

## II. *WHY PTI'S RURAL EXEMPTIONS SHOULD BE TERMINATED*

**Q. Please turn to the second section of your testimony, addressing in turn each of these basic questions. First, in your opinion, would termination of the exemptions of these three PTI companies be economically burdensome for PTI?**

A. No, in my opinion, it would not. In the first place, under the Commission's Order U-97-143(1), termination of the exemptions simply sets in motion the process by which PTI might eventually be required to meet the conditions of §251(c). Termination of the exemptions simply creates a path towards competition, but it does not in itself determine the extent to which competition will be allowed, nor the specific rules under which PTI and its competitors will operate. Hence, termination of the exemption does not impose an economic burden on PTI.

In fact, after removing the exemption, the Commission might subsequently conclude that certain provisions of the Telecom Act should be suspended for several years, or that they should not apply to some of the most rural portions of PTI's service territory. Similarly, it might modify the provisions of the Telecom Act to tailor them more appropriately to exchanges which include a mixture of high cost and more nearly average cost areas. The Commission can use the suspension and modification process, in conjunction with its ongoing rulemaking efforts, to examine the issues in detail, and to carefully consider the potential economic consequences of alternative policies designed to implement the intent of the Telecom Act in the context of the Alaska market.

Since this Commission is fully aware of the unique circumstances applicable to rural Alaska, there is no reason to assume that it would blindly apply the same rules to native villages that apply to Denver, Newark or Anchorage. In my opinion, there is no reasonable basis for assuming that the Commission will be unable, or unwilling, to craft rules which appropriately open markets to competition where feasible, while protecting universal service and ensuring that its rules do not impose an undue economic burden on PTI.

There are some costs which will undoubtedly arise if the exemption is lifted: PTI will be required to negotiate with GCI, and it will most likely need to participate in additional proceedings before the Commission. However, these costs will not be unduly burdensome for PTI, given its large number of customers and relatively strong financial backing. PTI complains

about being “first in the nation” to deal with implementation of competition in rural areas. But, within the context of Alaska, PTI is a relatively large entity which is well positioned to deal with the case-by-case complexities of implementing the Telecom Act in rural areas. There has been no showing that PTI cannot afford to participate in the arbitration and litigation process, or that the costs of this participation would be economically burdensome.

**Q. Second, does it appear that termination of the exemptions would be technically feasible?**

A. Yes. Although I am not an engineer and cannot speak with authority on the substance of technical requirements, there appear to be no significant technical problems that would arise through termination of the exemptions. Although there may be some potential for technical difficulties in certain specific locations, PTI has not alleged any such problems exist, nor is there any reason to assume that such problems cannot be readily resolved through the suspension/modification process, or the arbitration process.

**Q. Third, in your opinion, would the requested terminations be consistent with the universal service provisions of §254 of the Act?**

A. Yes. As an economist I see no direct economic impact of the terminations on the ability of PTI to continue providing the services it currently provides in rural and high cost areas, at the same rates it currently charges. Again, terminating the exemptions will not impose a serious threat to universal service; it will simply start the clock in a countdown toward potential local competition. Universal service can be protected, provided that the Commission and the FCC adequately deal with the many complexities associated with competition in the context of rural high cost areas. Of course, while these issues are being analyzed and resolved, it may be necessary to suspend various provisions of the Telecom Act as they apply to PTI. Furthermore, it may be appropriate to modify certain provisions, in order to help protect universal service while encouraging a movement towards effective competition. In my opinion, the primary thrust of the Commission’s efforts should be towards creating an appropriate system for supporting universal service in the context of a competitive market. It should not be concerned with limiting

the scope of competition in reaction to speculation about the potential consequences of increased competition in the absence of an appropriate set of regulatory decisions.

**Q. If the Commission terminates PTI's exemptions, what should happen next?**

A. In my opinion, following termination of PTI's rural exemptions for these three companies, the Commission should encourage PTI to submit an appropriate petition for suspension and modification, under §251(f)(2) of the Act. At that point, the various issues raised in PTI's testimony would become relevant and would need to be explored in considerable detail, as would PTI's proposed Rural Competition Plan (RCP) as presented in Table 1 of PTI's testimony in each of the dockets. Although I do not necessarily agree with the provisions of the RCP, I believe that they deserve to be debated on their merits, at the appropriate time.

**Q. If the Commission declines to terminate PTI's rural exemptions, what might be the consequences?**

A. In my opinion, granting a permanent exemption to PTI could result in a severe setback to the cause of effective local competition in Alaska. If PTI is to be completely exempt from the many provisions of the Telecom Act which are designed to encourage competition, what message will that send to the FCC, Alaskan carriers and others concerning the prospects for terminating the exemption for other, smaller, less financially strong LECs in Alaska? Furthermore, a blanket exemption approach could unnecessarily delay the emergence of competitive alternatives for some rural customers. In some markets, a blanket exemption policy may not delay or prevent competition, but it may instead encourage excessive reliance upon facilities-based competition, to the exclusion of resale and renting of unbundled elements. This would be unfortunate, particularly if facilities based competition is unduly encouraged in areas where other forms of competitive entry would be economically more efficient.

Maintaining the exemption could prevent meaningful competition through resale. Resale provisions are contained in both §251(b) [Obligations of All Local Exchange Carriers] and §251(c) [Additional Obligations of Incumbent Local Exchange Carriers]. Section 251(b)(1) states:

(b) OBLIGATIONS OF ALL LOCAL EXCHANGE CARRIERS- Each local exchange carrier has the following duties:

(1) RESALE- The duty not to prohibit, and not to impose unreasonable or discriminatory conditions or limitations on, the resale of its telecommunications services.

Section 251(c)(4) states:

(c) ADDITIONAL OBLIGATIONS OF INCUMBENT LOCAL EXCHANGE CARRIERS-

In addition to the duties contained in subsection (b), each incumbent local exchange carrier has the following duties:

(4) RESALE- The duty--

(A) to offer for resale at wholesale rates any telecommunications service that the carrier provides at retail to subscribers who are not telecommunications carriers; and

(B) not to prohibit, and not to impose unreasonable or discriminatory conditions or limitations on, the resale of such telecommunications service, except that a State commission may, consistent with regulations prescribed by the Commission under this section, prohibit a reseller that obtains at wholesale rates a telecommunications service that is available at retail only to a category of subscribers from offering such service to a different category of subscribers.

Without the additional requirements specified in section (c), the requirements of section (b) may have little or no impact on reducing barriers to entry.

**Q. Could maintaining the exemptions deprive consumers of lower rates?**

A. Yes. Despite the fact that PTI's subsidiary companies are all rural LECs, they are not equally rural, nor are all their exchanges equally high cost. According to the map attached to Mr. Bennett's testimony in each docket, all six TUA exchanges are in the vicinity of Fairbanks (2 exchanges) or Juneau (4 exchanges). PTICA's sole exchange is in Fairbanks. The 67 exchanges of TUNI are widely dispersed, and include some areas that are likely to involve very low density and high costs; however, they are not equally rural. TUNI has 17 exchanges in the Juneau-Sitka-Ketchikan area; it has nine exchanges along the Kenai peninsula and eight on Kodiak Island. Some of these serving areas may be fairly compact and may possibly be

capable of sustaining some degree of competition. While the potential for workable local competition is obvious in Anchorage, it may also be feasible in Fairbanks, Juneau, and many other parts of the state. If the exemptions are not terminated, it will be much more difficult for a competitor like GCI to install bops to provide ubiquitous service to all segments of the market—particularly residence customers. Thus a pattern of business competition may emerge, with no corresponding competitive pressures in the residence parts of these markets, to the possible detriment of residence customers.

**Q. Could retention of the exemptions lead to stranded costs for ILECs and higher costs for their residence ratepayers?**

A. Yes. As PTI witness Robert A. Smith has made clear, “competitors are free to become certified carriers in [PTI’s] service areas and to provide competing local exchange service by building their own networks.” [Direct testimony in Docket No. U-97-143, p. 4.] This is true enough, but it is not necessarily something that PTI should take comfort in. As Mr. Hitz of GCI has indicated, GCI is currently installing fiber in Fairbanks and Juneau, and GCI expects to find it economic to install distribution plant for the largest commercial customers, bypassing the distribution plant and local bops PTI has constructed to those customers, even though this means duplication of some facilities. GCI will do this where it can reasonably expect to make money. As Mr. Hitz notes, PTI will lose the revenues from this local plant, with consequent potential for upward pressure on its local rates. [Direct testimony in Docket No. U-97-82, p. 17.]

**III. *PTI’s Arguments for Retention of the Exemptions***

**Q. Please turn to the third section of your testimony. Why does PTI claim that its exemptions should be maintained?**

A. Although PTI claims that termination would be economically burdensome (if no rate relief were forthcoming) and might not be technically feasible, its principal arguments relate to the §254 provisions that safeguard universal service support. According to PTI witness Robert A. Smith, the Act deliberately exempts rural LECs

from those forms of competitive interconnection that would be most likely to disrupt the support mechanisms that make it possible to maintain affordable service to high cost customers.... TUA's customers are precisely the kind of high cost customers that Congress anticipated would be most dependent upon support mechanisms and therefore would have the most at risk with any potential erosion of that support. [Direct testimony in Docket No. U-97-143, pp. 5-6.]

This support, says PTI, is provided through higher rates for business, the federal universal service fund, and interstate and intrastate access charges; and all three sources would be threatened by removal of the exemption. [Id., p. 8.] Specifically, GCI could target business customers and could also bypass PTI's local network. PTI is also concerned about losing USF support if such support becomes portable, because it is assumed that the per line support would be the same regardless of zone.

**Q. Are PTI's concerns well founded?**

A. No. In my opinion the risks are overstated. This Commission has always shown a very high sensitivity to the needs of Alaska's rural population and has consistently worked to maintain the parity of rural and high cost areas with urban areas in both service quality and rates. Since the Commission now has open dockets investigating universal service support, access charge structure, and market structure, the issues PTI is worried about are already in the spotlight and will certainly be fully examined from every angle before they are decided.

For example, the Commission's market structure rules might not allow an entering carrier to cream-skim in an ILEC's rural service area but instead may require carriers to serve a reasonable mixture of urban and rural areas in order to be eligible for state universal service support. Similarly, there appears to be no serious prospect that the APUC will allow erosion of universal service support to rural and high cost areas--quite the opposite: the focus of much current debate is whether the level of support should be increased in recognition of a more generous definition of "basic universal service" than is used in the federal jurisdiction. Since PTI is a commenter in the Access Charge/Universal Service inquiry, PTI should be fully aware of the frame of that debate.

Nor should PTI be apprehensive regarding the portability of universal service support. The intent of the Act is to encourage telecommunications competition--whenever, however, and wherever it is economically feasible; and the portability of universal service support is a vital element in the promotion of competition in rural and high cost areas. The APUC's primary concern in this area will be to ensure that service in such areas remains reasonably priced, ubiquitous, and of high quality, not to favor one competitor over another. In short, the development of effective competition in PTI's service territories, when and if it emerges, won't necessarily prove to be a hardship for PTI. If PTI maintains or improves its service quality, cuts costs, stimulates traffic and subscribership in response to competitive pressures, the results may turn out to be as beneficial for PTI as for GCI, other competitors and customers. But if competition is to be encouraged, a reasonable first step is to lift the exemptions.

**Q. According to Mr. Smith, no rural exemptions have yet been terminated anywhere in the country. Should this be a source of concern for the Commission?**

A. Only in the sense that any precedent will attract attention and thus needs to be stated in clear and well-reasoned language. The fact that no rural carrier in the country has yet had its exemption terminated means nothing in itself--quite possibly no aspiring entrant has been quite as eager to operate in rural areas as GCI has shown itself to be.

**Q. If the Commission terminates PTI's rural exemption for the reasons you have advanced, won't that set a precedent that would expose all of Alaska's small rural ILECs to unrestrained competition?**

A, No, not at all. In fact, it should have the opposite effect. The approach I am recommending will allow the Commission to craft rules, and a case-by-case implementation of those rules, which will protect rural carriers to the extent they need and deserve such protection, without relying upon a broad, all encompassing exemption. §251(f)(2) of the Act clearly provides that a non-exempt carrier with less than a 2% share of the nation's access lines may petition its state commission for suspension and/or modification of the provisions of both §251(b) and 251(c); this provides a better mechanism for dealing with the complex issues involved with introducing

competition into rural Alaska than the exemption, since the exemption may or may not apply to §251(b) (there seems to be some disagreement concerning this point) and since the exemption provisions of the Telecom Act don't provide the Commission with any options short of the extreme approach of allowing "nothing but facilities based competition"--which could potentially lead to inefficient duplication of facilities and other consequences which are not in the public interest.

The Commission has the opportunity to use the suspension/modification provisions in order to carefully craft an appropriate set of rules of the Commission's own devising--rules that provide it with the flexibility to deal on a case by case basis with the unique circumstances facing each of Alaska's local exchange carriers. Using this approach, it should be possible to carefully distinguish rules which should apply in one part of a carrier's service territory with those that should apply to another part. The wide range of circumstances applying to TUNI's exchanges provides a perfect example of why it is appropriate to remove the exemption and then use the suspension/modification provisions to tailor a precise policy that fits each situation. In contrast, to maintain an exemption for TUNI's smallest exchanges, the Commission would need to also maintain a blanket exemption for TUNI's largest exchanges as well.

To reiterate: the lifting of PTI's exemption has two important effects: it sends a signal to the FCC and Alaska carriers that this Commission is working towards a set of policies which are consistent with the goals of the Telecom Act, and it sets the stage for a more detailed analysis of the issues within the context of a petition for suspension/modification under the 2% rule. This will provide the Commission and the parties an opportunity to work together in crafting an appropriate set of Alaska-specific rules which are tailored to the unique circumstances of the rural carriers in this state. Accordingly, I urge the Commission to grant GCI's petition to terminate PTI's rural exemption, while making it clear that it welcomes an appropriate petition from PTI for suspension and/or modification of some or all of the requirements of §251(b) and 251(c). Any proposal for suspension and/or modification should be tailored to match the unique circumstances applicable to each of the areas served by PTI.