunications service provided for resale to other telecommunications carriers shall equal the incumbent LEC's existing retail rate for the telecommunications service, *less avoided retail costs*, as described in § 51.609 of this part.[44]

This section also requires that,

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[40] ACS Comments, p. 27.
[41] Voices for Choices, p. 7.
[42] Voices for Choices, p. 9.
[43] ACS Comments, Exhibit A, p. 6.
[44] 47 C.F.R. § 51.607(a) (emphasis added).

[a] CLEC that has an established interconnection agreement with an incumbent provider is obligated to offer reciprocal services and unbundled network elements at rates, terms and conditions at least as favorable as those found in the interconnection agreement.

In addition, this requirement would create barriers to entry, an act that is contrary to federal law. AT&T Alascom opposes ACS's proposed resale regulation.

IV. CONCLUSION

For the reasons stated above, and based on the Legislative principles and policies underlying this docket, AT&T Alascom urges the Commission to adopt a new resolution on dominance, creation of a competitively neutral fund to support facilities-based Bush service, and, in appropriate circumstances, shared COLR responsibilities. As a competitive local exchange carrier, AT&T Alascom asks the Commission to maintain the availability of UNEs at fair and reasonable prices in accordance with the Telecommunications Act of 1996.

Dated: August 13, 2003

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August 6, 2003

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NEW TELECOMMUNICATIONS POLICY FOR ALASKA AREAS

Increased Service and Lower Costs Expected for Consumers in Isolated Communities

Washington, D.C.– Today, the Commission charted a new course to increase availability of affordable, innovative interstate long-distance telecommunications services for consumers in certain remote areas in Alaska by abolishing the long-standing "Alaska Bush" satellite earth station policy and instead allowing open-entry, facilities-based competition.

The Alaska Bush communities are rural areas, small in population and isolated in geography. The Commission's Alaska Bush earth station policy prohibited the installation or operation of more than one satellite earth station in any Alaska Bush community for competitive carriage of interstate Message Telephone Service (MTS) communications, *i.e.*, ordinary interstate, interexchange toll telephone service.

In a Report and Order adopted today, the Commission eliminated this out-dated policy. Expanding entry for facilities-based competition in the interstate telecommunications market, this action promises development of improved satellite network infrastructure, lower interstate long-distance rates and greater service options ranging from telephone calls and Internet usage to emergency services, telemedicine and distance learning.

In 1995, the Regulatory Commission of Alaska (RCA) granted General Communication, Inc. (GCI), an Alaskan facilities-based interstate long-distance carrier, a temporary waiver allowing it to install earth stations in 50 Alaska Bush communities to provide *intrastate* telephone service in competition with Alascom Inc. (Alascom) on an experimental basis.

In 1996, the International Bureau granted GCI a waiver of the FCC Alaska Bush earth station policy, allowing it to provide *interstate* services in those same 50 communities. The results of this trial were positive: introduction of new technology and competition provided many benefits to consumers.

In the Alaska Bush communities where GCI constructed a second earth station in competition with the incumbent carrier, AT&T Alascom, the quality of voice service and facsimile transmissions improved; consumers were able to send and receive data transmissions and use the Internet for the first time; upgrades in the network provided more reliability for public safety and emergency services; and, for the first time, communities were able to apply

satellite telecommunications technology for telemedicine purposes and connections to schools and libraries, which has translated into large savings on medical and transportation costs.

In its decision today, the Commission found that through a series of regulatory steps, the environment that once called for the Alaska Bush earth station policy has changed. Thus, the Commission determined that there no longer is a need for the Alaska Bush earth station policy and that it is appropriate to remove it.

Action by the Commission, August 6, 2003, by Report and Order (FCC 03-197). Chairman Powell, Commissioners Abernathy, Copps, Martin, and Adelstein.

-FCC-

International Bureau contact: JoAnn Lucanik, 202-418-0873, JoAnn.Lucanik@fcc.gov.

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Policy for Licensing Domestic Satellite Earth Stations in the Bush Communities of Alaska	)	IB Docket No. 02-30
	)	RM No. 7246
	)	
	)	
	)	
	)	

REPORT AND ORDER

Adopted: August 6, 2003 **Released: August 12, 2003**

By the Commission:

I. INTRODUCTION

1. By this action, we discontinue the Alaska Bush Earth Station Policy (Alaska Bush Policy), which precludes installing or operating more than one satellite earth station in any Alaskan Bush community[1] for competitive carriage of interstate Message Telephone Service (MTS) communications, *i.e.*, ordinary interstate, interexchange toll telephone calls. By discontinuing the Alaska Bush Policy, we are eliminating a long-standing exception to the Commission's general policy favoring open entry for facilities-based competition in the provision of interstate MTS telecommunications services. We believe that allowing facilities-based competition of interstate MTS in Alaska Bush communities will encourage improvement in the quality of service available in those communities, promote more efficient delivery of service, and reduce incentives for overcharging for use of these facilities.

II. BACKGROUND

2. A complete history of the Alaska Bush Policy may be found in the Notice of Proposed Rulemaking in this proceeding and will not be repeated here.[2] Briefly, the policy of

---

[1] Alaska Bush communities, as defined for purposes of the policy, are rural Alaskan communities of less than 1,000 residents that are isolated from larger cities by rugged terrain and harsh weather conditions. *See, e.g., Policies Governing the Ownership and Operation of Domestic Satellite Earth Stations in the Bush Communities in Alaska*, Tentative Decision, 92 FCC 2d 736 (1982) (*Tentative Decision*) at n.1 and ¶61.

[2] *See Policy for Licensing Domestic Satellite Earth Stations in the Bush Communities of Alaska*, Notice of

licensing only one satellite earth station in each Alaska Bush community to provide conventional interexchange MTS was formulated in the Commission's *Tentative Decision* in 1982.[3] Pursuant to the Alaska Bush Policy, Alascom, Inc. (Alascom), now a wholly owned subsidiary of AT&T Corp., alone or in partnership with United Utilities, Inc. (United), a local exchange carrier, was authorized to construct and operate the earth station facilities in the Alaska Bush communities and to provide MTS service. The Alaska Bush Policy was based on the principle that duplicative proposals for facilities in the Alaska Bush communities are mutually exclusive because one facility could provide all the services provided by either party, and there was no public interest benefit in the construction of duplicate MTS facilities.

3. When the Commission formally adopted the Alaska Bush Policy in 1984,[4] no MTS competition, in any form, had been authorized in Alaska. In 1990, however, the Alaska legislature opened most of the State's telecommunications markets to facilities-based competition, but not the Alaska Bush communities.[5] Five years later the Regulatory Commission of Alaska (RCA)[6] granted General Communication, Inc. (GCI), an Alaskan facilities-based interstate long distance carrier, a temporary waiver, allowing it to install earth stations in 50 Alaska Bush communities and to provide intrastate MTS in competition with Alascom on an experimental basis. The following year the International Bureau (Bureau) granted GCI's request to waive the Alaska Bush Policy in the same 50 Alaska Bush communities, thus allowing GCI to use its earth stations to provide both interstate and intrastate MTS in these 50 communities.[7] The Bureau concluded that the potential public interest benefits of providing the 50 Alaska Bush communities with increased service options, improved quality, and lower rates outweighed a rigid adherence to a policy that does not provide for technological

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Proposed Rulemaking, 17 FCC Rcd 2979 (2002) (*NPRM*) at 2980-84.

[3] Prior to 1969, the United States Air Force provided communications within Alaska, via the Alaska Communication System (ASC). Alascom purchased the ASC in 1970.

[4] *See Policies Governing the Ownership and Operation of Domestic Satellite Earth Stations in the Bush Communities in Alaska*, Final Decision, 96 FCC 2d 522 (1984) (*Final Decision*).

[5] *See* Act of June 7, 1990, 1990 Alaska Sess. Laws Ch. 93; *see also Regulations Governing the Market Structure for Interstate Interexchange Telecommunications Services*, 10 APUC 407 (1990).

[6] The agency was then known as the Alaska Public Utilities Commission.

[7] *See Petition of General Communication, Inc. for a Partial Waiver of the Bush Earth Station Policy*, Memorandum Opinion and Order, 11 FCC Rcd 2535 (Int'l Bur. 1996) (GCI Waiver). The Bureau granted GCI a waiver to construct and operate no more than 50 earth station sites for a period of time to run concurrently with the Alaska Public Utilities Commission's two year waiver. *Id.* at 2537. Thereafter, GCI has continued operation of the earth stations in these Alaska Bush communities pursuant to Special Temporary Authority (STA). *See e.g.*, Letter from Kathy L. Shobert, Director, Federal Affairs, GCI Communications Corp. to FCC, Common Carrier Domestic Earth Stations, dated August 3, 1998; *see also* Letter from Tina M. Pidgeon, CGI Communications Corp. to FCC, International Bureau – Earth Stations, dated July 26, 2002.

advancements and market changes.[8]

4. In 2000, the RCA found that allowing GCI to construct duplicate earth stations in the 50 Alaska Bush communities had, in fact, led to a more efficient use of available satellite resources, resulting in consumers benefiting from lower retail rates and improved service quality. In view of its finding, the RCA eliminated Alaska's restrictions on facilities-based MTS competition in the Alaskan Bush.[9] Thus, the FCC's Bush Policy remains the only significant regulatory barrier to facilities-based MTS competition throughout Alaska.

5. On February 15, 2002, the Commission released the *NPRM* in this proceeding, proposing to discontinue the Alaska Bush Policy. The Commission noted in the *NPRM* that the Alaska Bush Policy is based on the proposition that applications for "duplicative" Alaska Bush earth stations are mutually exclusive. It also noted that the Alaska Bush Policy was formulated prior to the advent of MTS competition, and is based on a regulatory policy designed to prevent non-dominant carriers from investing in facilities at their own expense to compete with a carrier with an established facilities monopoly. Finally, the Commission pointed to the fact that the RCA has removed the parallel intrastate entry barrier. Consequently, the Commission tentatively concluded that the time has arrived to remove the barrier against facilities-based interstate MTS in the Alaska Bush as well. The Commission also tentatively concluded that facilities-based competition in the provision of interstate MTS in Alaska Bush communities will result in public interest benefits comparable to those that were realized in the 50 Alaska Bush communities in which GCI has been allowed to provide competitive MTS service. Accordingly, the Commission invited comment on its proposal to abolish the Alaska Bush Policy.

III. DISCUSSION

6. Three parties, Alascom and AT&T, GCI, and the RCA, have filed comments in response to the *NPRM*. All three commenters support the Commission's proposal to eliminate its prohibition on the installation or operation of more than one satellite earth station in any Alaska Bush community for the competitive carriage of interstate MTS.

7. The RCA submits that since 1995, when both the RCA and the FCC waived applicable Alaska Bush facility restrictions to allow GCI to construct duplicate earth stations in Bush communities, consumers have benefited from lower retail rates and improved service quality. According to the RCA, these benefits are what ultimately motivated it to eliminate the State's restrictions on facilities-based intrastate MTS competition in Bush Alaska in 2000. The RCA states that elimination of the FCC's Alaska Bush Policy will remove the final regulatory barrier to facilities-based interexchange competition throughout Alaska, and thus, it fully

[8] *Id.* at 2537.

[9] *See Consideration of the Reform of Intrastate Interexchange Telecommunications Market Structure and Regulations in Alaska*, Docket R-98-1, Order No. 6 (RCA, Nov. 20, 2000).