ATTACHMENT

STATE OF ALASKA

REGULATORY COMMISSION OF ALASKA

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Before Commissioners:

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

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

Docket R-98-1

SUMMARY OF AT&T ALASCOM'S COMMENTS ON THE STAFF REPORT AND PROPOSED REGULATIONS

AT&T Alascom provides a summary of its comments to assist the Commission.

A. IT IS TIME TO REPEAL THE BUSH FACILITIES RESTRICTION

AT&T Alascom unconditionally supports repeal of the Bush facilities restriction presently set forth in 3 AAC 52.355. The Bush facilities restriction is not competitively neutral and therefore inconsistent with Section 253 of the 1996 Telecommunications Act. The Staff Report appropriately recommends a lifting of the restriction.

B. JOINT OWNERSHIP OF AT&T ALASCOM'S FACILITIES WOULD BE PROBLEMATIC

Absent AT&T Alascom's consent, any order requiring joint ownership of its facilities would be illegal and potentially impractical to administer. The Staff Report is appropriately skeptical about joint ownership of AT&T Alascom's facilities.

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Requiring prior Commission approval to construct new earth stations would be unprecedented and should be rejected. Regulatory commissions are not equipped to decide which technology should be deployed. AT&T Alascom's management is uniquely suited to make these decisions.

C. THE STMP ALONE IS INSUFFICIENT TO INDUCE MODERNIZATION OF BUSH FACILITIES; A RURAL SUBSIDY IS NEEDED

1. High-cost and low-traffic volumes in the Bush create obstacles to facilities investment and modernization.

The Commission has relied on geographical rate averaging as a means to flow implicit subsidies from urban ratepayers to pay the costs of long distance service to rural Alaskans. With competition, this implicit subsidy no longer adequately supports Universal Service. As the only COLR in the state, AT&T Alascom bears a unique burden serving the high-cost, low-density rural areas of Alaska. A replacement to the implicit subsidy provided by geographic rate averaging is needed.

2. Technology and consumer expectations are constantly changing.

As technology rapidly advances, consumer demands for services also change rapidly. The costs to deploy new technology in rural Alaska, like high bandwidth digital transmission facilities for Internet service, however, are high. AT&T Alascom cannot deploy new facilities without a reasonable opportunity to recover its costs and earn a return.

3. AT&T Alascom's Bush losses can be quantified.

AT&T Alascom estimates that it is losing approximately $7.3 million annually serving Bush Alaska. The shortfall will increase as competition increases. AT&T Alascom no longer can rely on geographic rate averaging alone to cover this shortfall in a competitive environment.

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4. **Mere enforcement of the STMP will not solve the problem.**

The Staff Report recommends that the Commission ensure quality of service is being provided to Bush Alaska through enforcement of the State Modernization Telecommunication Plan ("STMP"). This recommendation overlooks the fundamental economic problem confronting facilities-based IXCs, which is the lack of adequate financial support for service to the Bush. Without appropriate financial incentives, monitoring and regulation alone will not suffice.

5. **A targeted, competitively-neutral Bush subsidy is the only feasible solution.**

The only way to increase investment in rural Alaska to ensure that long distance service is maintained at a level reasonably comparable to urban Alaska is to institute a competitively-neutral, explicit rural subsidy for facilities-based IXCs. The time to do it is in this rulemaking, not later.

6. **A subsidy is also needed to make Internet access affordable to customers in Bush Alaska.**

In response to calls for local dial-up Internet access, AT&T Alascom offers the Commission an analysis of the costs to provide the service. We estimate that to provide local dial-up Internet service at 56 Kbps to consumers in Bush Alaska (Category 3) would cost approximately $50 per subscriber per month. A subsidy of approximately $30 per line per month, or $1.7 million per year, would be necessary to reduce this rate to a level comparable to ISP rates in Anchorage. If collected through the AUSF, it would increase the monthly surcharge by approximately $0.36 per access line per month.

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D. THE RESALE MARKET WILL NOT BE IMPROVED BY GREATER REGULATION OF AT&T ALASCOM'S WHOLESALE TARIFF

1. The Staff Report's analysis of the wholesale market overlooks several important facts.

The Staff Report reflects a basic misunderstanding of AT&T Alascom's Wholesale Tariff and the wholesale market. The Staff Report's analysis is premised in part on a faulty comparison between wholesale and retail rates. Wholesale rates are not required to be geographically averaged whereas retail rates are. The two rates fundamentally differ as do their respective markets. AT&T Alascom's Wholesale Tariff was designed in 1990 to accommodate a facilities-based carrier, like GCI, not to accommodate the needs of pure resellers. Thus, there are few customers capable of using AT&T Alascom's Wholesale Tariff. Discounted retail plans based on geographically-averaged retail rates, like CustomNet, offer resellers more favorable rates than the deaveraged rates in AT&T Alascom's Wholesale Tariff.

2. Requiring a further unbundling of wholesale services would be pointless.

Further unbundling of wholesale services by technology is pointless. Rural IXCs generally have no satellites, earth stations, and other interexchange facilities. Because they need end-to-end service, no useful purpose would be served by an expensive, time-consuming proceeding to unbundle network elements. A greater unbundling of wholesale services will not provide rural resellers with lower rates than AT&T Alascom's discounted retail plans. Unbundling by technology imposes a greater burden on facilities-based IXCs than that imposed on the LECs under the 1996 Act and would be impractical.

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3. The long distance resale market would be better served with less regulation, not more.

Resellers today have many more opportunities and options to purchase long distance services and network capacity than existed in 1991 when competition first commenced. The Commission should support and strengthen inter-carrier agreements and retail discount plans to promote long distance competition.

E. WHOLESALE RATES SHOULD BE COST-BASED AND NOT GEOGRAPHICALLY AVERAGED

Unlike geographically-averaged retail rates that are designed for social and policy reasons to provide implicit subsidies to rural consumers, geographically-averaged wholesale rates would provide implicit subsidies only to competing IXCs. It makes perfect sense not to require geographically-averaged wholesale rates.

F. THE COSTS OF REVIEWING AT&T ALASCOM'S WHOLESALE TARIFF EVERY THREE YEARS OUTWEIGH THE BENEFITS

There is no cause to think that wholesale rates are too high. They may, in fact, not be high enough. Review of AT&T Alascom's wholesale rates in 1999 and every three years thereafter would result in greater regulation of AT&T Alascom's Wholesale Tariff, which should be eliminated altogether. Less regulation is needed in the wholesale market, not more.

G. THE PROPOSED NEW PUBLIC NOTICE RULES GOVERNING TARIFF CHANGES ARE ANACHRONISTIC

New rules regarding tariff filings would only add costs and hamper competition with no commensurate benefit to consumers.

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H. ALASKA FIBER STAR SHOULD BE REGULATED LIKE ANY OTHER IXC

There is no sound reason to provide AFS with a special exemption from the rules governing other IXCs.

I. GEOGRAPHICAL AVERAGING OF RETAIL RATES CAN CONTINUE TO WORK IN CONJUNCTION WITH CHANGES TO THE COLR RULE AND THE ADOPTION OF A RURAL IXC SUBSIDY

The recommendation to maintain geographical averaging of retail rates is sound. AT&T Alascom opposes, however, the recommendation to prohibit all carriers from offering urban consumers bundling discounts. Service packages are extremely popular with consumers. Non-monopoly carriers should be allowed to offer these bundles and discounts. Monopoly carriers, on the other hand, must not be allowed to leverage their monopoly service by including it in a discounted bundle with a competitive service. So long as non-monopoly carriers offer discounts to similarly situated consumers, there is no violation of any law or Commission regulation.

J. A 30-DAY PUBLIC NOTICE OF WHOLESALE AND RETAIL TARIFF FILINGS IS INCONVENIENT, ANTI-COMPETITIVE, AND NOT NEEDED TO PROTECT CONSUMERS

A 30-day public notice requirement hampers competition, with no benefit to consumers in a competitive marketplace. The Commission should adopt a one-day rule to mirror the federal notice rules for all rate changes, up or down, that do not exceed AT&T Alascom's current tariffed rates.

K. REGULATIONS GOVERNING IXC INTERCONNECTIONS ARE UNNECESSARY

Interconnection disputes are exceedingly rare in AT&T Alascom's experience. If and when they occur, parties can use the Commission's normal complaint procedures. There is no need for special interconnection rules.

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L. AT&T ALASCOM SHOULD NO LONGER BE DEEMED A DOMINANT CARRIER; THE COLR REGULATIONS SHOULD BE MODIFIED

1. There is abundant network capacity offered by rival companies that can and will respond to price increases by AT&T Alascom.

The long distance market is characterized by a mix of firms able to respond to any perceived opportunity to expand their output in the face of a price increase by AT&T Alascom. On major routes, AT&T Alascom owns only a small fraction of available capacity.

2. Since 1991, AT&T Alascom's market share has diminished to the point that it no longer has the power to control prices.

In October 1999, AT&T Alascom retained approximately a 51 percent market share in the urban markets of Anchorage, Fairbanks, and Juneau based on total minutes of use. Because competition in the urban markets drives and sets the rates statewide as a result of geographic rate averaging, AT&T Alascom's ability to control prices in the market must be evaluated by its power in the urban markets. On a statewide basis, in October 1999, AT&T Alascom retained a 56 percent market share based on minutes of use. In a recent month, its share of originating minutes in Anchorage was only 31 percent.

3. A review of demand characteristic in the long distance market shows that the in-state long distance market is competitive.

Competitive forces in the marketplace have resulted in steadily declining prices. Price reductions of approximately 30 percent in the toll market far exceed access price reductions over the past several years. AT&T Alascom has lost substantial market share even while lowering rates in a market that has not grown significantly overall. AT&T Alascom cannot raise prices above competitive levels without losing further market share.

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4. **The market data demonstrate that dominant carrier regulation for AT&T Alascom in no longer appropriate.**

The market data overwhelmingly prove that dominant carrier regulation for AT&T Alascom no longer is appropriate because AT&T Alascom no longer possesses market power. The Commission should cease regulating AT&T Alascom as a dominant carrier.

5. **Imposing COLR obligations exclusively on AT&T Alascom is plainly unfair and anything but "competitively neutral."**

There is no justification to impose COLR obligations exclusively on AT&T Alascom. This treatment is unfair and discriminatory. Other facilities-based IXCs, like GCI, can and should shoulder some of the COLR responsibilities for serving rural Alaska. Rules providing for an equitable sharing of COLR responsibilities between facilities-based IXCs are needed.

M. THE RULE ALLOWING ALL CARRIERS BUT AT&T ALASCOM THE RIGHT TO WITHDRAW SERVICE UPON 30-DAY NOTICE IS NOT COMPETITIVELY NEUTRAL

For the same reasons that the COLR rule is unfair and should be changed, the regulation set forth in 3 AAC 52.365 likewise should be modified so that AT&T Alascom alone is not required to bear the burdens of COLR responsibilities.

N. COMPULSORY ARBITRATION PROCEDURES ARE UNNECESSARY

AT&T Alascom agrees that disputes between carriers should be resolved promptly, but it is not convinced that compulsory arbitration is the best or most economical way to do it. Arbitrators can be very expensive. The Commission's hearing officers should be able to adjudicate disputes and provide recommended decisions to the Commission.

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O. NEW REGULATIONS GOVERNING INTRASTATE RETAIL PROMOTIONAL OFFERINGS WOULD INHIBIT COMPETITION AND HARM CONSUMERS

More regulations governing the marketplace are not needed. Consumers today enjoy dramatically more choices, better service, and lower rates than they did in 1990. The Commission can protect consumers through its power to investigate on its own initiative or otherwise respond to a consumer complaint.

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Attorney for AT&T ~~Alascom~~

Date: February 4, 2000 By A. William Saupe
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I.

INTRODUCTION AND SUMMARY

Compared to 1990, when in-state long distance competition was first permitted, consumers in Alaska today have substantially better service quality, dramatically lower rates, and a dizzying array of service providers from which to choose. The purpose of this docket is to consider reforms to the long distance market needed to reflect the substantial progress we have made since 1990 and to accommodate the federal Telecommunications Act of 1996, including its mandate to replace implicit subsidies with those that are explicit and competitively neutral. Several rounds of general comments are already on file. In Order No. 4, the Commission requested specific comments on the proposed regulations set forth in Appendix B to the order, which are the product of an October 16, 1998 Staff Report. AT&T Alascom's comments focus on the Staff Report and are organized along the same lines in order to aid the Commission's review.

Overall, AT&T Alascom commends Staff on its analysis and fine work on an extremely complicated subject. We endorse many of the Staff Report's recommendations. These include the recommendations: (1) to eliminate the facilities-based restriction in 3 AAC 52.355; (2) to not require joint ownership of AT&T Alascom's earth stations; (3) to not require AT&T Alascom and General Communication, Inc. ("GCI") to provide resellers with below-cost wholesale discounts derived from geographically-averaged retail rates; (4) to not require geographically-averaged wholesale rates; and (5) to preserve geographically-averaged retail rates. These key recommendations make good sense and are supported in the record.

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However, AT&T Alascom takes issue with and strongly opposes several of the Staff Report's other recommendations. AT&T Alascom disagrees, for instance, with the Staff Report's paradoxical recommendations of more regulatory intervention in order to promote greater competition. Crucial facts and data submitted by AT&T Alascom in earlier comments are not taken into account by the Report, while unwarranted credence is given to those commenters who claim that the long distance market is not competitive. As a consequence, several of the proposed regulations perpetuate a rigidly regulated environment in which AT&T Alascom remains the only "dominant carrier" and alone bears the burdens of being the Carrier of Last Resort ("COLR"). The rules need to be brought up to date to reflect current market realities.

Staff's principal analysis of the prevailing market conditions is set forth in one brief, conclusory paragraph at page 34 of the Report, which recommends continuing the regulation of AT&T Alascom as a dominant carrier. As explained below in much greater detail by AT&T Alascom's economist, Dr. Robert Kargoll, the Report's analysis is seductively superficial, its factual assumptions are now outdated, and the conclusion is inaccurate. The current data presented in Mark Vasconi's affidavit reveal a robustly competitive long distance market in which AT&T Alascom does not have the power to control prices, restrict output, or otherwise restrain entry. Because of the intense competition in the long distance market, AT&T Alascom's share of originating traffic in Anchorage, Fairbanks and Juneau has gone from roughly 100 percent in 1990 to only 40 percent as of October 1999. Statewide, AT&T Alascom's share of originating minutes was down to 49 percent for the first ten months of 1999. Geographically-averaged rates have been driven down to just above the cost of access charges of approximately 13.3 cents a minute. AT&T Alascom, for example, offers an intrastate residential rate

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of 15 cents a minute with no other monthly fees. The data also show that customers frequently and easily change long distance companies, depending on where they can obtain the best rates and packages of services. All of which is strong evidence that long distance competition is vibrant and working successfully to the benefit of consumers. Under these circumstances, the dominant carrier restrictions that apply exclusively to AT&T Alascom can safely be relaxed without any risk of public harm.

The proposed regulations also fail to address the pressing need for financial incentives to provide service to the high-cost, low-density areas of the state. AT&T Alascom proposed a workable subsidy concept in its initial comments. *See* Appendix 1 to AT&T Alascom's Comments in Response to Notice of Inquiry on Interexchange Market Structure, dated June 15, 1998. On this issue, the Staff Report asserts that AT&T Alascom has not presented sufficient evidence to justify the need for a rural subsidy in the long distance market. To ensure that modern facilities are deployed in rural Alaska, the Staff Report instead recommends that the Commission merely institute annual monitoring reports of the facilities-based carriers with 25 percent of the market share, "with the reports indicating areas of noncompliance with the State Telecommunication Modernization Plan ("STMP") and progress the carrier is making towards meeting future STMP deadlines." Staff Report at 8.

This recommendation ignores the economic reality that as competition intensifies, particularly in the urban areas, statewide rates are declining and the revenues are being divided among numerous IXCs. While this competition has benefitted consumers, as evidenced by the steep reductions in long distance rates, the data in the Vasconi Affidavit demonstrate clearly that the implicit subsidies from the high-density urban areas, which AT&T Alascom once relied on to cover the high costs of service to rural Alaskans, are no longer dependable or sufficient. As the Carrier of Last Resort, AT&T Alascom

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is losing millions of dollars a year serving Bush Alaska, without any reasonable expectation of recovering these losses and without any economic incentive to invest additional capital to fund the next round of expansion and improvement in Bush service. Annual STMP reporting requirements will do nothing to remedy this problem.

An explicit, competitively-neutral subsidy is necessary to encourage economic investment in modern interexchange facilities in rural Alaska. In these comments, AT&T Alascom provides the evidence to support its proposal for a rural toll subsidy and reassures the Commission of its continuing willingness to serve as COLR if this issue can be satisfactorily addressed. AT&T Alascom also presents a detailed quantification of the costs of providing Internet service in the Bush and suggests a viable means of supporting those costs through an explicit, competitively-neutral support mechanism.

These comments further explain why it would not promote interexchange competition to require facilities-based IXCs to file "unbundled" wholesale tariffs. While this proposal vaguely resembles the requirements placed on incumbent LECs by the Telecommunications Act of 1996, the problem is that Alaska's competitive interexchange market has very different characteristics from those of the monopoly LEC markets that Congress sought to open up with the 1996 Act. As explained more fully below, unbundling wholesale rates on a tariffed basis would be a costly and ultimately futile exercise. Better alternatives exist that have worked successfully in the Lower 48 and have also been working in Alaska for some of the more savvy resellers. These include, among other possibilities, the negotiation of individual agreements, tailored to a particular customer's needs that are also available to all other similarly situated IXCs.

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In sum, the Staff Report and the proposed regulations contain many excellent recommendations, but also contain elements that can be substantially improved upon. The facts, data and other evidence AT&T Alascom presents in these comments demonstrate that competition and consumers will benefit from relaxation of the discriminatory dominant carrier rules that now apply only to AT&T Alascom. They further show that targeted Bush subsidies can be conceived and implemented that will produce the intended result – greater investment in Bush facilities and greater parity between urban and rural service quality – without the accountability and other problems identified in the Staff Report. Finally, these comments lay out an alternative vision of how wholesale pricing and interconnection should develop.

AT&T Alascom genuinely appreciates the Commission's attention to these difficult issues, which are extremely important to the company. Providing modern and reliable statewide long distance telecommunications services is AT&T Alascom's core business. We look forward to an active discussion, and we pledge to work cooperatively with the Commission and the other interested parties to develop new rules that better fit today's conditions.

II.

AT&T ALASCOM'S RESPONSE TO THE STAFF REPORT AND PROPOSED REGULATIONS

A. IT IS TIME TO REPEAL THE BUSH FACILITIES RESTRICTION

The Staff Report recommends that the Commission repeal the Bush facilities restriction set forth in 3 AAC 52.355. In 1990, the former APUC adopted the regulation restricting the construction of facilities in the Bush together with the dominant carrier and COLR regulations as a package to

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implement in-state long distance competition. These rules work together so that a change in one should prompt a change in the others. *See* 10 APUC 407 (APUC 1990), Order No. R-90-1(6) (Sept. 6, 1990). In its Initial Comments, AT&T Alascom supported the repeal of this regulation and recommended that the Commission simultaneously implement other reforms, including (1) the lifting of AT&T Alascom's dominant carrier designation, (2) more equitable allocation of the COLR responsibilities, and (3) implementation of an explicit, competitively-neutral subsidy for high-cost Bush service. In the proposed regulations, however, the Bush facilities restriction is repealed, but the dominant carrier designation and COLR rules remain unchanged.[1]

AT&T Alascom unconditionally supports repeal of the Bush facilities restriction for a variety of reasons. Retaining a facilities-based restriction in rural Alaska is not competitively neutral and therefore not consistent with Section 253(a) of the 1996 Telecommunications Act.[2] If carriers like GCI are willing to deploy facilities to serve the rural areas of the state, the Commission should not forbid it. Unless the Commission allows the marketplace to operate freely, we will never really know whether facilities-based competition can succeed in a given location. Rural Alaskans can only benefit from such competition. The requirement that retail rates are geographically averaged protects them from any rate increases that might otherwise result from the uneconomic duplication of facilities. Shareholders of carriers willing to deploy facilities to serve rural Alaskans are those at risk, not the consumers. If

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[1]*See* Staff Report at 32-36.

[2]Section 253(a) states that:

> No state or local statute or regulation, or other state or local legal requirement, may prohibit or have the effect of prohibiting the ability of any entity to provide any interstate or intrastate telecommunications service.

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facilities-based competition proves to be uneconomical in any particular location, then either GCI or AT&T Alascom or any other facilities-based provider present should have the option to leave, subject to the Commission's regulatory oversight to ensure that there is a Carrier of Last Resort that is fit, willing and able to continue service.

B. JOINT OWNERSHIP OF AT&T ALASCOM'S FACILITIES WOULD BE PROBLEMATIC

The Staff Report recommends that the Commission not require AT&T Alascom to relinquish ownership in its earth stations. Absent AT&T Alascom's consent, any order requiring joint ownership of its facilities would be illegal and potentially impractical to administer. How, for example, would ownership percentages be determined? How would deployment, maintenance, upgrade and retirement decisions be made? Would other IXCs also contribute to the satellite's costs and share costs associated with the DAMA controller? On what basis? From where would the other IXCs obtain the funds for this investment? Would their LEC affiliates pay and, if so, would they attempt to recover the money from AT&T Alascom in access charges? Would other facilities-based carriers, such as GCI, be subject to similar requirements? These are just a few of the unanswered questions raised by any joint ownership proposal.

One point in the Staff Report's discussion of this matter, however, merits a response. The Staff Report recommends that the Commission require IXCs like AT&T Alascom to obtain prior review and approval from the Commission before constructing any new earth stations. Staff Report at 6. The proposed regulations do not implement this recommendation. The Staff is apparently concerned that IXCs should not overlook the possibility of using terrestrial instead of satellite facilities to improve the

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quality of service. However, any rule or order requiring prior Commission review and approval of new construction would be unprecedented and unwarranted. Regulatory commissions are not equipped to perform network design and engineering, which has traditionally and properly been the province of management. AT&T Alascom management is in the best position to decide which technologies are most suitable for a particular application. Management has the unique ability to balance the competing considerations of cost, available capital, market demand, likely return on investment, and technical feasibility.

C. THE STMP ALONE IS INSUFFICIENT TO INDUCE MODERNIZATION OF BUSH FACILITIES; A RURAL SUBSIDY IS NEEDED

The Staff Report recommends regulatory oversight as the best way to ensure that Bush telecommunications facilities remain up to date and reliable. AT&T Alascom believes strongly that regulation by itself is insufficient. A targeted, explicit and competitively-neutral Bush IXC subsidy is the only feasible way to preserve and enhance Bush service.

1. High-cost and low-traffic volumes in the Bush create obstacles to facilities investment and modernization.

The original order in this docket requested suggestions for policy changes to increase the deployment of new technology and rate of investment in rural Alaska. Order R-98-1(1) at 9. Comments were sought in response to the Alaska 2001 Advisory Committee's March 1996 Report, which observed a growing disparity in the quality of service offered in urban Alaska versus rural Alaska. The Alaska 2001 Advisory Committee keenly observed that part "of the problem in the Bush has to do with investment incentives faced by Alascom." *Id.*

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In its Initial Comments, AT&T Alascom explained at length how competition in the long distance market is undermining the economic incentives of facilities-based IXCs to invest capital in the continued modernization of Bush facilities. In brief, the Commission traditionally has relied on statewide geographical rate averaging as a means to flow implicit subsidies from urban ratepayers to pay the costs of long distance service to rural Alaskans. *See* Staff Report at 23. Prior to competition, AT&T Alascom's rates were set by calculating its total costs, adding a reasonable return, and dividing by the total number of minutes on the network. It was straightforward and relatively simple. The company and the Commission could depend on the implicit subsidies created by averaged rates to recover the high costs of deploying facilities in rural Alaska. With competition, numerous IXCs are now competing for a share of the urban and rural markets, driving down rates, reducing AT&T Alascom's market share, and increasing pressures for technological upgrades. The result is that AT&T Alascom no longer can reasonably expect to recover and profit from future investments in facilities in the state's vast high-cost, low-density areas. With competition, margins are squeezed and geographical averaging alone is inadequate to encourage investment in rural Alaska.

AT&T Alascom, as COLR, faces unique challenges. AT&T Alascom is the only IXC that must bear the burden of serving the Bush while simultaneously competing aggressively in Alaska's urban markets. Unlike AT&T Alascom, its principal competitors are affiliated with highly profitable monopoly operations that can help to subsidize their long distance businesses. GCI, for example, owns extensive cable TV properties, and ATU-LD is supported by a far-reaching local exchange monopoly. The LECs, which must also serve in high-cost Bush areas, do not have to compete simultaneously in the urban areas. Plus, rural LECs receive substantial subsidies from the USF and access charges to

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support the high costs of Bush service and assure a return on their investments. AT&T Alascom faces costs of a similar magnitude as those LECs, but without the subsidies, and it also has urban competition with which to contend.

In the 1990 order initiating in-state competition, the APUC expressly recognized the unique burdens that AT&T Alascom would have to shoulder as COLR. At a time when Alascom still controlled 100 percent of the in-state market, the Commission stated:

> The Commission has decided to adopt a system for weighting access minutes to define IXC market shares for the purpose of allocating the bulk bill component of access charges. The Commission has further determined that access minutes should be weighted based on their time of day, calling distance, and status as high density or low density.
>
> With regard to high density/low density weighting, the Commission is convinced that the introduction of competition in the provision of intrastate interexchange service presents risks to the price and quality of service to rural areas of Alaska where traffic densities are low and the cost of providing service is high. These risks have been thoroughly documented to the Commission both in this proceeding and in prior proceedings, including the investigation of Alascom's rate design and in conjunction with prior proposals of GCI to allow competition in the provision of interexchange telecommunications service. The risks have also been recognized by the Legislature, which authorized the Commission to establish a "mechanism to be used to ensure the provision of long distance telephone service at reasonable rates throughout the state and to otherwise preserve universal service." (AS 42.05.840.)
>
> The system of weighting access minutes for bulk bill allocation purposes is designed to minimize the foregoing risks. Weighting of bulk bill access charges partially levelizes the profitability of urban and rural toll routes. By maintaining profitability on low density, high cost rural routes, IXCs have an incentive to provide service to those routes. Alascom, as the present provider of service to all such routes, will be able to continue to profit from those routes, reducing incentives for it to raise prices or lower quality for those routes. In these respects, the Commission is firmly convinced that the system for weighting bulk bill access charges is in the public interest. Furthermore, the weighting system protects universal service throughout the state without requiring payments between competing IXCs. Such payments were a feature of the regulations previously proposed by GCI and were one of the reasons those regulations were rejected.

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10 APUC 407 at 15-16. For a variety of reasons, weighting did not work and was abandoned in the Access Reform docket. Order Nos. R-97-5(7)/R-97-6(7)/U-98-168(1) at 13 (Nov. 23, 1998). But, the problem weighting was intended to address has not gone away. On the contrary, it has intensified with competition, and a replacement mechanism is needed now more than ever.

2. Technology and consumer expectations are constantly changing.

The goalpost is constantly being moved further down the field. For years, AT&T Alascom was criticized for its analog earth stations that required a double satellite hop for village-to-village voice communications. Everyone clamored for DAMA technology because it would eliminate the double hop, substantially improve voice transmissions, and make fax communications more reliable. AT&T Alascom and GCI have now spent millions of dollars installing DAMA facilities, which are successfully meeting those demands. DAMA technology is, however, not optimal for high-speed data transmission and Internet connections, as the Commission was told by the network engineers at the public meeting on the "state of the network" in December of 1999. Now, the clamor is for Internet and other broad-band services to the home in every village across Alaska. DAMA is taken for granted. Before DAMA's multimillion dollar deployment is even completed, and well before the costs have been recovered (if they ever will be), the next level of expensive technology is expected.

Internet service does not involve village-to-village calling. It requires direct, high bandwidth connections to Anchorage, Fairbanks or Juneau. As a purely technical matter, AT&T Alascom's village earth stations, still in the process of being converted to DAMA, can also be upgraded with digital TDM. The two technologies are compatible and can work together on the same earth station. In fact, AT&T Alascom is presently deploying this digital transmission technology, capable of

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supporting Internet service at up to 56 Kbps, in over 110 locations at an estimated average cost of $85,000 per location. In some rural hubs, the earth stations are already equipped with both DAMA and digital TDM equipment.

The cost is high, however, to install high wideband digital transmission facilities and the other equipment required for Internet service in a typical rural Alaska village. As an example, it would cost approximately $1,700 per month in Aniak.[3] Vasconi Affidavit, ¶ 35. To make Internet service available to customers in Aniak at $20 per month (the approximate cost in Anchorage), at least 85 subscribers would be required. Vasconi Affidavit, ¶ 35. Unless and until there is sufficient demand to provide a reasonable opportunity for AT&T Alascom to recover its costs and earn a return, AT&T Alascom cannot justify the capital and other expenditures necessary to provide the services that are now being demanded.

3. AT&T Alascom's Bush losses can be quantified.

The costs of providing service to rural Alaskans far exceed the revenue that may be earned from such service. The attached Vasconi Affidavit quantifies approximately $7.3 million in annual losses that AT&T Alascom incurs in serving Bush Alaska, *i.e.*, Category 3. To arrive at this amount, Mr. Vasconi first calculated that the average cost per billed minute in Category 3 is approximately $0.41. He then calculated AT&T Alascom's average statewide revenue per minute to be only $0.23, which leaves a shortfall of $0.19 per minute in Category 3. When this shortfall is multiplied by AT&T

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[3]This number assumes that the earth station has already been digitized and has the capacity to carry 56 Kbps data transmissions. Digitization costs another $85,000 per location on average.

Alascom's total annual Category 3 billed minutes, the aggregate shortfall AT&T Alascom experiences is approximately $7.3 million per year. Vasconi Affidavit, ¶ 30.

Using this method of analysis, the Vasconi Affidavit establishes that, on a statewide basis, AT&T Alascom is not covering its costs, much less earning its authorized rate of return. The average cost per minute on a statewide basis is $0.2371, with average revenue per minute of $0.2256; this produces a $0.0115 per-minute deficit. Multiplying this deficit by AT&T Alascom's total minutes for 1999 based on September data produces an annual shortfall of $2 million. Without the $7.3 million Category 3 deficit, the overall picture would be positive. Vasconi Affidavit, ¶ 31.

This shortfall is not new. The costs to serve rural Alaskans have always exceeded the revenues. As explained above, the difference today is that the implicit subsidies from urban ratepayers that AT&T Alascom once relied on prior to 1991 to cover the shortfall are now being divided among numerous IXCs. In 1990, AT&T Alascom held a virtual monopoly in the in-state long distance market, but today its market share based on originating minutes of use ("MOU") has decreased dramatically to approximately 40 percent in the urban areas. As of December 1999, AT&T Alascom's share of originating minutes in Anchorage only was down to 31.2 percent. Vasconi Affidavit, ¶ 9.

At the same time its market share is shrinking, AT&T Alascom's average revenue per minute has plummeted 30 percent from approximately $0.32 in 1991 to approximately $0.23 at the end of 1998. Vasconi Affidavit, ¶ 13. Total traffic volumes have not grown sufficiently to make up the difference. In 1995, total statewide minutes (originating plus terminating) were 743 million. Based on the first ten months of 1999, AT&T Alascom estimates total yearly statewide minutes to have been

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759 million, an increase of only two percent. Vasconi Affidavit, ¶ 15. The combination of these three trends is devastating.

Meanwhile, the Commission continues to impose COLR obligations exclusively on AT&T Alascom, which means that AT&T Alascom alone is required to provide service and to maintain the infrastructure to support the high-cost, low-density areas. In recent comments to the Commission regarding the FCC's inquiry in CC Docket No. 96-45, AT&T Alascom explained the significant costs required to provide long distance service to rural Alaskans. With competition, AT&T Alascom is serving rural Alaskans at a loss and no longer can reasonably expect to recover its costs nor earn a reasonable return on its investment through implicit subsidies. This situation will grow worse for AT&T Alascom as competition in the long distance market continues to flourish to the benefit of consumers.

4. Mere enforcement of the STMP will not solve the problem.

In its Initial Comments, AT&T Alascom proposed a competitively-neutral, explicit subsidy to provide incentives to facilities-based IXCs to invest in the deployment of modern facilities in rural Alaska. *See* Appendix 1 to AT&T Alascom's Initial Comments. The Staff Report is essentially agnostic on the proposal, taking the position that there is insufficient evidence to support a rural subsidy for in-state long distance at this time. The Report simply recommends that the Commission more fully investigate the matter in the future.[4] Staff Report at 8 and 31-32. Additionally, the Staff Report raises a number of questions about how the toll subsidy would operate. Staff Report at 31-32.

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[4] Staff recommends that the Commission review data in the wholesale rate dockets it proposes for AT&T Alascom and GCI as a starting point for determining whether there is a need for the subsidy. Staff Report at 32.

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Consistent with the Staff Report's recommendations, the proposed regulations do not provide for a rural toll subsidy.

The Staff Report proposes no specific change in the regulations, but recommends that the Commission "monitor (via annual reports) modernization of equipment to promote compliance with the STMP, and take appropriate action as necessary in cases of noncompliance." Staff Report at 9. The Staff Report also recommends that the Commission review the minimum quality-of-service standards for the long distance market. *Id.*

Regrettably, the STMP alone will not remedy the fundamental economic problem confronting facilities-based IXCs, which is that the implicit subsidy provided by statewide geographical rate averaging is no longer adequate. The Commission cannot simply order carriers to deploy new facilities in rural Alaska to meet standards in the STMP unless those companies have a reasonable opportunity to recover their costs and earn a fair return. This principle is a fundamental tenet of utility regulation that should not be overlooked even in this era of competition. *Cf. Bluefield Water Works & Improvement Company v. Public Service Comm'n*, 262 U.S. 679, 692 (1923).

Telecommunications providers, like all other corporations, must evaluate and prudently choose among competing investment opportunities on behalf of their shareholders. AT&T Alascom, and its parent AT&T Corporation, operate in the same manner and must compete in the same capital markets. As we all know, investors today have high expectations for healthy returns. Successful companies must invest only in projects that improve their overall rate of return. They cannot survive if they make investments that return less than their own cost of equity. Thus, when AT&T Alascom requests capital from AT&T for investment to deploy new facilities in rural Alaska, it must compete internally with

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many other investment alternatives that AT&T could make throughout the United States. Given the available returns, AT&T Alascom has difficulty making a strong economic case to justify new investments for projects in rural Alaska.

5. **A targeted, competitively-neutral Bush subsidy is the only feasible solution.**

In its comments to the FCC in CC Docket No. 96-45, dated December 15, 1999, the Commission reported on the disparity between rural and urban Alaskans with respect to Internet access and concluded that "as long as local Internet access in rural Alaska is not provided or is unaffordable, rural areas of the State will be at a social and economic disadvantage relative to urban Alaskan areas and the rest of the nation, ..." Comments of the RCA at 15. The Commission went on to recommend that the FCC extend Universal Service Fund support for limited levels of in-state toll service in order to promote universal service. *Id.* at 19. The same reasons that persuaded the Commission to comment in favor of federal Universal Service Fund subsidies for in-state toll equally support a *state* subsidy for in-state long distance service.

The only way to increase investment in rural Alaska and to ensure that first-class long distance service is maintained at a level reasonably comparable to urban Alaska is to institute a competitively-neutral, explicit rural subsidy for facilities-based IXCs. Similar subsidies exist to support local exchange service in rural Alaska. They also should be available to support long distance service in the same high-cost areas. Alaska Statute 42.05.840 expressly authorizes the Commission to establish a "mechanism to be used to insure the provision of long distance telephone service at reasonable rates throughout the state and otherwise preserve universal service." AT&T Alascom

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strongly urges the Commission to consider its proposal for a rural subsidy set forth in the attached Vasconi Affidavit.

At pages 31-32, the Staff Report claims that there are too many details that need to be resolved before finalizing the rules to implement a rural toll subsidy. While there certainly are outstanding questions, there is no reason to defer the matter into the future. AT&T Alascom suggests that the Commission address the matter now and undertake whatever inquiry it deems necessary in this docket to promulgate the necessary rules. As the pace of technology continues to accelerate, the disparity between telecommunications services available to urban and rural Alaskans will widen unless the Commission provides economic incentives to IXCs to deploy and modernize Bush facilities.

AT&T Alascom submits the following brief responses to the Staff Report's questions about the proposed Bush subsidy:

- **Why is an IXC Universal Service Fund needed?** Because AT&T Alascom is losing approximately $7.3 million per year serving Category 3 as the COLR, because it is in the process of investing over $145 million to serve Bush Alaska with slim prospects of recovering that investment, and because there is already growing pressure to improve Bush service to include affordable Internet access, before AT&T Alascom's DAMA and digital earth station upgrade programs are even complete.

- **Is the fund needed to pay for infrastructure development that would not otherwise occur?** Yes, as well as to enable AT&T Alascom, and GCI for that matter, to recover amounts already invested. Without a subsidy, Internet service to residential and business customers in the Bush will be unaffordable for years to come. Without a subsidy, it would not be economically feasible for any carrier to install the necessary facilities.

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- **What type of infrastructure development would occur and what locations deserve funding?** Continued DAMA deployment, the launch of Aurora III, and earth station digitization are three types of modernization that deserve support. Also, if Bush Internet service is going to happen, installation of the necessary facilities listed in the Vasconi Affidavit must be subsidized.

- **Has any carrier made any commitment to construct facilities if given access to Universal Service funding?** Yes. AT&T Alascom has committed to launch Aurora III, it has spent another $35 million on DAMA deployment and digital earth station upgrades. If the Internet subsidy outlined in the Vasconi Affidavit is established, AT&T Alascom will commit to provide the necessary facilities. As an aside, AT&T Alascom notes that rural LECs receive substantial subsidies for simply being there (*e.g.*, USF, DEM support from the AUSF) without being asked for similar commitments.

- **Would the fund replace implicit cost support provided to the rural areas from urban areas?** Yes. That support has already evaporated. It is gone. The Vasconi Affidavit documents the amount of the shortfall. Vasconi Affidavit, ¶¶ 28-31.

- **What urban rates would be correspondingly reduced if implicit subsidies were removed and replaced with an explicit fund?** None, although AT&T Alascom would be willing to consider a cap on its current rates. As documented elsewhere in these comments, there is no longer any cushion provided by the rates on high-density, low-cost urban routes. Because there is no cushion, there would be no reductions. The proposed subsidy would *replace* the implicit subsidy that used to inhere in Alascom's pre-competition rates and was intended to be provided by Bulk Bill weighting, which went away in 1998.

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- **Which rural customer rates would receive the benefit of the subsidy?** Rural MTS rates are already well below cost, benefitting from geographical rate averaging and the effects of aggressive competition in urban Alaska. Rural Internet rates would be slashed by approximately 60 percent if AT&T Alascom's Internet subsidy were implemented.

- **What would facilities-based IXCs do with a subsidy if provided?** AT&T Alascom would provide Internet service to rural homes and businesses, apply the general rural subsidy against the costs of its massive program of Bush modernization, and continue to offer competitively-priced, high-quality service in both urban and rural Alaska.

- **How much funding is needed?** Approximately $9 million. The data in the Vasconi Affidavit demonstrate beyond any reasonable doubt that AT&T Alascom is "unduly burdened to the point that a new IXC subsidy mechanism is needed" and that "statewide average rates are insufficient to insure [compensatory] service in rural areas." Losses in the Bush are approximately $7.3 million per year; AT&T Alascom's annual statewide losses are approximately $2 million. The Internet subsidy would require approximately $1.7 million. The total ($1.7 million plus $7.3 million) would be $9 million per year. Vasconi Affidavit, ¶¶ 28-36.

- **If support is needed, should it be calculated based on embedded costs, forward-looking costs (the FCC approach), or on some other basis?** Mr. Vasconi's analysis uses forward-looking costs developed by GCI. AT&T Alascom is presently conducting its own forward-looking cost study, which it expects will closely mirror GCI's cost calculations. Forward-looking costs are the most appropriate because the purpose of the proposed subsidy is to reward new investment. If the subsidy is sized on the basis of the forward-looking costs of one

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efficient carrier per location, and shared on the basis of Category 3 market share, there will be no risk that those paying the subsidy will be asked to pay for uneconomic duplication. Only the carriers and their shareholders will be at risk if they overbuild.

- **Would the Commission review how the funding is spent through some type of reporting or auditing procedure?** Yes. The proposed Internet subsidy would be the easiest to monitor. The carrier providing the service in any given location would simply record its actual costs, report the number of customers paying the $20.00 monthly fee, and collect the balance from the AUSF. The general Bush IXC subsidy, as conceived by AT&T Alascom, would be paid on a per-minute basis to each facilities-based carrier originating or terminating Category 3 traffic. The accounting would be based on access billing records. To ensure that the subsidy was spent on Category 3 facilities, a reasonable system of annual reporting could be created. AT&T Alascom suggests a workshop with Staff, GCI, and the AUSF to work out the details. As part of the reporting process, AT&T Alascom could provide engineering and economic justification for the type of technology deployed on any given route. AT&T Alascom would also agree to work on establishing appropriate quality of service standards. Vasconi Affidavit, ¶¶ 27 and 37.

- **Should the subsidy be equally available to all facilities-based IXCs?** Yes. Subsidies should be explicit and competitively neutral in both the manner they are collected and the way they are distributed.

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6. **A subsidy is also needed to make Internet access affordable to customers in Bush Alaska.**

The Commission was correct when it said in a recent filing with the FCC that Internet service in rural Alaska is necessary if residents are to avoid being socially and economically disadvantaged relative to urban Alaskans. Already there are federal programs to subsidize Internet service to schools and libraries and to rural health care providers. The next question is how to make Internet service to private homes and businesses available at rates reasonably comparable to those paid by urban Alaskans. The reason that private Internet service is not presently available in rural Alaska to the degree it is in urban areas is ***not*** that the technology is lacking. As AT&T Alascom's engineers John Hendricks and Scott Wood explained to the Commission at its hearing on the status of the IXC network in December 1999, existing satellite capacity, together with the planned upgrade of Bush earth stations, will allow Bush subscribers to have local dial-up Internet service at 56 Kbps.

The real problem is created by high cost and low population density. The cost to provide the service in a typical Bush village varies, but is approximately $1,500 per month. Without a subsidy, a minimum of about 75 customers is required to cover this cost, assuming that each customer pays $20.00 per month. Vasconi Affidavit, ¶ 35. Many Bush communities simply have too few potential customers to permit an Internet Service Provider ("ISP") to operate profitably. Without a subsidy similar to that provided to schools, libraries and health care providers, Internet service will likely remain unaffordable to most Bush residential and business customers.

AT&T Alascom has preliminarily analyzed the cost of providing Internet service to a typical Bush customer, on a local dial-up basis, without toll charges. In his affidavit, Mark Vasconi calculates that the cost of equipment, local business lines, satellite transponder space, and other necessary service

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elements would amount to approximately $1,500 per village, which breaks down to approximately $50.00 per subscriber per month. The analysis is based on certain assumptions about probable subscription levels in 164 small rural communities (all in Category 3), which AT&T Alascom serves by satellite and which, for the most part, do not presently have residential or business Internet service. Assuming that each subscriber would be responsible for paying $20.00 per month, which is the approximate rate that Anchorage Internet customers pay, Mr. Vasconi calculates that the necessary subsidy would average $30.00 per line per month, or $1.7 million per year for these 164 villages.[5] If this amount were collected equally from every access line in the state, it would require an increase to the AUSF surcharge of approximately $0.36 per line per month. Vasconi Affidavit, ¶ 37.

AT&T Alascom can imagine that there might be some "political" resistance in the urban areas of Alaska to a subsidy of this nature. However, a rural Internet subsidy would also have obvious attractions. It would certainly lessen the so-called Digital Divide. It would reduce the mounting pressure for EAS, such as we are seeing in the case in Docket U-99-70.[6] It would also tend to increase IXC traffic and revenue generated in Bush locations, leading to more efficient use of satellite and

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[5]To put it in perspective, $1.7 million is not much more than half of the $3.3 million that AUSAC collects annually to support the rural LECs' switching costs, known as DEM, or Dial Equipment Minutes.

[6]In the Public Advocacy Section Report recently filed with the Commission on February 1, 2000, the PAS stated that:

> . . . it is clear from the petition and other comments filed in the docket that local Internet access is the main goal of the Port Graham petitioners. There may be a creative solution to provide Internet access without EAS that would meet the needs of Port Graham for the present.

Id. at 15.

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