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MEMORANDUM

TO: Docket Control

FROM: Deborah R. Scott
Director
Utilities Division

DATE: September 22, 2000

RE: IN THE MATTER OF THE APPLICATION OF GTE COMMUNICATIONS CORPORATION FOR A COMPETITIVE CERTIFICATE OF PUBLIC CONVENIENCE AND NECESSITY AUTHORIZING INTER-EXCHANGE FACILITIES-BASED SERVICES AND THE CONSTRUCTION AND OPERATION OF A COMPETITIVE INTER-EXCHANGE LONG DISTANCE TELECOMMUNICATIONS SYSTEM THROUGHOUT THE STATE OF ARIZONA. (DOCKET NO. T-03258A-00-0236)

IN THE MATTER OF THE APPLICATION OF GTE COMMUNICATIONS CORPORATION FOR AUTHORITY TO OPERATE AS A PROVIDER OF ALTERNATIVE OPERATOR SERVICES STATEWIDE IN ARIZONA. (DOCKET NO. T-03258A-97-0568)

IN THE MATTER OF THE APPLICATION OF GTE COMMUNICATIONS CORPORATION FOR A COMPETITIVE CERTIFICATE OF PUBLIC CONVENIENCE AND NECESSITY AUTHORIZING LOCAL EXCHANGE SERVICES VIA RESALE AND THE CONSTRUCTION AND OPERATION OF A COMPETITIVE LOCAL EXCHANGE TELECOMMUNICATIONS SYSTEM THROUGHOUT THE CURRENT LOCAL EXCHANGE OPERATING AREAS IN THE STATE OF ARIZONA OF U S WEST COMMUNICATIONS, INC.; AND CITIZENS UTILITIES COMPANY AND AFFILIATES. (DOCKET NO. T-03258A-97-0545)

IN THE MATTER OF THE APPLICATION OF GTE COMMUNICATIONS CORPORATION FOR A CERTIFICATE OF PUBLIC CONVENIENCE AND NECESSITY TO PRIVIDE COMPETITIVE INTRASTATE TELECOMMUNICATIONS SERVICES AS A RESELLER. (DOCKET NO. T-03258A-96-0492)

Attached is the Staff Report for the above referenced consolidated applications. The Applicant is applying for approval to provide the following services:

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- Facilities-based local services
- Facilities-based interexchange services
- Resold local services
- Resold interexchange services
- Access services
- AOS services

Staff is recommending approval of the application following a hearing.

/mgk

Originator: Marta Kalleberg
Attachment: Original and Ten Copies

2-15-01

STAFF REPORT

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

GTE COMMUNICATIONS CORPORATION
(NOW KNOWN AS VERIZON SELECT SERVICES INC.)

DOCKET NOS. T-03258A-00-0236, T-03258A-97-0568,
T-03258A-97-0545, and T-03258A-96-0492

IN THE MATTER OF THE APPLICATION OF GTE COMMUNICATIONS CORPORATION FOR A COMPETITIVE CERTIFICATE OF PUBLIC CONVENIENCE AND NECESSITY AUTHORIZING INTER-EXCHANGE FACILITIES-BASED SERVICES AND THE CONSTRUCTION AND OPERATION OF A COMPETITIVE INTER-EXCHANGE LONG DISTANCE TELECOMMUNICATIONS SYSTEM THROUGHOUT THE STATE OF ARIZONA

IN THE MATTER OF THE APPLICATION OF GTE COMMUNICATIONS CORPORATION FOR AUTHORITY TO OPERATE AS A PROVIDER OF ALTERNATIVE OPERATOR SERVICES STATEWIDE IN ARIZONA

IN THE MATTER OF THE APPLICATION OF GTE COMMUNICATIONS CORPORATION FOR A COMPETITIVE CERTIFICATE OF PUBLIC CONVENIENCE AND NECESSITY AUTHORIZING LOCAL EXCHANGE SERVICES VIA RESALE AND THE CONSTRUCTION AND OPERATION OF A COMPETITIVE LOCAL EXCHANGE TELECOMMUNICATIONS SYSTEM THROUGHOUT THE CURRENT LOCAL EXCHANGE OPERATING AREAS IN THE STATE OF ARIZONA OF U S WEST COMMUNICATIONS, INC.; AND CITIZENS UTILITIES COMPANY AND AFFILIATES

IN THE MATTER OF THE APPLICATION OF GTE COMMUNICATIONS CORPORATION FOR A CERTIFICATE OF PUBLIC CONVENIENCE AND NECESSITY TO PRIVIDE COMPETITIVE INTRASTATE TELECOMMUNICATIONS SERVICES AS A RESELLER

SEPTEMBER 22, 2000

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STAFF ACKNOWLEDGMENT

The Staff Report for the consolidated applications of GTE Communications Corporation (now known as Verizon Select Services Inc.), Docket Nos. T-03258A-00-0236, T-03258A-97-0568, T-03258A-97-0545, and T-03258A-96-0492, was the responsibility of the Staff members listed below. Marta G. Kalleberg was responsible for the review and analysis of the Applicant's applications for Certificates of Convenience and Necessity to provide facilities-based and resold interexchange services; facilities-based and resold local exchange services; access telecommunications service; and petitions for a determination that its proposed services should be classified as competitive. Jim Fisher was responsible for the review and analysis of the Applicant's application for a Certificate of Convenience and Necessity to provide alternative operator services (AOS).

Marta G. Kalleberg
Economist II

Jim Fisher
Executive Consultant I

1. INTRODUCTION

On September 12, 1996, GTE Communications Corporation ("Verizon" or "Applicant") filed an application for a Certificate of Convenience and Necessity ("CC&N") to provide resold interexchange services throughout the State of Arizona. On October 2, 1997, Verizon filed an application for CC&N to provide facilities-based and resold local exchange services; and access service within the operating areas of USWC (now known as Qwest), Citizens Utilities Company, and the affiliates of Citizens. Verizon petitioned the Arizona Corporation Commission ("Commission") for a determination that its proposed services should be classified as competitive. On October 17, 2000, Verizon filed an application for a CC&N to provide alternative operator services (AOS) within the State of Arizona. On April 11, 2000, Verizon filed an application for a CC&N to provide facilities-based interexchange services throughout the State of Arizona. Verizon petitioned the Arizona Corporation Commission ("Commission") for a determination that its proposed services should be classified as competitive.

On June 8, 2000, a procedural order was filed granting the motion to consolidate the above filings. On July 21, 2000, Verizon informed the Commission of a name change to Verizon Select Services Inc. Hereafter, Verizon will be referred to as "Verizon" or "Applicant".

Staff's review of these applications addresses the overall fitness of the Applicant to receive a CC&N. Staff's analysis also considers whether the Applicant's services should be classified as competitive and if the Applicant's initial rates are just and reasonable.

2. VERIZON'S APPLICATIONS FOR CERTIFICATES OF CONVENIENCE & NECESSITY

This section of the Staff Report contains descriptions of the geographic market to be served by Verizon, the requested services, and Verizon's technical and financial capability to provide the requested services. In addition, this section contains the Staff evaluation of Verizon's proposed rates and charges and Staff's recommendation thereon.

2.1 DESCRIPTION OF THE GEOGRAPHIC MARKET TO BE SERVED

Verizon seeks authority to provide facilities-based and resold interexchange services throughout the State of Arizona. Verizon also seeks authority to provide alternative operator services within the State of Arizona. Verizon seeks authority to provide facilities-based local services, resold local services, and access services within the operating areas of USWC (now known as Qwest), Citizens Utilities Company, and the affiliates of Citizens. Verizon's Parent Company, GTE Corporation, is a publicly traded company on the NYSE.

2.2 DESCRIPTION OF REQUESTED SERVICES

Verizon proposes to provide facilities-based and resold interexchange services; facilities-based and resold local exchange services; switched and special access services; and alternative operator service. These services include, but are not limited to the following: directory assistance, CLASS services, directory listings, calling cards, and digital private line service.

2.3 THE ORGANIZATION

Verizon is incorporated under the laws of the State of Delaware and has provided a copy of its approved Application for Authority to transact business in Arizona.

2.4 TECHNICAL CAPABILITY TO PROVIDE THE REQUESTED SERVICES

Verizon is authorized to provide faclities-based interexchange services in 11 states and the District of Columbia. Verizon has authority to provide resold interexchange services in 49 states. Verizon is also authorized to operate as an AOS provider in 17 states and has registration pending with the remaining states. Verizon is authorized to provide facilties-based local services in 18 states and resold local services in 29 states.

2.5 FINANCIAL CAPABILITY TO PROVIDE THE REQUESTED SERVICES

Verizon has submitted the unaudited financial information of its parent company, GTE Corporation for the quarterly period ended September 30, 1999. These financial data list assets of $48.27 billion, retained earnings of $4.4 billion, total shareholders' equity of $10.92 billion, and net income of $1.3 billion on revenues of $6.43 billion. Based upon this information, Staff believes that Verizon has sufficient financial strength to offer the requested telecommunications services in Arizona absent the procurement of a performance bond.

2.6 ESTABLISHING RATES AND CHARGES

Verizon will initially be providing service in areas where an incumbent local exchange carrier ("ILEC"), along with various competitive local exchange carriers ("CLECs") and interexchange carriers are providing telephone service. Therefore, Verizon will have to compete with those providers in order to obtain subscribers to its services. Verizon would be a new entrant and would face competition from both an incumbent provider and other competitive providers in offering service to its potential customers. Therefore, Verizon will generally not be able to exert market power. Thus, the competitive process should result in rates that are just and reasonable.

Both an initial rate (the actual rate to be charged) and a maximum rate must be listed for each competitive service offered, provided that the rate for the service is not less than the Company's total service long-run incremental cost of providing the service pursuant to A.A.C. R14-2-1109. Verizon has filed a tariff with rates and charges for its interexchange service

offerings that Staff believes is in compliance with A.A.C. R14-2-1109. However, Verizon has not provided a tariff for its local exchange or access service offerings. Therefore, Staff recommends that Verizon be required to file a tariff for its proposed local exchange and access services within 30 days of an Order in this matter or within 30 days of an Order approving its interconnection agreement, whichever is later.

3. LOCAL EXCHANGE CARRIER SPECIFIC ISSUES

Since Verizon intends to provide local exchange service, the issues related to the provision of that service are discussed below.

3.1 INTERCONNECTION

Verizon has applied for a CC&N to become a local exchange company. As such, Verizon will need to connect its network to other local exchange company networks in order to provide ubiquitous calling capabilities to its customers. The Commission approved the parameters under which interconnection between Verizon and other telephone service providers will take place (Decision No. 59761, dated July 22, 1996, in Docket No. RT-00000F-96-0001). The 1996 Telecommunications Act has set forth general guidelines for interconnection. Consistent with these guidelines, Verizon has entered into an Interconnection Agreement with U S WEST Communications, Inc. ("USWC") that became effective by operation of law on June 24, 1999.

3.2 DIRECTORY LISTINGS AND DIRECTORY ASSISTANCE

Callers should be able to determine the telephone numbers belonging to customers of alternative local exchange companies, such as Verizon. There are three issues associated with the provision of Directory Assistance for subscribers to new local exchange company services, no matter what service provider the subscriber uses. These issues are:

1. Should there be one Directory Assistance database administrator?
2. If there is one Directory Assistance database administrator, what should the rates be for inclusion in the directories?
3. What should be included in the Directory Assistance database?

Staff recommends that Verizon indicate how it plans to have its customers' telephone numbers included in the incumbent's Directories and Directory Assistance databases before it begins providing local exchange service.

3.3 NUMBER PORTABILITY

Another issue associated with Verizon's proposal to become a competitive local exchange company relates to how telephone numbers should be administered. Local exchange competition may not be vigorous if customers, especially business customers, must change their telephone numbers to take advantage of a competitive local exchange carrier's service offerings. Staff recommends that Verizon pursue interim and permanent number portability arrangements with other local exchange carriers ("LECs") that are consistent with federal laws, federal rules and state rules.

3.4 PROVISION OF BASIC TELEPHONE SERVICE AND UNIVERSAL SERVICE

The Commission has adopted rules to address maintenance of universal telephone service during and after the transition to a competitive telecommunications services market. The rules contain the terms and conditions for contributions to and support received from telephone service subscribers to finance the Arizona Universal Service Fund ("AUSF"). Under the rules, Verizon will be required to participate in the financing of the AUSF and it may be eligible for AUSF support. Therefore, Staff recommends that approval of Verizon's application for a CC&N be conditioned upon Verizon's agreement to abide by and participate in the AUSF mechanism established by Decision No. 59623, dated April 24, 1996 (Docket No. RT-00000E-95-0498).

3.5 QUALITY OF SERVICE

Staff believes that Verizon should be ordered to abide by the quality of service standards that were approved by the Commission for USWC in Docket No. T-01051B-93-0183 (Decision No. 59421). Because the penalties that were developed in this docket were initiated only because USWC's level of service was not satisfactory, Staff does not recommend that those penalties apply to Verizon. In the competitive market that Verizon wishes to enter, Verizon generally will have no market power and will be forced to provide a satisfactory level of service or risk losing its customers. Therefore, Staff believes that it is unnecessary to subject Verizon to those penalties at this time.

3.6 ACCESS TO ALTERNATIVE LOCAL EXCHANGE SERVICE PROVIDERS

Staff expects that there will be new entrant providers of local exchange service who will install the plant necessary to provide telephone service to, for example, a residential subdivision or an industrial park much like existing local exchange companies do today. In those areas where Verizon installs the only local exchange service facilities, Verizon will be a monopoly service provider. In the interest of providing competitive alternatives to Verizon's local exchange service customers, Staff recommends that Verizon provide customers served in these areas with access to alternative local exchange service providers. In this way, a customer may be served by an alternative local exchange service provider if the customer so desires. With this requirement in place, Verizon will not be able to exert monopoly power over customers who are located in areas where Verizon is the only provider of facilities to serve the customer. Access to

other providers should be provided pursuant to the provisions of the 1996 Telecommunications Act, the rules promulgated thereunder and Commission rules on interconnection and unbundling.

3.7 911 SERVICE

Verizon has not indicated in its application whether it will provide all customers with 911 and E911 service, where available, or will coordinate with ILECs and emergency service providers to provide the service. Staff believes that Verizon should be required to work cooperatively with local governments, public safety agencies, telephone companies, the National Emergency Number Association and all other concerned parties to establish a systematic process in the development of a universal emergency telephone number system. Staff recommends that Verizon be required to certify, through the 911 service provider in the area in which it intends to provide service, that all issues associated with the provision of 911 service have been resolved with the emergency service providers before it begins to provide local exchange service.

3.8 CUSTOM LOCAL AREA SIGNALING SERVICES

In its decisions related to USWC's proposal to offer Caller ID and other CLASS features in the State, the Commission addressed a number of issues regarding the appropriateness of offering these services and under what circumstances it would approve the proposals to offer them. The Commission concluded that Caller ID could be offered provided that per call and line blocking, with the capability to toggle between blocking and unblocking the transmission of the telephone number, should be provided as options to which customers could subscribe with no charge. The Commission also approved a Last Call Return service that will not return calls to telephone numbers that have the privacy indicator activated, which indicates that the number has been blocked. The Commission further required that USWC engage in education programs when introducing or providing the service(s).

Staff recommends that Verizon be required to abide by all the Commission decisions and policies regarding Caller ID and other CLASS services. However, Staff does not believe that it is necessary for Verizon to engage in the educational program that was ordered for USWC as long as customers in the areas where Verizon intends to serve have already been provided with educational material and are aware that they can have their numbers blocked on each call or at all times with line blocking.

3.9 EQUAL ACCESS FOR INTEREXCHANGE CARRIERS

Although Verizon did not indicate that its switch will be "fully equal access capable" (i.e. would provide equal access to interexchange companies), the Commission requires local exchange companies to provide 2-Primary Interexchange Carriers ("2-PIC") equal access. 2-PIC equal access allows customers to choose different carriers for interLATA and intraLATA toll service and would allow customers to originate intraLATA calls using the preferred carrier on a 1+ basis. Staff recommends that Verizon be required to provide 2-PIC equal access.

4. ALTERNATIVE OPERATOR SERVICE ISSUES

This section of the Staff Report contains information on Verizon's proposed alternative operator services and Verizon's technical and financial capability to provide the requested services. In addition, this section contains the Staff evaluation of Verizon's proposed rates and charges and Staff's recommendation thereon.

4.1 BACKGROUND

On October 17, 1997 Staff received an application from Verizon for certification as an Alternative Operator Services provider in the State of Arizona.

Alternative Operator Services (AOS) is a sector focused service industry providing resold telecommunications and operator services to larger distinct customers, such as hotels, motels, health care and correctional facilities. The AOS provider will contract with the hotel or correctional facility to provide services. The hotel or correctional facility is referred to as an "aggregator" as in the ordinary course of its operations it allows for intrastate telephone services to be available to its patrons. The patrons of the "aggregator" are referred to "end-users." AOS services are provided by routing all calls originating from the aggregator premise to the AOS provider, which then handles the call as required to meet the needs of the end-user.

"End-users" have no control over the aggregator's subscription for long distance service, and as such are essentially captive customers for telecommunications services. The Commission has previously determined that it is in the public interest to ensure that an end user using telecommunications services of an AOS provider be charged rates consistent with the corresponding rates and service charges of certified facilities-based toll carriers available to the calling public.

Staff has reviewed the authorized rates and service charges applicable to AOS providers. Staff reviewed the rates of AT&T Communications of the Mountain States, Inc. (AT&T), MCI Telecommunications Corporation, (MCI), Sprint Communications Company, (Sprint), Allnet Communications Services, Inc., (Allnet), and US West Communications of Arizona (US West). Staff then developed the attached Schedule 1 and 2, establishing maximum rates for the AOS services. These maximum rates coupled with discounting authority provide the market participants with the ability to compete on price and service quality. The Commission adopted this process in Decision No. 61274.

4.2 THE APPLICANT

Verizon does not have any pending civil or criminal complaints, nor any judgement or conviction related to the provision of telecommunications services. Neither the Applicant nor any of its officers or directors have been involved in any formal complaint, investigatory or enforcement action involving their business operations.

Verizon currently offers interstate and intrastate, interexchange telecommunications services using the network facilities of WorldCom, Inc. and MCI Communication Corporation. Verizon possesses the managerial ability and technical competency to provide AOS in the State of Arizona.

4.3 FINANCIAL STATEMENTS

Staff has reviewed the financial statements of GTE submitted to the Securities and Exchange Commission for the quarterly period ending September 30, 1999. The financial statements indicate that the Applicant had positive net income of $1.3 billion for the quarter. Total assets of the Applicant appear sufficient during the same period. The Applicant appears to have sufficient financial resources to provide its proposed alternative operator services.

The Commission has found competition in telecommunications services to be in the public interest. Competition inherently produces winners and losers. If an AOS provider encounters financial difficulty, there should be minimal impact to its customers because there are numerous competitors willing to replace any failed provider. In addition, the customer may choose a facilities-based carrier such as AT&T, MCI, Sprint, etc. If the customers would like to receive service from a different carrier immediately, they can "dial" around an AOS provider to the carrier of their choice.

4.4 RATE REVIEW PROCESS

Staff has reviewed the rates of five major toll carriers to establish the maximum AOS rates, service charges and operator-dialed surcharges set forth on Schedules 1 and 2. If any of the carriers forming the rate group obtain higher rates, Verizon should be authorized to allow its rates to float in accordance with the carrier's revised higher rates so long as the AOS provider complies with the following tariff filing requirements. The Applicant is required to file: 1) an estimate of the value of the Applicant's plant to serve Arizona customers; 2) a tariff setting forth the new maximum rates, which do not exceed the maximum rates of the five major carriers; and 3) supporting documentation estimating the overall impact of the new maximum rate upon the Applicant's rate of return.

In example, AT&T currently has maximum rates in the night/weekend rate period in mileage bands 0 through 292 for the first minute and additional minutes in Schedule 1. In the event AT&T were to increase its rates in these mileage bands, the changed rates would establish new maximum rates in Schedule 1. Pursuant to Staff's recommendation, Verizon would be allowed to seek authorization to increase its maximum rates and/or service charges accordingly by complying with the filing requirements described above.

The Commission has authorized floating maximum rates for coin-operated pay telephone (COPT) providers that have been certified under the generic tariff established by A.A.C. R14-2-905. This mechanism is particularly appropriate for a market with alternative providers in which it is reasonable to set rates in reference to the rates of established carriers providing similar services. These factors are present in the AOS industry; therefore, Staff believes that it is reasonable for the Commission to authorize Verizon to adopt floating maximums.

4.5 DISCOUNTING AUTHORITY

Staff recommends that Verizon should be allowed to discount its rates and service charges to the marginal cost of providing the services. Discount authority will provide the Applicant with pricing flexibility to compete with other providers, as well as allow the potential benefits of price competition to accrue to end-users.

4.6 INTERLATA TOLL CHARGES

Staff recommends that interLATA rates and service charges be based on the maximum rates and service charges authorized for certain interexchange carriers (IXCs) certificated in Arizona as described above.

Staff recommends that the Commission authorize Verizon to charge the maximum rate in each mileage band, respective of the day of the week and time of the day, currently authorized for any of the facilities-based IXC's as set forth in Schedule 1. In addition, Staff recommends that the Commission limit the Applicant's service charges to the highest authorized maximum service charge of any of the facilities-based IXC's as set forth in Schedule 1.

4.7 INTRALATA TOLL CHARGES

Staff recommends that IntraLATA rates and service charges be based on the maximum rates and service charges of the various facilities-based carriers certified to carry intraLATA toll calls in Arizona as described above.

Staff recommends that the Commission authorize Verizon to charge the maximum rate in each mileage band, respective of the day of the week and time of the day, currently authorized for any of the various facilities-based intraLATA carries set forth in Schedule 2. Furthermore, Staff recommends that the Commission limit the Applicant's service charges to the highest authorized maximum service charge of any of the facilities-based intraLATA carriers set forth in Schedule 2.

The attached Schedule 1 and 2 in Appendix A set forth Staff's recommended surcharges for interLATA and intraLATA toll calls respectively.

4.8 OPERATOR-DIALED SURCHARGE AND PROPERTY SURCHARGE

An operator-dialed surcharge is imposed when an end user has the capability to dial the call, but requests the operator to dial and make the call. A property surcharge is a per call bonus paid to the aggregator by the AOS Company. In prior decisions the Commission has approved both an operator-dialed surcharge and a property (location-specific or subscriber) surcharge.

Staff recommends that the property surcharge be limited to $1.00 per call. The Commission has approved a property surcharge of $1.00 for ten out of twelve AOS carriers certified in Arizona. Limiting the property surcharge provides a level playing field for the competitors. Staff recommends consistency in the property surcharge to stress the importance of providing service to the end-users, rather than higher payments to aggregators for the opportunity to serve end-users.

Staff recommends approval of the operator-dialed surcharge and the property surcharge as described in Schedule 1 and 2.

4.9 ZERO-MINUS CALLS

The term "zero-minus" refers to calls by individuals who dial "0" for the operator when they are experiencing an emergency situation rather than "911." The majority of calling public dial "911" for emergency telephone service, yet others will dial "0" in the same situation. The Commission adopted A.A.C. R14-2-1006.A, which requires the AOS provider to route all zero-minus calls to the originating LEC. The Commission also provided a waiver from the requirement upon a showing that the AOS provider could provide the caller with equally quick and reliable service. Verizon has not requested a waiver.

4.10 PROPOSED TARIFF

Verizon's tariff filing of October 17, 1997 comports with the recommendations in the above sections. The Applicant's proposed rates and service charges for either interLATA or intraLATA telephone services are identical to or less than the rates and service charges contained in Staff's attached rate schedules 1 and 2. Therefore, Staff believes Verizon's proposed tariff is reasonable and should be approved.

5. COMPETITIVE SERVICES ANALYSIS

Verizon has petitioned the Commission for a determination that the services it is seeking to provide should be classified as competitive. Verizon has published legal notice of the application in all counties in which it requests authorization to provide service. Verizon has certified that all notification requirements have been completed. Staff's analysis and recommendations are discussed below.

5.1 COMPETITIVE SERVICES ANALYSIS FOR VERIZON'S REQUESTED LOCAL EXCHANGE SERVICES

5.1.1 A description of the general economic conditions that exist which make the relevant market for the service one that is competitive.

The analysis of the market for local exchange service that Verizon seeks to enter must take into account the fact that there are two local exchange service submarkets. The first is the local exchange service market that consists of locations where ILECs currently provide service. The second local exchange service market consists of locations within ILECs' service territories where ILECs are authorized to provide local exchange service, but where they do not actually provide service.

The local exchange market that Verizon seeks to enter is one in which a number of new CLECs have been authorized to provide local exchange service. Nevertheless, ILECs hold a virtual monopoly in the local exchange service market. At locations where ILECs provide local exchange service, Verizon will be entering the market as an alternative provider of local exchange service and, as such, Verizon will have to compete with those companies in order to obtain customers. In areas where ILECs do not serve customers, Verizon may have to convince developers to allow it to provide service to their developments. Staff recommends that, in those instances where the Applicant provides the only facilities used to provide telecommunications service, that the Applicant be required to allow other local exchange companies to use those facilities to serve customers who wish to obtain service from an alternative provider pursuant to federal laws, federal rules and state rules.

5.1.2 The number of alternative providers of the service.

Qwest and various independent LECs are the primary providers of local exchange service in the State. Several CLECs and local exchange resellers are also providing local exchange service.

5.1.3 The estimated market share held by each alternative provider of the service.

Since Qwest and the independent LECs are the primary providers of local exchange service in the State, they have a large share of the market. Since the CLECs and local exchange resellers have only recently been authorized to offer service they have limited market share.

5.1.4 **The names and addresses of any alternative providers of the service that are also affiliates of the telecommunications Applicant, as defined in A.A.C. R14-2-801.**

GTE California Incorporated
One GTE Place
Thousand Oaks, CA 91362-3811

5.1.5 **The ability of alternative providers to make functionally equivalent or substitute services readily available at competitive rates, terms and conditions.**

ILECs have the ability to offer the same services that Verizon has requested in their respective service territories. Similarly many of the CLECs and local exchange resellers also offer substantially similar services.

5.1.6 **Other indicators of market power, which may include growth and shifts in market share, ease of entry and exit, and any affiliation between and among alternative providers of the service(s).**

The local exchange service market is:

a. One in which ILECs own networks that reach nearly every residence and business in their service territories and which provide them with a virtual monopoly over local exchange service. New entrants are also beginning to enter this market.

b. One in which new entrants will be dependent upon ILECs:

   1. To terminate traffic to customers.
   2. To provide essential local exchange service elements until the entrant's own network has been built.
   3. For interconnection.

c. One in which ILECs have had an existing relationship with their customers that the new entrants will have to overcome if they want to compete in the market and one in which new entrants do not have a long history with any customers.

d. One in which Qwest provides a quality of service that has generated a significant number of complaints. These complaints led the Commission to adopt service quality rules that contain penalties if the service quality standards are not met. A provider of alternative service, such as Verizon, should provide Qwest--as well as other incumbents--with the incentive to produce higher quality service including service installation and repair on a timely basis.

e. One in which most customers have few, if any choices since there is generally only one provider of local exchange service in each service territory.

f. One in which Verizon will not have the capability to adversely affect prices or restrict output to the detriment of telephone service subscribers.

5.2 COMPETITIVE SERVICES ANALYSIS FOR VERIZON'S REQUESTED INTEREXCHANGE SERVICES

5.2.1 **A description of the general economic conditions that exist which make the relevant market for the service one that is competitive.**

The interexchange market that Verizon seeks to enter is one in which numerous facilities-based and resold interexchange carriers have been authorized to provide service throughout the State. Verizon will be a new entrant in this market and, as such, will have to compete with those companies in order to obtain customers.

5.2.2 **The number of alternative providers of the service.**

There are a large number of facilities-based and resold interexchange carriers providing both interLATA and intraLATA interexchange service throughout the State. In addition, various ILECs provide intraLATA interexchange service in many areas of the State.

5.2.3 **The estimated market share held by each alternative provider of the service.**

The large facilities-based interexchange carriers (AT&T, Sprint, MCI WorldCom, etc.) hold a majority of the interLATA interexchange market, and the ILECs provide a large portion of the intraLATA interexchange market. Numerous other interexchange carriers have a smaller part of the market.

5.2.4 **The names and addresses of any alternative providers of the service that are also affiliates of the telecommunications Applicant, as defined in A.A.C. R14-2-801.**

GTE California Incorporated
One GTE Place
Thousand Oaks, CA 91362-3811

5.2.5 **The ability of alternative providers to make functionally equivalent or substitute services readily available at competitive rates, terms and conditions.**

Both facilities-based and resold interexchange carriers have the ability to offer the same services that Verizon has requested in their respective service territories. Similarly many of the ILECs offer similar intraLATA toll services.

5.2.6 **Other indicators of market power, which may include growth and shifts in market share, ease of entry and exit, and any affiliation between and among alternative providers of the service(s).**

The interexchange service market is:

a. One with numerous competitors and limited barriers to entry.

b. One in which established interexchange carriers have had an existing relationship with their customers that the new entrants will have to overcome if they want to compete in the market and one in which new entrants do not have a long history with any customers.

c. One in which Verizon will not have the capability to adversely affect prices or restrict output to the detriment of telephone service subscribers.

5.3 COMPETITIVE SERVICES ANALYSIS FOR VERIZON'S REQUESTED ACCESS SERVICES

5.3.1 **A description of the general economic conditions that exist which make the relevant market for the service one that is competitive.**

The market for telecommunications service in which Verizon intends to provide access service is:

a. One in which ILECs are the main providers of intrastate access service.

b. One in which ILECs own networks that reach nearly every residence and business in their service territories, which provide them with a virtual monopoly over intrastate access service in their service territories.

c. One in which Verizon may be reliant upon ILECs to access customers in order to provide competitive access services.

5.3.2 **The number of alternative providers of the service.**

ILECs are still the main providers of access service in their territories. However, a number of new entrants are competing for intrastate access customers.

5.3.3 **The estimated market share held by each alternative provider of the service.**

Since ILECs have historically been the only providers of access service in their service territories, they have a majority of the market share in those territories. However, new entrants are gaining market share.

5.3.4 **The names and addresses of any alternative providers of the service that are also affiliates of the telecommunications applicant, as defined in A.A.C. R14-2-801.**

GTE California Incorporated
One GTE Place
Thousand Oaks, CA 91362-3811

5.3.5 **The ability of alternative providers to make functionally equivalent or substitute services readily available at competitive rates, terms and conditions.**

Each service that Verizon provides will have at least one alternative supplier.

5.3.6 **Other indicators of market power, which may include growth and shifts in market share, ease of entry and exit, and any affiliation between and among alternative providers of the service(s).**

The following represent other indications of ILECs' market power in the intrastate switched access service market:

a. The fact that ILECs, such as Qwest, are providing the majority of intrastate access. New entrants have been authorized to provide intrastate access and are beginning to establish a presence in the market.

b. Customer relationships with incumbent carriers, such as Qwest, that have existed over a number of years.

c. The fact that the ILECs, such as Qwest, have access to information about all of the customers located in their service territories that other providers do not (e.g. billing and calling pattern information).

d. The fact that the ILEC is often the first contact for customers entering an area.

6. RECOMMENDATIONS

The following sections contain the Staff recommendations on Verizon's Application for a CC&N and Verizon's Petition for a Commission Determination that its Proposed Services Should be Classified as Competitive.

6.1 RECOMMENDATIONS ON VERIZON'S APPLICATION FOR A CC&N

Verizon is incorporated under the laws of the State of Delaware. Verizon is authorized to provide faclities-based interexchange services in 11 states and the District of Columbia. Verizon has authority to provide resold interexchange services in 49 states. Verizon is also authorized to operate as an AOS provider in 17 states and has registration pending with the remaining states.

Verizon is authorized to provide facilties-based local services in 18 states and resold local services in 29 states. Verizon has demonstrated that it has the capability to provide its proposed services, as requested, and the provision of these would merely be an extension of its current activities elsewhere. Verizon seeks authority to provide facilities-based and resold interexchange services throughout the State of Arizona. Verizon also seeks authority to provide alternative operator services within the State of Arizona. Verizon seeks authority to provide facilities-based local services, resold local services, and access services within the operating areas of Qwest, Citizens Utilities Company, and the affiliates of Citizens. Therefore, Staff recommends that Verizon's application for a CC&N to provide intrastate telecommunications services, as listed in Section 2.2 of this Report, be granted subject to the following recommendations:

1. That Verizon file with the Commission, within 30 days of an Order in this matter, its plan to have its customers' telephone numbers included in the incumbent's Directories and Directory Assistance databases;

2. That Verizon does not provide facilities-based local service; resold local service; or access service in the service territory of its affiliate, GTE California Incorporated;

3. That Verizon only provides facilities-based local service; resold local service; or access service in the service territories of Qwest, Citizens Utilities Company, and the affiliates of Cititzens;

4. That Verizon pursue permanent number portability arrangements with other LECs pursuant to Commission rules, federal laws and federal rules;

5. That Verizon agree to abide by and participate in the AUSF mechanism instituted in Decision No. 59623, dated April 24, 1996 (Docket No. RT-00000E-95-0498);

6. That Verizon abide by the quality of service standards that were approved by the Commission for USWC in Docket No. T-01051B-93-0183;

7. That in areas where Verizon is the sole provider of local exchange service facilities, Verizon will provide customers with access to alternative providers of service pursuant to the provisions of Commission rules, federal laws and federal rules;

8. That Verizon be required to certify, through the 911 service provider in the area in which it intends to provide service, that all issues associated with the provision of 911 service have been resolved with the emergency service providers within 30 days of an Order in this matter;

9. That Verizon be required to abide by all the Commission decisions and policies regarding CLASS services;

10. That Verizon be required to provide 2-PIC equal access;

11. That Verizon be required to notify the Commission immediately upon changes to Verizon's address or telephone number;

12. That Verizon comply with all Commission rules, orders, and other requirements relevant to the provision of intrastate telecommunications service;

13. That Verizon maintain its accounts and records as required by the Commission;

14. That Verizon file with the Commission all financial and other reports that the Commission may require, and in a form and at such times as the Commission may designate;

15. That Verizon maintain on file with the Commission all current tariffs and rates, and any service standards that the Commission may require;

16. That Verizon cooperate with Commission investigations of customer complaints; and

17. That Verizon participate in and contribute to a universal service fund, as required by the Commission.

Staff also recommends that Verizon's application for a CC&N to provide intrastate telecommunications services be granted subject to the following condition:

- That Verizon be required to file its tariffs within 30 days of an Order in this matter or within 30 days of an Order approving its interconnection agreement, whichever is later.

6.2 RECOMMENDATION ON VERIZON'S PETITION TO HAVE ITS PROPOSED SERVICES CLASSIFIED AS COMPETITIVE

Staff believes that Verizon's proposed services should be classified as competitive. There are alternatives to Verizon's services. Verizon will have to convince customers to purchase its services, and Verizon has no ability to adversely affect the local exchange, access, or interexchange service markets. Therefore, Verizon currently has no market power in the local exchange, access or interexchange service markets where alternative providers of telecommunications services exist. Staff therefore recommends that Verizon's proposed services be classified as competitive.

Staff further recommends that Verizon be subject to the Commission's rules governing interconnection and unbundling and the 1996 Telecommunications Act and the rules promulgated thereunder. In the event that Verizon provides essential services or facilities that potential competitors need in order to provide their services, Verizon should be required to offer those facilities or services to these providers on non-discriminatory terms and conditions pursuant to federal laws, federal rules and state rules.

APPENDIX A:

RATE SCHEDULES FOR AOS

Schedule 1

Alternative Operator Services
Maximum InterLata Usage Charges

Mileage Band	Day Time (a)		Evening/Holiday (b)		Night/Weekend (c)	
	First Minute	Addtl. Minute	First Minute	Addtl. Minute	First Minute	Addtl. Minute
0-10	0.3000	0.3000	0.3000	0.3000	0.3000	0.3000
11-16	0.4000	0.3000	0.3000	0.3000	0.3000	0.3000
17-22	0.4000	0.3000	0.3000	0.3000	0.3000	0.3000
23-30	0.4500	0.3000	0.3135	0.3000	0.3000	0.3000
31-40	0.5065	0.3000	0.3135	0.3000	0.3000	0.3000
41-55	0.5307	0.3332	0.3135	0.3000	0.3000	0.3000
56-70	0.5560	0.3732	0.3590	0.3000	0.3000	0.3000
71-124	0.5560	0.3865	0.3590	0.3000	0.3000	0.3000
125-196	0.5560	0.4265	0.3590	0.3000	0.3000	0.3000
197-292	0.5560	0.4799	0.3590	0.3000	0.3000	0.3000
293 & Over	0.5800	0.4820	0.3908	0.3000	0.3000	0.3000

Rate Periods

(a) Day time is Monday through Friday 8:00 a.m. to 5 p.m.
(b) Evening/Holiday is Sunday through Friday 5:00 p.m. to 11:00 p.m.
Officially recognized holidays are: New Year's Day, Memorial Day, Independence Day, Labor Day, Thanksgiving and Christmas Day. Evening rates are applicable during all holiday hours, except for hours when a lower rate (i.e. Night/Weekend) is applicable.
(c) Night/Weekend is Sunday through Thursday 11:00 p.m. to 8:00 a.m., 11:00 p.m. Friday through 5:00 p.m. Sunday.

Alternative Operator Services
Maximum InterLata Services Charges

Service (1) (2)	Maximum Charge
Customer Dialed Calling or Credit Card	$1.50
Operator Dialed Calling or Credit Card	$2.50
Station – to – Station Collect	$2.33
Person – to – Person Collect	$4.66
Third Party Person – to – Person	$4.66
Third Party Station – to Station	$2.33
Person—to – Person	$4.50
Station – to – Station	$3.50
Directory Assistance	$2.00

(1) An Operator Dialed Surcharge of $2.00 will be applied to the capability to call, but it is requested that the operator complete the call instead. In accordance with A.A.C. R14-2-1005, end users shall be informed of this charge before call completion. This surcharge will not be imposed in cases of equipment failure or where the end user is experiencing a disability.
(2) A Property Surcharge, Subscriber Surcharge or Location Specific Charge may be added to all operator assisted calls completed from Company subscriber locations. This surcharge will appear on the customer's bill and will be capped at $1.00 per call. All of this surcharge will be remitted to the aggregator. However, this surcharge will not be collected by the Company if the aggregator is also collecting a surcharge.

Schedule 2

Alternative Operator Services
Maximum IntraLata Usage Charges

Mileage Band	Day Time (a)		Evening/Holiday (b)		Night/Weekend (c)	
	First Minute	Addtl. Minute	First Minute	Addtl. Minute	First Minute	Addtl. Minute
0-10	0.3000	0.3000	0.3000	0.3000	0.3000	0.3000
11-16	0.4000	0.3000	0.3000	0.3000	0.3000	0.3000
17-22	0.4000	0.3000	0.3000	0.3000	0.3000	0.3000
23-30	0.4500	0.3000	0.3135	0.3000	0.3000	0.3000
31-40	0.4500	0.3000	0.3135	0.3000	0.3000	0.3000
41-55	0.4500	0.3000	0.3135	0.3000	0.3000	0.3000
56-70	0.5200	0.3300	0.3590	0.3000	0.3000	0.3000
71-124	0.5200	0.3300	0.3590	0.3000	0.3000	0.3000
125-196	0.5300	0.3600	0.3590	0.3000	0.3000	0.3000
197-292	0.5800	0.3600	0.3590	0.3000	0.3000	0.3000
293 & Over	0.5800	0.3800	0.3980	0.3000	0.3300	0.3000

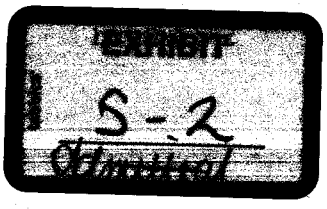
Rate Periods

(a) Day time is Monday through Friday 8:00 a.m. to 5 p.m.
(b) Evening/Holiday is Sunday through Friday 5:00 p.m. to 11:00 p.m.
Officially recognized holidays are: New Year's Day, Memorial Day, Independence Day, Labor Day, Thanksgiving and Christmas Day. Evening rates are applicable during all holiday hours, except for hours when a lower rate (i.e. Night/Weekend) is applicable.
(c) Night/Weekend is Sunday through Thursday 11:00 p.m. to 8:00 a.m., 11:00 p.m. Friday through 5:00 p.m. Sunday.

Alternative Operator Services
Maximum IntraLata Services Charges

Service (1) (2)	Maximum Charge
Customer Dialed Calling or Credit Card	$1.50
Operator Dialed Calling or Credit Card	$2.50
Station – to – Station Collect	$2.30
Person – to – Person Collect	$4.50
Third Party Person – to – Person	$4.50
Third Party Station – to Station	$2.30
Person—to – Person	$4.50
Station – to – Station	$3.50
Directory Assistance	$2.00

(3) An Operator Dialed Surcharge of $2.00 will be applied to the capability to call, but it is requested that the operator complete the call instead. In accordance with A.A.C. R14-2-1005, end users shall be informed of this charge before call completion. This surcharge will not be imposed in cases of equipment failure or where the end user is experiencing a disability.
(4) A Property Surcharge, Subscriber Surcharge or Location Specific Charge may be added to all operator assisted calls completed from Company subscriber locations. This surcharge will appear on the customer's bill and will be capped at $1.00 per call. All of this surcharge will be remitted to the aggregator. However, this surcharge will not be collected by the Company if the aggregator is also collecting a surcharge.



(Insert on page 15, line 10, after "Section 2.2"):

"and Section 4"

(Delete lines 14-18 from page 16 and insert the following after recommendation #17):

18. That for its AOS services, Verizon be authorized to charge the maximum rate in each mileage band, (respective of the day of the week and time of day) currently authorized for any of the facilities-based interexchange carriers as set forth in Schedule 1 and for any of the intraLATA carriers as set forth in Schedule 2.

19. That Verizon's AOS service charges be limited to the highest authorized maximum service charge of any of the facilities-based interexchange carriers as set forth in Schedule 1 and of any of the intraLATA carriers as set forth in Schedule 2.

20. That for its AOS services, Verizon abide by the operator-dialed surcharge and property surcharge recommendations as stated in Schedules 1 and 2.

Staff also recommends that Verizon's consolidated applications for a CC&N to provide the requested telecommunications services be granted subject to the following conditions:

- That Verizon be required to file a consolidated tariff for all its requested services in compliance with the Decision within 30 days of an Order in this matter. The tariffs should be approved on an interim basis.

- That Verizon be required to file in this Docket, within 18 months of the date it first provides service following certification, sufficient information for Staff analysis and recommendation for a fair value finding, as well as for an analysis and recommendation for permanent tariff approval. This information must include, at a minimum, the following:

  1. A dollar amount representing the total revenue for the first twelve months of telecommunications service provided to Arizona customers by Verizon following certification, adjusted to reflect the **maximum rates** that Verizon has requested in its tariff. This adjusted total revenue figure could be calculated as the number of units sold for all services offered times the maximum charge per unit.

  2. The total actual operating expenses for the first twelve months of telecommunications service provided to Arizona customers by Verizon following certification.

3. The value of **all assets,** listed by major category, used for the first twelve months of telecommunications service provided to Arizona customers by Verizon following certification. Assets are not limited to plant and equipment. Items such as office equipment and office supplies should be included in this list.

- That Verizon's failure to meet the condition to timely file sufficient information for a fair value finding and analysis and recommendation of permanent tariffs should result in the expiration of the certificate and of the tariffs.