

1 Risks and Benefits

2
3 **Q. Even so, the Commission must be mindful of its responsibility to preserve reliable**
4 **service to the public by limiting risks. Does GCI risk losing money on this**
5 **experiment?**

6 A. Yes. GCI has apparently made an effort to minimize costs, and thus reduce the risks.

7 However, they have not demonstrated that this project will be profitable. In her testimony,
8 Dana Tindall claims that "The earth station network has been designed to provide state-of-
9 the-art services with minimum installation costs and maximum reliability." [GCI, Tindall
10 Testimony, p.3.] Yet, according to GCI's response to questions raised in Appendix A of
11 Order U-95-38(1), the Company will invest a total of \$12,303,958 to set up the 50
12 demonstration sites. This amounts to approximately \$250,000 per site. The Company also
13 estimates that it will spend approximately \$3,200,000 in operation and maintenance
14 expenses during the first full year of the demonstration. Although GCI can afford risks of this
15 magnitude, these are fairly large numbers for a relatively limited market.

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17 There is, of course, a mitigating factor. The equipment in question is largely fungible and
18 transportable. Hence, the full cost of this demonstration would therefore not be at risk if GCI
19 is unable to generate enough revenue to justify continuation of the project. To the contrary,
20 if some of the sites prove to be financially unsuccessful, GCI would be able to salvage some
21 of its investment by transporting the equipment to other sites (e.g, in larger markets).

22 Similarly, if the Commission were to conclude that some of the sites do not merit continued
23 competitive provision, and thus required GCI to exit the market at certain locations, the
24 equipment could potentially be relocated to another site which is more appropriate for
25 permanent competitive provision. I will have more to say on this point later in discussing the
26 conditions that the Commission should impose on GCI in return for the grant of the waiver.

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28 Furthermore, the amount of GCI's investment should be considered in context. For years,
29 GCI has claimed that it can provide reliable communication services in rural Alaska at lower

1 cost than Alascom. This demonstration project gives GCI the opportunity to support these
2 claims with hard evidence. While \$12 million is a substantial sum, it is a relatively small
3 amount compared with what Alascom has spent in the state. The GCI investment, for
4 example, is less than one tenth the size of Alascom's recent federal transitional payments and
5 associated investment write-downs.

6
7 **Q. Have you considered how much of its investment GCI is likely to recover?**

8 A. Yes, I have. Using the Company-provided figures that I mentioned above, I have estimated
9 both the costs that GCI will incur and the amount that the Company will either save or
10 generate in revenue during the first full year of operation.

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12 Considering the full cost of the deployment of the DAMA technology, the monitoring and
13 control facilities, the upgrade to the Issaquah Earth Station, and the "additional capital costs"
14 that GCI has included in its estimate, GCI will incur a total capital cost of \$12,303,958.
15 [Duncan Exhibit RAD-4.] An annual cost factor that accounts for such items as depreciation
16 and the cost of money must be applied to this figure. Using a total annual cost factor of about
17 20%, (which is comparable to the factor many companies use for various types of telephone
18 plant) the annual cost associated with capital investment equates to approximately \$2.5
19 million per year.

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21 Beyond these costs, GCI estimates that it will incur operations and maintenance (O&M)
22 costs of \$3,200,000 during the first full year of operation. [Duncan Exhibit RAD-4.] As
23 described by the Company, this amount covers the cost of such things as transponder,
24 airplane insurance, corporate overhead, and access charges paid to local exchange
25 companies. It apparently includes both intrastate and interstate costs, but does not include
26 costs specifically related to any private line services which may be provided as a result of
27 this network expansion.

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1 Adding the O&M cost to the annual carried cost, GCI's total cost for this project during its
2 first full year of operation is around \$5.7 million. Of course, operating costs may decline over
3 time.

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5 There are several potential benefits to GCI that can serve to offset this cost. First, the
6 Company will save on wholesale rates that it would otherwise pay Alascom to carry its
7 existing traffic. Second, the introduction of higher quality service will encourage stimulation of
8 traffic, which will yield additional revenue for GCI. Third, the enhanced quality of service
9 and physical presence may allow GCI to increase its share of the existing market, also
10 generating revenues for GCI. Fourth, GCI will be better able to serve private line customers
11 in these areas.

12
13 According to Dara Tindall's testimony, "all of the Bush locations account for only 20% of
14 Alascom's traffic...GCI is proposing to serve about 1/4 of the remote sites." [Tindall
15 Testimony, Page 9.] Using this information and data concerning total Alaska toll minutes, I
16 have estimated that GCI currently carries roughly 2.6 million minutes of intrastate traffic at
17 these sites. Using current Alascom tariffed wholesale rates, weighted by time of day, I have
18 estimated that GCI will save roughly \$500,000 in intrastate wholesale payments to Alascom
19 for existing traffic which will be carried by its proposed facilities.

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21 Using the same methodology described above to determine the total minutes from these
22 sites, I have estimated the total intrastate market at these 50 sites to be around 16 million
23 minutes per year. Due to enhanced service it can be anticipated that new traffic will be
24 generated at these sites. Assuming a stimulation factor of 10%, total intrastate market at the
25 50 sites will rise to around 17.5 million minutes. If one were to assume that GCI could
26 capture as much as 40% (or slightly more than double its current share) of this market, the
27 Company could carry around 4.4 million new minutes of intrastate traffic each year. Using a
28 combination of toll rates from GCI's intrastate tariff, and estimates of the percentage of traffic
29 carried across short- and long-haul routes at various times of the day, I have estimated a

1 weighted average retail rate of approximately 24 cents per minute. Multiplying this figure by
2 the new traffic which GCI could gain yields an increase in intrastate revenues of
3 approximately \$1,060,000 per year.

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5 Adding this amount to the anticipated wholesale savings yields around \$1.6 million in benefits
6 to help offset the \$5.7 million annual cost.

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8 Of course, GCI will receive other benefits, as well. For instance, it may increase its interstate
9 revenues at these locations, and it may reduce its wholesale interstate costs. Similarly, the
10 Company may generate additional revenue from private line voice circuits, and it may
11 generate additional revenues from video, computer, or other enhanced private line services
12 as a result of this network expansion. I do not have an independent basis for estimating these
13 non-jurisdictional benefits, but it would not be implausible for these non-jurisdictional
14 benefits to exceed the intrastate benefits. For example, according to the Company's 10-K,
15 during 1994 its interstate billable minutes exceeded its intrastate billable minutes by a ratio of
16 approximately 5 to 1.

17
18 Presumably, GCI believes the total benefits of the project outweigh the total costs, or they
19 wouldn't be going forward with it. However, even if the direct benefits (revenues and
20 savings) do not exceed the costs, GCI may be willing to withstand a shortfall, if the project
21 yields other, less direct benefits. For instance, this project may enhance its image as a state-
22 of-the-art, full service, statewide carrier. If this project improves GCI's image in the
23 marketplace, it may help it increase or maintain its market share in Anchorage and other
24 more densely populated sections of the state. In any event, it is fair to say that there is no
25 guarantee that this demonstration project will prove to be financially successful from GCI's
26 perspective.

27
28 **Q. Have you considered changes to the bulk bill in the event that this demonstration is**
29 **approved?**

1 A. Yes, to a limited extent. If GCI is able to increase its share of the intrastate market, or if it
2 stimulates increased traffic, (e.g., because the DAMA technology provides better quality,
3 and therefore people are willing to spend more time on the phone), one would expect GCI's
4 share of the bulk bill to increase, thereby reducing the burden on Alascom. We requested
5 information from GCI concerning such changes. In response to Staff Interrogatories No. 1
6 and No. 2, the Company responded that it was certain that the bulk bill would change and
7 that GCI's share would rise. The Company stated that it had not attempted to calculate the
8 specific effect on the bulk bill payment; however, the Company did provide a weighted
9 average bulk bill cost per minute for each mileage band which GCI states that it used as a
10 component of the access charge associated with all new traffic that would result from this
11 demonstration project. Assuming GCI's share of the market increases by 4.4 million
12 minutes, its share of the bulk bill payments would increase by roughly \$330,000 (based upon
13 7.5 cents per minute).

14
15 **Q. What about the risks to Alascom?**

16 A. The primary concerns regarding Alascom are the effect of decreased wholesale revenues
17 from the sale of services to GCI, and the potential impact of a reduction in its retail revenues
18 if GCI gains a larger share of the existing market, due to higher quality. Both are valid
19 concerns, which would weigh heavily if the total dollars at risk were great enough. However,
20 the limited scope of this demonstration project limits the downside risks for Alascom.

21
22 Furthermore, GCI's proposal is not entirely a zero-sum game, with benefits to GCI being
23 exactly offset by detriments to Alascom. With GCI's new technology, it will not simply be
24 given a greater opportunity to compete with Alascom for current intrastate toll customers. In
25 addition, GCI will provide data-on-demand and other services that Alascom is currently
26 incapable of providing. Applications such as Distance Learning and Video Conferencing will
27 be available, as well as greatly improved service for fax and computer modems. Of course,
28 higher voice grade service will encourage some customers to switch toll carriers. But,
29 improved quality may also induce customers to spend more time on the phone. Instead of

1 just taking a large slice of the current pie, GCI will actually get a larger share of a larger pie.
2 Ms. Tindall addresses this prospect in her testimony:

3
4 GCI strongly believes that the stimulation that will result in rural Alaska from the installation
5 of these facilities will be far greater than the large stimulation that has occurred in other
6 markets. The reason is that high quality service will be available for the first time. [GCI,
7 Tindall testimony, p. 10.]

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9 Further, as Ms. Tindall notes in her testimony,

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11 all of the Bush locations account for only 20% of Alascom's traffic, so even if GCI got 50%
12 of the market, Alascom would lose only 10% of its overall traffic. In regards to GCI's
13 present application, GCI is proposing to serve about 1/4 of the remote sites, so the effect is
14 further reduced. [GCI, Tindall Testimony, p. 9.]

15
16 Even if GCI were to handle 80% of the existing traffic in these 50 locations, the
17 demonstration project would only result in about a 4% reduction in overall traffic for
18 Alascom. While such an extreme swing in market shares would reduce Alascom's profits,
19 the impact would not be severe. Furthermore, this ignores traffic stimulation effects. To the
20 extent the overall size of the market increases, this would partially, or fully, offset the impact
21 of the GCI project on Alascom. I therefore conclude that allowing the project to go forward
22 would not materially affect Alascom's rates.

23
24 **Q. Have you considered the benefits and risks to subscribers in the designated**
25 **communities?**

26 A. Yes, I have weighed both the risks to these ratepayers and the benefits that might accrue to
27 them. It is certainly possible that after the minimum allowed period of deployment (an issue I
28 address later in my testimony) GCI might decide to pull out of some or even all of its
29 demonstration sites. This might create problems for subscribers who bought expensive

1 equipment or made costly commitments in expectation of permanent service from GCI.
2 These risks can appropriately be mitigated by requiring GCI to disclose the potentially
3 temporary nature of its deployment and by insisting that GCI provide advance notice before
4 termination of service at a site. However, I do not believe the risks should be completely
5 eliminated (e.g., by invoking the public interest provisions of 3AAC 52.365). I don't think
6 GCI should be guaranteed the permanent right to operate at these locations, regardless of
7 what is learned from this experiment. Under these circumstances, to ensure that GCI's risks
8 are manageable, I don't think it should be forced to provide service on a permanent basis.
9 For example, if its costs greatly exceed the projected level, GCI should be given the
10 opportunity to abandon the service after a reasonable period (e.g., two years).

11
12 I would note, however, that if the experiment is as successful as GCI clearly expects it to be,
13 then the improved quality of service and expanded offerings will stimulate usage in the
14 demonstration areas. If it is extremely successful, then GCI may emerge as the dominant
15 carrier in some or all of these markets. Were this to occur, GCI should understand that it
16 may be required to assume the responsibilities of a dominant carrier, including the carrier of
17 last resort obligations.

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19 When the risks and costs to society are weighed against the benefits--including improved
20 quality and increased reliability due to the presence of redundant facilities), the benefits
21 appear to substantially outweigh the risks.
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