ALASKA LEGISLATURE COMMITTEE FILES, 2003-2004 8672

11226 SENATE LABOR & COMMERCE

SOURCES INTERVIEWED

Will Abbott, Commissioner, RCA
Martin Cary, VP Broadband Services, GCI
Wesley Carson, President and COO, ACS
Sharon Cissna, Alaska State Representative
Earl Comstock, Sher Blackwell, Attorneys at Law. Former Staff Aide to Senator Ted Stevens
Patricia DeMarco, Commissioner, RCA
Ron Duncan, President, GCI
Jim Dunlap, Oklahoma State Senator
Robert Dunn, Director of Regulatory Affairs, TelAlaska, Inc.
Tiffany Dunn, ACS
Tom Eisenmann, Assistant Professor, Harvard Business School
Kim Elton, Alaska State Senator
Michael Felix, President/CEO, AT&T Alascom
David Geesin, Deputy Director, Alaska Public Broadcasting, Inc.
Rick Halford, President of the Senate, Alaska State Legislature
Steve Hamlen, President, United Utilities, Inc.
Donald Hicks, Professor, Department of Social Sciences, University of Texas at Dallas,
Alex Hills, Professor, Engineering and Public Policy, Carnegie Mellon University
Rick Hitz, Director Rates, Tariffs and Economic Analysis, GCI
Krag Johnsen, Denali Commission
John Katz, Director of State/Federal Relations and Special Counsel to the Governor of Alaska
James Kenworthy, Ph.D., Executive Director, Alaska Science and Technology Foundation
Dale Lehman, Professor, Alaska Pacific University
Jay Livey, Commissioner, Alaska Department of Health and Human Services
Thomas Meade, VP Revenue Requirements, ACS
Jim Milnor, Strategic Alliance Manager – ILEC Relations, Qwest Communications
Ted Reed, Staff Aide to Senator Frank Murkowski
Jack Rhyner, CEO, TelAlaska
Don Rinker, Alaska Public Broadcasting
Jim Rowe, Executive Director, Alaska Telephone Association
Jim Strandberg, Commissioner, RCA
Leonard Steinberg, General Counsel and Corporate Secretary, ACS
Eugene Smith, Chief Information Officer, Maniilaq Association
Steve Smith, CIO, University of Alaska
Robin Taylor, Chairman, Judiciary Committee, Alaska State Senate
Dana Tindall, Sr. VP for Legal, Regulatory and Governmental Affairs, GCI
G. Nanette Thompson, Commissioner Chair, Regulatory Commission of Alaska
Jeffrey Tyson, VP State of Alaska Telecom Partnering Agreement, ACS
Fran Ulmer, Lt. Governor, State of Alaska
Mark Vasconi, Director of Business Planning, AT&T Alascom
Doug White, Managing Director, KPMG Consulting Infrastructure Solutions

SAMPLE QUESTIONS

Universal Service

- Do all areas currently have telecommunications service?
- What is your organizations role in providing service?
- How is the service currently funded?
- What have you seen change regarding universal service since the Telecommunications Act of 1996 was put into effect?
- What is the market demand for telecommunications service in Alaska?
- Urban areas?
- Rural areas?
- What can be done to stimulate this market demand for telecommunications service in those areas that would encourage both infrastructure investment and competition?
- What service is currently available to residents by geo area or city? What prices are charged for what services?
- Does the State of Alaska currently contribute to the Lifeline program? If so, how much per line?
- What cities are growing and why? What population migrations (if any) are occurring (e.g. rural to urban, or urban to rural)?

Infrastructure Investment

- What areas in Alaska do you see infrastructure investment occurring?
- Where do you see shortcomings? What is preventing infrastructure investment in those areas?
- Where do you see strengths? What is encouraging infrastructure investments in those areas?
- How can investment be encouraged in the future?
- What access methods are receiving the largest amount of investment?
- Has a standard been developed for the type and minimum bandwidth required for each area? Perhaps metrics baring area size, population, etc.
- Are there any government assistance programs that would encourage additional investment?

Competition

- What is, as you see the competitive landscape in Alaska now?
- Who is providing the service?
- Where are they providing service?
- What products and services...
  - ... Are being offered?
  - ... Are most competitive?
- How do you see being able to promote competition in light of the current competitive landscape?
- What do you see as the government's role in competition?
- What is the penetration rate/market share/degree of use for various access mechanisms?: landline (copper/fiber), cable Internet, broadband satellite, fixed and mobile wireless?
- Have any Alaska statewide long distance plans been introduced? (e.g. similar to WorldCom's nationwide one rate local/long distance plan)

Public Policy in Alaska

- Do you anticipate deregulation...
  - ... Happening in the near future
  - ... Helping the current environment
- What needs to happen for deregulation to occur in the current environment?

- Once deregulation occurs, what do you see needing to happen to allow truly competitive forces to work in the marketplace?
- Does it make sense for the state or federal government to pay subsidies to the carriers instead directly to the end users (the group that is supposed to benefit)? This is a hypothetical, but it could lead us to policy recommendations.
- What are the relative priorities of telecom vs. other types of services to rural areas such as water/sewer?

INDEX

A

access lines · 9, 22, 33, 65
ACS · 5, 7, 8, 9, 14, 16, 17, 32, 33, 47, 48, 49, 57, 59, 63, 80, 81
advanced services · 1, 5, 42, 64, 68
Alascom · 9, 16, 32, 33, 53, 81
APUC · 27, 33, 56, 60, 62, 63, 80
AT&T · 8, 9, 10, 16, 21, 26, 32, 36, 43, 50, 57, 80, 81

B

Bandwidth · 10, 77, 78

C

cable · 2, 10, 11, 12, 16, 17, 18, 19, 20, 21, 22, 23, 26, 35, 43, 47, 50, 59, 60, 65, 68, 82
CLEC · 1, 16, 33, 35, 49, 57, 80
CLECs · 6, 16, 22, 29, 34, 35, 45, 47, 48, 49, 56, 59, 73, 75
Community technology centers · 45
competitive neutrality · 1, 5, 43, 45

D

DBS · 17, 27, 28, 80
Denali Commission · 11, 44, 55, 81
deregulation · 10, 18, 22, 28, 35, 43, 46, 47, 66, 67, 73, 82, 83
DLC · 50
DSL · 8, 9, 11, 12, 18, 22, 40, 43, 45, 47, 50, 52, 56, 60, 63, 67, 68, 75, 80

E

eGovernment · 27, 45, 71
E-rate · 2, 11, 16, 27, 28, 36, 37, 39, 41, 42

F

FCC · 2, 3, 5, 9, 10, 11, 16, 21, 22, 26, 27, 28, 29, 32, 35, 37, 39, 40, 43, 45, 46, 47, 48, 49, 50, 54, 55, 56, 57, 58, 59, 60, 63, 77, 78, 79, 80
Federal-State Joint Board on Universal Service · 41

G

GCI · 8, 11, 12, 16, 20, 26, 32, 33, 35, 40, 49, 52, 56, 59, 81

H

High Cost Fund · 11, 60
High Cost Support · 33

I

ILEC · 7, 11, 12, 13, 29, 33, 34, 48, 49, 57, 59, 65, 80, 81
ILECs · 5, 7, 13, 14, 17, 18, 20, 26, 29, 33, 34, 43, 44, 47, 48, 49, 57, 59, 62, 65
interconnection · 8, 10, 14, 18, 23, 33, 34, 36, 41, 43, 47, 48, 49, 50, 52, 62, 66, 71
intermodal · 3, 67
Internet Service Providers · *See* ISP
ISP · 10, 43, 80

L

LifeLine · 37, 42
Link-Up · 37, 38
local service · 9, 19, 32, 33, 35, 40, 42, 43, 47, 49, 50, 56, 59, 67, 80

M

Maniilaq · 12, 52, 81
MPLS · 14

N

R

Rate integration · 26, 54
RBOC · 5, 49, 80
RBOCs · 7, 22, 29, 34, 47, 49, 50, 65, 75

RCA · 2, 10, 16, 27, 28, 29, 33, 38, 39, 40, 42, 46, 47, 48, 55, 56, 57, 59, 60, 61, 62, 63, 66, 80, 81
regulated monopoly · 18, 42, 48, 50, 66
Rural Health Care · 2, 37, 42

S

satellite · 10, 11, 12, 17, 18, 19, 21, 22, 23, 26, 27, 28, 32, 43, 47, 50, 51, 53, 65, 67, 68, 82
Schools and Libraries · 2, 37, 39, 42, 55
Section 251 · 49

T

TelAlaska · 15, 44, 81
Telecommunications Act of 1996 · 1, 2, 5, 8, 27, 28, 34, 35, 36, 39, 47, 48, 57, 61, 77, 78, 79, 82
Telecommunications Information Council · 2, 28, 63
TELRIC · 47, 56, 57, 59, 79
TIC · *See* Telecommunications Information Council

U

UNE · 2, 33, 43, 47, 48, 55, 56, 57, 59, 63, 66, 80
universal service · 1, 3, 5, 19, 27, 28, 29, 30, 32, 34, 36, 37, 38, 39, 42, 47, 54, 55, 60, 63, 64, 67, 82

V

W

wireless · 1, 9, 10, 11, 12, 13, 17, 18, 19, 23, 28, 29, 30, 37, 43, 52, 59, 62, 65, 67, 68, 80, 82
WorldCom · 6, 8, 9, 50, 57, 73, 76, 77, 82

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

Fiscal Note Number: 1
Bill Version: SB 72
(S) Publish Date: 2/19/03

Revision Date/Time (Note if correction):
Title: Regulatory Commission of Alaska: Sunset Extension
Sponsor: Rules
Requester: Governor

Dept. Affected: DCED
BRU: Regulatory Commission of Alaska (399)
Component: Regulatory Commission of Alaska
Component No. 2417

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Personal Services	3,982.9	3,982.9	3,982.9	3,982.9	3,982.9	
Travel	60.0	60.0	60.0	60.0	60.0	
Contractual	1,920.0	1,920.0	1,920.0	1,920.0	1,920.0	
Supplies	62.5	62.5	62.5	62.5	62.5	
Equipment	13.8	13.8	13.8	13.8	13.8	
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	**6,039.2**	**6,039.2**	**6,039.2**	**6,039.2**	**6,039.2**	**0.0**
CAPITAL EXPENDITURES						
CHANGE IN REVENUES ( )						

FUND SOURCE (Thousands of Dollars)

Fund Source	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
1141 - RCA Receipts	6,039.2	6,039.2	6,039.2	6,039.2	6,039.2	
TOTAL	**6,039.2**	**6,039.2**	**6,039.2**	**6,039.2**	**6,039.2**	**0.0**

Estimate of any current year (FY2003) cost: 6,003.1

Mark this box (X) if funding for this bill is included in the Governor's FY 2004 budget proposal: X

POSITIONS

	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Full-time	62	62	62	62	62	
Part-time						
Temporary						

ANALYSIS: *(Attach a separate page if necessary)*

This legislation extends the Regulatory Commission of Alaska to June 30, 2007. In accordance with AS 08.03.020, funding is extended one year following the termination date allowing the commission to conclude its affairs. The information above identifies direct expenditure and revenue information included in the FY 2004 Operating Budget Request. The RCA's budget is funded through the Regulatory Cost Charge (RCC) mechanism and direct charge mechanisms. No general funds are allocated for support of the agency. The RCC is recalculated each year and allows the agency to recover its operating costs through an assessment on the revenues of the utilities and pipeline carriers it regulates.

Prepared by: G. Nanette Thompson, Chair
Phone: 907-276-6222
Division: Regulatory Commission of Alaska
Date/Time: 1/29/03 9:33 AM

Approved by: Edgar Blatchford, Commissioner
Date: 1/29/2003
Agency: Department of Community & Economic Development

(Revised 9/2002 OMB)

COMMITTEE COPY

FRANK H. MURKOWSKI
GOVERNOR

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February 18, 2003

The Honorable Gene Therriault
President of the Senate
Alaska State Legislature
Staet Capitol, Room 107
Juneau, AK 99801-1182

Dear President Therriault:

Under the authority of art. III, sec. 18, of the Alaska Constitution, I am transmitting a bill that would extend the life of the Regulatory Commission of Alaska (RCA) to avoid its termination on June 30, 2003. The bill also includes a provision for an immediate effective date.

It is important to pass this bill before the RCA's termination date. The RCA regulates utilities statewide and intrastate pipelines. The continued operation of the RCA is essential to ensure that Alaskan consumers have reliable and affordable utility services and to assure a stable business environment for utilities and pipelines.

Failure to extend the commission this session would significantly interfere with its work. Though the sunset Act provides for a "wind down" year, the commission would have to redirect its time and energy to plan for closing its operations. Failure to extend the RCA would leave the regulated utilities as well as consumers in a state of confusion and uncertainty.

I urge your prompt and favorable action on this measure.

Sincerely yours,

Frank H. Murkowski
Governor

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 8-K

CURRENT REPORT
Pursuant to Section 13 or 15 (d) of the Securities Act of 1934

Date of Report (Date of earliest reported) January 31, 2003

CHUGACH ELECTRIC ASSOCIATION, INC.
(Exact name of registrant as specified in its charter)

Alaska	**33-42125**	**92-0014224**
(State or Other Jurisdiction of Incorporation)	(Commission File Number)	(IRS Employer Identification No.)

5601 Minnesota Drive, Anchorage, Alaska — **99518**
(Address of Principal's Executive Offices) — (Zip Code)

Registrant's telephone number, including area code: **(907) 563-7494**

None
(Former Name or Former Address, if Changed Since Last Report)

Submitted by
Chugach Electric

Item 5. Other Events

On February 6, 2003, Chugach Electric Association, Inc. (Chugach) received Order No. 26, "Order Determining Revenue Requirement and Rate Design Issues and Requiring Filings" in Docket U-01-108, "In the Matter of the Tariff Revision, Designated as TA226-8, Filed by CHUGACH ELECTRIC ASSOCIATION, INC., for a Rate Increase and Rate Redesign," from the Regulatory Commission of Alaska (RCA).

Chugach filed a general rate case on July 10, 2001, based on the 2000 test year, requesting a permanent base rate increase of 6.5%, and an interim base rate increase of 4.0%. On September 5, 2001, the RCA granted a 1.6% interim increase effective September 14, 2001. Chugach filed a petition for reconsideration and on October 25, 2001, the RCA revised its Interim Approval to permit Chugach to collect an interim base rate increase of 3.97%. The additional rate increase was implemented on November 1, 2001. The interim rate increase was based on a normalized (adjusted for recurring expenses) test year and a system ratemaking Times Interest Earned Ratio (TIER) of 1.35.

In its filing with the RCA, Chugach proposed that margins be calculated using a rate base/rate of return methodology rather than the TIER methodology previously used. The request to change from the TIER-based methodology to the return-on-rate-base methodology would not have any material adverse effect on future ratemaking or on Chugach's ability to service its outstanding indebtedness.

As anticipated in Chugach's July 2001 original filing, on April 15, 2002, Chugach submitted a filing with the RCA to update certain known and measurable costs and savings that had occurred outside the 2000 Test Year. In the updated filing, Chugach reduced its base rate increase request from 6.5% to 5.7%, or approximately $0.9 million in the revenue requirement on a system basis. The revised filing also reflected an increase in depreciation expense of approximately $1.5 million due to the completion of the Beluga Unit 7 re-powering project and a reduction in annualized interest expense of $2.4 million due to Chugach's recent refinancings. In this revised filing, Chugach continued to request $11.9 million in margins. As a result of reduced interest costs, Chugach's supplemental filing would have yielded an equivalent system TIER of 1.47.

The RCA hearing on Chugach's proposed rates took place in November and December of 2002, concluding on December 13, 2002. The RCA issued an order dated January 31, 2003, on February 6, 2003.

The Order resolved several issues in Chugach's favor:

- The RCA rejected intervenor mismanagement allegations regarding re-powering of Beluga Units 6, 7 and Cooper Lake Power Plant (CLPP) overhaul and polychlorinated biphenyl (PCB) remediation.

- The RCA accepted Chugach's rate lock cost amortization and did not question other refinancing activities.

- The RCA approved the 1999 depreciation study, in part, and allowed implementation of remaining life depreciation methodology.

- The RCA approved recovery of rate lock and CLPP remediation expenses.

The Order contains several adjustments not in Chugach's favor:

- The RCA required Chugach to continue using TIER in calculating return levels.

- The RCA adjusted Chugach's system overall TIER downwards from 1.35 to 1.30, a difference of approximately $1.3 million in margins based on the 2000 test year and would have similar impacts in subsequent years. Chugach had requested that its permanent rates in this case be established with an effective TIER of 1.47, or a difference of approximately $4 million in margins based on the 2000 test year between the now-authorized TIER of 1.30.

- The RCA required Chugach to treat Allowance for Funds Used During Construction/Interest During Construction (AFUDC / IDC) as a reduction to long-term interest expense, which reduces the revenue requirement by approximately $1.2 million. With the required AFUDC/IDC adjustment alone, Chugach's effective TIER would be below a 1.30.

- The RCA required a 1.8 percentage point interest rate reduction (from 3.8% to 2%) on Chugach's $60.0 million of variable debt, which equates to a revenue requirement reduction of approximately $1.1 million.

- Chugach's overall Depreciation Study was approved, although the RCA did require approximately $0.7 million in downward adjustments, primarily related to Bernice Lake Units 2 – 4 and Chugach's North Submarine Cable field. This reduction in the revenue requirement will match Chugach's reduction in depreciation expense, resulting in a net effect of zero to margins in subsequent years.

Chugach's analysis of the financial impact of the Order is still preliminary. There are several outstanding questions regarding interpretation of the Order that have not yet been clarified. However, based upon this preliminary analysis, the Order would require the following:

- A refund of revenues collected in 2001 of approximately $1.1 million and in revenues collected in 2002 of approximately $6.0 million, which would result in a net operating loss of $2 million in 2002. Under the Order, Chugach's financial performance for 2002 would fall below the 1.10 level contained in the Rate Covenant in its currently effective indenture. In accordance with the Rate Covenant, Chugach is taking the actions described below to promptly address this margin shortfall.

- A reduction in estimated 2003 revenues of approximately $6.0 million. Chugach has calculated, that based on the budgeted revenues and expenditures, under Order 26, Chugach may have insufficient margins over interest in 2003 to comply with the requirements of the Rate Covenant in its bond indenture. Chugach is taking the actions described below to promptly address this margin shortfall.

On February 13, 2003, Chugach filed a Motion with the RCA asking the RCA to stay the effect of its Order until after the RCA considers Chugach's Petition for Reconsideration of Order 26.

On February 18, 2003, the RCA granted in part Chugach's motion for stay. Specifically, the RCA stayed until further order of the RCA Ordering Paragraph 1, of Order U-01-108(26) which states "Chugach's rates will be established on the basis of the 2000 test year revenue requirement recomputed in accordance with our decisions set out in the body of this Order." The RCA also stayed two other obligations until further order of the Commission pertaining to filing tariff sheets and a recalculated Cost of Power Adjustment Base Cost of Power. The RCA also allowed a one-week extension until February 28, 2003 to comply with ordering paragraphs 2 and 3 which require Chugach to recalculate its revenue requirement and cost-of-service studies reflecting the impact of Order U-01-108(26) on Chugach's rates. The RCA also extended the time to file Petitions for Reconsideration of Order U-01-108(26) one week to February 28, 2003. Chugach intends to file the Petition for Reconsideration with the RCA on or before February 28, 2003.

SIGNATURES

Pursuant to the requirements of the Securities and Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: February 19, 2003

CHUGACH ELECTRIC ASSOCIATION, INC.

By:

Evan J. Griffith
General Manager

Honorable Con Bunde, Chair
Senate Labor and Commerce Committee
Alaska Capital, Room 506
Juneau, AK 99801-1182

February 24, 2003 RE: SB 72 (Governor Murkowski) - Support

Dear Chair Bunde:

On behalf of the AARP members in Alaska, we encourage you and your colleagues on the Senate Labor and Commerce Committee to support SB 72, submitted by the Senate Rules Committee at the request of Governor Murkowski.

SB 72 would reauthorize the Regulatory Commission of Alaska for a period of four years. Much of the debate over the RCA in the past has focused on the utilities supervised by the Regulatory Commission of Alaska and the relationship of the RCA with the entities it supervises. AARP relies on the RCA because it offers our members and all Alaskans the best opportunity to achieve basic consumer protections:

- The ability to make informed choices about utility services
- The security of safe and reliable energy and telecommunications services
- The assurance that sales practices and advertisements are fair, so they do not confuse, mislead, or frighten the public
- The reassurance that consumers receive accurate information, communicated clearly and in plain language so we understand our rights and remedies

The RCA assures consumers the right to affordable rates and access to such basic necessary services as utilities and communications. We emphasize "reasonable" rates but we also emphasize access for our rural citizens.

The RCA allows consumers an opportunity to participate in the governmental decision-making process that shapes the marketplace and ensures meaningful consumer input.

3601 C Street, Suite 1420 | Anchorage, AK 99503 | 907-341-2277 | 907-341-2270 fax | 1-877-434-7598 TTY
James G. Parkel, President | William D. Novelli, Executive Director and CEO | www.aarp.org

When wronged, the RCA offers consumers redress and complaint resolution.

AARP believes the Regulatory Commission of Alaska is necessary for our organization and for our members. Without the RCA, we would be deprived of any public oversight of energy and telecommunications services and, when a complaint is warranted, we would not have the RCA available and willing to listen to a consumer's side of an argument.

The RCA protects our rights as consumers. We ask that the Senate Labor and Commerce Committee support Governor Murkowski's bill to reauthorize the RCA for four years. Our AARP families need it. All Alaskans need it.

AARP urges an "AYE" vote on SB 72.

Should you have any questions about our position, please feel free to contact Marie Darlin (907.586.3637), Coordinator of the AARP Capitol City Task Force; Patrick Luby (907.762.3314), AARP Legislative Representative; or me (907.245.5259).

Thank you for your consideration.

Sincerely,

Marguerite Stetson
AARP Alaska
Executive Council Member for Advocacy
3009 Northwood Street
Anchorage, AK 99517-1871
907.245.5259 voice
907.245.5279 fax
ffmas@aurora.uaf.edu

cc: Senator Gary Stevens
Senator Ralph Seekins
Senator Bettye Davis
Senator Hollis French
Governor Frank Murkowski
Senator John Cowdery
Marie Darlin
Patrick Luby

Good afternoon, Senator Bunde and members of the committee. For the record, my name is Mike Felix, President of AT&T Alascom, with its main business address at 210 E. Bluff Drive, Anchorage, Alaska, 99501.

Thank you for the opportunity to be here today to present at this hearing. As you know, AT&T Alascom, and before that, Alascom, has a long history of providing telecommunications services to the state of Alaska. In fact, the longest history of any interexchange carrier in the state today. It is from those very roots, and having witnessed the broad changes in technology and market shift over the years, that we would like to offer our perspective and respectfully make some requests for the legislature to consider.

It seems to me that both telecom service providers and policy-makers alike have a two-fold obligation to the constituents of this state. Those are: ensuring that basic telecom services remain affordable to everyone in the state; and providing a regulatory environment that fosters continued investment in the state telecom infrastructure, thereby ensuring that advanced services will reach to all parts of the state.

In the early days, Alascom was the only long distance carrier in Alaska, and as such, the regulated monopoly. Regulations were put in place to ensure that Alascom did not misuse its monopoly power in pricing its services to consumers. In 1991, when intrastate long distance competition was initiated, additional regulations were developed to ensure that Alascom did not misuse its monopoly power to subvert competition, as well. At the same time, new entrants to the long distance market were granted broad and significant freedoms. And even though the market was highly competitive in 1995, when AT&T bought Alascom, for the most part, it bought a company regulated as though it were a monopoly. As we all know, the regulations governing utilities with a legal monopoly work in two directions: they protect the consumer from unreasonable prices on one side of the equation, and they ensure a reasonable return for the regulated entity on the other side. Without a reasonable return, companies do not invest and services, therefore, do not advance.

Many of the regulations which restrict AT&T Alascom today are vestiges of that monopolistic environment I spoke of previously. Only, in this highly competitive marketplace, they do not serve as an incentive for investment – they only serve to add cost and thereby provide a disincentive for investment. As far as protection of the consumer on prices, we have almost 20 years of empirical evidence in the long distance market in the U.S. to show that competition serves the consumer well. In 1984, when AT&T was first broken up, the average discounted corporate minute was around $.45. Today, the average discounted corporate minute is under $.045. That's a whole order of magnitude swing. And yet, during that same time period, the long distance industry went from approximately $9 -10B to about $90-110B. It was deregulation of the industry and the management of competition that spurred investment. And in 1995, when AT&T fell below 60% market share in the lower 48, the FCC ceased regulating AT&T as the "dominant carrier" and deemed the market for long distance as "competitive".

And yet, here in Alaska, where AT&T Alascom now has 42% of the long distance business (and shrinking), and our largest competitor, GCI, has 46-48% of the long distance business (and growing), AT&T Alascom is still considered the dominant carrier, despite a four-year attempt to get relief from this regulation at the RCA. This regulation adds substantially to our cost structure for tracking, journalization, and reporting. It also adds regulatory process that our competitors don't have that keeps us from being competitive in the marketplace. The whole situation really begs a definition for "dominance". Additionally, with the increased costs and inability to compete effectively because of outdated regulations, our ability to attract capital and invest in the network is severely "hamstrung".

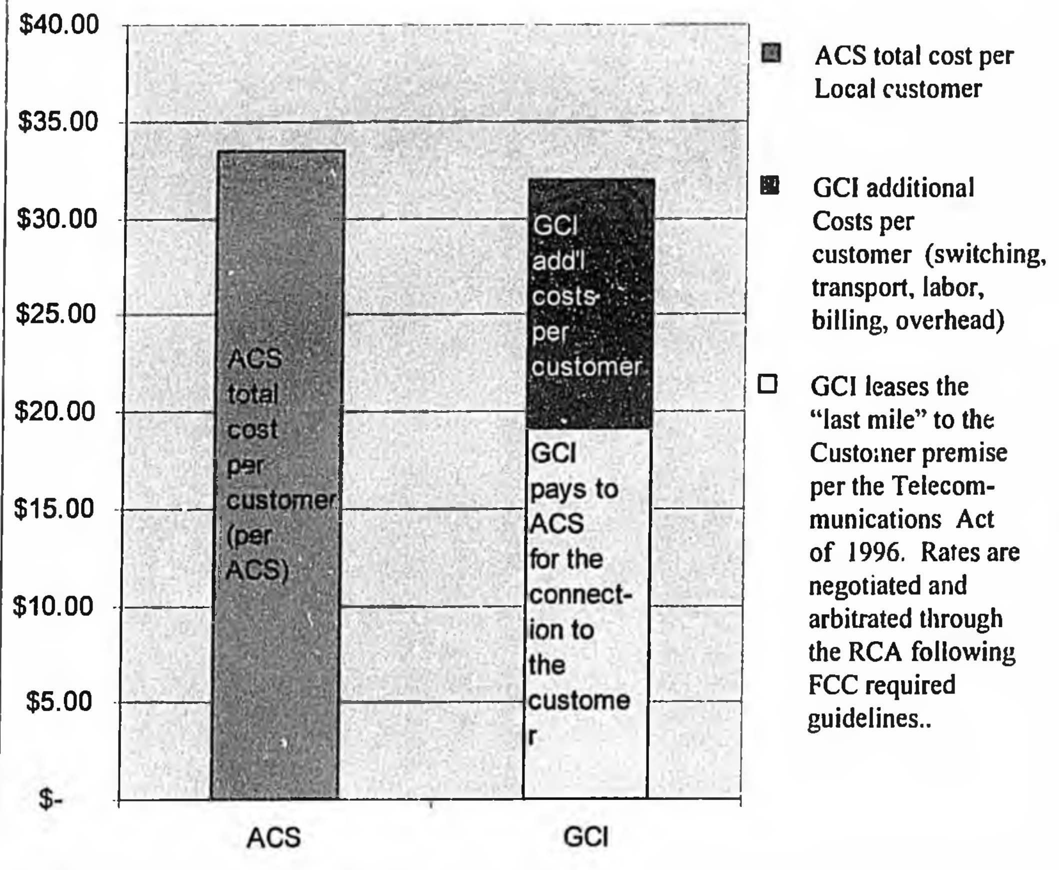
I believe that over the next 12-18 months, this state must wrestle with some difficult issues of telecom regulation. At stake is the very survival of an infrastructure that's struggling to keep up with the rest of the country. In a true free market, there is less regulation, not more. And competition, not regulation, becomes the force to shape the market.

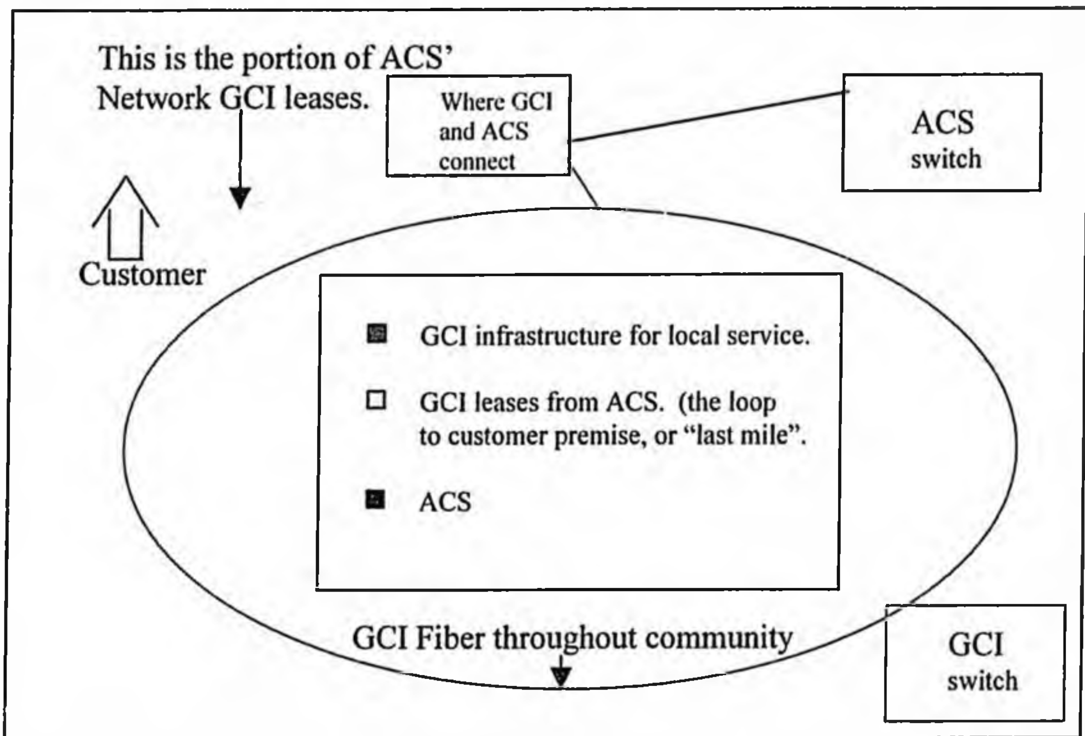
I would ask you to carefully and thoughtfully consider the market dynamics at work here, and the definitions of broader market issues such as "dominance" and "competition". I would also ask you to carefully consider your role in mandating an environment that has less regulation, not more, in order to create and maintain incentives to invest in the modern telecommunications infrastructure that all Alaskans desire.

As you consider Senate Bill 72 reauthorizing the RCA, please know that AT&T Alascom could support legislation which would extend the RCA for another 2-4 years, however, as we stated last fall – only if the RCA is truly committed to bringing about regulatory reform. Status quo is not an option, if you intend to have a healthy, competitive telecom market and infrastructure in Alaska. We are in the process of drafting appropriate language to assist the legislature in defining "dominance", and will be submitting it for your consideration, shortly.

Thank you, once again for this opportunity to present our testimony. I will be happy to answer any questions you may have.

NEW





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Regulatory Commission of Alaska

The Commission's Mandate: The Regulatory Commission of Alaska (RCA) is charged, under Alaska Statutes 42.04 / 42.05 / 42.06, with regulating Alaska public utilities and pipeline services to ensure safe and adequate services and facilities at fair and reasonable rates, terms, and conditions.
Utilities Regulated by the RCA: With the exception of municipally owned utilities, very small utilities, and cooperatives which have opted to be deregulated, the RCA regulates electric, gas, water, sewer, garbage, steam, oil pipeline companies, and local and long distance telephone services in the state.
The RCA's Budget: The Regulatory Cost Charge was established by statute (AS 42.05.254) to require all regulated utilities to share in the expenses of certifying, overseeing, and regulating utility services in the state; therefore, the state does not fund the RCA. It is funded by the regulated utilities.
Consumers: The primary purpose of the RCA is to investigate, regulate, monitor, and when necessary, fine utilities on behalf of Alaska consumers. Utilities, by their very nature, are necessary to the safety and well being of the consumers they serve.
Decisions by the RCA: By statute, specific rules of conduct and proceedings are stipulated for the RCA and utilities. Additionally, final administrative determinations by the RCA are subject to judicial review. This ensures faithful interpretation of applicable state and federal statutes and regulations and provides due process for the parties involved.
Criticisms of the RCA: 1) The legislative audit report cites concerns regarding too little oversight of small water and sewer facilities in the most rural communities in Alaska. This is an issue the RCA is taking seriously and addressing. It should be noted this audit was a vast improvement over audits performed on the previous regulatory commission, the Alaska Public Utilities Commission. 2) There have been various concerns raised among regulated utilities regarding timeliness of decisions, an issue addressed during the 2002 Special Legislative session held in June. New regulations were instituted as a result. It should be noted that when the RCA was established in 1999, it inherited over 800 unresolved dockets. The backlog has been substantially reduced to less than 200. 3) Another issue raised by an incumbent local telephone company involves rates paid by its competitor to lease elements of its network and the elimination of the "rural" designation of specific study areas. The formula for setting these rates is federally regulated. Access to an incumbent's network by a competitive company is required by the Telecommunications Act of 1996. The incumbent local telephone company, ACS, has appealed RCA implementation of these federal requirements. These appeals are now before the Alaska Supreme Court and the 9th Circuit Court of Appeals.
Role of RCA / Role of Legislature: The very nature of a regulatory body invites periodic criticism by those who are regulated. The RCA regulates diverse utilities, many of which are very complex. Alaska Statutes and Regulations are just a part of what the RCA is mandated to take into consideration. The Federal Energy Regulatory Commission and the Federal Communication Commission play a major role in mandating regulations for the energy and telecommunications industries. While utility regulatory functions are complex, they are just one of a limitless number of issues legislators must work with throughout the year. It is not reasonable to expect the legislature to be experts in the area of utility regulation, nor is it reasonable for the Legislature to substitute the RCA's decision making with its own.
Changes within the RCA: Of the five RCA commissioners one is new having recently been appointed by Governor Murkowski. Another was appointed and confirmed effective July 1, 2003. Additional new members will be appointed each year as terms expire with the next appointment due in 2005. The new commissioners and the recent regulations have addressed concerns that were raised in the last legislative session regarding the RCA. The RCA should be extended for four more years for the benefit of Alaska consumers.

Financial Condition of ACS

ACS claims its poor financials are caused by unfair prices GCI pays for portions of their plant (a mandate set forth by the federal Telecommunications Act of 1996 to foster fair competition in the local telephone service industry nationwide). ACS further claims that being forced to lease portions of its network to competitors will lead, eventually, to its bankruptcy. ACS blames the RCA for setting the rates too low.

Summary of ACS Business Segments (According to Charles King[1]):

- Local telephone service (regulated business line) – is healthy and growing in cash flow.
- Directory (unregulated business line) – is very healthy with strong cash flow and positive EBITDA (earnings before income taxes, depreciation, and amortization – the standard measure of health in the telecommunications industry).
- Cellular (unregulated business line) – has just enough EBITDA to fund capital expenditures but not enough to offer a return on the original investment.
- Internet (unregulated business line) – has very significant and increasing losses in EBITDA and capital expenditures.
- Long distance telephone service (partially regulated business line) – shows slight improvement, but small EBITDA, with very high capital expenditures.
- Other (unknown whether it is regulated or unregulated) – because of the lack of detail on ACS financial documents, it is uncertain as to what business line "other" refers. Regardless, this segment indicates healthy EBITDA with relatively low capital expenditures.

How an increase in what GCI pays would affect ACS bottom line: ACS has been unsuccessful in providing evidence to the RCA that GCI pays too little for the portion of the ACS plant GCI leases. If ACS succeeded in achieving an increase of approximately $5 per line, the reality (based upon an estimated 70,000 lines) is ACS cash flow would only increase by 1% and EBITDA 3%.

ACS financial woes: The Charles King analysis concludes that ACS financial woes stem from two primary causes;

1) ACS paid $250 million over book to purchase the Anchorage, Fairbanks, and Juneau local telephone companies. It also paid over book value for its other subsidiaries; and
2) ACS is sustaining losses in its deregulated businesses. In 2002, ACS was forced to write down $150 million in goodwill. ACS also realized losses of $431,000 and wrote down assets of $7,060,000 when it discontinued operations of Alaska Choice Television.

While ACS's local telephone business is sustainable in and of itself, it is required to bear both the burden of overly high debt expenses, as well as losses in ACS' deregulated lines of business making ACS less than financially healthy overall.

Will ACS go out of business? Unlike most businesses, a utility may not simply go out of business.

Will ACS go into bankruptcy? In the view of the King report, ACS is not in imminent danger of bankruptcy. ACS has over $20 million in cash plus an unused revolving line of credit for $75 million. Further, with the minor principle repayments owed until November 2006, ACS could fairly easily be cash flow positive until refinancing at that point. A review of the debt covenants also shows that ACS should be able to live within the existing covenants. Should the deregulated business sectors continue to falter and interest rates rise dramatically between now and 2006, ACS would likely reorganize, becoming a more vigorous and thriving business.

[1] Charles King of Snavely King Majoros O'Connor & Lee economic consulting firm of Washington, DC.

New Reports/Documents Distributed to You Since Last Week

1. Regulatory Commission Annual Report 2002
2. Telecommunications Policy Study and Assessment for the State of Alaska *(published by Bearing Point Consulting)*
3. Regulatory Commission at a Glance (facts and graph on workload)
4. LB&A Regulatory Commission of Alaska Sunset Review
5. ACS Briefing for Legislators: *Issues Relating to Re-Authorization of the RCA*
6. ARECA white paper

Testimony to Senate Labor and Commerce Committee,
March 6, 2003
G. Nanette Thompson, RCA

Good afternoon Chair Bunde and committee members. Thank you for allowing me to testify before your committee today. I am in Anchorage testifying by phone because we have a hearing scheduled today that I need to attend. We are taking a break from the hearing to accommodate my testimony before you. I also want to thank you for so quickly confirming the Governor's two new appointments to the RCA, Dave Harbour and Mark Johnson.

I listened to the tape of last week's hearing, and prepared remarks to respond to some of the issues raised. I am also providing you with information to put the RCA and the reauthorization legislation in context. We support the Governor's bill that will reauthorize the agency for four years.

Every state has a regulatory agency to insure that utility service is available at reasonable prices to its citizens. I realize that no self-respecting Alaskan is willing to concede that the rest of the country is doing it right, so I hope to explain why this state needs the RCA.

Regulatory agencies historically were formed to make sure that monopoly providers of utility service did not take advantage of their customers. In markets transitioning to competition, our role is different. We need look no further than the California energy markets for an example of why responsible deregulation is important. The transition from a monopoly to a competitive market does not happen overnight. It is our responsibility to effect the transition that the law directs, and make sure that consumers continue to receive fairly priced service during and after the transition. Timing is everything in this process. The utilities want less regulatory oversight immediately, and consumers are frustrated when they cannot count on us to resolve billing and service quality problems with their cellular or internet providers. We strive to strike the appropriate balance and constantly adjust the level of regulation as markets develop.

Because the telecommunications industry and their lobbyists in your halls have played out the "phone wars", I'll use that industry as an example and try to put some of what you are hearing from them in perspective.

There is competition in the telecommunications industry because in 1996 Congress said there should be. They gave states enormous responsibility to transition monopoly markets to competition because they recognized that markets varied by state, and national rules would not get the job done. The larger local markets in Alaska are ahead of the rest of the county in the transition to competition. We got a head start because MaBell never provided service in Alaska. All other states had to go though what telecom nerds call the "271 process" to insure that the incumbent carrier's network was open to competitors before the local company could enter the long distance business. We skipped that step, and the three to five years it took most states to complete it, and went directly to arbitrating interconnection agreements. Just after the Telecom Act was passed, GCI filed

a petition for interconnection and asked us to set prices for leasing parts of the incumbent's network. The APUC finished that process even before the FCC adopted regulations telling state commissions how to set prices. The APUC's order acknowledged that the FCC was in the process of setting national pricing rules, and invited either party to ask them to revisit the results after those rules were clear. The RCA is now in the process of doing that for the Anchorage market.

It is important for you to know that the controversy you see here about the appropriate level of continued regulation and the best way to set prices, is being played out in almost every state nationwide, and in the courts. Verizon, a large incumbent that serves the mid-Atlantic region, took their argument that the FCC had gone too far by requiring it to lease its network to competitors all the way to the Supreme Court. In May of last year, the Supreme Court said the FCC was correctly interpreting its duties under the Telecom Act. Verizon's objections that this strategy was destroying investment incentives were not factually based. The Supreme Court noted that competitors were making significant investments. On the cost issue you heard testimony about last week they said the FCC correctly looked at what is would cost for another efficient carrier to replace the incumbent's network with the best available technology, not what the incumbent spent or would spend to rebuild the existing network. (*Verizon v. FCC,* 122 S.Ct.1646, 2002). The RCA has stayed involved in the details of these enormous changes in the telecommunications sector, as it has played out in our markets and across the country.

Our appeal record tells you that we are doing our job well. As an administrative agency, we do not make the law; we apply it. If we are not applying it correctly, parties may appeal to state or federal court and ask them to set us straight. The RCA has issued hundreds of final orders since we started in July 1999. So far, sixteen have been appealed. The agency's decisions have not yet been reversed, although there are several appeals pending. In one case the court remanded a case to us with instructions to hold a hearing before making a decision, but none have reversed a substantive decision. That track record should tell you that we are successfully analyzing the facts presented to us and issuing decisions that are consistent with legal precedents and supported by the facts in the record. We make decisions based on evidence presented through a process designed to insure that all parties' rights are protected, not on rhetoric.

Consumers win when there is competition. I agree with Mike Felix when he told you last week that competition serves the customer well. You need look no further than your own phone bill for evidence. Your local and long distance rates are low, and you have the option to purchase many additional services that were not available five years ago. I hope that competition will soon bring high-speed internet access to all residents of the state of Alaska.

The RCA does more than settle phone wars. We administer the PCE program. We are reviewing our PCE regulations in response to a resolution from ARECA to improve the reliability of the information we use to administer the program and to increase efficiency amongst the program's beneficiaries. We also review tariff prices for pipelines to insure that those who ship to destinations in Alaska pay just and reasonable rates. We also

review costs incurred by providers of monopoly services; water, sewer, electric and gas, to insure that customers pay a fair price for the services they receive. We set rules in other markets that are transitioning to competition, such as refuse in some parts of the state, and long distance statewide. We just finished modifying our regulations to make it easier for long distance carriers that serve only a small part of the market to sell their services to Alaskan consumers.

Our regulatory oversight changes as markets change. Knowledge of the way service is provided is important to regulating it correctly. In the local telephone markets, as soon as a competitor has entered the market we allow the incumbent to lower their prices in response to market pressures without cost justification. It is only rate increases that must be supported by financial proof before they are allowed. The rules for how much notice a long distance carrier has to give the RCA and its customers are eased when a competitor enters the market.

Responsible deregulation is a moving target. The standards for when less regulatory oversight is required vary by industry and market. It is our job to figure that out, and we carefully review any petitions by utilities to remove unnecessary regulatory requirements. I look forward to seeing Alascom's effort to define market dominance. We will need to carefully balance their desire to be less regulated in competitive markets with the fact that they provide the only telecommunications link to the rest of the state for many rural communities.

I offer a few final notes. First, about the infamous backlog. It is gone. The chart I distributed shows the change since 1999 dramatically. This was accomplished with a lot of hard work by dedicated staff and Commissioners. Our caseload has stabilized at around 200 open dockets. We have met the deadlines imposed by the legislature last year. We hope to be able to focus on some of the important policy issues that arise in markets transitioning to competition this year. We have an open proceeding on changes to the competitive local market rules. Second, our budget. All of the money used by the RCA comes from utility ratepayer through the Regulatory Cost Charge. We get no general fund monies. Third, the reports you got last week. The legislative auditor spent time in our office and is familiar with our mission. I commend their report to you. The study commissioned by Department of Administration has some helpful background on the telecommunications industry in our state. The recently released Darby report is the work of three individuals, not the seven contemplated by the statute, and did not include any input from the RCA. It can hardly be called a comprehensive study of the agency when they never talked to us. Many of the recommendations are for actions that we have already begun that the author could have learned of by research on our website.

I encourage you to let this agency continue to do its job. Participation in the sunset reauthorization process is time-consuming for the agency and detracts from our ability to handle cases. The legislature has the option any year to redirect our mission. I urge you to reauthorize the agency for four years so we can get back to work.

Audit Report

DEPARTMENT OF COMMUNITY AND ECONOMIC DEVELOPMENT
REGULATORY COMMISSION OF ALASKA
SUNSET REVIEW

November 26, 2002

Audit Control Number:

08-20021-03

Division of Legislative Audit
P.O. Box 113300, Juneau, Alaska 99811-3300

LEGISLATIVE BUDGET AND AUDIT COMMITTEE

DIVISION OF LEGISLATIVE AUDIT

The Legislative Budget and Audit Committee is a permanent interim committee of the Alaska Legislature. The committee is made up of five senators and five representatives, with one alternate from the Senate and two from the House. The chairmanship of the committee alternates between the two chambers every legislature.

The committee is responsible for providing the legislature with audits of state government agencies. The programs and activities of state government now cost more than $6 billion a year. As legislators and administrators try increasingly to allocate state revenues effectively and make government work more efficiently, they need information to evaluate the work of governmental agencies. The audit work performed by the Division of Legislative Audit helps provide that information.

As a guide to all their work, the Division of Legislative Audit complies with generally accepted auditing standards established by the American Institute of Certified Public Accountants and with government auditing standards established by the U.S. General Accounting Office.

Audits are performed as mandated by Alaska Statutes or at the direction of the Legislative Budget and Audit Committee. Individual legislators or committees can submit requests for audits of specific programs or agencies to the committee for consideration. Copies of all completed audits are available from the Division of Legislative Audit's offices in Juneau, Anchorage, or at our web site http://www.legis.state.ak.us/legaud/web/default.htm.

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ALASKA RURAL ELECTRIC COOPERATIVE ASSOCIATION, INC.

White Paper Regarding ARECA Board Resolution 03-17

The Regulatory Commission of Alaska (RCA) was created in 1999 through passage of the Alaska Public Utilities Regulatory Act, ch. 25 SLA 1999. In 2002, the RCA was under sunset review by the 2002 Alaska Legislature. During that review, the utility industry and some legislators expressed significant concerns about the RCA's inability to process cases in a timely manner and a perceived lack of impartiality in the RCA's decision-making processes. Following a special session, the Legislature and the Governor extended the RCA's termination date by one year, imposed modest statutory timelines for deciding cases, and enacted a statute regarding impartial decision-making. The Legislature also created a task force to analyze the operation of the RCA.

In its sunset review audit of the RCA, dated November 26, 2002, the Alaska Division of Legislative Audit recommended that the RCA's termination date be extended by two years to June 30, 2005. For the reasons stated below, ARECA believes more vigilant legislative oversight is still required and proposes that the RCA's termination date be extended by one year to June 30, 2004.

Despite the efforts expended during the last session and the RCA's recent progress in attending to the case backlog it inherited from the Alaska Public Utilities Commission, ARECA's members have seen little improvement in the RCA's operations. ARECA's members have expressed serious concerns about the RCA's continued lack of timely case processing and order issuance, inefficient use of staff resources, inconsistent application of regulatory principles and precedent, and procedural irregularities in performing rulemaking functions.

Related to these problems, there has been significant delay in the RCA's implementation of a Management Information System (MIS) in the three and one-half years since it was required by Section 26 of the 1999 Act. Despite the Legislative Auditor's charitable finding that the MIS has been "substantially implemented," that implementation was only recently completed and only "on a piecemeal basis spread among a variety of systems rather than on a single, fully-integrated mainframe." This failure to implement an adequate MIS has resulted in inefficiency and non-compliance with state statute.

For example, the RCA has repeatedly failed to comply with AS 42.05.254(h), which the Legislature enacted in 1999. That statute required the RCA to adopt regulations establishing a cost-based methodology for fairly allocating collection of the RCA's annual budget from the various utility industries through regulatory cost charges (RCCs). The RCA has consistently declined to even begin that rulemaking process, despite ARECA's encouragement that it do so. The 1999 Act exempted the RCA from this requirement for the fiscal year 2001 RCC determination. Because of the RCA's failure to adopt the required regulations, its fiscal year 2002 and 2003 RCCs were not determined based on the methodology required by AS 42.05.254(h).

To help address the continuing deficiencies of the RCA, ARECA proposes that the Legislature adopt new statutory amendments that will guide the RCA toward more efficient and fair regulation of Alaska's utilities. ARECA proposes statutory amendments in three general areas: (1) RCA procedure and decision-making; (2) the Public Advocacy Section; and (3) RCA rate making. ARECA's primary proposed amendments are summarized below.

RCA procedure and decision-making

In 2002, the Legislature adopted modest statutory timelines for issuance of RCA orders after a utility makes a complete filing (AS 42.05.175). To enhance and protect the effectiveness of those timelines, ARECA proposes amendments that will: (1) require the RCA to clearly state what documents and additional information are needed for a filing to be considered "complete"; (2) limit what constitutes "good cause" for the RCA to unilaterally extend a statutory timeline; and (3) expand the scope of these and other statutory timelines to also apply to the RCA's processing of power cost equalization filings by unregulated electric utilities.

One of the concerns of ARECA members is that the RCA is inconsistent in its application of regulatory rules and principles and is not guided by its own precedent. To help address these issues, ARECA proposes a new statute requiring the RCA to either adhere to its own precedent or explain its departure from precedent.

The RCA relies heavily on its advisory staff when deciding cases. In some orders, the RCA attaches to its decision a copy of a written advisory staff recommendation. Other times, the RCA does not attach the recommendation or even notify the parties that such a recommendation exists. ARECA proposes amendments that will require the RCA to publish all substantive, written recommendations of its advisory staff and provide a means by which an affected party can file a response prior to the RCA issuing its decision.

Public Advocacy Section

Currently, the Public Advocacy Section (PAS) intervenes in RCA cases whenever directed to do so by the RCA Chair. In theory, the PAS is supposed to be an independent party and the RCA is prohibited from having *ex parte* communications with the PAS. In practice, however, the RCA gives significant deference to the PAS, including special discovery powers that no other parties have. The RCA assigns the PAS as a party to virtually every docket that will result in a hearing, even when the issues are relatively narrow or insignificant, when there are already several adverse parties in a case, or when the PAS' involvement would unduly delay a case. To make the PAS' involvement more efficient and independent, ARECA proposes statutory amendments that will: (1) clarify that the PAS' role is to advocate for the public interest, including both customers' rate interests and reasonable cost recovery for utilities; (2) require that the PAS consider the need for its advocacy, procedural efficiency, and avoidance of case delay before it seeks to intervene in a docket; (3) increase the independence of the PAS by making it reportable to the Commissioner of the Department of Community and Economic Development, instead of to the RCA Chair; and (4) prohibit the RCA from affording the PAS greater rights and powers than those of other independent parties.

RCA Rate Making

ARECA members are concerned about the RCA not following its own precedent and inconsistently applying rules when determining what costs should be recovered in utility rates. These inconsistencies create unwarranted uncertainty regarding what the RCA will or will not allow.

In addition, despite the RCA's backlog of cases and difficulties with issuing timely orders, the RCA has established a pattern of attempting to increase the number of utilities that have to file rate cases, which are very costly and burdensome to litigate. For example, for decades electric utilities have used monthly cost of power adjustment (COPA) surcharges to quickly flow-through fuel, purchased power, and related cost changes (both increases and decreases) to customers without the utility having to spend hundreds of thousands of dollars on a general rate case every year. In 2002, the RCA, on its own initiative, proposed new regulations that would significantly limit the types of costs that a utility could recover through the COPA mechanism. The results would have been increased costs for utilities to file full rate cases more often and an increased number of RCA dockets opened when the RCA already suffers from a significant case backlog.

To address these issues, ARECA proposes statutory amendments to AS 42.05.381 that will require the RCA to (1) allow an electric utility to elect to recover all reasonable fuel, purchased power, and related costs through the COPA mechanism; (2) allow a utility to defer and amortize rate recovery of certain significant, non-recurring costs to better match customer costs with customer benefits; and (3) allow a utility to recover through rates all reasonable costs associated with conducting a rate case before the RCA. Finally, ARECA proposes an amendment that will clarify existing AS 42.05.381(b) to allow a municipally-owned and -operated utility to include a reasonable annual rate of return on investment when calculating its revenue requirement and to do so under a rate base/rate of return methodology.

Conclusion

ARECA recommends that its proposed statutory amendments be enacted and that the RCA's termination date be extended by one year to June 30, 2004.

Resolution 03-17
A Resolution Regarding the Sunset Review of Regulatory Commission of Alaska and Recommending Changes

The Regulatory Commission of Alaska (RCA) was under sunset review by the 2002 Alaska Legislature it was given a one-year extension by the Legislature and Governor following a special session. The legislation also established an interim committee to review the RCA process and make recommendations on how the functions of the commission can be streamlined.

ARECA members have expressed serious concerns about the RCA's impaired timeliness, duplication of staff effort and poor quality decision-making in some economic and non-economic regulatory cases. The members' concerns have caused both unnecessary expenses and significant lost revenues costing electric ratepayers millions of dollars over the past three years.

Additional staff were given the to the RCA over the past three years but several hundred filings remain unresolved many of which are several years old. Alaska's electric ratepayers deserve timely, cost-effective reviews based upon sound regulatory rule-making practices.

Furthermore, the 1999 Legislature, added a new but separate regulatory review staff function known as the "Public Advocacy Section" (PAS) within the RCA to intervene in filings when designated by the chair of the RCA resulting in duplicative staff reviews and audits which have concluded with conflicting analysis and recommendations costing ratepayers unnecessary expenses and lost revenues.

It is ARECA's intention to establish a "white paper" on changes that need to be considered by the legislature to streamline the RCA and to realign the value and effectiveness of the PAS. Pending the changes required to make the RCA a valued and effective regulatory body, ARECA recommends a conditional one-year sunset extension for the RCA.

ARECA REVISED STATUTORY AMENDMENTS REGARDING THE RCA
February 25, 2003

I. Allow RCA to hire non-DOL attorneys as RCA employees [AS 42.04.040]

II. Provide for an executive director to supervise and manage advisory staff, not the RCA chair [AS 42.04.050]

III. Restructure the Public Advocacy Section (PAS) [AS 42.04.070(a), (c); AS 42.04.080(c); 42.04.150]
   A. Move PAS under the direction of the Commissioner of Department of Community and Economic Development
   B. Clarify PAS' public interest role
   C. Afford the PAS the same rights and duties as other parties

IV. Clarify existing timelines statute to apply the timelines to unregulated PCE filings and requests for changes to depreciation rates [AS 42.05.175(b)]

V. Require RCA to follow its own precedent or explain its departure [AS 42.05.195]

VI. Increase RCA Staff pay scale to allow RCA to attract and retain qualified professionals [AS ??]

Larry F. Darby
Darby Associates
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Washington, DC 20015

January 30, 2003

MEMORANDUM

FOR: Senate Appointees to the Task Force on Operations of the Regulatory Commission of Alaska (RCA)

ATTENTION: Mr. James Duncan
Mr. Marvin Weatherly
Mr. Gordon George

FROM: Larry F. Darby

Attached you will find our report to the Task Force on issues raised in Sec. 7, ch. 2, TSSLA 2002 relating to operation of the Regulatory Commission of Alaska (RCA) and specifically our response to seven questions posed to us by Mr. Rick Halford, President of the Alaska Senate.

As we have discussed in the past few days, these questions are far ranging and reach in principle the full scope of RCA processes, policies and rules. Yet, they individually address specific attributes of Commission policy and processes. We have tried to stay focused on those matters, while recognizing that the questions clearly reflect wide-ranging dissatisfaction and deep concern with the conduct of various aspects of regulatory policy and procedures by the RCA. Our report reflects the breadth and depth implied by the specific questions posed to us.

These materials have been researched and written under the constraint of very tight timetables and very limited resources made available to support them. We have not, neither Task Force members, nor we, had the opportunity to interview parties or otherwise get a more detailed sense of the difficulties that have motivated these questions and concerns. We are especially indebted to you and others on the Task Force for sharing your perceptions and views. While these were conveyed during our very limited opportunity to interact, they were quite valuable to us.

Let me summarize the thrust of our main findings and recommendations.

Identifying Goals. Federal statutes are clear on the need for federal and state regulators to fashion rules designed to encourage investment so as to foster innovation and the introduction of new services; to extend service to remote areas; and to offer

meaningful choices to consumers. But, the law leaves the RCA and other regulatory bodies substantial discretion in choosing ways to harmonize use of limited, and not always consistent, policy tools available to them.

Competition is a very important instrument for bringing about choice and innovation, but alone, and without regard to form and substance, is not sufficient to ensure continued and high levels of investment by entrants and incumbents alike. As indicated by the dramatic shifts in market share, competition in Alaska's markets for telecommunications services has brought new choices to many of its citizens. Competition is growing and working to change market realities on which existing regulatory assumptions and schemes are based.

Success of competitors is marked by increases in consumer choice, but it also signals the need to re-examine the need for and forms of existing regulatory schemes -- in particular, their impacts on the critical issue of long term investment in telecommunications infrastructure in Alaska.

Reviewing Progress and Accomplishments. In light of the success of past pro-competition policies and efforts to promote market choices, it is entirely appropriate for the RCA immediately to "take stock" of those efforts and to evaluate the specific effects – on investment, universal service and the need for legacy regulations -- of current rules and market developments they have brought about.

Issues related to the interplay among regulatory rules regarding rates and terms for interconnection, the emergence of different forms of competition, the impact on investment incentives, development of advanced telecommunications infrastructure and the overall public interest are now being reviewed and debated at the FCC. It is appropriate, and necessary to advance the interests of citizens of Alaska, for the RCA to do the same with respect to rules it has adopted in the context of the market place changes they have fostered.

More generally, it is critical for the legislature and the RCA to examine the agency's statutory mandate and assure that it conforms with the requirements of the dynamic technological and market environment in Alaska to which it applies. In that same vein, we think the RCA should be given the resources and the obligation to undertake a "basement to attic" review of the adequacy, need and rationale for many of the legacy regulations which are based on the assumption of incumbent market power.

Using Available Regulatory Discretion. The RCA has broad discretion under provisions of federal law in the Communications Act of 1934 as amended by the Telecommunications Act of 1996 to design, impose and enforce -- or forebear from -- economic regulation with respect to telecommunications carriers providing a wide variety of local exchange, local access, local interconnection and interexchange services.

The agency is not constrained to apply any particular regulatory or deregulatory approach, but has the discretion to choose, based on a finding of the requirements of the

broad public interest. The agency can and should use that discretion to evaluate its role in the marketplace and the extent to which the costs of its regulations continue to exceed the benefits measured in terms of investment and universal service.

Tailoring Regulation to Market Realities and Consumer Needs. Pervasive regulation is warranted in our view only where other forces, market forces included, are not adequate to protect the public.

In this regard we find Sections of the Alaska Law anachronistic and very much out of sync with current market realities. We are especially skeptical about a variety of provisions that mandate the agency to apply old, arguably and in our opinion clearly, out-of-date regulatory tools premised on market conditions that no longer exist. Thus, such regulatory constructs as rate-base, rate of return regulation, extensive accounting regulation -- particularly depreciation accounting -- and other artifacts of the need for detailed control of monopoly rates should be carefully reexamined in light of current market pressures and realities.

The RCA should reconsider the value in the context of current market realities of a variety of carrier reporting requirements and other artifacts of the old days of "protected and regulated monopoly."

Adopting Best Practices of Other State Agencies. Without the luxury of time and resources necessary to undertake a thorough review and analysis of RCA funding, procedures and policies, we nonetheless believe that the citizens and taxpayers of Alaska could well benefit from a fundamental review of RCA's procedures – particularly as they pertain to delay and fundamental fairness to all parties. We note that the National Association of Regulatory Utility Commissioners and its research affiliate, the National Regulatory Research Institute, have accumulated substantial information about the experiences of other state regulatory bodies. These insights and experiences should be reasonably available to the legislature. They indicate to us that as markets are opened to competition, Commissions like the FCC, the RCA and other state Commissions must demonstrate that their interventions positively impact the public interest.

Ensuring Universal Service. Universal service is at the same time one of the most worthy and yet elusive goals of regulatory policy. It will never be achieved to the satisfaction of citizens or their representatives. Technological and economic potential will forever be moving universal service goals just outside the reach of our abilities as defined by fiscal and cost realities. Service will never be universally available, nor will service quality and features – where service is available – be adequate to meet our needs and desires.

Thus, the pursuit of universal service is not and cannot be absolute. It must reflect fiscal realities and be balanced with other goals. Recognizing this fact is not to deny the worthiness of the pursuit. It is imperative, though, to keep the goal and reasonable means for achieving it in perspective.

Old ways of advancing the universal service goal are rendered obsolete by competitive market place developments. There are few if any monopoly revenues to fund provision of service below cost – the classic means of funding universal service. New ways are also unstable. This is suggested by the fact that the new universal service mechanism is under pressure from increasing demands on the universal service funds and increasing reluctance -- and inability -- for firms to be taxed on their revenues to capitalize the fund.

These facts dictate limited future courses of action with regards to universal service. They imply the need to forecast accurately the amount of funding that may be available and from what source and then to make hard choices about the use of those funds – particularly in the context of competing needs for rural support, support for low income users and support for added choices (competitive choices) for those with service now. State regulators and state legislators face a budget constraint. There will be only so much support available; not nearly enough to fund all needs and wants; enough to advance toward the goal, but require tough choices to be made about where to fall short.

Reconsidering Baseball Arbitration. The advantages of baseball arbitration are in its relative simplicity, economy and speed with which issues are resolved. However, those come at significant potential costs in terms of the fidelity of outcomes to reflect fully and fairly the public's interest in balancing goals of universal service, investment, competition and procedural fairness. While speed, economy and simplicity are valued in public decision-making, advancing the public interest takes precedence.

Accordingly, we believe that the RCA should search for, evaluate and choose other alternative dispute resolution mechanisms. A good start in that direction would be to undertake a review of practices in other state regulatory bodies with responsibilities and duties similar to those of the RCA. That review should be driven by the goal of gathering information about alternative dispute resolution mechanisms, their relative merits and the identification of "best practices" for consideration of decision-makers in the state.

Determining the appropriate level and form of regulation. We have considered that question in the specific context of coops and municipally owned utilities, but also in the broader context of investor owned utilities and firms more generally. While these differences suggest the need to differentiate the regulatory treatment of utilities with different ownership forms, those differences alone do not necessarily warrant deregulation of noninvestor-owned utilities.

On the broader question of the level and form of regulation, our general answer is that regulation – its form, scope, intent, reach, level, whatever dimension – must be carefully tailored to reflect current and evolving conditions in the marketplace. Application of old regulatory models based on market conditions that no longer prevail does a gross disservice to the people of Alaska. And, the more diligent the application, the greater the disservice.

Both markets and regulation as a means of serving the public are imperfect. Neither should enjoy a presumption that will outweigh a critical evaluation of its true effects on the citizens of Alaska. Competition is growing in Alaskan markets, dramatically so, but it is not yet "perfect." But competitive forces may be and probably are in some cases sufficient to warrant allowing them to substitute for what we understand to be decidedly "imperfect" regulation. No more evidence or proof of these imperfections is needed beyond the focus on regulatory infirmities and lack of regulatory performance clearly implied by the questions posed to us about fairness, timing, structure, procedures and policies of the RCA.

It is time to explore a wide range of less regulatory options in Alaska and to find ways to substitute markets for regulation. We are not commending full deregulation or elimination of the role of the RCA. We are commending a targeted, but substantially reduced role – one that reflects programs focused on the needs of the people for investment, innovation and new services and that can show results to that end.

Regulating noninvestor-owned utilities. It may continue to be a matter of practical concern in some instances in Alaska, that noninvestor-owned utilities – despite the congruence in the structure of their customers and owners – may still possess market power that can be used to the detriment of other consumers, workers, competitors and the public interest more generally. Of particular concern might be the ability of a consumer or taxpayer owned entity to use market power in ways that disserve the broader public interest. To the extent the RCA finds that to be the case, the practice would be a barrier to complete deregulation.

Again, there is the question of balancing to contending considerations. Our general view is that the consonance of owner and user interests in these cases weighs heavily against regulating them along classic utility lines. But, the threat of abuse of market power to the detriment of other competitive providers may be sufficient to warrant continued RCA regulation. In this sense, each case must be evaluated on its own facts and merits.

Establishing a separate telecommunications commission. The question of whether to establish a separate commission is driven by dual concerns. First, that the size and apparent importance of the telecommunications sector and the complexity of its issues will draw resources, attention and expertise away from consideration of other important utility sectors and the issues they bring for regulatory attention and resolution. Second, that the size of the telecom sector warrants its own Commission and "protection" as it were from having scarce regulatory resources taken from it and focused on other non-telecom matters before the RCA. A related concern is that given the differences in technology, issues and skill sets required to "understand" different utility sectors, that staff and other resources cannot be fungible and go back and forth between sectors and issues.

We are not persuaded that multiple jurisdictions of the RCA is the problem or that regulatory specialization is the solution. Dividing the RCA – its staff, offices, supporting

infrastructure and other resources – and allocating them to separate agencies with dedicated staff and specialized responsibilities for a given industry would not alone resolve the problem. Lack of adequate attention to particular issues, in whatever sector, is more likely the result of inadequate procedures, inadequate resources – either qualitatively or quantitatively, inadequate management, failure to establish priorities that truly reflect the public's broad interest, or something else. None of these is unambiguously resolved simply by replicating agencies. Nor is that solution reflected in the organization of other state regulatory bodies, almost all of which have broad mandates across industry lines.

Rather than create separate agencies, we commend looking more specifically and determining the extent and severity of the problem, its root causes and alternative ways to address the resource problem without resort to dividing existing agencies and creating new ones.

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Report to Senate Appointees to the Task Force on Operations of the Regulatory Commission of Alaska

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January 30, 2003

INTRODUCTION

We have been asked to address seven questions in the context of the current review of the adequacy and direction of RCA regulation of the telecommunications industry in Alaska.

These questions are:

1. What type of arbitration is best suited to rate and tariff issues?
2. What is the appropriate level of regulation for utilities in Alaska?
3. Should telecommunication regulation be moved to a separate commission?
4. Recommendations for mitigation of delays in RCA findings.
5. Evaluate the policy regarding payment of the cost of utility proceedings.
6. How can we assure procedural fairness before the RCA?
7. Review issues of preserving universal telephone service in rural Alaska.

The limited time and resources available for fact-finding and analysis were constraining. We have not had the opportunity to discuss these matters with regulatory practitioners, observers of the RCA, with RCA members or staff, nor as fully as we would have liked with the Task Force itself. What follows is our best effort under these challenging time and resource constraints.

That said, we are nonetheless confident in the overall thrust of our analysis and findings which uniformly imply a serious need to review, re-evaluate and redirect RCA policies and processes in ways that reflect competitive market developments and current conditions in the telecom sector in Alaska. Staying the current course is not a feasible option.[1]

Current practices or recommendations for change cannot be made without regard to the goals and purposes of such practices in the first instance. Accordingly we begin with a review of telecommunications goals for Alaska as they are expressed in relevant statutes -- the Communications Act of 1934 as amended by the Telecommunications Act of 1996, with particular emphasis on the latter amendments to the earlier Act.

Provisions of that Act define the rulemaking discretion of state regulatory bodies, like the RCA, on matters that qualify as interstate commerce. While the question of jurisdiction is often raised and debated, there is, in the matters raised by our mandate, no important question about jurisdiction or inconsistency between state and federal goals. Moreover, what follows is fully

1 We note at the outset that some of the material that follows is repetitive. That is the result of the fact that the questions themselves overlap and share some common factual and analytical bases. Thus, we have chosen a format that begins with general background relevant to all the questions, then turns to individual questions. We have constructed our response to each question in a way that allows it to be read and our views considered on a question-by-question basis. The editorial advantage of this is to eliminate the need for tedious cross referencing to material in other sections.

consistent with the FCC's and successive Federal-State Joint Boards' views of the reach of Federal jurisdiction in these matters.

BACKGROUND

Telecommunications Act of 1996. The Telecommunications Act of 1996 followed two decades of debate over national policy and how best to modify the Communications Act of 1934. By 1996 the FCC and state regulators had, in the preceding three decades, morphed application of the 1934 Act and mirroring state statutes from an orientation of monopoly protection and regulation to one motivated by growing reliance on competition in less regulated markets.

Rule changes involving promotion of competition, deregulation of existing markets and regulatory forbearance of new firms and services were made under statutory authority intended for and applied to protect and regulate monopoly providers. Opening markets and allowing new firms to compete was done slowly. The FCC and states introduced competition and implemented reform on a piecemeal, rule-by-rule basis.

Goals of the 1996 Act. The principle underlying goal of the Telecommunications Act of 1996 was investment that would either expand service to new areas, improve and add to service in areas being served or, more generally, both. Other goals – competition, deregulation, specific universal service provisions – were means to the end of increasing network investment and the reach and scope of the nation's telecom infrastructure.

The 1996 Act was strongly motivated by: a) a belief that telecommunications networks served as platforms and drivers of information technology markets -- equipment, components, software, etc.-- and the economy more generally; and, b) the desire to encourage higher, sustainable levels of investment in the telecommunications sector. Regulation was creating a drag on private capital formation and consumer benefits that follow from it.

Debates leading to the 1996 Act commonly referred to Information Superhighways, building a new national information infrastructure, accelerating the next generation of broadband and interactive services, providing universal Internet access and other policy objectives whose realization would require commitment of enormous amounts of new risk capital to the sector. Reflecting these concerns, the report of the conference committee convened to bridge different versions of a new Law and stated its purpose clearly:

> "...provide for a pro-competitive, deregulatory national policy framework designed to accelerate rapidly private sector deployment of advanced telecommunications and information technologies and services to all Americans."

This declaration of purpose expresses four discrete goals as the Act's broad purposes--increased competition, less regulation, heightened investment (deployment of advanced telecommunications and information technologies) and universal service. Thus, implementation of the purposes of the Act must reflect harmonization of different objectives -- objectives that are not necessarily consistent in all cases, nor able to be simultaneously pursued to the maximum in each policy decision.

It is notable that this statement of the goals combines directives, two of which require regulatory bodies to be sensitive to the effects of rules on investment. One goal is to encourage investment in advanced technologies for all users. The other expressly requires regulators to encourage investment specifically in pursuit of universal service -- that is, investment for users that might not otherwise be served.

The 1996 Act carried over the investment goal by setting forth in Section 706 (Advanced Telecommunications Incentives) clear provisions requiring regulatory Commissions to encourage development of investment supporting advanced telecommunications services. Specifically:

> The Commission and each state commission with regulatory jurisdiction over telecommunications service shall encourage the deployment on a reasonable and timely basis of advanced telecommunications capability...by utilizing...price cap regulation, regulatory forbearance, measures that promote competition in the local telecommunications market, or other regulating methods that remove barriers to infrastructure investment. (Emphasis added.)

The meaning of this part of the Act is plain. The FCC and state regulators shall promote investment and innovation in new telecommunications networks and services. While the language suggests alternative means for doing so, it clearly states the ends to which those means are to be applied: remove barriers to network investment.

Congress was joined by the President in support of promoting investment. In the message accompanying his signing of the Bill, President Clinton emphasized the Administration's intent to stimulate investment:

> For the past three years, my Administration has promoted the enactment of a telecommunications reform bill to stimulate investment, promote competition, provide access for all citizens to Information Superhighway [and] strengthen universal service. With this legislation today we are building the Information Superhighway that will lead all Americans into a more prosperous

future. (Emphasis added.)

Thus, the Clinton Administration expected the Act to lead to promotion of network investments and thereby to complement its other initiatives to grow the "Information Superhighway". The Administration's second regulatory reform goal was to "promote competition". The dual policy goals of stimulating investment and promoting competition, along with a third -- ensuring "universal" and equal access to the networks of the future -- were shared by most members on Capitol Hill.

The 1996 Act encouraged investment via: "...deployment on a reasonable and timely basis of advanced telecommunications capability" and made clear two important points. First, it made clear that the requirement applied to the Federal Communications Commission and "...each state commission with regulatory jurisdiction over telecommunication services." Secondly, the Act provided several preferred means for encouraging investment including: a) "regulatory forbearance", which is generally regarded to mean less regulation; and, b) measures that promote competition in the local telecommunications market and other "regulatory methods that remove barriers to infrastructure investment."

Thus, the Act clearly intends that state regulators, including the RCA, should advance a variety of goals, including competition, incentives to invest and extension of service to users who would otherwise be denied benefits of access to modern telecommunications networks.

The 1996 Act has provoked considerable debate over the meaning of its requirement that regulators "promote competition" -- particularly in the context of its simultaneous requirement that it stimulate investment in "advanced telecommunications capability" and promote "universal service" which also requires substantial "risky" investment in plant and equipment. The main dispute is over the type of competition to be promoted. The key issue is whether the emergence of competitors, without regard to their investment in plant and equipment, suffices.

Regulators are required to resolve issues related to whether the statutory mandate to promote competition requires firms -- either in the short run or the long run -- to invest rather than being reliant for their long term growth on regulations that guarantee favorable access to incumbent facilities.

These conflicts and concerns are being revisited, and the FCC's initial inclinations and rules being reconsidered, as part of a wide ranging, current statutorily mandated "triennial review" of the FCC's initial and modified rules governing interconnection terms and rates to be offered by incumbents to their competitors. Both the kinds of facilities that must be offered (that is the kind and quality of unbundled network elements or UNEs) by incumbents and the cost basis for the rates which incumbents are permitted to charge is being considered as part of this review.

FCC implementation. A particular vexing challenge for state and federal regulators under the 1996 Law was hinted at above: that is, how best to harmonize achievement of statutory and public interest goals that are not always fully compatible. Conflicting goals are a hallmark of the Act. For example, the universal service objective and the means set out for its pursuit may and do sometimes conflict with goals of promoting competition or encouraging investment.

Promoting universal service has become synonymous with maintaining sub-cost rates for making local connections, while keeping other rates higher, which discourages demand and investment, in order to provide support. Below-cost rates encourage households to subscribe and thereby support the universal service objective. Rates below costs are a barrier to investment by both incumbents and entrants--an outcome that discourages capital formation and undermines the viability of local competition. An entrant into the local services market must compete against the subsidized rate, not the cost achieved by the incumbent. The entrant's technology and management skills must be good enough to beat the incumbent *and* the subsidy program.

The FCC's initial interconnection order expressly notes the existence of both competition and universal service as discrete goals of the 1996 Act. In addition to promoting competition in different submarkets, the Commission goes on to articulate the statutory obligation for regulators to commit to: "reforming our system of universal service so that universal service is preserved and advanced as local exchange and exchange access markets move from monopoly to competition."(Competition Order, para. 3, page 7.)

Conflicting Goals. The FCC recognized that universal service policies must include significant reform and revisions to the current system which, as currently applied, places universal service and competition at odds with each other ("...subsidies are intended to promote telephone subscribership, yet they do so at the expense of deterring or distorting competition..."). The FCC recognized that promoting competition within the current framework of universal service polices could hinder the achievement of both policies and that universal service policies must be sensitive to the incentive structures of both incumbents and entrants. ("Some [universal service] policies place competitors at a disadvantage...Other universal service policies place the incumbent LECs at a competitive disadvantage."(Competition Order, page 8.)

The FCC recognized that there would be trade-offs required among the goals of deregulation, promotion of competition and competitors, and fostering investment. Less regulation of incumbents arguably would encourage incumbents to invest. But, the very same reduction in regulation would reduce the incumbents' handicap and permit them to be stronger competitors and temper the growth of entrants. Incumbent providers urge less regulation as a means of reducing regulatory barriers to investment and encouraging delivery of new services to the public. Opponents inveigh against "deregulating monopolies". Federal and state regulatory commissions must address and resolve these conflicting points of view and recognize that the truth will be found in facts not competing rhetoric.

The Act requires balancing conflicting goals. The challenge is to find the correct balance and to make the difficult trade-offs among conflicting goals.

By handing over for implementation a law with objectives reflecting substantial unresolved conflict among its members, Congress dealt the FCC and state regulators a very tough regulatory hand to play. After two decades of debate, members knew all the competing interests and were under enormous pressure to pass a law that placated contending interests among their supporters. The result was a law -- balanced in the view of some, unconscionably ambiguous in the views of others -- that could support rival stakeholder claims to victory and precedence in the regulatory battles that have unavoidably followed. The Act's goals are uneasy companions and left the FCC and state commissions with the chore of making high stakes trade-offs. Notably, Congress also left the FCC and state regulators with substantial discretion to do so.

Role of the States. The states in general, and RCA specifically, are given substantial discretion and authority to regulate under the Telecom Act of 1996. Under the 1934 Act as interpreted in a series of Federal Court proceedings, including important decisions of the US Supreme Court, the states are accorded jurisdiction over intrastate services -- which involves local exchange services and long distance services originating and terminating within a state's borders.

State regulators and RCA have broad authority and discretion. The 1996 Act and FCC rules implementing it give the states and the RCA broad authority in one of the most important matters addressed by the Act, namely establishment of interconnection rates for services and network elements provided by incumbents to new competitive entrants.

The FCC competition order noted: "...states will play a critical role in promoting competition, including taking a key role in the negotiation and arbitration process... [that will establish]... rates, terms and conditions governing the competing carriers, interconnection to the incumbent's network access to the incumbent's unbundled network elements, or the provision of wholesale rates for resale by the requesting carrier." (Competition Order, p. 66) The Commission specifically deferred to state commissions and left them: "...responsible for setting specific rates in arbitrated proceedings." (Emphasis added.) The Order contains four long paragraphs enumerating specific state Commission authorities and responsibilities, then concludes that these are a "representative sampling" of the role that states will have in steering the course of local competition. (Competition Order, p. 67) State commissions will make critical decisions concerning a host of issues involving rates, terms and conditions of interconnection and unbundling arrangements and exemptions, suspensions, or modifications of the requirements of Section 251 [the interconnection section of the Act].

Neither the Act nor the FCC rules implementing it restricted state agencies to the form of dispute resolution or arbitration of differences arising from negotiations among the parties. The

Act provides merely that "...the state commission shall resolve each issue" set forth by petition of a party or parties unable to agree through negotiations.

Even though the FCC specified: a) the initial bundle of network elements that had to be provided by incumbents; and, b) a general method for calculating the cost basis for rates for such network elements, the states still had enormous latitude within those bounds for establishing both rates and other terms of service. The wide variation in rates and terms of interconnection under 251 and the FCC guidelines is an indication of the discretion afforded states in those matters.

Nor was the discretion over interconnection rates and conditions a minor matter in the new law. In fact, it is arguably the single most important matter addressed in it, inasmuch as the decision determining interconnection rates will and did have significant impact on the evolution and character of market competition, on incentives and disincentives of different carriers to invest and through each of those on the development of universal service.

The Commission's initial order recognized and defined a significant role for the states in carrying out the federal objectives of the Act. Thus, the FCC interconnection order set "...minimum, uniform, national rules", but also relied "heavily on states to apply these rules and to exercise their own discretion...[and]...to create a factual record distinct to a state or to balance unique local considerations... We ask the states to develop their own rules that are consistent with general guidance contained [in the federal rules]." (para. 22) The order established a framework (forward looking cost) for determining rates, but left to the states, in recognition of specific details of carrier finances and operating circumstances unique to individual states, to make a variety of individual and discrete determinations with respect to: "...among other things, the appropriate risk adjusted cost of capital and depreciation rates."

Response of the RCA. The Act set relatively short statutory time limits for the FCC and the states for their resolution of the disputed terms. The states and RCA were obliged to act quickly once one of the parties petitioned a state commission. Recognizing that most states were unlikely to undertake their own studies within the time frame allowed, the FCC's Interconnection Order adopted the proxy model which the states could use. The FCC's Order established the basic set of UNEs that the ILECs must provide if requested, the cost framework to be followed, and default ranges based on the proxy model. Several states adopted, as did the RCA, the FCC's framework. Even there they disputed the FCC's interpretation of its authority from the Act.

RCA followed two tracks: it opened an arbitration proceeding designed to meet the statutory deadline for arbitration, and it opened a proceeding addressing the use of forward looking interconnection costs.

In the arbitration proceeding RCA retained a consultant to evaluate the interconnection cost analysis submitted by ACS and GCI. ACS submitted a cost analysis it created, while GCI

submitted an analysis based on the Hatfield cost model. RCA retained a consultant to analyze the submissions. Based on the recommendation of its consultant, it adopted the FCC proxy model. Parties then proposed inputs to be used and a baseline estimation was calculated using the default continental U.S. profile and its baseline as a reference point in evaluating inputs.

The RCA arbitration involved selection of the most reasonable Alaska-specific inputs from the evidence submitted. The RCA provided technical advice to the arbitrator.

Several criticisms have been leveled at the RCA's approach, but many of those have also been addressed to the FCC for its choice of UNEs; its definition of the (TELRIC) cost standard to be used; many of the elements and inputs of the Hatfield model and disregard for other evidence and arguments. It is notable, however, that the RCA in these regards did in general what the FCC prescribed and used decision variables not wholly unlike those followed in other state jurisdictions. Questions remain though about the accuracy of the underlying cost data and its relevance to current and future operating conditions in Alaska.

It appears that many of the findings of the RCA and rules based thereon were the direct result of the form of dispute resolution -- "baseball arbitration" -- it chose. It appears that having chosen baseball arbitration as the means for exercise of its regulatory authority, the RCA may have "locked itself out" of a number of important policy and public interest considerations that it might otherwise, under other dispute resolution mechanisms, have found probative and in ways to alter its decisions.

Since past decisions cannot be undone, it remains to determine whether baseball arbitration is the preferred means going forward. With this background for policy, legal and procedural context, we turn to the first question, then sequentially address the others.

ISSUE ONE:
WHAT TYPE OF ARBITRATION IS BEST SUITED TO RATE AND TARIFF ISSUES?

Statutory Background and Legal Basis. Jurisdiction over tariffs listing rates and terms of service of regulated common carriers is shared between Federal authorities (Federal Communications Commission) and state authorities with responsibilities resembling those in Alaska of the Regulatory Commission of Alaska.

The federal Telecommunications Act of 1996 grants state regulatory bodies, like the RCA, the obligation and authority to resolve or "arbitrate," by whatever means they choose, differences naturally arising among different parties with respect to, specifically and to none other, rates and terms of service involving interconnections to be made available by incumbent telephone companies to their actual and potential competitors. The specific form of interconnection, or access by others to incumbent-owned telephone networks, is referred to as the lease or sale of "unbundled network elements" (UNEs) of the incumbent's facilities, plant and equipment. The "arbitration" authority in the 1996 Act refers specifically to UNE rates and services, even though the RCA and other state authorities have broad jurisdiction and authority under the 1934 Communications Act to regulate and establish rates for local and other "intrastate" services.

The reference to "arbitration" of the specific statutory language of the 1996 Act is a general reference to dispute resolution and is not binding as to form or practice. Both the legislative history of the 1996 law and subsequent practice in other state jurisdictions make clear that that the RCA is not obliged to use "arbitration," "baseball arbitration" or otherwise, as practiced in other dispute resolution contexts.

Thus, consistent with the Telecommunications Act of 1996, FCC rules interpreting it, and with state telecommunications statutes and policy goals, the RCA has substantial discretion in determining and choosing the "best" means, from a variety of alternative dispute resolution methods, of settling conflicts between parties' views of UNE rates. It is not limited to any of the array of formal arbitration processes now in use in other sectors, nor is there any preference expressed in the law and rules for doing so.

The FCC's rules do not require a specific form of arbitration. In describing its vision of how states would play a role in fostering local competition under sections 251 and 252, the FCC stated: "Initially, the requesting carrier and incumbent LEC will seek to negotiate mutually agreeable rates, terms, and conditions governing the competing carrier's interconnection to the incumbent's network, access to the incumbent's unbundled network elements, or the provision of wholesale rates for resale by the requesting carrier. Either party may ask the relevant state commission to "mediate specific issues to facilitate agreement during the negotiation process." (at para 133, emphasis added.) Thus, the Commission envisioned the states playing an important role in the process "...including by taking a key role in the negotiation and arbitration process."

The FCC noted that owing to the unequal bargaining power and complexities of the agreements that "...the negotiation process contemplated by the Act bears little resemblance to a typical commercial negotiation." It did not either commend or foreclose alternative dispute resolution mechanisms, but rather left the details to the states with the proviso that the state regulator could "...assure that such agreements are consistent with applicable state requirements." (at para. 134)

Means of Dispute Resolution. Arbitration is only one of numerous means of dispute resolution. It is a procedure providing for submission of a dispute, by agreement of the parties, to an arbitrator or a tribunal of arbitrators, who in turn hear the cases and render a decision that is binding on the parties. In contrast to mediation processes, from which parties can withdraw, commitment of a dispute to arbitration binds a party to its conclusion and forecloses the option of unilateral withdrawal.

Formal arbitration of commercial disputes is widely used. However, its use is generally confined to special circumstances not clearly prevailing in the case of UNE rates, where the impact of alternative conflict resolution mechanisms can have a significant impact on the public interest.

Under what has come to be known as "baseball arbitration," each party presents the arbitrator with a number or cluster of numbers or position it advocates along with its rationale. The "arbitrator" must then pick one or the other. Knowing this, the theory is that the advocates will have an incentive to eschew extreme positions (on the basis of the assumption that doing so reduces the probability of its being selected) and gravitate toward some "true" or "realistic" value.

Use of baseball arbitration offers the greatest advantage, as a form of dispute resolution, when the public's main or only interest is in getting the dispute resolved quickly and conclusively. Where there is public merit and interest in not just getting matters resolved, but also in the specific character of the resolution itself and in its consequences for the public, there is nothing to recommend use of baseball arbitration over other dispute resolution mechanisms.

"Baseball arbitration" is widely used when there are extreme differences and the parties don't want the outcome compromised or "the baby split." The method provides for both relatively quick and decisive resolution. Its use appears to be concentrated in disputes in which the third parties, including the public at large, are more interested in having the dispute resolved and thereby protected from the cost of ongoing disagreement (strikes, work stoppages, service declines, as well as long, contentious, costly and inconclusive administrative and judicial procedures).

Evaluation of "Baseball Arbitration". The main advantages of the baseball arbitration model are its simplicity, its economy in the use of regulatory resources and staff, and its speed, certainty and conclusiveness in the resolution of disputes.

Both the Telecom Act of 1996, from which the authority and obligation to establish interconnection rates derives, and under prevailing state statutes there is a clear intent that state regulatory bodies shall use their authority to regulate rates and tariff terms in ways that specifically serve various "public interests" or particular statutory goals such as the promotion of universal service, just and reasonable rates, investment, competition, innovation and others.

The main disadvantages of baseball arbitration include: a) lessening the ability and opportunity of the "expert" body of regulators and staff to determine the precise criteria and weights on which to base a decision; b) limiting consideration to the positions and arguments of only two parties, when in fact the issues and their resolution implicate the interests of multiple parties, none of whom have the opportunity to shape details of the final outcome; and, c) failure to assure that the decision will be the correct one that optimizes across all interests, but is only the best of two on the table. In that respect, there is the chance that what is decided is the least damaging of two terrible options and no assurance that the two on the table are reasonably related to the broad public interest.

While the theory of "baseball arbitration" holds that contenders will have an incentive to come toward the middle, there is some basis for doubting that other incentives might not soften or contravene that to some extent. Again, recognizing that the process may leave the Commission to choose the least worst option, parties may correctly believe, and have incentives based thereon, that in an either/or decision context, that the RCA will not choose the other side.

The "baseball arbitration" method limits the ability of the RCA to determine criteria for judging; weights to be accorded those criteria; methods of estimating key decision variables related to costs and benefits; and the discretion to substitute its expert judgment in both direct and subtle ways.

Conclusion and recommendation. The advantages of baseball arbitration are in its relative simplicity, economy and speed with which issues are resolved. However, those come at significant potential costs in terms of the fidelity of outcomes to the need for the representatives of the citizens of Alaska – staff and members of the RCA – to exercise expert judgment and to assure that the decisions made reflect fully the public's interest in balancing goals of universal service, investment, competition and procedural fairness. While speed, economy and simplicity are valued in public decision-making, so is fidelity to the public interest.

Accordingly, we believe that the RCA should search for, evaluate and choose other alternative dispute resolution mechanisms.

A good start in that direction would be to undertake a review of practices in other state regulatory bodies with responsibilities and duties similar to those of the RCA. That review should be driven by the goal of gathering information about alternative dispute resolution mechanisms, their relative merits and the identification of "best practices" for consideration of decision-makers in the state. (Our responses to questions four and five below address more details about RCA procedural fairness and delay in decision processes.)

ISSUE TWO: WHAT IS THE APPROPRIATE LEVEL OF REGULATION FOR UTILITIES IN ALASKA?

It is helpful to begin with the principles on which the answer to this question might very well be based. I believe that these include the following:

Principle One. The appropriate level, type and intensity of regulation must be determined in the context of:

- the needs of the people of Alaska;
- the particular policy goals set forth by its government representatives;
- the structure of individual markets in Alaska;
- the efficacy of free market forces in satisfying these needs and goals; and,
- the costs (delay, resource use inefficiencies, etc.) and benefits of regulation.

These factors combine to determine the mix of regulation -- imposition of government rules -- and the incentives embodied in competitive forces in the market place. We note that choosing the level of regulation involves a balancing of market imperfections with regulatory imperfections and that imperfect markets might well substitute for imperfect regulation. The choice of means – regulation versus markets – requires equally diligent analysis and assessment of both as forms of serving the public. There should be no presumptions favoring one or the other.

Principle Two. The adequacy of markets and the need for regulation change over time with changes in:

- market structures;
- technology;
- user needs;
- changing policy goals.

Technology, markets, political processes and user needs are dynamic; it is simply not acceptable to have all these overlain with a stagnant, inflexible, and static set of regulations and processes.

Principle Three. Some goals cannot be fully met by free markets alone. Universal service is the single best example. Markets will fail to bring service to some areas and to some users at "affordable" levels of cost. The result is to require regulation -- government rulemaking intervention -- to bring about "implicit subsidies" or direct subsidies funded by government.

Given foreseeable changes in cost, technology , and population demographics in Alaska, it is unlikely that universal service objectives will in the future be able to be met without active regulatory intervention.

In recognition of these principles we can observe several trends and tendencies in other regulatory jurisdictions. These include efforts to:

- regulate only when market forces are not sufficient;
- relax or eliminate regulation when presence of competitors and user choice increase, and as market power of incumbents is diminished; and,
- tailor or customize regulation to specific services and market conditions to reflect differential development of competition and market forces.

The approach of the FCC's initial order also recognized the statutory admonition to tailor regulation of incumbents as markets develop. Thus, "given the dynamic nature of telecommunications technology and markets, it will be necessary over time to review proactively and adjust these rules to ensure that both the statutes mandate of competition is effectuated and enforced, and that regulatory burdens are lifted as soon as competition eliminates the need for them." It went on to define the specific role of state regulators in this regard: "Efforts to review and revise these rules will be guided by the experience of states in their initial implementation efforts." (Competition Order, p. 9)

Discussion. Alaska's unique geography and climate make telecommunications infrastructure development especially important to its long term economic development. Alaska's population centers are widely separated, and a significant portion of the state lives in small rural communities that are separated by natural barriers without physical road or rail connections. Electronic communications are considered vital. Telecommunications policies must take into account a mix of monopoly regulation, private market competition, as well as municipal and state public-supported funding required to support its goal of achieving adequate levels of service in all areas of the state. The mix of competition and regulation reflect the incentives for private finance. Some rural markets may not support multiple local exchange providers, while larger population centers will.

In urban markets, competition will exert pressure on costs and prices that will put pressure on current intra-carrier subsidies. As entry proceeds, RCA must relax price regulation and service restrictions, and allow the incumbent flexibility in meeting competition. Small business/residential and remote customers with fewer options will end up paying more. Users (typically large users) that have options will pay less. Interexchange carriers (IXCs) and their customers typically subsidize local customers through access charges and through other subsidies. As IXCs and ILECs invade each other's markets, reform of intrastate access charges is vital to the survival of both IXCs and ILECs.

Regulation in rural markets is subject to different forces. It is critical for the level and details of RCA regulation to recognize that in many areas of the state that the size of market demand and the basics of network economics are such that competition among many or even a

few competitors is not viable. Monopoly, or something close to it, may simply be "natural" and unavoidable where markets are small and network costs per household or subscriber are unavoidably high. The potential for competition and the number of rivals are driven by considerations of minimum efficient scale relative to the size of the market being served. There are numerous examples of single providers of goods and services throughout many rural markets in Alaska and no reason why telecommunications provision is not subject to the same set of economic laws. While access to High Cost and Low Income set asides in universal service fund programs may seem to help, in fact the funds available will frequently not suffice to support a single competitor, never mind two or more.

The level of regulation must be sensitive to the persistence and continuation – or the absence -- of the conditions for which it was in the first instance imposed. If monopoly is the reason for regulation, then the regulatory imperative and rationale is diluted by the growth of competition and competitive market shares. Unfortunately, there is not a one-to-one or otherwise perfect correspondence between measures of competition, say market share or number of competitors or reduction in rates, but each of those must be taken as a reliable indicator of the emergence of market forces and a consequent "lessening" of the need for the regulation either as intense, detailed or broad as in the initial monopoly environment.

We note several indicators of increased competitive strength, reduced market power and both actual and potential consumer choices. First of these indicators is markets served and subscribers passed by a potentially competitive wireline alternative. Data indicate that 97,000 homes out of an estimated 220,000 in Alaska – approximately 90% -- are passed by cable. While the use of cable-based local telephone service is modest, the potential for competition, its growth and the intention of competitors are clear and thereby should be reflected in public policy, as they are in the market plans and conduct of incumbents. Second, the market share of incumbents is declining with the growing share, economic base and market presence of competitors. Third, but by no means least, the weak financial performance of incumbents reflects convictions in capital markets about increased market risk and concerns about the role of current level of regulation.

The growth of competition creates a dilemma of sorts for regulators. Simply put, they must decide when the competition—and competitors -- they have fostered through favorable access to incumbent facilities and through other means have worked sufficiently to enable a cut back in degree and kind of regulatory intervention. The choice is not simple and burdened with the threat of two kinds of errors – continuing to regulate when market forces are sufficient to protect and promote the public interest versus forbearing regulation when market power is still a substantial threat to the public interest. Difficult or not, this is a finding and decision that the RCA cannot avoid making.

The RCA must be given a clear mandate to:

- evaluate evolving market conditions;
- determine the adequacy of competitive market forces to protect the public;
- assess the need for and costs of continuing regulation; and,

- change the form, or forebear entirely from, traditional forms of regulation.

We note again the importance of balancing the imperfections of markets against the imperfections of regulatory processes. And, that efforts to improve market forces must be complemented with companion efforts to assess the value of regulation and adapt it accordingly.

The authority to forebear from or reform existing regulation should be considered in the context of the overall rate level, including provisional and incentive schemes, flexibility with respect to the individual rates and their relation to each other, investment programs, and others as the RCA might find appropriate after considering public comments on the matter.

In assessing the need for reforming or forbearing regulation and determining the types to retain or impose going forward, the RCA should be sensitive to the effects of alternative courses of action on both the type of competition that would ensue, but also the impact of such reform or forbearance on investment in advanced facilities and universal service. Both those goals are companions to that of supporting competitors as a means of fostering competition.

Dual provisions in the 1996 Act -- to encourage competition and to forebear from regulation where it is not needed -- can best be read to envision a time when market forces are sufficient and government involvement to manage markets is no longer necessary. It is worth noting that the FCC confronted and resolved this very dilemma in the context of the chain of events in the long distance sector -- opening entry into monopoly markets, promoting competition through regulatory forbearance of competitors and other means, then "deregulating" the incumbent AT&T on grounds that it was no longer dominant in the marketplace.

In the long run, state regulators must take care to ensure that the form of competition being created is creating real options for end users, that it is consistent with creating investment incentives for both incumbents and entrants, and that the market rivalry being fostered can be sustained in the long run without sustained, continuous and detailed intervention by the RCA. If the terms of competition must be subjected to detailed regulatory intervention and enforcement, then market competition is replaced by managed competition and effective government control of resources and user choice. That is not the vision of the Telecom Act of 1996.

In place of the current rate of return regulation, RCA needs to move to more flexible regulation -- allowing some discretion for incumbents to react to competition -- and to consider on a market-by-market, service-by-service basis, whether price regulation is needed at all. First, RCA needs to limit regulation to markets (geographical and service markets) where providers have "significant market power" sufficient to disserve the public interest. In this regard the RCA should adopt expansive market definitions that may include converging networks such as wireless and cable providers of voice and Internet access services as well as wireline. To the extent that the RCA concludes that a provider has significant market power over one or more services, it may want to consider price caps in place of cost-of-service regulation or other regulatory mechanisms to encourage economic efficiency and instill incentives to undertake

risky capital formation.

Recommendation. Regulators must adapt to changing technological and market conditions. All indications are that investment patterns, the competitive environment and progress toward wider availability of service have all changed dramatically since passage of the 1996 Act and its implementation by the FCC and RCA. It is therefore not only appropriate, but obligatory in pursuit of the best interest of citizens in all parts of Alaska for policymakers and decision-makers to:

- undertake a broad scale inquiry designed to understand these changes;
- evaluate policy alternatives in the context of these changes; and,
- implement policy and rule changes to reflect market conditions and trends.

Our limited review of the evidence suggests that increasingly powerful competitors are in some markets segments sufficiently effective in constraining incumbents to warrant relaxation of regulation of incumbents. If not now, the RCA should be obliged to say why and under what circumstances less regulation should suffice.

Special Issues regarding Municipally-owned utilities and co-ops. With investor-owned utilities, users of utility services and owners of the assets committed to produce them are different sets of citizens. However, in the case of coops and municipally-owned utilities, there is a high correlation with respect to the identities of owners and customers. Classic utility regulation has been imposed for the most part because of potentially frequent and substantial divergence of the interests of users of utility services and owners of the assets. In the case of coops and municipally owned utilities, there is in principle at least rather greater identity and fewer differences in the interests of the owners and users of services.

While these differences suggest the need to differentiate the regulatory treatment of utilities with different ownership forms, those differences alone do not necessarily warrant deregulation of noninvestor-owned utilities.

It may continue to be a matter of practical concern in some instances in Alaska, that noninvestor-owned utilities – despite the congruence in the structure of their customers and owners – may still possess market power that can be used to the detriment of other consumers, workers, competitors and the public interest more generally. Of particular concern might be the ability of consumer or taxpayer-owned entities to use their market power in ways that need not serve the broader public interest. To the extent the RCA finds that to be the case, the practice would be a barrier to complete deregulation.

Again, there is the question of balancing to contending considerations. Our general view is that the consonance of owner and user interests in these cases weighs heavily against regulating them along classic utility lines. But, the threat of abuse of market power to the detriment of other competitive providers may be sufficient to warrant continued RCA regulation. In this sense, each case must be evaluated on its own facts and merits.

For these reasons we are not persuaded that these noninvestor-owned utilities be "deregulated" without regard to their ability to use market power to the detriment of other users, firms and the public interest.

ISSUE THREE:
SHOULD TELECOMMUNICATIONS REGULATION BE MOVED TO A SEPARATE COMMISSION?

The current structure of the RCA consolidates into a single agency responsibility for industries and markets with substantially dissimilar technological, economic and market characteristics. It has been suggested that the quality of regulation and the extent to which it reflects the unique characteristics and public interest requirements of individual sectors could be improved by separating regulatory responsibilities of the RCA into two agencies – one for telecommunications and one for all its other responsibilities.

The concern seems to be based in the fact that telecom issues tend to dominate both the public policy and political agendas and thereby command the bulk of RCA time, resources, and expertise. These are serious concerns. The relative importance of telecom to the welfare of Alaska's citizens does not diminish the absolute importance of other activities in other markets and other firms subject to RCA oversight and regulation.

That said, however, it is not clear that moving telecom to a separate agency, dedicated only to regulation of telecommunications, would improve the performance of the RCA, the new agency or the degree to which regulation overall addresses and advances the public interest.

In principle, there is no clear relationship between the size and scope of an agency and its administrative efficiency. There are not clear economies or diseconomies of scope or scale in the operations of a government regulatory agency and no clear relationship between scope/scale and quality of service of the public agency.

In practice, experience at both the federal and state levels does not indicate any particular "economies of specialization" either in terms of cost efficiencies or ability to produce satisfactory quantities of high quality output.

While the FCC is limited to "communications issues" broadly construed, its regulatory authority spans spectrum management and licensing, broadcast television regulation, cable television regulation, mobile radio and cellular telephony, satellite services and both international and domestic matters.

State regulatory bodies are almost without exception charged with broad responsibilities over "public utility" sectors including both telecommunications and alternative forms of energy. Some have even broader obligations extending to different modes of transportation and assorted other regulatory duties.

A more thorough review of the operation of the RCA is likely to find whatever shortcomings it may suffer to be related less to the scope of its jurisdiction than to staffing, budget, processes, timing and sense of the regulatory goals it is charged to advance.

Recommendation. There is no compelling reason for telecommunications regulation to be administered in an agency confined only to consideration of telecommunications issues. However, in recognition of the clear public stake in the effective regulation of non-telecom firms and industries, it is critical that the legislature assure that: a) that the RCA be given adequate resources to support effective exercise of all its regulatory responsibilities; and, b) such resources be earmarked and dedicated in ways to make sure that pressing issues outside the telecom sector be fairly, quickly and competently addressed.

ISSUE FOUR: RECOMMENDATIONS FOR MITIGATION OF DELAYS IN RCA FINDINGS

Regulatory delays are inherent in administrative, rulemaking processes. Time is needed to assure that the RCA gets all the relevant information needed to make informed decisions and to discharge its obligation to advance the public interest. However, time absorbed by regulatory proceedings may also reflect inefficiencies growing from the interplay of statutory requirements, commission rules, administrative processes and the quality and quantity of resources available to the regulatory body.

Some sage observed that an unsatisfactory, but timely decision may very well be better than a satisfactory decision rendered after long delay. Businesses can adapt to decisions they would not have preferred. There is no good means for them to adapt to regulatory delay, volatility and uncertainty.

Therefore, solutions addressing regulatory delay – particularly in the context of concerns that some parties are afforded inadequate access and opportunity or fairness in existing processes – require consideration of a broad range of alternatives and careful balancing.

An exhaustive review of these possibilities is not possible with the resources assigned to this task. The following discussion and suggestions are based on our review of general administrative principles and practices in other jurisdictions. In doing so we have drawn on the experience of other state commissions and the FCC.

Without a more detailed study and assessment of the specific causes of delay in RCA proceedings, we are not in a position to rank these as to importance. But, the list should be regarded as a barometer of officials in other states as to key sources of delay and the preferred means for resolving them. These should be considered by the legislature in the context of other changes recommended elsewhere in this report.

Reduce regulation where possible. Less regulation means fewer resources needed and less time consumed. Thus, we suggest that a provision be established in the RCA charter requiring objective, measurable criteria for "workable competition" and the "need to forbear or lessen or tailor regulation of markets under its authority." The RCA should devise workable definitions of competition and could draw guidance in doing so from other jurisdictions.

Replace judicial proceedings and formal hearings with informal processes. There are very likely some unexploited opportunities to substitute more economical dispute resolution mechanisms for costly and lengthy current ones. The choice of mechanism always involves balancing. But in weighing alternatives, the cost of delay should not be minimized. As indicated above, in some proceedings, the opportunity to move towards different processes is limited. Interconnection under section 252 of the Telecommunications Act is unlikely to result in

agreement on terms of interconnection between incumbents and new entrants. There may, however, be some sub issues that can be "carved out" and resolved piecemeal without energizing the full administrative process. If the RCA abandons use of baseball arbitration and commits instead to "compromises" and middle ground resolutions of some of the key issues, the parties might well have more incentive to negotiate and/or to present the RCA with options that are closer in their long term effects on the parties and the broader public interest.

Individual consumer complaints are better handled through the use of a knowledgeable mediator. The use of mediation or arbitration as an alternative dispute resolution process as a first resort is well established as a more desirable alternative to an advocacy process. With mediation and/or mediation-arbitration, there is a better chance that the complainant will end the process with greater satisfaction in the result and hence in the agency.

Look for and adopt "best practices" from other regulatory bodies. Several "best practice" recommendations were suggested at an NRRI/NARUC workshop to encourage alternatives to formal proceedings. More, much more, analysis and fine-tuning would be required to convert any to useful forms in the current regulatory environment, but they ought to be considered.

- Consider a range of dispute resolution services including mediation, arbitration and facilitation teams including judges and staff.
- Convene CLEC/ILEC working groups to address, on a semi-monthly basis, common issues.
- Allow either party to an interconnection agreement to request a settlement conference with Commission staff within 10 business days of request.
- Expedite resolution of formal, interconnection-related complaints to 30 days after filing of formal complaint
- Expedite carrier-to-carrier complaints. This could be done by, among others:
    - adopting a 'quick-look' process where parties are advised of likely outcomes;
    - sharply expediting procedures to arrive at decision;
    - allowing for mediation and voluntary arbitration for complaints;
    - allow RCA to award litigation costs to a prevailing party; and,
    - allow RCA to impose sanctions for frivolous activity or tactical delays.

These practices are applicable to different kinds of disputes and the point is not to advocate any one, but rather to encourage the RCA to be creative, innovative and to find more cost effective and timely ways to operate. Regulators expect and hold carriers under their purview accountable for being innovative and adopting new production techniques and cost cutting measures as they become available. There is no reason why regulators should not be held similarly accountable.

Eliminate nonessential, obsolete regulatory programs. The 1996 Telecommunications Act required the FCC to streamline its accounting practices which established "used and useful" depreciable asset lives. The FCC has now disbanded its accounting department because it is no

longer relevant under competition.

Establish performance review procedures in meeting defined activities. Various departments should develop a system of performance assessment procedures suitable to their own activities. These should be quantifiable where possible but also contain qualitative indicators. Performance measured against criteria should be part of annual division reports. RCA staff must articulate what they are trying to achieve and to what extent they are meeting their goals.

Regulators, like the firms they regulate, should be required to be efficient. Indeed, there is at the margin probably more payoff to the public from increasing efficiency of the regulator compared to the regulatee. We can find no good reason why some performance standards should not be put in place. Doing so is vital for purposes of improving internal efficiency of the units and important for raising the level of accountability of the RCA to its constituents – the public who buys service and those who pay the bills.

Reduce turnover of key commission senior and staff personnel. Given the rapid changes in the telecommunications sector, having experienced commissioners expert in a sector as policy maker is key. Adequate resources should be provided to reduce the turnover of key staff. This turnover at a minimum impedes the speed at which cases can be brought and completed. Turnover can slow down decision resolution. Experience is often acquired on a case-by-case basis when regulating rapidly changing industrial structures and as new technologies need to be brought into consideration. Besides identifying clear goals, required activities and performance measures, staff developmental training processes should be instituted with the purpose of collecting information from other state commissions, and ensuring a well trained, skilled staff.

Shorten statutory deadlines for tariff proceedings. The Telecommunications Act of 1996 streamlined procedures for the FCC to act, and for other parties to challenge tariff filings. The statutory deadline was reduced from 12 to five months for the FCC, and a tariff filing was deemed lawful after seven days if not challenged rather than 15 days. The comparable procedures in the Alaska statute are 15 months and 45 days. We see no reason for the gross disparity. If it can be rationalized on closer examination and more facts, so be it. If not, then eliminate it.

Expedite complaint proceedings. New complaint provisions under the 1996 Act imposed considerably expedited complaint proceedings on the FCC. In response, the FCC adopted expedited formal and informal complaint procedures and made them available for all complaints. One of the main goals was to implement requirements that encourage potential parties to resolve their differences prior to adjudication before the FCC. Informal complaint rules currently apply only to complaints against common carriers, including wireless carriers. They emphasize ease of filing by consumers, including those with disabilities, and voluntary, cooperative efforts by consumers and affected companies to resolve their differences informally. The FCC has extended this uniform, streamlined consumer complaint process to all services

regulated by the Commission.

Establish "blanket" or "streamlined" review procedures. For example, FCC merger applications meeting specified criteria -- such as certain small incumbent local exchange carrier (LEC) transactions, or transactions involving only non-facilities-based carriers, or those in which the acquiring party is not a telecommunications provider -- are automatically granted 30 days after public notice unless applicants are otherwise notified by the Commission.

Promote regulatory forbearance and flexibility. The commission should determine whether continued enforcement of provisions are not necessary to ensure public interest goals. RCA should establish a clear connection between regulations and their public interest objectives, and regulations should be reevaluated periodically to ensure that the public interest is still being served and that other, better methods cannot be identified. The FCC's requirement for a biennial review is an example of this flexibility.

Impose and enforce shorter time deadlines across the board. The foregoing generally addresses the problem of regulatory delay indirectly, by limiting matters that come before the RCA; by providing expedited or streamlined processes; by adopting new procedures and the like. The most direct way to speed up the process is to limit the time available to conduct different proceedings. We suggest imposing stricter time constraints on all proceedings. Different proceedings have different time structures from dispute or issue recognition: giving public notice; receiving evidence in comments and replies; evaluating the evidence; making a decision; making it public and enforcing it.

Any deadline is in a fundamental sense arbitrary. We cede that argument at the outset, but do not give it much weight. To save time, the time constraint must bind – it must make practitioners inside and outside the agency feel the pressure of deadlines. Regulated carriers have time constraints on providing service; budget constraints on the amount of labor they can expend; and limits on the duration of all sorts of business activities, and other time constraints. Firms in the private sector routinely do "time studies" to improve efficiency. These time constraints are discomfiting, and the more so, the less permissive and more effective.

Conclusion. The foregoing list of best practices and suggestions should be regarded as a menu of possible items for consideration. It is not exhaustive by any means, nor do we expect every one will be helpful. The precise composition from the different groups will depend on how the legislature, the RCA and its constituents come to understand the sources of delay.

We emphasize again the need to consider these suggestions for reducing delay and otherwise improving the quality of regulation and its responsiveness to consumer needs in the specific context of a broader investigation of the sources of delay in RCA processes. We have not done so, but emphasize the indispensability of understanding fully and precisely the sources of delay as a predicate for undertaking particular measures to remedy it.

Recommendation. The legislature should consider as a default limit, subject to further

consideration and review, imposing a deadline of six months on all RCA rulemakings. As an interim step, the RCA, as the expert agency, could be invited to share its views with the legislature on what complementary steps would be needed to accomplish that goal.

ISSUE FIVE: EVALUATE THE POLICY REGARDING PAYMENT OF THE COST OF UTILITY PROCEEDINGS

There are two approaches to funding commissions — through general taxpayers or through assessments on the regulated utilities as a user fee. Only a small number (six) of other state regulatory commissions depend exclusively on general tax revenues to underwrite regulatory agency expenses. Self-funding assessments are not used in all US states. Where they are, state statutes establish the level and structure of utility user fee assessments. Thus, there is considerable variation state-to-state. Typically, state statutes provide authority to impose charges on utility companies for the costs of special investigations, specific proceedings, and general regulatory functions. They also typically involve a reimbursement to the state treasury after the commission has expended its authorized budget. The basis for each utility's levy is generally its proportionate share of all intrastate gross operating revenues generated by the utility sector.

When all is said and done, the citizens of Alaska pay for the expenses of the RCA under either or combined options. The different means provided merely shift around both economic and political responsibility for the budgets. Direct funding through user charges imposed on carriers and others using "regulatory services" provided by the RCA are passed through in part directly to end users (as a hidden tax) or absorbed by shareholders and indirectly passed through to end users in the form of higher capital costs. Either way consumers pay – in higher utility rates if the RCA is funded by user fees levied on practitioners before the agency, or in higher taxes if the RCA budget is funded from general tax revenues.

Alaska Statute. The Alaska statute provides for charges to regulated entities to fund RCA regulatory activities.[2]

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2 (a) A regulated public utility operating in the state shall pay to the commission an annual regulatory cost charge in an amount not to exceed the maximum percentage of adjusted gross revenue that applies to the utility sector of which the utility is a part. The regulatory cost charges that the commission expects to collect from all regulated utilities may not exceed .8 percent of the total adjusted gross revenue of all regulated public utilities derived from operations in the state. An exempt utility shall pay the actual cost of services provided to it by the commission.

(b) The commission shall by regulation establish a method to determine annually the amount of the regulatory cost charge for a public utility. If the amount the commission expects to collect under (a) of this section and under AS 42.06.286 (a) exceeds the authorized budget of the commission, the commission shall, by order, reduce the percentages determined under (h) of this section so that the total amount of the fees collected

There are both advantages and disadvantages to self funding. First, in terms of the incidence of benefits and costs, it is argued that since utility shareholder and ratepayers derive the benefits of regulation, they should be assigned responsibility for offsetting the costs. Setting fees proportional to revenue, it is argued, results in a rough correspondence between benefits received and conferred on the one hand and the amount paid for those services on the other. Some regulated firms may rightfully contest that they get any specific shareholder "benefits" from regulation or that their customers do either. That contention should be given considerable attention and analysis, particularly as the "monopoly franchise" basis of such benefits diminishes and the cost of regulatory burdens differentially imposed on different firms and types of firms increases.

As firms are assigned greater responsibilities for universal service funding (under the FCC program for example) and responsibilities for obligations, such as supplier of last resort, the sources of revenue may shrink in the future. Also, the willingness of the regulated entities to comply will lessen in a competitive environment, particularly on the part of the incumbent utilities who are losing market share. The willingness of the jurisdictional utilities and the public to fund the RCA activities will depend upon how well the RCA is perceived as providing services that are professionally competent and in the public interest.

To the extent that there is pressure to shift responsibility for recovering the costs of RCA "regulatory services" through what effectively are user fees, that is likely the result of: a) dissatisfaction with the quality of services being rendered and in particular concerns with issues of delay, fairness, access, bias, etc.; and/or, b) disputes over the notion that some regulated firms are getting any benefits from regulation that appears to increase their risk and reduce returns to shareholders while reducing also the number of customers it is serving.

Absent any other sources of concern over current methods of funding we think it should continue, but in full recognition that there is widespread dissatisfaction with the "value of

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approximately equals the authorized budget of the commission for the fiscal year.

(c) In determining the amount of the regulatory cost charge imposed under (a) of this section,

(1) a utility selling utility services at wholesale shall modify its gross revenue by deducting payments it receives for wholesale sales;

(2) a local exchange telephone utility shall modify its gross revenue by deducting payments received from other carriers for settlements or access charges;

(3) an electric utility shall reduce its gross revenue by subtracting the cost of power; in this paragraph, "cost of power" means the costs of generation and purchased power reported to the commission.

(d) The commission shall calculate the total regulatory cost charges to be levied against all regulated electric utilities under this section. The commission shall allocate the total amount among the regulated electric utilities by using an equal charge per kilowatt hour sold at retail.

(e) The commission shall administer the charge imposed under this section. The Department of Revenue shall collect and enforce the charge imposed under this section. The Department of Administration shall identify the amount of the operating budget of the commission that lapses into the general fund each year. The legislature may appropriate an amount equal to the lapsed amount to the commission for its operating costs for the next fiscal year. If the legislature does so, the commission shall reduce the total regulatory cost charge collected for that fiscal year by a comparable amount.

services" being rendered by the RCA and the rationale for having to pay substantial sums therefore. A related difficulty is the intervention of parties with a stake in the outcome, but who have no obligation under the statute to pay; or that parties with minor stakes in the outcomes avail themselves of procedural opportunities to "slow the process" when doing so serves no clear larger, public interest. These and related instances in which process dominates policy and in which private and parochial interests trump the public interest are difficult to address with statutory change, but are easier to at the agency level with procedural and rule changes. The RCA should be encouraged to do so.

The final and perhaps most persuasive reason for continuing the user charge and fee basis rather than general tax revenues, is that doing so frees this very important function from day-to-day state budget politics. The legislature very likely has other authority and discretion to influence RCA activities without doing so through budgetary means.

ISSUE SIX:
HOW CAN WE ASSURE PROCEDURAL FAIRNESS BEFORE THE RCA?

The Task Force identified to us: a) concerns about the ability of the RCA to judge fairly and without regard to the identity of parties; and, b) the RCA's overall ability to analyze fully and fairly the issues before it. There is concern over unequal contact with RCA Commission members, particularly that Anchorage-based companies are favored in that regard. There was also some indication that parties were concerned over the possibility of retribution and were constrained thereby from availing themselves fully of procedural options.

We are obliged at the outset to call attention to three obvious points.

First, we have not had a full opportunity to gather all relevant and necessary information related to current administrative standards of procedural fairness or experiences of parties subject to RCA practice.

Second, the RCA must have access to relevant, accurate and timely information if it is to make important decisions and it must do so in ways that advance the broad public interest and the amalgam of private interests it is charged to protect and promote. Much or most of this information is possessed by parties with a substantial stake in the outcome of proceedings. Thus, there must be a balance between the need for contact with private parties to collect information and the need to protect the rights of all parties in that process.

Third, we all know that fairness is a matter of perception; it cannot be guaranteed by law and rule under all circumstances; and, ultimately it is up to public officials to protect the interests of all parties – ensuring their rights are heard and that they have confidence in an unbiased decision-making processes.

Parties will do their best, according to their privilege and rights under law, to influence decisions and outcomes in important proceedings. It is up to lawmakers, rulemakers and decision-makers to set the constraints and ground rules to assure procedural fairness.

Rules can help, and some rules are better than others, but at the end of the day fairness depends on the actions of the decision-makers themselves. Without the commitment of decision-makers to fairness, and their willingness to take actions consistent with assuring fairness, rules designed to assure fairness are no more than inconveniences and may be readily reduced in practice to a nullity.

A former chairman of the Commerce Committee of the US House of Representatives who chaired numerous hearings on regulatory reform in telecommunications observed that all who came to him wanted the same thing: "a fair advantage" in the marketplace and rules and processes that would advance that goal.

That said, there are objective standards of fairness that can and should be pursued for all parties to regulatory proceedings in which large sums of money, as well as critical elements of the public interest, are at stake. These standards are embodied in numerous statutes and rules that now govern administrative procedures in both Federal and state regulatory bodies. Nevertheless, responsibility for procedural fairness resides in large measure with the staff, political appointees and decision-makers of the RCA. No rules can guarantee fairness. The legislature can only do its best to advance the cause of fairness by identifying, if and where they exist, then taking steps to diminish opportunities and appearance of favoritism, bias and discriminatory access to decision-makers and decision-making processes.

In the short period of time and with the limited resources made available to address this question, we have come to several conclusions. These are clearly implied by the following recommendations, which focus on further steps the State might take, in ways you and others are best suited to choose, in the direction of assuring due process and fairness of access to all parties.

- The RCA should review its rules and practices and evaluate the extent to which they assure full and equal opportunity for all parties to make their views known to decision-makers in a timely manner. Following such a review, the RCA should issue a report to the legislature with its findings and recommendations.

- As a part of its review the RCA should consult with other regulatory officials either directly or through the national association or through NRRI about "best practices," helpful safeguards, model rules or other inputs useful to informed, but fair, decision-making processes. The question of procedural fairness is not limited to the Alaskan context. The state should take whatever economic and timely measures it may choose to discover how "fairness" is assured in similar contexts in other jurisdictions.

- The review should encompass evaluation of current processes, personnel and practices involved in formal hearing processes. Given the importance of these procedures, it is critical that the public have full confidence in their conduct. Should more resources be needed – private or public --this appears to be one place in which additions can be especially productive.

- Ex parte contacts with decision-making officials should be limited to those necessary for such officials to gather decisionally indispensable information. The purposes and information conveyed in such contacts should be made available to all parties to the dispute or proceeding involved.

- The RCA should set forth clearly its rules and practices to governing such contacts and those should be observed by staff and enforced with respect to the conduct of petitioners (advocates, private parties, etc.). Our reading of section Sec. 42.04.090 suggests that it imposes rather strict standards respecting impartial decision-making, ex parte

communication and the propriety of various kinds of behavior by panels, staffs and decision-makers. To the extent that such laws are on the books and address the problem, it remains only to enforce them to assure compliance. If the RCA does not have the resources to comply, then the remedy should address that, rather than impose new procedural requirements.

Finally, the RCA could usefully do a more effective job assuring the public and practitioners before it that its processes are fair and that its decisions are in the public interest very broadly, consistently and accurately construed. To this end the agency might be more expansive and detailed in spelling out the analysis underlying its decisions, the alternatives considered and the relative (de)merits of each. The use of informal en banc hearings to foster public dialogue, with inclusion of the press, might advance the image of the RCA and give comfort to practitioners in the openness and fairness of Commission processes.

ISSUE SEVEN:
REVIEW ISSUES OF PRESERVING UNIVERSAL TELEPHONE SERVICE IN RURAL ALASKA

Recommendations. It is imperative for government officials in Alaska to recognize that for all the substantial benefits of open competition and more consumer choice, a necessary result is also the imperative to rebalance rates and to find other ways and means to promote and finance universal service. Equally imperative is the need to provide both telecommunications policy adjustments and fiscal choices reflecting that fact.

Alaska receives federal support on the order of about $98M. The support comes from several sources. Twenty five percent of the costs of local line (loop costs) are recovered from interstate services. The 1996 Act provides for imposing a surcharge -- currently 7 % – on all interstate revenues and using the proceeds to form a pool, the Universal Service Fund, from which is drawn subsidies including: a rural, high cost (fund) subsidy if costs are greater than 115% of average nationwide loop costs, a rural switching subsidy, low income and lifeline support, and support for wiring schools, libraries and rural healthcare facilities. In addition to these continuing subsidies, a federal grant was provided for rural infrastructure development for communities not online.

The federal USF fund has grown substantially and there are increased demands on it from different claimants and historic claimants wanting more. But, there are limits on its growth, limits that very likely have been reached, and countervailing pressures from contributors to the fund (providers of interstate telecommunications services) to cap and reduce their obligations. Thus the demand for support is dramatically greater than its prospective supply from federal sources.

The hard facts of the matter are that there is not enough funding to bring all users in all areas in all markets the most up-to-date set of telecom services. That is the case not just in Alaska but in all markets. This implies the need to ration; to make hard choices; to say yes to some, but no to other demands for improved services. In this regard the legislature should and must address the following, very difficult, but unavoidable questions:

Question One. As a practical matter how much funding is likely to be available over the next five years to support services that cannot be provided on profitable, stand-alone market-driven basis? More specifically, what amounts are likely to be made available from each of the following main current sources of universal service support?

- from implicit subsidies – higher rated services support lower rated services
- from federal and interstate sources
- from state sources

Question Two. What services, users, areas, markets should be subsidized? This is the

easy part in the sense that it is a "wish list" of sorts:

- low income support
- rural support: long distance, local and other services
- special needs -- schools, libraries, medical facilities, government needs, etc.

<u>Question Three</u>. How much in rough terms is needed to provide support for the above beyond what the market will provide?

- minimum level
- maximum level
- feasible level

With facts demanded by these questions in hand, it is possible to compare the available budget to the demands on it and begin the process of reconciliation. That process will involve two key politically sensitive sets of decisions:

- How much government funding, if any, to provide and how to raise it; and, :
- What "needs" will not be met, be deferred; or met only in part?

Discussion. These are the hard questions that are seldom confronted specifically, in detail and comprehensively. But, without addressing them, there is no good way to organize a coherent program that effectively and realistically addresses the issues, while setting forth both funding and development priorities.

The Telecom Act. The Communications Act of 1934 sets out the universal service goal and the role of federal and state agencies to:

> "...regulate...communication...so as to make available, so far as possible, to all of the people of the United States...a rapid, efficient, Nation-wide, and world-wide wire and radio communications service with adequate facilities at reasonable charges..." (Section 1 Communications Act of 1934.

The 1996 amendment to the 1934 Act also accords a high priority to creating and reforming policies and rules related to making service "universally" available. Specifically, the Act directs federal and state regulators to:

- promote services at affordable rates;
- assure access to all, including low income, rural, insular, and high cost areas at rates that are reasonably comparable to those charged in urban areas;
- assure that all providers of telecommunications services contribute;
- devise predictable and sufficient Federal and State funding mechanisms;

and,

- assure access to advanced telecommunications services for schools, health care and libraries.

The Act recognized that traditional methods of funding universal service: a) were not efficient; b) were not sustainable and would be undercut by emphasis in the Act on promotion of competition and investment as discrete goals; and, c) were not sufficient in any event to fund expanded universal service goals and mandates in the Act.

How it was. In the days of protected monopolies and meticulous regulation of individual rates and their relationship to each other, it was possible for regulators to act effectively as fiscal authorities -- taxing some classes of users and use by maintaining rates well above production costs, then using the proceeds to subsidize other classes of use and users by prescribing rates well below costs.

Generally the scheme was implemented by holding long distance rates high to support low local access and exchange services; to hold business rates high to enable residential rates below cost; and to subsidize rural areas out of revenues generated in and between urban areas, and through federally supported schemes of low cost loans to subsidize capital costs and expenditures in rural areas.

Analysts and policymakers alike are aware that this " tax and subsidy" scheme administered through state and federal regulation of the structure of rates for different services and to different users was sustainable only for so long as government regulators -- not markets -- controlled individual rates. Regulators can fix rates in relation to costs. Markets drive all rates toward cost. Unless there is some nonmarket provision (direct taxes or direct subsidies), rates below cost must go up and rates above cost must go down.

Changes in regulatory policy favoring competitors and competition by first permitting, then promoting, competition set in motion forces that would lead to market determined rates, which in the end game will be related to costs. New entrants naturally and with good sense first attacked markets where incumbent margins and entrants' expected returns were highest. Competitors and competitive processes drive rates that previously had been sufficient to fund subsidies for other services toward long run costs and thereby effectively eliminate the very foundation of the implicit tax and subsidy scheme.

Competition in long distance markets has reduced the availability from that source of revenue to subsidize other services, while selective competition in local markets has tended to reduce rates and the opportunity to generate subsidy pools to support other services.

It is critical to recognize and to provide policy adjustments reflecting the fact that for all the substantial benefits of open competition and more consumer choice, a necessary result is also the imperative to rebalance rates and to find other ways and means to promote universal service. The driving force of competition, and competitors, is the pursuit of profit and earnings for

shareholders who provide the necessary capital. Competition and competitors first target the most profitable submarkets -- those with high margins. And, those are precisely the markets (services and users) that provided subsidies in the past. The spread of competition and the resulting pressure on rates to go to costs will compound the need to find alternative, nonmarket sources for funds to subsidize service provision in high cost areas.

Draining the subsidy pool long administered by incumbents to fund some customers with revenues from others had a second set of results manifest in their impact on users that had previously been subsidized. These include individually and combination:

- upward pressure on rates;
- reduced opportunity and incentive to maintain high service quality; and,
- reduced ability and incentive to invest in support of subsidized users and uses.

The problem is familiar when expressed in fiscal terms -- if you cut taxes, which competition forces, then you must either cut support for universal service programs or find another source of revenue support.

The problem is compounded by the fact that reductions in the ability of the system of implicit transfers to fund universal service programs have been accompanied by increased demands for more funding to accelerate infrastructure development in unserved or poorly served areas; underwrite investment not only for basic services but also for an array of new, advanced, "broadband," Internet compatible services; and, advance the pro-competition objective by providing support for more than one carrier in a geographic market.

Balancing universal service, competition and investment. We have more goals than policy instruments for achieving them. This creates tension. Tensions among the goals of encouraging competition, universal service and investment are nowhere more pronounced, serious and apparent with respect to the growing controversy over the availability of universal service subsidies for competitive providers in "high-cost" areas. The FCC has asked the federal-state joint board on universal service to review rules relating to high-cost universal service support in study areas in which a competitive eligible telecommunications carrier (ETC) provides service, as well as to review its rules regarding support for second lines.

FCC rules permit a competitive ETC serving customers where service is offered by an incumbent local exchange carrier to be entitled to the same amount of support from the universal service high cost fund as would the incumbent for serving the same customer. Further, the FCC's rules do not distinguish between primary and secondary lines and consequently allow end-users to draw support from the high cost fund for second, third and fourth lines.

The issue raises questions about the reach of universal support. In particular, is it in the public interest to use USF funds to subsidize choices of second or third carriers and/or second and third lines when other users are denied first choices of carriers or lines?

ACS Fairbanks, Inc. initiated the FCC action with its petition for declaratory ruling requesting that high-cost support for competitive ETCs be calculated based on their own costs, rather than as is current practice, calculating high cost eligibility and support amounts on the basis of charges for unbundled loops. ACS asked the FCC to establish requirements for high-cost loop support for competitive ETCs using loops purchased as unbundled network elements. Concurrently the National Telecommunications Cooperative Association filed a petition asking the FCC to redefine eligibility requirements as a means of scaling back and suppressing growth of draws on the Universal Service Fund. The FCC called attention to the conflict between competition and universal service funding by directing the board to "take into consideration the universal service principles outlined in section 254 of the [Telecommunications Act of 1996] and the principle of competitive neutrality."

The FCC observed that it had not capped support for competitive ETCs, but had limited the amount of rural high-cost loop support available to incumbents. It directed the Joint Board to "address the potential benefits and costs of modifying these rules for stability, predictability, and sufficiency of the fund, as well as their potential effects on competition and competitive neutrality." It also asked the joint board to determine whether the goals of the Act (section 254) would be served if support were to be limited to a single connection to end-users, and how such a rule could be squared with competitive neutrality.

These matters are under consideration by the Joint Board which will, in due time, consider the evidence and merits of opposing arguments and submit a recommendation to the FCC. Thereafter, the FCC will decide or not decide, and launch another proceeding.

Pending those decisions, in which Alaska officials and interests will play a significant role, we can only make the following observation. "Competition," "competitive neutrality" and "nondiscriminatory access to the USF" are each important goals and we do not want to diminish them. However, they may well conflict with two other important goals – universal service and infrastructure development. If the record being adduced shows that they do, the position of Alaska should be to focus on investment and universal service as primary goals, even if it means subordinating, temporarily or on a case-by-case basis to them concerns for "neutrality" and equal access to federally generated largesse.

Testimony of Wesley E. Carson
Before the Senate Labor and Commerce Committee
February 25, 2003

Mr. Chairman and members of the committee, thank you for this opportunity to address you today. My reason for being here is to emphasize the importance of deferring any action to re-authorize the Regulatory Commission of Alaska until the state has articulated a clear set of telecommunications policies to guide the commission.

Although we have long advocated for the development of state policies to guide the RCA, this is of even more critical importance today. On February 20th, the Federal Communications Commission issued its long-awaited rules to revise network unbundling obligations for competition in the local telephone market. In making this decision, the FCC took the unprecedented step of delegating to state commissions broad regulatory discretion that previously was thought only to be exercised by federal authority.

This delegation will allow the RCA to now unilaterally determine whether incumbent local telephone companies, like ACS, must continue to provide elements of their networks to competitive carriers at below-cost prices. As the FCC has failed to provide specific instructions to the states, it is now imperative that the Legislature act to develop appropriate telecommunications policies to guide the RCA in its decision-making going forward.

There are many telecommunications policy issues that require your attention. The Report to the Senate Appointees to the Task Force on Operations of the RCA, submitted on January 30 by Darby Associates, makes some very relevant points, including that regulators need to fashion rules designed to encourage investment; that the RCA should review the adequacy, need and rationale for legacy regulations based on an assumption of incumbent market power; and that it is time to explore a wide range of less regulatory options and find ways to substitute market forces for regulation.

The RCA has clearly demonstrated a propensity for more regulation as the means of promoting competition, rather than allowing market forces to govern. The Darby Report quite correctly concludes that "application of old regulatory models based on market conditions that no longer prevail does a gross disservice to the people of Alaska."

As you may know, Anchorage holds the distinction for being the most competitive local telephone market in the country. Although open to competition for a much shorter period of time, Fairbanks and Juneau are rapidly moving in a similar direction. In all three of these markets, the RCA has unfairly mandated that the competitor be allowed to use the ACS networks at rates that are below cost. The RCA has also taken an activist role in terminating the "rural exemptions" that Congress authorized to ensure that the nation's smaller markets remained viable – even terminating the "rural exemption" in locations as small and costly to serve as Nenana and Seldovia.

The net result of these regulatory actions has been to compromise the Company's ability to attract and commit capital. This is clearly not just an ACS opinion, but rather a fact that is becoming broadly understood.

As you are aware, the Sate of Alaska contracted with BearingPoint (formerly KPMG Consulting) to produce the "Telecommunications Policy Study and Assessment for the State of Alaska," which was submitted to the Department of Administration in November 2002. The report concluded that local telephone competition which forces incumbent local telephone companies to lease their network to competitors as below-cost pricing "potentially imposes a financial burden on incumbents, and may artificially support competitors at the same time." The RCA, by means of the interconnection terms it imposed on ACS, has done exactly that.

A recent press release by Standard & Poor's addresses the downgrade of ACS as being "based on competitive pressure that has materially weakened ACS's business profile, impaired operating performance, and resulted in credit measures." The press release further explains: "The rating on ACS reflects the company's position as the leading local exchange carrier in Alaska, offset by heavy competition in the local retail access line business due to low regulatory mandated local resale loop rates to the company's local network, a narrow market with limited growth opportunities, and high acquisition and capital spending–related debt levels."

Clearly, we are not alone in our judgment that the RCA has impaired ACS's ability to raise capital. The State must act to assure that the RCA does not destroy the economic viability of Alaska's largest local telephone company, providing the last-mile connection to nearly three out of four of its citizens.

ACS urges the Legislature to move cautiously in your deliberations on the RCA extension and to properly sequence your decisions. In addition to a general review of the RCA's structure and procedures, Alaska's policy-makers must carefully review the Commission's ongoing role in the administration of the Telecommunications Act of 1996. While this was an important consideration at the beginning of the legislative session, it has been magnified considerably by the FCC's decision on February 20. As the RCA goes forward to accept the broad new delegation it has received from the FCC, it should have the benefit of clear policy guidance that is lacking in the FCC's ruling. Once the legislature has provided that guidance, the second matter of reauthorizing the Commission can be decided.

On behalf of Alaska Communications Systems, I thank you, Mr. Chairman and Committee members, for the privilege of addressing you today.

Honorable Con Bunde, Chair
Senate Labor and Commerce Committee
Alaska Capital, Room 506
Juneau, AK 99801-1182

February 24, 2003 RE: SB 72 (Governor Murkowski) - Support

Dear Chair Bunde:

On behalf of the AARP members in Alaska, we encourage you and your colleagues on the Senate Labor and Commerce Committee to support SB 72, submitted by the Senate Rules Committee at the request of Governor Murkowski.

SB 72 would reauthorize the Regulatory Commission of Alaska for a period of four years. Much of the debate over the RCA in the past has focused on the utilities supervised by the Regulatory Commission of Alaska and the relationship of the RCA with the entities it supervises. AARP relies on the RCA because it offers our members and all Alaskans the best opportunity to achieve basic consumer protections:

- The ability to make informed choices about utility services
- The security of safe and reliable energy and telecommunications services
- The assurance that sales practices and advertisements are fair, so they do not confuse, mislead, or frighten the public
- The reassurance that consumers receive accurate information, communicated clearly and in plain language so we understand our rights and remedies

The RCA assures consumers the right to affordable rates and access to such basic necessary services as utilities and communications. We emphasize "reasonable" rates but we also emphasize access for our rural citizens.

The RCA allows consumers an opportunity to participate in the governmental decision-making process that shapes the marketplace and ensures meaningful consumer input.

3601 C Street, Suite 1420 | Anchorage, AK 99503 | 907-341-2277 | 907-341-2270 fax | 1-877-434-7598 TTY
James G. Parkel, President | William D. Novelli, Executive Director and CEO | www.aarp.org

When wronged, the RCA offers consumers redress and complaint resolution.

AARP believes the Regulatory Commission of Alaska is necessary for our organization and for our members. Without the RCA, we would be deprived of any public oversight of energy and telecommunications services and, when a complaint is warranted, we would not have the RCA available and willing to listen to a consumer's side of an argument.

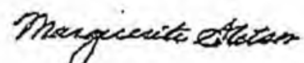
The RCA protects our rights as consumers. We ask that the Senate Labor and Commerce Committee support Governor Murkowski's bill to reauthorize the RCA for four years. Our AARP families need it. All Alaskans need it.

AARP urges an "AYE" vote on SB 72.

Should you have any questions about our position, please feel free to contact Marie Darlin (907.586.3637), Coordinator of the AARP Capitol City Task Force; Patrick Luby (907.762.3314), AARP Legislative Representative; or me (907.245.5259).

Thank you for your consideration.

Sincerely,



Marguerite Stetson
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Executive Council Member for Advocacy
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cc: Senator Gary Stevens
Senator Ralph Seekins
Senator Bettye Davis
Senator Hollis French
Governor Frank Murkowski
Senator John Cowdery
Marie Darlin
Patrick Luby

SB

73

FRANK H. MURKOWSKI
GOVERNOR

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JUNEAU

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February 18, 2003

The Honorable Gene Therriault
President of the Senate
Alaska State Legislature
State Capitol, Room 107
Juneau, AK 99801-1182

Dear President Therriault:

Under the authority of art. III, sec. 18, of the Alaska Constitution, I am transmitting a bill that would extend the sunset on the Alaska Industrial Development and Export Authority's (Authority) bonding authorization until July 1, 2007.

The bill would extend the Authority's bonding authorization for development projects of $10,000,000 or less. The Authority's general bonding authorization will expire June 30, 2003, unless extended. Allowing that authorization to expire would severely restrict the Authority's ability to assist in key development projects.

In a time of dwindling state resources, this bill would further the Authority's mission to forge public-private partnerships that can strengthen the state's economic base.

I urge your prompt and favorable action on this measure.

Sincerely,

Frank H. Murkowski
Governor

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

Fiscal Note Number: 1
Bill Version: SB 73
(S) Publish Date: 2/19/03

Revision Date/Time (Note if correction):
Title: AIDEA Bonding Authority
Sponsor: Rules
Requester: Governor

Dept. Affected: DCED
BRU: AIDEA (125)
Component: AIDEA
Component No. 1234

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0
CAPITAL EXPENDITURES						
CHANGE IN REVENUES ( )						

FUND SOURCE (Thousands of Dollars)

FUND SOURCE	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2003) cost: 0.0

Mark this box (X) if funding for this bill is included in the Governor's FY 2004 budget proposal: [ ]

POSITIONS

POSITIONS	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Full-time						
Part-time						
Temporary						

ANALYSIS: *(Attach a separate page if necessary)*

This legislation extends to July 1, 2007 the sunset of statutory authority for AIDEA to issue bonds that do not exceed $10 million for development projects. Unless extended, AIDEA's general bonding authority would sunset on July 1, 2003.

Prepared by: Sara Fisher-Goad, Financial Analyst
Phone 907-269-4623
Division: Alaska Industrial Development and Export Authority
Date/Time 2/11/03 9:05 AM
Approved by: Edgar Blatchford, Commissioner
Date 2/11/2003
Agency: Department of Community & Economic Development

(Revised 9/2002 OMB)

COMMITTEE COPY

SB

82

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

Fiscal Note Number:
Bill Version: CSSB82(L&C)
() Publish Date:

Revision Date/Time (Note if correction):
Title: Alcoholic Beverage Tax for Wine and Others
Sponsor: Senator Gary Stevens
Requester: Senate Finance Committee

Dept. Affected: Revenue
BRU: Revenue Operations
Component: Tax Division
Component No. 2476

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0
CAPITAL EXPENDITURES						
CHANGE IN REVENUES ( )	(18.6)	(18.6)	(18.6)	(18.6)	(18.6)	(18.6)

FUND SOURCE (Thousands of Dollars)

	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2003) cost: 0.0

Check this box (X) if funding for this bill is included in the Governor's FY 2004 budget proposal: [ ]

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: *(Attach a separate page if necessary)*

This legislation would exempt from the state excise tax on alcoholic beverages a small amount of wine per taxpayer per year (importer or in-state producer). The intent is to assist small in-state wineries.

The Department estimates the tax revenue loss to the state at $18,600 per year, based on the following assumptions:
1) Estimated revenue reduction based on returns received for the 2002 tax year.
2) No increase in the number of taxpayers is projected.
3) Effective date of the first annual exclusion is July 1, 2003.

Prepared by: Chuck Harlamert — Phone 465-4773
Division: Tax Division — Date/Time 3/29/03 8:31 AM

Approved by: Larry Persily, Deputy Commissioner — Date 3/29/2003
Agency: Department of Revenue

(Revised 9/2002 OMB)

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SENATE COMMITTEE REPORT
First Committee of Referral

2/26/03 FURTHER: Finance

5-Day Notice:________________
rdance with Uniform Rule 23)

DATE TURNED IN TO OFFICE: 3/31/03

ıd Commerce Committee considered SENATE BILL NO. 82

SB 82 ALCOHOLIC BEVERAGE TAX FOR WINE & OTHERS

relating to the state alcoholic beverage tax for certain wine and other beverages."

ımmends:

replaced with C CS SB 82 (L&C)

ıpt previous ________ CS ________________ (________)

:ched amendment(s)

pt Letter of Intent by ____________________ Committee

ıer referral to ____________________ Committee

Senate Bill:
[ ] same title
[ ] new title
House Bill:
[ ] same title
[ ] technical title
[ ] new: SCR #_____

ISCAL NOTE(S):

nent	Date	Fiscal	Zero	FN#

PREVIOUS FISCAL NOTE(S):

Department	Date	Fiscal	Zero	FN#

'ROPRIATION - no fiscal note

NATURES AND RECOMMENDATIONS:	DO PASS	DO NOT PASS	NO REC	AMEND
Betty Davis	✓			
[illegible]			✓	
[illegible]			✓	
[illegible]	✓			
IR: [illegible]	✓			

AMENDMENT 1

OFFERED IN LABOR AND COMMERCE BY SENATE G. STEVENS

TO: SB 82, Draft Version "A"

1 Page 2, line 3: After "exceed", delete "3000" insert "100", After "a" delete "year", insert "month".
2 Page 2, after line 5: insert "New section 43.60.010(d): (d) For purposes of the threshold for taxable wine under (a)(3) of this section, two or more taxpayers who have a relationship, as that term is defined under 26 U.S.C. 267(b), shall be treated as a single taxpayer.
3 Renumber accordingly.

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

Fiscal Note Number:
Bill Version: SB 82
() Publish Date:

Revision Date/Time (Note if correction):
Title: Alcoholic Beverage Tax for Wine and Others
Sponsor: Senator Gary Stevens
Requester: Senate Labor and Commerce

Dept. Affected: Revenue
BRU: Revenue Operations
Component: Tax Division
Component No. 2476

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0
CAPITAL EXPENDITURES						
CHANGE IN REVENUES ( )	(95.6)	(50.6)	(50.6)	(50.6)	(50.6)	(50.6)

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2003) cost: 0.0
Check this box (X) if funding for this bill is included in the Governor's FY 2004 budget proposal: [ ]

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: *(Attach a separate page if necessary)*

This legislation would exempt from the state excise tax on alcoholic beverages the first 3,000 gallons of wine per year per taxpayer sold in or consigned for shipment into Alaska.

Revenue assumptions:
1) Revenue reduction for FY04 based on returns received for 2002 amd 2003 tax years. Subsequent fiscal year revenue reductions reflect just one year's tax returns.
2) No increase in the number of taxpayers is projected.
3) Effective date of the first annual exclusion is between July 1 and December 31, 2003. (The bill has no effective date clause.)

Prepared by: Chuck Harlamert — Phone 465-4773
Division: Tax Division — Date/Time 3/7/03 5:33 PM
Approved by: Larry Persily, Deputy Commissioner — Date 3/7/2003
Agency: Department of Revenue

(Revised 9/2002 OMB)