

1 **IV. PTIC's "Cherry Picking" Arguments**

2

3 **Q. Let's turn to the fourth section of your testimony. The PTIC "lost support"**
4 **calculations you have been discussing are based upon a uniform 36%**
5 **penetration assumption. However, Mr. Smith alludes to other problems which**
6 **might arise if GCI's market penetration isn't uniform, does it not?**

7 A. Yes. PTIC suggests that the impact could be worsened, if GCI engaged in "cherry
8 picking" or achieved different penetration rates in different markets. Specifically, Mr.
9 Smith states:

10

11 [M]y instinct tells me that GCI is more likely to go after and capture
12 customers in the more dense service zones, business rather than
13 residential customers, and customers who generate more than average
14 access minutes. If any of these suspicions were true, it would magnify
15 the impact on universal service. [pp. 29-30]

16

17 **Q. Do you agree with PTIC that GCI may try to capture customers in the more**
18 **dense zones?**

19 A. I agree that, assuming all other factors are equal, GCI may have an incentive to initially
20 concentrate its growth efforts in urban areas. GCI is likely to experience lower internal
21 costs per line in urban areas, and GCI may find it easier to market its services in urban
22 areas. Hence, there might be some tendency for GCI to penetrate dense zones more
23 quickly, or to a greater extent, than the less dense (rural) zones. However, PTIC has
24 not quantified the extent to which this might occur, nor has it demonstrated that a
25 differential pattern of market penetration would adversely affect its profits to any
26 significant extent. To the contrary, PTIC has only offered a single impact estimate,
27 corresponding to a perfectly uniform rate of penetration across all zones.

1 Furthermore, PTIC has assumed UNE prices will be averaged across zones.
2 This type of price structure does not provide any added incentive for GCI to target the
3 denser zones. In other words, mandatory rental of unbundled loops, *per se* does not
4 provide any incentive for GCI to target dense zones. Furthermore, PTIC ignores the
5 fact that telecommunications services are necessarily offered across broad geographic
6 areas. Even if GCI wanted to target the customers closest to its wire centers, it will
7 probably find it necessary to offer service throughout the entire exchange, and it will
8 undoubtedly attract many customers that it isn't specifically targeting. This natural
9 tendency to serve all zones on a somewhat uniform basis is reinforced by public policies
10 which discourage "red lining" and encourage carriers to serve customers in all zones.
11 For instance, federal universal service support is an important revenue source to PTIC,
12 and it can be an equally important source of revenues for GCI. To qualify for this
13 funding source, GCI will need to meet the criteria for an "eligible carrier." These criteria
14 are established by regulators, and they preclude a carrier from totally focusing its
15 attentions on zone 1 customers, or refusing to serve customers in zones 4 and 5:

16
17 **§ 54.201 Designation of eligible telecommunications carriers,**
18 **generally.**

19
20
21 (b) A state commission shall upon its own motion or upon request designate a
22 common carrier that meets the requirements of paragraph (d) of this section as
23 an eligible telecommunications carrier for a service area designated by the state
24 commission.

25

26
27 (d) A common carrier designated as an eligible telecommunications carrier
28 under this section shall be eligible to receive universal service support in
29 accordance with § 254 of the Act and shall, throughout the service area for
30 which the designation is received:

1 (1) offer the services that are supported by federal universal service support
2 mechanisms under subpart B of this part and § 254(c) of the Act, either using
3 its own facilities or a combination of its own facilities and resale of another
4 carrier's services (including the services offered by another eligible
5 telecommunications carrier); and

6
7 (2) advertise the availability of such services and the charges therefore using
8 media of general distribution.
9

10 **Q. PTIC suggests that GCI is more likely to go after business customers. Do you**
11 **agree?**

12 A. Yes. Business customers pay higher rates, and generate higher revenues (and
13 potentially more profits) per account. This creates an incentive for GCI to make an
14 extra effort to win business accounts, holding all other factors equal. I would also agree
15 that if GCI captures more than 36% of the business market using UNEs, the reduction
16 in PTIC's profits would be higher than if it achieves a uniform 36% penetration of both
17 business and residence markets. This follows directly from the fact that the reduction in
18 revenues is somewhat greater when PTIC loses a business customer to GCI than when
19 it loses a residential customer, while the UNE rental income will be the same per line in
20 either case.

21 However, the mere fact that GCI has an incentive to target business customers
22 doesn't necessarily indicate that it will be more successful in convincing them to buy
23 their local service from GCI. Inertia and resistance is likely to be greater for business
24 customers. Their telecommunications bills are typically more complex, and they may be
25 reluctant to expend the time and effort required to analyze the effect of changing
26 carriers. Moreover, uninterrupted, flawless telephone service is absolutely vital to most
27 businesses, and they may be unwilling to risk disrupting their business by changing local
28 carriers.

1 Consequently, even if GCI is more likely to go after business rather than
2 residential customers, that doesn't mean they will be more successful in capturing these
3 customers. In fact, GCI's experience in Anchorage suggests the direct opposite.
4 GCI's response to PTIC's Interrogatory 4 indicates that over the first 24 months, GCI
5 captured a larger percentage of the residence market than the business market.
6 Furthermore, GCI is serving over 90 percent of its residence lines with unbundled
7 loops, while it is serving just 73 percent of its business lines with UNEs. In other
8 words, the primary effect of renting unbundled loops is to make it easier for GCI to
9 serve residential customers. GCI will be able to provide local service to many of its
10 business customers regardless of whether or not it is allowed to rent loops from the
11 incumbent LEC. If one focuses on unbundled element competition, as Mr. Smith claims
12 to be doing, the Anchorage data suggests that purchases of unbundled loops are more
13 likely to be skewed toward the residence market. If the uniform penetration
14 assumption proves to be invalid in PTIC's service territory, and GCI captures
15 proportionately fewer business lines than residence lines using UNEs, the adverse
16 impact of UNE rentals on PTIC's profits will be lower than Mr. Smith has estimated
17 using his uniform penetration assumption. This follows directly from the fact that the
18 reduction in revenues will be somewhat smaller if PTIC loses proportionately fewer
19 business customers, while the UNE rental income will be the same per line regardless of
20 the mix of business and residence customers.

21
22 **Q. Do you agree with Mr. Smith that GCI is more likely to go after customers who**
23 **generate more access minutes?**

24 **A.** Yes. High volume toll users are especially important to GCI; these are their best
25 customers, generating the highest toll revenues. GCI has a particularly strong incentive

1 to convince these customers to switch to GCI for their local service, thereby making it
2 less likely that they will subsequently switch their toll service to PTIC or another toll
3 carrier. However, PTIC didn't quantify, or demonstrate, any specific problems would
4 arise if GCI's market penetration is higher amongst high volume toll users. PTIC has
5 only offered a single impact estimate, corresponding to a uniform penetration rate
6 across all types of customers. Mr. Smith implied that the impact would be exacerbated
7 if it loses higher volume toll customers, but he didn't specifically quantify the extent to
8 which this might be a problem. Logically, one can see that the reduction in access
9 revenues would be higher per line, if the customers lost to GCI had higher than average
10 volumes of toll traffic. However, the switching and other costs of serving these high
11 volume customers will also be higher than average. After netting the higher level of
12 avoided switching costs against the higher level of lost access revenues, the net impact
13 may not be much different than if GCI were to attract a perfectly uniform mix of
14 customers, as Mr. Smith has assumed.

15 In this regard, it is important to recognize that the non-traffic sensitive (NTS)
16 portion of PTIC's access revenues will not decline precipitously if it loses high volume
17 toll customers to GCI. Within the intrastate jurisdiction, recovery of NTS access costs
18 is achieved on a flat per line basis. Similarly, in the federal jurisdiction recovery of NTS
19 costs is achieved through a flat per line charge imposed on long distance carriers, called
20 a "PICC." Accordingly, PTIC's recovery of loop related access charges will tend to
21 vary with the number of access lines it serves, rather than the number of access minutes
22 it provides. There is no reason to assume that a disproportionate loss of high volume
23 toll customers to GCI will have a disproportionately adverse impact on the NTS related
24 access revenues received by PTIC.