Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Review of the Commission's Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Service by Incumbent Local Exchange Carriers	)	WC Docket No. 03-173
	)	

<u>REPLY COMMENTS OF ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.</u>

ALASKA COMMUNICATIONS SYSTEMS GROUP, INC.

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Alaska Communications Systems Group, Inc. ("ACS"), on behalf of the ACS local exchange carriers ("LECs"),[1] hereby submits these reply comments in response to the comments filed in the Commission's proceeding established to review the current Total Element Long Run Incremental Cost ("TELRIC") pricing rules for unbundled network elements ("UNEs").[2] Through its comments and reply comments, ACS asks the Commission to amend its TELRIC rules to provide more specific guidance to state commissions on establishing forward-looking cost-based rates that promote the goals of Section 251 of the Communications Act of 1934, as amended (the "Act").[3]

I. SUMMARY

ACS agrees with USTA's observation that devaluation of facilities investment and the under-recovery produced by UNE rates generally has a disproportionately large effect on

[1] ACS of Anchorage, Inc., ACS of Fairbanks, Inc., ACS of Alaska, Inc., and ACS of the Northland, Inc. are wholly-owned subsidiaries of Alaska Communications Systems Group, Inc.

[2] *Review of the Commission's Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Service by Incumbent Local Exchange Carriers*, WC Docket No. 03-173, Notice of Proposed Rulemaking, FCC 03-224 (rel. Sept. 15, 2003) ("*TELRIC NPRM*").

[3] *See* 47 U.S.C. § 251.

smaller and more rural ILECs.[4] ACS has been particularly hard hit by the effects of UNE rates that do not reflect ACS's forward-looking economic cost. The current UNE rates in Alaska were generated by a misapplication of TELRIC that did not consider any actual costs in ACS's markets.[5] Taking advantage of these below-cost UNE rates, and assisted by universal service support in ACS's rural markets based on ACS's costs rather than its own, General Communication, Inc. ("GCI"), ACS's primary competitor, has captured 45 percent of the Anchorage market, 30 percent of the Juneau market[6] and 22 percent of the Fairbanks market.[7] ACS's inability to recover its costs through inappropriately low UNE rates has reduced network investment. The Commission should reexamine the current TELRIC rules in light of these detrimental effects of below-cost UNE rates.

While the TELRIC methodology utilizes a cost model based on a hypothetical network assuming the most efficient technology and network design (but existing wire center locations), the cost inputs must be based on costs that actually exist in the market in question in order to send appropriate market entry signals. The Commission can help ensure that states are properly implementing TELRIC by requiring the use of real-world attributes in establishing forward-looking costs. As part of this guidance, the Commission should direct states to use the ILEC's current costs as the most reliable evidence to determine forward-looking cost inputs. The best evidence of what something will cost tomorrow is what it costs today. All other

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[4] *See* USTA Comments at 8.

[5] ACS Comments at 5-6.

[6] *See* Fairbanks Daily News Miner, "*Ruling Rekindles Debate Over Local Phone Market*," (Dec. 13, 2003).

[7] *See id.*

evidence is inherently less reliable, and the least reliable evidence is a purely theoretical figure produced by a model or an expert.

Many of the comments in this record support the proposals in ACS's comments and also advocate further guidance from the Commission on specific cost inputs. The Commission should make clear that only through cost-based UNE rates that reflect the real costs of the ILEC in question will the goals of facilities-based investment be achieved. The Commission should also require states to undertake a periodic review of the state of competition that has resulted from the UNE rates and to make any adjustments necessary to ensure that the UNE rates are sending appropriate market entry signals. In ACS's initial comments, ACS recommends that state commissions be required to revisit rates every three years.[8] This is the most effective manner in which to monitor whether UNE rates are sending appropriate entry signals and encouraging investment in facilities.

II. THE RECORD SUPPORTS ACS'S REQUEST FOR GUIDANCE ON NETWORK ASSUMPTIONS THAT RELATE TO THE ILEC'S ACTUAL NETWORK

A. While Network Design Can Be Hypothetical, Cost Inputs Must Be Realistic

Based on the comments in this proceeding, the Commission should conclude that the most reasonable way to implement TELRIC is to assume a hypothetically efficient network design in the actual geographic market in which the ILEC in question serves. The forward-looking costs of the hypothetical network, however, must be based on actual costs that can be attained in the market. While TELRIC calls for a hypothetical network *design*,[9] any rule that also relies on hypothetical cost inputs is almost certain to result in UNE rates that are unjust and

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[8] ACS Comments at 48.

[9] *See Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, First Report and Order, 11 FCC Rcd 15499 at ¶ 685 (1996) (subsequent history omitted) ("*Local Competition First Report and Order*").

unreasonable. Models based on hypothetical cost inputs may produce rates that are too high or too low, but they certainly will not produce rates that reflect forward-looking economic costs achievable by the ILEC in the market in question. The forward-looking nature of the network *design* is intended to minimize inefficiencies and promote competitive entry, but some realistic and unavoidable inefficiencies are incorporated by using actual wire center locations and real and actual costs to build the hypothetical network.[10]

NASUCA claims that forward-looking costs are hypothetical, and the only way to avoid hypothetical costs is to use embedded costs.[11] ACS agrees that forward-looking costs are inherently predictive, but disagrees with NASUCA's conclusion. Forward-looking costs are projections of costs and the use of a hypothetical design assumes some increased efficiency in network architecture, but the basis for those costs need not be hypothetical. They can and should use as their starting point the costs the ILEC is incurring today.[12] However, reliance on actual costs of an efficient carrier for the basis of projecting a forward-looking cost is not reliance on an embedded cost, but rather reliance on the best evidence of what that future cost is likely to be. The Commission defined embedded costs as book costs.[13] These may be lower or higher than today's actual costs.[14]

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[10] *Verizon Communications, Inc. v. FCC*, 535 U.S. 467 at 504 (2002); *Local Competition First Report and Order* at ¶ 685.

[11] NASUCA Comments at 4-5.

[12] *Petition of WorldCom, Inc. Pursuant to Section 252(e)(5) of the Communications Act for Preemption of the Jurisdiction of the Virginia State Corporation Commission Regarding Interconnection Disputes with Verizon Virginia Inc., and for Expedited Arbitration*, CC Docket No. 00-218, Memorandum Opinion and Order, DA 03-2738 at ¶¶ 30 (rel. Aug. 29, 2003) ("*Verizon Virginia Arbitration Order*").

[13] TELRIC NPRM at 32-33.

[14] ACS Comments at 32-33.

As set forth in the *Local Competition First Report and Order*, while prices are set assuming the most efficient new technology, hypothetical network design must be compatible with existing infrastructure, for example, by assuming the actual location of existing wire centers.[15] Further, according to the Commission's *Triennial Review Order*, state commissions must take into account real-world considerations in determining inputs for cost of capital and depreciation. TELRIC-based cost of capital should reflect the risks of a competitive market,[16] and asset depreciation should be accelerated to reflect the anticipated decline in the value of assets.[17] Thus, the Commission's NPRM correctly noted that TELRIC-based pricing must reflect real-world attributes in all of its cost inputs.[18]

There is ample support in the record for the Commission to adopt new TELRIC rules that provide guidance on developing more accurate forward-looking costs that are based on actual attributes of the ILEC and its network, rather than models or national averages or the opinions of experts. Many of the commenters believe TELRIC can be made workable and can only promote the goals of the Act if its application is not divorced from reality.[19] Many commenters have also acknowledged that in order to provide proper price signals, TELRIC must be applied in a way that reflects real-world attributes of the ILEC's network.[20]

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[15] *Local Competition First Report and Order* at ¶ 685; *see also*, 47 C.F.R. § 51.505(b)(1).

[16] *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, CC Docket No. 01-338, Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, FCC 03-36 at ¶¶ 680-84 (rel. Aug. 21, 2003) ("*Triennial Review Order*").

[17] *Triennial Review Order* at ¶ 690.

[18] TELRIC NPRM at ¶¶ 4, 50, 52.

[19] *See, e.g.,* USTA Comments at 2; BellSouth Comments at 7; SBC Comments at 24-25; Verizon Comments at 25; Competitive Enterprise Institute Comments at 4.

[20] *See, e.g.,* Covad Comments at 6; Allegiance Telecom Inc. Joint Comments at 29; Sprint Coments at 15; MCI Comments at 21.

Sprint correctly asserts, "the Act's requirement that UNE pricing be based on 'costs' necessitates an examination of actual cost data."[21] ACS agrees that "real-world cost data is essential to determine realistic forward-looking costs" since carriers' costs will vary significantly from one another depending on their size and market characteristics.[22] For instance, compared to larger carriers, smaller carriers generally have higher costs per line, including higher costs of capital and higher procurement costs from suppliers. Likewise, relative to urban carriers, rural carriers have higher construction and operating costs per line due to the decreased alternatives for contract work, lower customer density and non-contiguous service territories.[23] MCI argues that "it was never a feature of TELRIC to ignore facts about the physical world."[24]

Additionally, some state commissions have even demonstrated their understanding that TELRIC pricing is meant to reflect forward-looking costs that are specific to the market in question and reported that their UNE prices already reflect real-world costs and attributes.[25] For instance, the Public Service Commission of the State of Missouri ("MO PSC") has already used samples of existing network components to estimate the forward-looking cost of UNEs.[26] Similarly, the New York Department of Public Service ("NY DPS") reports that it has adopted a model that relies on historical data and forward-looking estimates of cost which reflect dynamic inefficiencies inherent in provisioning services in a real network. The NY DPS reasons that reflecting some inefficiencies in TELRIC promotes facilities-based competition by

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[21] Sprint Comments at 15.

[22] *Id.* at 15-16.

[23] Sprint Comments at 15; *see also*, Iowa Telecommunications Service Inc. Comments at 4-5.

[24] MCI Comments at ii.

[25] *See, e.g.*, Public Service Commission of the State of Missouri ("MO PSC") Comments at 6; New York Department of Public Service ("NY DPS") Comments at 6; BellSouth Comments at 2.

[26] MO PSC Comments at 6.

making it more likely that CLECs will invest in facilities if they can provide service over their own facilities at lower cost. Creating this type of competition also promotes efficiency by the ILEC, according to the NY DPS.[27] The fact that some states are already incorporating real-world costs into their UNE rate determinations illustrates that it is feasible for states to implement the types of changes that ACS requests in this proceeding.

Nevertheless, new rules are required to ensure that all states adopt this approach and produce realistic UNE rates. ACS agrees that even though TELRIC-based rates are forward-looking, they must be based on realistic assumptions about the network and the carriers in the market, or else UNE rates will not achieve a just and reasonable result.[28] Although many commenters accept that using real-world attributes is the only rational application of TELRIC principles, not all state commissions have properly applied TELRIC in this manner. As ACS described in its comments, the Regulatory Commission of Alaska ("RCA") has established UNE rates in Anchorage, Fairbanks and Juneau that in no way reflect ACS's costs in those markets.[29] In determining forward-looking costs, the arbitrator selected by the RCA "referred to [the theoretical] network as a network in the sky. If overlaid on the earth for example, the model could put a switch in the middle of a lake. It is not bounded by on earth realities."[30] ACS urges the Commission to give states more clear guidance on accounting for real-world attributes when determining forward-looking costs to avoid precisely this interpretation of the TELRIC methodology.

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[27] NY DPS Comments at 6.

[28] MO PSC Comments at 6; NY DPS Comments at 6.

[29] *See* ACS Comments at 5-6.

[30] *Interconnection Agreement Between General Communication, Inc. and PTI Communications of Alaska, Inc., Telephone Utilities of the Northland, Inc. and Telephone Utilities of Alaska, Inc.*, Arbitration Decision on Model Inputs, U-99-141/142/143 at n. 44 (Reg. Comm'n of Alaska, July 17, 2000).

State commissions commenting in this proceeding assert that they have extensive experience in setting UNE rates using TELRIC and that the Commission should maintain the discretion of the states to apply TELRIC in their respective jurisdictions.[31] If this request is to be granted, the Commission must provide guidance on the need to rely on real-world attributes and the types of actual local data that should be considered in order to achieve the cost-based ratemaking goals of UNE pricing.[32] The Commission also should clarify what evidence should be deemed reliable indicators of the ILECs' costs, and what evidence should be given little or no weight.

B. Guidance On Using Real-World Assumptions Would Ensure Proper Application of TELRIC

By adopting guidelines for state commissions to follow in establishing the forward-looking costs that will be used in generating UNE prices, the Commission will offer a level of clarity that does not exist in the vague TELRIC rules in place currently. Certain CLEC comments assert that changes to the TELRIC rules would disrupt the current unbundling regime[33] and would have "disastrous effects on the fledgling competition for local exchange services that is just emerging."[34] However, the guidelines proposed by ACS would not drastically change the rules. The TELRIC framework would remain untouched. But, importantly, ACS's proposed guidelines would help ensure that UNE prices more accurately reflect costs that will be incurred by an efficient carrier in the particular market.

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[31] *See* NARUC Comments at 1; Pennsylvania Public Utility Commission ("PA PUC") Comments at 4; Public Utility Commission of Texas Comments at 3; NASUCA Comments at 18.

[32] SBC Comments at 24-25.

[33] Z-Tel Communications Inc. Comments at 2.

[34] ACCtion Communications Joint Comments at 3. Some CLECs apparently fear the type of business disruption they have successfully imposed on some ILECs.

Until now, proponents in UNE arbitrations have been able to advocate widely disparate rates based on the same ILEC's network and operations because TELRIC currently allows proponents virtually unlimited flexibility as to the evidence on which they base their cost estimates and proposed rates.[35] As pointed out by former FCC Chief Economist, Dr. Howard Shelanski, under the current rules, regulators have considerable latitude to set rates without regard to costs.[36] Indeed, the "TELRIC standard introduces an unacceptable level of analytic indeterminacy into the process of implementing the Act. . . . TELRIC's plasticity leads to wide variability in rates that cannot be squared with the Commission's stated desire for a pricing methodology 'conducive to efficient facilities investment.'"[37] USTA and SBC both included analyses that demonstrate that there is little relationship between the rates produced by the application of TELRIC by the states and actual forward-looking costs in those states or differences in population or geography.[38] Thus, the UNE rate-setting process is entirely unpredictable and creates an unstable regulatory environment, which in itself is a disincentive to investment.[39] Armed with clear guidance, state commissions will be able to send more accurate market entry signals through UNE pricing.

ACS applauds the Commission's proposal to adopt guidelines that would direct state commissions to use real-world considerations in developing UNE prices. As Dr. Shelanski advises, a correct application of TELRIC would take as its starting point the ILEC's current costs and market conditions: "Unlike under TELRIC in its current form, the inquiry would not start

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[35] *See* ACS Comments at 4.

[36] *See* Verizon Comments, Shelanski Declaration at 7; *see also,* SBC Comments at 20-21.

[37] Progress & Freedom Foundation Comments at 2.

[38] SBC Comments at 20, Exhibit A at 4.4; USTA Comments at 6-7, Attachment A.

[39] USTA Comments at 7.

with experts investing hypothetical architectures and mixes of technologies or speculating on what fill levels might be in some ideally efficient world. Instead, these inputs would be determined on a far more objective and verifiable basis by looking first to available information about the incumbent's real-world network."[40] ACS urges the Commission to take this exercise one step farther and clarify that the best evidence of an ILEC's forward-looking costs is found in the ILEC's present costs and that the national average costs, theoretical cost models and the unsupported testimony of experts are inherently unreliable as evidence of an ILEC's forward-looking cost. Only through clear guidance can the Commission ensure that state commissions are applying TELRIC in a manner that promotes the goals of the Act.

C. Current Costs Are The Best Evidence Of Future Costs

The Commission should adopt rules setting forth a hierarchy of evidence from the most reliable to the least reliable for determining forward-looking costs. The most reliable evidence of what labor or materials will cost for any particular ILEC tomorrow is the cost that the ILEC incurs for such items today.[41] There simply is no better predictor of an ILEC's cost of labor and materials tomorrow than what it cost that ILEC today. As discussed above, some states are already using this type of evidence to establish UNE prices. Both the MO PSC and NY DPS report that they have used samples of existing network components, historical data and forward-looking cost estimates of real ILEC networks.[42] Additionally, BellSouth reports that several states have endorsed its loop model, which includes actual network data, assumes that the

[40] Verizon Comments, Shelanski Declaration at 11.

[41] SBC Comments at 25.

[42] *See* MO PSC Comments at 6; NY DPS Comments at 6.

loop network is built along existing roads, and accounts for real-world routing and existing equipment locations.[43]

Based on these and other examples,[44] the Commission can conclude that state commissions are capable of implementing the types of real-world assumptions that ACS proposes in its comments, and that such models are not too complex for state commissions to implement. Although the state commissions cited here may have applied TELRIC using actual cost evidence, the Commission must still provide guidance that makes clear to states that the ILEC's actual costs are the best evidence of forward-looking costs.

After actual, current cost evidence of the ILEC, the next most reliable evidence of forward-looking costs might be what another, similarly situated carrier has to pay for the same labor and materials that go into the UNE pricing model.[45] As ACS points out in its comments, these costs have less relevance than the ILEC's actual costs, but could be a useful reference point, if such a carrier exists.[46] National averages, and cost predictions produced by models based on national average inputs, are far less reliable than either of these two sources because they bear no relation to the subject ILEC's real-world attributes. Finally, at the bottom of the list, the least reliable evidence of a forward-looking cost should be an expert's unsubstantiated opinion on what the cost should be. Unless such opinion testimony is supported by documented

[43] BellSouth Comments at 14, 23.

[44] *See, e.g., Verizon Virginia Arbitration Order* at ¶¶ 32, 55-56 (rejecting a full replacement model).

[45] ACS Comments at 34; Qwest Comments at 21; *see also*, Competitive Enterprise Institute Comments at 8.

[46] ACS Comments at 34.

evidence, evidentiary proceedings that are dominated by this type of evidence is likely to "disintegrate into protracted and expensive battles between experts and consultants."[47]

III. THE ULTIMATE GOAL OF TELRIC PRICING IS TO PROMOTE FACILITIES BASED COMPETITION SO THAT MARKET-BASED PRICES NEGOTIATED BY THE PARTIES MAY EMERGE

ACS was not the only party to comment on the failure of below-cost UNEs to promote the competitive goals of Section 251 of the Act. Below-cost UNE rates send inaccurate price signals to the market, which result in artificially depressed incentives for CLECs to deploy their own facilities.[48] Other commenters recognize that the Commission has stressed the importance of encouraging CLECs to build their own facilities or migrate toward facilities-based entry.[49] Further, UNE rates must allow ILECs to recover their costs so that they are able to finance capital investments in the network.[50] Without the opportunity to recover its investment in the network, "there is little incentive for the incumbent LEC to invest or even maintain the current network."[51]

Experience bears out that UNE rates that are set below the actual forward-looking cost of the ILEC in question not only discourage investment in facilities by both the ILEC and the CLECs, but also subsidize the economically inefficient entry of CLECs who would otherwise be unable to sustain operations.[52] USTA's comments cite investment analysts' conclusions that "TELRIC has deterred new facilities investment by competitors and devalued existing investment for all facilities-based carriers including ILECs, large and small, across the

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[47] USTA Comments at 8-9.

[48] SBC Comments at 9.

[49] *See, e.g.,* SBC Comments at 9; Communications Workers of America Comments at 6.

[50] Communications Workers of America at 5.

[51] Welsh Group, LLC Comments at 2.

[52] SBC Comments at 10-11; Communications Workers of America Comments at 7.

country."[53] Further, Verizon cites to investment reports that describe the substantial decline in overall investment in networks by wireline telecommunications carriers.[54] The comments of USTA and Verizon confirm ACS's experience in Anchorage, Fairbanks and Juneau, where the company has been forced to reduce the amounts allocable to the maintenance of network facilities and capital spending.[55]

However, some commenters have ignored the basic goals of TELRIC. CompTel and Ascent, in their joint comments, assert that TELRIC would still be appropriate even if there were deeply rooted competition because TELRIC is designed to send the same investment signals to the market that would be sent in a fully competitive marketplace.[56] However, TELRIC was not meant to be used to set prices indefinitely. In a fully competitive marketplace, prices would be set by the market, not by a regulatory regime;[57] "no regulatory regime can substitute for a real market process."[58] Given the stated goals of facilities-based competition, competitors should have an incentive eventually to leave the ILEC's network and serve customers using their own facilities. Where competition in the market is increasing, therefore, TELRIC rates should not remain static. As discussed below, forward-looking assumptions, particularly those addressing the cost of capital and depreciation, must be corrected to account for any changes in the levels of competition that were not contemplated at the time UNE rates were established, so that proper entry signals are maintained.

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[53] USTA Comments at 2.

[54] Verizon Comments at 9.

[55] *See* ACS Comments at 12.

[56] CompTel Joint Comments at 5.

[57] Competitive Enterprise Institute Comments at 6.

[58] *Id.* at 3.

IV. UNE RATE CHANGES ARE APPROPRIATE TO REFLECT CHANGING MARKET CONDITIONS

While many parties agree with the Commission's proposition that UNE rates need to be adjusted over time, the comments largely favor a periodic review by the state commissions of market conditions, rather than an automatic true-up mechanism or productivity factor.[59] The Commission should direct states periodically to revisit rates and adjust them to reflect actual market conditions as competition in the market evolves. In doing so, the Commission should alert states that action is warranted where facilities investment is not being encouraged. ACS requests in its comments that the Commission require states to revisit UNE rates every three years.[60]

Some of the comments by CLECs cite examples of markets in which they claim that TELRIC has promoted investment.[61] While this may be true in some areas, in others such as Anchorage, Fairbanks and Juneau, where ACS has experienced significant losses in market share, current UNE prices have decreased ACS's and its competitors' incentives to invest in the network.[62] Although GCI has its own switching and transport facilities in Anchorage and has never leased these as UNEs from ACS, GCI has recently expressed interest in ordering UNE-P in Anchorage at the below-cost rates set by the RCA.[63] Similarly, although GCI has its own switching and transport facilities in Fairbanks and Juneau, it continues to rely on below-cost UNE-P where it is more economic than using its own facilities. As other markets see increasing competition, they could more closely resemble ACS's markets. For example, Communications

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[59] *See*, *e.g.*, Sprint Comments at 22-23; NY DPS Comments at 13-15; AT&T Corp. Comments at 128.

[60] ACS Comments at 48.

[61] CompTel Joint Comments at 4.

[62] ACS Comments at 7, 11.

[63] *See id.* at 7.

Workers of America cite projections that indicate that BOCs could lose 16 percent or more of their primary access lines to voice-over-Internet protocol ("VoIP") provided over cable facilities in the next five years.[64] Therefore, the Commission should provide guidance for markets with higher levels of competition, as ACS proposes here and in its initial comments.

The Commission should set guidelines that will help states identify competitive market conditions that would warrant adjustments in UNE prices. For instance, mature competition, the presence in the market of a CLEC with resources that are comparable to the ILEC's, and a CLEC's announced intention to deploy its own facilities, should inform the state commission that UNE prices should be adjusted to account for higher risk due to the competitive environment.[65] Such a requirement would better align UNE rates with the forward-looking realities of the market.

V. SPECIFIC COST INPUTS

ACS urges the Commission to provide guidelines on the specific cost inputs identified in the NPRM consistent with ACS's comments in this proceeding. As described above, many commenters agree that forward-looking costs should be based on real costs that relate to the market and location in which the ILEC's network exists. However, this practice is by no measure ubiquitous. While some states may have made the correct assumptions, without guidance, TELRIC will not be properly applied on a widespread basis without clear national rules. As ACS detailed in its comments, the RCA has not properly applied TELRIC in Alaska, and this has resulted in improper entry signals to competitors, and reduced infrastructure investment by ACS. In this section, ACS responds to a number of specific comments regarding

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[64] Communications Workers of America Comments at 4.

[65] ACS Comments at 14; *see also*, Competitive Enterprise Institute Comments at 12.

specific cost inputs, and respectfully refers the Commission to ACS's initial comments, in which many of these issues were addressed.

A. Network Routing, Construction, Technology

In its initial comments in this proceeding, ACS requests that the Commission clarify that UNE prices must be based not only on the actual location of the wire centers, but also on the actual location and conditions of network routes. Prices must also account for any costs specific to the geographic location of the ILEC's network, including not only topography and climate, but also the costs of complying with state and local regulations.[66] Many of the comments support the adoption of these types of guidelines and offer similar types of proposed guidance. Covad agrees that real-world network attributes that any carrier would face and that are outside the ILEC's control should be factored into forward-looking costs.[67] Physical attributes of the geographic area in which the ILEC's markets are located, that would cause higher or lower construction costs, would be included in this category, as would any costs associated with compliance with construction codes and standards required by the locality or the state. When applying TELRIC, "the facts of the physical world are not ignored. It is not part of TELRIC to assume terrains are flat when they are mountainous, or sand when they are paved."[68] While some states have considered these types of cost adjustments, in Alaska, the RCA has ignored these cost differences in establishing below-cost UNE rates.[69]

Sprint also asserts that while forward-looking costs are to some degree hypothetical, the TELRIC methodology, as generally applied, is (or should be) grounded in

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[66] ACS Comments at 35.

[67] Covad Comments at 7.

[68] MCI Comments at 21.

[69] *See* ACS Comments at 5-6.

actual networks and actual network design. Sprint indicates that its own cost studies "reflect not merely the actual location of ILEC wire centers, but also real-world customer locations; real-world wire center boundaries; real-world cable routing along actual streets and over actual terrain, topography, and obstacles; . . . real world construction costs in the relevant market; and real-world vendor costs."[70] Sprint agrees that the "use of pertinent, documented, current data is fully consistent with TELRIC and yields the fairest and most efficient possible results."[71]

Further, the ILEC's existing network routes should be used in the hypothetical network model. The Commission should presume that the existing network routes are the most efficient for a ubiquitous network that was designed to meet carrier-of-last-resort and service quality obligations.[72] Any model that assumes the replacement of the entire ILEC network would dramatically increase the cost of capital and shorten depreciation lives, resulting in UNE rates that are artificially high.[73] Instead, using the existing network routes would ensure that rates fully capture the scale economies that the ILEC has achieved.[74]

B. Structure Sharing

Despite the CLECs' comments supporting the Commission's proposal to use real-world attributes, some still insist that forward-looking costs should reflect opportunities to optimize structure sharing that are not likely to exist in the real world. The comments of a CLEC coalition in this docket ("CLEC TELRIC Coalition") indicate that it believes there are "significant opportunities to optimize structure sharing percentages in a competitive

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[70] Sprint Comments at 11.

[71] *Id.* at 11-12.

[72] SBC Comments at 25.

[73] *Id.*

[74] *Id.* at 57-58.

marketplace," but notes that these opportunities are more prevalent in greenfield situations.[75] However, most markets are not greenfield; the Commission should instruct states to maintain structure sharing assumptions that are realistic for the market in question, so that costs are not artificially lowered based on efficiencies that could never be achieved in the real world. Forward-looking costs for structure sharing also should reflect current market conditions based on actual market evidence that occurs in both developed and greenfield areas.[76]

C. Fill Factors

ALTS and Covad have proposed that fill factors reflecting efficient levels of spare capacity should assume only enough spare capacity to allow operational flexibility.[77] Likewise, the CLEC TELRIC Coalition argues that the Commission should reject use of actual fill levels because such levels may reflect inefficient levels of spare capacity.[78] What these proposals fail to consider, however, is that ILECs are charged with carrier-of-last-resort ("COLR") responsibilities. As the COLR, the ILEC must be capable of providing, operating and maintaining lines to all customers in the market whether or not doing so is economically efficient. CLECs and intermodal competitors bear no similar obligation.[79] UNE rates should reflect the costs to the ILEC of maintaining customer lines in a manner that allows the offering of service to all customers. Even when a facilities-based competitor captures the ILEC's lines, the ILEC cannot reduce its capacity; those facilities already have been built and must be maintained. If the customer were ever to return to the ILEC, the ILEC would be required to

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[75] Broadview Networks Inc. Joint Comments at 83.

[76] Qwest Comments at 34.

[77] ALTS Comments at 11-12; Covad Comments at 11.

[78] Broadview Networks Inc. Joint Comments at 84; *see also*, Covad Comments at 11; ALTS Comments at 12.

[79] BellSouth Comments at 7.

serve that customer. On the other hand, CLECs are able to cherry-pick the most profitable customers and leave the remainder to the incumbent carriers with the COLR burden.[80] UNE-based competitors benefit from having customer lines available and well-maintained when and if they win the customer from the ILEC. Thus, UNE prices should be set at levels that reflect the realities of the ILEC's COLR obligations. It is necessary for the Commission to establish a demand factor, in addition to the fill factor, as ACS proposed in its comments.[81]

D. Cost of Capital

There is considerable support in this proceeding for a TELRIC-based cost of capital that reflects the risks of a competitive market.[82] For example, the NY DPS has indicated that it has established UNE rates that reflect the real world risks to Verizon as the market evolves into a competitive environment.[83] While state commissions still can have discretion to set the appropriate cost of capital to reflect the level of competition in the markets of the particular state, ACS continues to urge the Commission to establish a floor of 11.25% rate of return, with higher rates for areas with greater competition.[84] This proposal still leaves state commissions discretion to determine the appropriate cost of capital, while ensuring that rates reflect the increasing risk of competition.

Allegiance Telecom, in their joint comments, argues that cost of capital should be applied separately to each type of unbundled facility because the risk assumptions for each are

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[80] *Id.* at 7-8.

[81] *See* ACS Comments at 38-39.

[82] *See, e.g.,* NY DPS Comments at 9.

[83] NY DPS Comments at 10.

[84] ACS Comments at 41.

different in a competitive market.[85] ACS disagrees with Allegiance's proposal because it does not reflect the reality of how a company's cost of capital is determined. Investment risk is based on the economics of the entire company, and thus, is equally allocated to all capital investments. This is particularly true in telecommunications where virtually all capital is raised through company financings rather than project financings. Applying different risk assumptions to different network elements is not a meaningful distinction for the market, and the Commission should reject Allegiance's proposal. However, in its comments, Allegiance cites loops as an example of facilities with high entry barriers.[86] On this basis, Allegiance assumes that there is a minimal risk of stranded investment for loop plant. Even if the Commission adopts the approach that Allegiance proposes for cost of capital assumptions, however, the Commission should also warn states that where the risk of stranded investment is high, the cost of capital input should reflect such increased risk. In ACS's markets, GCI has aggressive plans to roll out its cable telephony platform, on which it would move a majority of its customers from ACS's loop facilities.[87] In markets such as this, where the risk of stranded investment is imminent, the cost of capital should be assumed to be much higher as well.

AT&T prematurely concludes that there is no longer any risk of facilities-based competition after the Commission's decision in the *Triennial Review Order* to limit unbundling of network elements.[88] AT&T offers extensive analysis based on the premise that the impairment standard adopted in the *Triennial Review Order* "requires incumbents to unbundle network elements only when the likelihood of significant facilities-based entry is remote," and

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[85] *See* Allegiance Telecom Comments at 30.

[86] *See id.*

[87] ACS Comments at 7, Exhibit B at 22.

[88] *See* AT&T Comments at 88.

that "UNEs will be provided only when the competitive risk of facilities-based competitive entry is virtually non-existent."[89] However, in practice, state commissions have not followed this interpretation (nor do they appear to intend to implement the unbundling requirements in such a limited manner). In Alaska, there is still much to be determined in applying the *Triennial Review Order* despite the fact that ACS faces a competitor that has garnered over 45% of the market share in Anchorage and uses predominantly its own switching and transport facilities to serve all of those customers.[90] This competitor, GCI, is also on the verge of deploying cable telephony over its own existing cable network facilities, which reaches 95% of the homes in the state.[91] Nonetheless, ACS is still obligated to provide UNEs to GCI, and it is up to the RCA to determine how long some of that obligation will remain in place.[92] Despite AT&T's characterization of the impact of the *Triennial Review Order*, the risk of stranded investment remains high and must be given consideration in such cases.

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[89] *See id*. at 90.

[90] Declaration of Frederick W. Hitz, III, *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, CC Docket 01-338, at 2 (filed April 5, 2002).

[91] Prefiled Testimony of Dana L. Tindall, Senior Vice President, General Communication Inc., Before the United States Senate Committee on Commerce, Science and Transportation, Communications Subcommittee, Hearing on the Current Status and Future of the Universal Service Fund, at 3 (April 2, 2003).

[92] The obligation to provide UNEs upon request has been suspended in ACS's rural markets. *See ACS of Alaska, Inc. v. Regulatory Comm'n of Alaska,* Supreme Court No. S-10466, Opinion No. 5762 (Alaska Dec. 12, 2003) (reversing the RCA's decision terminating ACS's rural exemption in the Glacier State Study Area); Petition *by GCI Communications Corp. for Termination of the Rural Exemption and Arbitration With PTI Communications and Alaska, Inc./Telephone Utilities of Alaska, Inc./Telephone Utilities of the Northland, Inc., under 47 U.S.C. §§ 251 and 252 for the Purpose of Instituting Local Exchange Competition*, U-97-82 (15), U-97-143 (15), U-97-144 (16), Order Granting, In Part, the ACS Rural Companies' Motion For Interim Relief (Reg. Comm'n of Alaska, Jan. 16, 2004).

E. Depreciation Expense

As ACS explained in its initial comments, regulatory asset lives are not appropriate for setting UNE prices.[93] The Commission should direct state commissions to use shorter asset depreciation lives that reflect the current competitive environment. The FCC's regulatory asset depreciation lives were prescribed over ten years ago and have become obsolete. ILECs now operate in a more competitive environment than when these asset lives were established for the purpose of setting retail rates under rate-of-return regulation.[94] The monopoly environment in which these lives were established no longer exists.[95] Further, the rate of innovation and change has accelerated during the last decade. In ACS's experience, the useful lives for some equipment has decreased significantly due to the rapid changes in network technology in recent years. Therefore, the regulatory lives should be updated to reflect these developments. The Commission should direct states to use shorter service lives to reflect the risks in competitive markets, including the risk of stranded facilities.

Still, many CLECs commented that FCC asset lives are the only non-biased lives available. ACS disagrees. Many parties have advocated use of asset lives established under generally-accepted accounting principles ("GAAP") for financial purposes. For instance, the NY DPS indicated in its comments that it has used GAAP asset depreciation lives, recognizing that markets are increasingly competitive and that regulatory accounting should likewise move in a

[93] *See* ACS Comments at 44.

[94] SBC Comments at 51.

[95] Welsh Group LLC Comments at 10.

similar fashion to the use of GAAP.[96] Such an approach would more accurately forecast costs that would arise in a competitive market populated with facilities-based competitors.

F. Resale

Many commenters agree with ACS that the Commission should amend its resale pricing rules to clarify that the wholesale discount must only reflect "avoided costs," as directed by the Eighth Circuit Court of Appeals. However, some comments advise that there is no need for further guidance, as the court's interpretation of the statutory language is sufficiently clear.[97] ACS agrees with BellSouth's assertion that there is still some ambiguity regarding the standard for "actually avoided costs."[98] In fact, this proposition was proven in ACS's recent Anchorage interconnection proceeding where ACS proposed an 8.91% wholesale discount and GCI proposed a 33% wholesale discount, both purportedly based on the decision of the Eighth Circuit Court of Appeals.[99] The Commission needs to establish a clear standard. Only certain categories of costs are actually avoided in a resale arrangement, such as billing and collection costs, and only a small percentage of costs are avoided.[100] The primary nature of the costs that will be avoided are customer contact costs. When the ILEC acts as a wholesaler, some costs

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[96] NY DPS Comments at 8; *see also*, SBC Comments at 50-51.

[97] *See* Iowa Utility Board Comments at 7; PA PUC Comments at 8.

[98] *See* BellSouth Comments at 51.

[99] *See* Prefiled Direct Testimony of David C. Blessing on Behalf of ACS of Anchorage, Inc., *Petition of GCI Communications Corp. for Arbitration Under Section 252 of the Communications Act of 1996 with the Municipality of Anchorage a/k/a ATU Telecommunications for the Purpose of Instituting Local Exchange Competition*, U-96-89 at Appendix DCB-3 at 1 (filed Aug. 29, 2003) (Attached as Attachment 1); ACS Comments at Exhibit A, Prefiled Opposition Testimony of David C. Blessing on Behalf of ACS of Anchorage, *Petition of GCI Communications Corp. for Arbitration Under Section 252 of the Communications Act of 1996 with the Municipality of Anchorage a/k/a ATU Telecommunications for the Purpose of Instituting Local Exchange Competition*, U-96-89 at 30 (filed Sept. 29, 2003).

[100] *See* BellSouth Comments at 51.

actually increase.[101] The "avoided cost" standard would benefit from clarification of which categories of costs should be deemed avoided in setting the wholesale discount, so that it is set at a reasonable level as required by the court.

VI. CONCLUSION

Current TELRIC pricing practices vary widely among the states. The Commission's rules are not sufficiently detailed to ensure that UNE rates are set at levels designed to achieve the goals of the Act. ACS respectfully requests that the Commission amend its TELRIC rules to give states concrete guidelines consistent with ACS's comments and reply comments in this proceeding. ACS urges the Commission to direct states to use real-world attributes of the ILEC's network in establishing UNE rates, as described in greater detail in these reply comments and in ACS's initial comments, so they appropriately reflect the efficient forward-looking costs achievable in the market in question. The Commission also should establish priority for evidence that reflects the realities of the ILEC and its market, and discount evidence that is not based on local market information. Only through such uniform national rules can the Commission be assured that states will apply TELRIC in a way that achieves the goals of facilities-based competition. Further, state commissions should be required to revisit UNE rates no less frequently than every three years in order to determine whether UNE rates are set at levels that are reasonably designed to promote investment in facilities.

[101] *Id.*

Respectfully submitted,

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