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MEMORANDUM
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FROM: Ernest G. Johnson ^{EGJ} AZ CORP COMMISSION
Director DOCUMENT CONTROL
Utilities Division

DATE: October 29, 2004

RE: IN THE MATTER OF THE APPLICATION OF SOUTHWESTERN BELL COMMUNICATIONS SERVICES, INC. DBA SBC LONG DISTANCE FOR A CERTIFICATE OF CONVENIENCE AND NECESSITY TO PROVIDE FACILITIES-BASED LONG DISTANCE TELECOMMUNICATIONS SERVICES (DOCKET NO. T-03346A-04-0413)

Attached is the Staff Report for the above referenced application. The Applicant is applying for approval to provide the following service:

- Facilities-based interexchange services

Staff is recommending approval of the application.

EGJ:AJL:cal

Originator: Adam Lebrecht

Attachment: Original and Thirteen Copies

Arizona Corporation Commission

DOCKETED

OCT 29 2004

DOCKETED BY	<i>CAJ</i>
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SERVICE LIST FOR: SOUTHWESTERN BELL COMMUNICATIONS SERVICES, INC.
DOCKET NO. T-03346A-04-0413

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STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION

SOUTHWESTERN BELL COMMUNICATIONS SERVICES, INC.
DOCKET NO. T-03346A-04-0413

IN THE MATTER OF THE APPLICATION OF SOUTHWESTERN BELL
COMMUNICATIONS SERVICES, INC. DBA SBC LONG DISTANCE FOR A
CERTIFICATE OF CONVENIENCE AND NECESSITY TO PROVIDE FACILITIES-
BASED LONG DISTANCE TELECOMMUNICATIONS SERVICES.

OCTOBER 29, 2004

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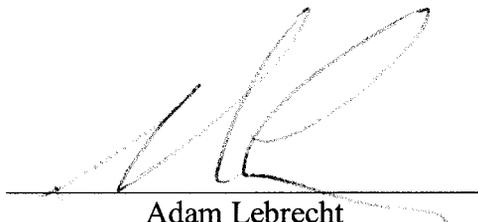
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STAFF ACKNOWLEDGMENT

The Staff Report for Southwestern Bell Communications Services, Inc. Docket No. T-03346A-04-0413, was the responsibility of the Staff member listed below. Adam Lebrecht was responsible for the review and analysis of the application for a Certificate of Convenience and Necessity to provide facilities-based interexchange services; and petition for a determination that its proposed services should be classified as competitive.

A handwritten signature in black ink, appearing to read 'AL', is written over a horizontal line.

Adam Lebrecht
Executive Consultant I

1. INTRODUCTION

On June 3, 2004, Southwestern Bell Communications Services, Inc. ("SBCS" or "Applicant") filed an application for a Certificate of Convenience and Necessity ("CC&N") to provide facilities-based interexchange service within the State of Arizona. The Applicant also petitioned the Arizona Corporation Commission ("Commission") for a determination that its proposed services should be classified as competitive.

Staff's review of this application 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. THE APPLICATION FOR A CERTIFICATE OF CONVENIENCE & NECESSITY

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

2.1 DESCRIPTION OF THE GEOGRAPHIC MARKET TO BE SERVED

SBCS seeks authority to provide telecommunications services throughout the State of Arizona.

2.2 DESCRIPTION OF REQUESTED SERVICES

On November 23, 1998, in Decision No. 61227, SBCS obtained a CC&N to provide resold long distance service in Arizona. On April 6, 2004, in Decision No. 66891, SBCS obtained a CC&N to provide resold and facilities-based local exchange service in Arizona. In this application, SBCS proposes to provide facilities-based interexchange services.

2.3 THE ORGANIZATION

SBCS is incorporated under the laws of the State of Delaware and has authority to transact business in Arizona.

2.4 TECHNICAL CAPABILITY TO PROVIDE THE REQUESTED SERVICES

SBCS indicated that it currently has the authority to provide facilities-based interexchange service in 9 states, excluding Arizona (see Attachment A). Based on this information, Staff has determined that the Applicant has sufficient technical capabilities to provide facilities-based interexchange telecommunications services.

2.5 FINANCIAL CAPABILITY TO PROVIDE THE REQUESTED SERVICES

The Applicant did provide unaudited financial statements of its Parent Company, SBC Communications, Inc., for the six months ending June 30, 2004. These financial statements list assets in excess of \$100 billion; equity in excess of \$39 billion; and a net income of \$3 billion. The Applicant did not provide notes related to the financial statements. Also, the Applicant did state in its Application that it will not rely on its ultimate Parent Company for financial support.

The Applicant stated in its Application/Tariff that it would be relying on SBC Telecom, Inc.'s existing Arizona resold interexchange tariff for service, rate and deposit information. SBC Telecom, Inc.'s tariff is on file with the Commission. SBC Telecom, Inc.'s resold interexchange tariff indicates that it may collect from its customers an advance, deposit and/or prepayment (reference section 2.5 on page 26). Staff believes that advances, deposits and/or prepayments received from the Applicant's customers should be protected by the procurement of a performance bond. The amount of bond coverage needed for a company offering facilities-based long distance service is \$100,000. The bond coverage needs to increase in increments equal to 50 percent of the total minimum bond amount when the total amount of the advances, deposits and prepayments is within 10 percent of the total minimum bond amount.

To that end, Staff recommends that the Applicant procure a performance bond equal to \$100,000. The minimum bond amount of \$100,000 should be increased if at any time it would be insufficient to cover advances, deposits and/or prepayments collected from the Applicant's customers. The bond amount should be increased in increments of \$50,000. This increase should occur when the total amount of the advances, deposits and prepayments is within \$10,000 of the bond amount. If the Applicant desires to discontinue service, it must file an application with the Commission pursuant to Arizona Administrative Code ("A.A.C.") R14-2-1107. Additionally, the Applicant must notify each of its customers and the Commission 60 days prior to filing an application to discontinue service. Failure to meet this requirement should result in forfeiture of the Applicant's performance bond. Staff further recommends that proof of the above mentioned performance bond be docketed within 365 days of the effective date of an Order in this matter or 30 days prior to the provision of service, whichever comes first, and must remain in effect until further order of the Commission.

If this Applicant experiences financial difficulty, there should be minimal impact to its customers because there are many companies that provide resold

telecommunications services or the customers may choose a facilities-based provider. If the customer wants interexchange service from a different provider immediately, that customer is able to dial a 101XXXX (dial around) access code. In the longer term, the customer may permanently switch to another company.

2.6 ESTABLISHING RATES AND CHARGES

The rates proposed by this filing are for competitive services. In general, rates for competitive services are not set according to rate of return regulation. Staff obtained information from the Applicant and has determined that its fair value rate base is zero. Staff has reviewed the rates to be charged by the Applicant and believes they are just and reasonable as they are comparable to several operating long distance carriers. Therefore, while Staff considered the fair value rate base information submitted by the Applicant, the fair value rate base information provided should not be given substantial weight in this analysis.

3. REVIEW OF COMPLAINT INFORMATION

The Applicant indicated that it has not had an application for service denied, nor revoked in any state. There are, and have been, no formal complaint proceedings involving the Applicant. There have not been any civil or criminal proceedings against the Applicant. Consumer Services reports no complaint history within Arizona.

The Applicant indicated that none of its officers, directors or partners have been involved in any civil or criminal investigations, or any formal or informal complaints. The Applicant also indicated that none of its officers, directors or partners have been convicted of any criminal acts in the past ten (10) years.

4. COMPETITIVE SERVICES ANALYSIS

The Applicant has petitioned the Commission for a determination that the services, it is seeking to provide, should be classified as competitive. Staff's analysis and recommendations are discussed below.

4.1 COMPETITIVE SERVICES ANALYSIS FOR INTEREXCHANGE SERVICES

4.1.1 **A description of the general economic conditions that exist, which makes the relevant market for the service one that, is competitive.**

The interexchange market that the Applicant seeks to enter is one in which numerous facilities-based and resold interexchange carriers have been authorized to provide service throughout the State. The Applicant will be a new entrant in

this market and, as such, will have to compete with those companies in order to obtain customers.

4.1.2 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.

4.1.3 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 and one in which new entrants do not have a long history with any customers.

4.1.4 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.

SBC Telecom, Inc.
300 Convent Street, 13-M-5
San Antonio, Texas 78205

4.1.5 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 the Applicant has requested in their respective service territories. Similarly many of the ILECs offer similar intraLATA toll services.

4.1.6 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 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.

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

5. RECOMMENDATIONS

The following sections contain the Staff recommendations on SBCS' application for a CC&N and the SBCS' Petition for a Commission Determination that its Proposed Services Should be classified as Competitive.

5.1 RECOMMENDATIONS ON THE APPLICATION FOR A CC&N

Staff recommends that the application for a CC&N to provide intrastate telecommunications services, as listed in Section 2.2 of this Report, be granted. In addition, Staff further recommends:

1. The Applicant should be ordered to comply with all Commission rules, orders and other requirements relevant to the provision of intrastate telecommunications service;
2. The Applicant should be ordered to maintain its accounts and records as required by the Commission;
3. The Applicant should be ordered to 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;
4. The Applicant should be ordered to maintain on file with the Commission all current tariffs and rates, and any service standards that the Commission may require;
5. The Applicant should be ordered to comply with the Commission's rules and modify its tariffs to conform to these rules if it is determined that there is a conflict between the Applicant's tariffs and the Commission's rules;
6. The Applicant should be ordered to cooperate with Commission investigations including, but not limited to customer complaints;
7. The Applicant should be ordered to participate in and contribute to the Arizona Universal Service Fund, as required by the Commission;
8. The Applicant should be ordered to notify the Commission immediately upon changes to the Applicant's name, address or telephone number;
9. The Applicant's intrastate interexchange service offerings should be classified as competitive pursuant to A.A.C. R14-2-1108;

10. The maximum rates for these services should be the maximum rates proposed by the Applicant in its proposed tariffs. The minimum rates for the Applicant's competitive services should be the Applicant's total service long run incremental costs of providing those services as set forth in A.A.C. R14-2-1109;
11. In the event that the Applicant states only one rate in its proposed tariff for a competitive service, the rate stated should be the effective (actual) price to be charged for the service as well as the service's maximum rate;
12. The rates proposed by this filing are for competitive services. In general, rates for competitive services are not set according to rate of return regulation. Staff obtained information from the Applicant and has determined that its fair value rate base is zero. Accordingly, the Applicant's fair value rate base is too small to be useful in a fair value analysis. Staff has reviewed the rates to be charged by the Applicant and believes they are just and reasonable as they are comparable to major long distance carriers. Therefore, while Staff considered the fair value rate base information submitted by the Applicant, the fair value rate base information provided should not be given substantial weight in this analysis;
13. In the event the Applicant requests to discontinue and/or abandon its service area it must provide notice to both the Commission and its customers. Such notice(s) shall be in accordance with A.A.C. R14-2-1107.

Staff further recommends that the Applicant be ordered to comply with the following. If it does not do so, the Applicant's CC&N shall be null and void without further order of the Commission and no time extensions shall be granted.

1. The Applicant shall docket conforming tariffs for each of its CC&Ns within 365 days from the date of an Order in this matter or 30 days prior to providing service, whichever comes first, and in accordance with the Decision;
2. The Applicant shall:
 - a. procure a performance bond equal to \$100,000. The minimum bond amount of \$100,000 should be increased if at any time it would be insufficient to cover advances, deposits and/or prepayments collected from the Applicant's customers. The bond amount should be increased in increments of \$50,000. This increase should occur when the total amount of the advances, deposits and prepayments is within \$10,000 of the bond amount;
 - b. docket proof of the performance bond within 365 days of the effective date of an Order in this matter or 30 days prior to the provision of service, whichever comes first. The bond shall remain in effect until further Order of the Commission.

5.2 RECOMMENDATION ON THE APPLICANT'S PETITION TO HAVE ITS
PROPOSED SERVICES CLASSIFIED AS COMPETITIVE

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

ATTACHMENT A

SBCS currently has the authority to provide facilities-based interexchange service in the following states:

California
Colorado
Florida
Georgia
Illinois
Missouri
Ohio
Texas
Washington

Financial Data

SBC Communications Inc.

Consolidated Statements of Income

Dollars in millions except per share amounts

Unaudited	Three Months Ended			Six Months Ended		
	6/30/04	6/30/03	% Chg	6/30/04	6/30/03	% Chg
Operating Revenues						
Voice	\$ 5,225	\$ 5,579	-6.3%	\$ 10,457	\$ 11,330	-7.7%
Data	2,727	2,491	9.5%	5,374	4,970	8.1%
Long-distance voice	815	612	33.2%	1,564	1,190	31.4%
Directory advertising	1,055	1,080	-2.3%	2,115	2,156	-1.9%
Other	492	474	3.8%	932	965	-3.4%
Total Operating Revenues	10,314	10,236	0.8%	20,442	20,611	-0.8%
Operating Expenses						
Cost of sales (exclusive of depreciation and amortization shown separately below)	4,305	4,067	5.9%	8,543	8,150	4.8%
Selling, general and administrative	2,627	2,442	7.6%	5,035	4,840	4.0%
Depreciation and amortization	1,888	1,977	-4.5%	3,811	3,973	-4.1%
Total Operating Expenses	8,820	8,486	3.9%	17,389	16,963	2.5%
Operating Income	1,494	1,750	-14.6%	3,053	3,648	-16.3%
Interest Expense	236	376	-37.2%	467	693	-32.6%
Interest Income	120	143	-16.1%	236	279	-15.4%
Equity in Net Income of Affiliates	369	471	-21.7%	961	836	15.0%
Other Income (Expense) - Net	(44)	84	-	817	1,665	-50.9%
Income Before Income Taxes	1,703	2,072	-17.8%	4,600	5,735	-19.8%
Income Taxes	535	684	-21.8%	1,495	1,892	-21.0%
Income Before Cumulative Effect of Accounting Changes	1,168	1,388	-15.9%	3,105	3,843	-19.2%
Cumulative Effect of Accounting Changes, net of tax	-	-	-	-	2,541	-
Net Income	\$ 1,168	\$ 1,388	-15.9%	\$ 3,105	\$ 6,384	-51.4%
Basic Earnings Per Share:						
Income Before Cumulative Effect of Accounting Changes	\$ 0.35	\$ 0.42	-16.7%	\$ 0.94	\$ 1.16	-19.0%
Net Income	\$ 0.35	\$ 0.42	-16.7%	\$ 0.94	\$ 1.92	-51.0%
Weighted Average Common Shares Outstanding (000,000)	3,312	3,323	-0.3%	3,310	3,321	-0.3%
Diluted Earnings Per Share:						
Income Before Cumulative Effect of Accounting Changes	\$ 0.35	\$ 0.42	-16.7%	\$ 0.94	\$ 1.15	-18.3%
Net Income	\$ 0.35	\$ 0.42	-16.7%	\$ 0.94	\$ 1.92	-51.0%
Weighted Average Common Shares Outstanding with Dilution (000,000)	3,323	3,334	-0.3%	3,323	3,334	-0.3%

Financial Data

SBC Communications Inc.

Consolidated Balance Sheets

Dollars in millions except per share amounts

6/30/2004

12/31/2003

Unaudited

Assets

Current Assets

Cash and cash equivalents	\$ 11,586	\$ 4,806
Accounts receivable - net of allowances for uncollectibles of \$974 and \$914	5,564	6,178
Short-term investments	346	378
Prepaid expenses	783	760
Deferred income taxes	575	712
Other current assets	1,103	1,134
Total current assets	19,957	13,968
Property, plant and equipment - at cost	134,943	133,923
Less: accumulated depreciation and amortization	84,387	81,795
Property, Plant and Equipment - Net	50,556	52,128
Goodwill- Net	1,625	1,611
Investments in Equity Affiliates	2,074	6,947
Investments in and Advances to Cingular Wireless	11,351	11,003
Other Assets	14,859	14,509
Total Assets	\$ 100,422	\$ 100,166

Liabilities and Shareowners' Equity

Current Liabilities

Debt maturing within one year	\$ 2,460	\$ 1,879
Accounts payable and accrued liabilities	9,386	10,870
Accrued taxes	907	478
Dividends payable	1,035	1,033
Total current liabilities	13,788	14,260
Long-Term Debt	15,162	16,060
Deferred Credits and Other Noncurrent Liabilities		
Deferred income taxes	15,681	15,079
Postemployment benefit obligation	12,663	12,692
Unamortized investment tax credits	205	220
Other noncurrent liabilities	3,643	3,607
Total deferred credits and other noncurrent liabilities	32,192	31,598

Shareowners' Equity

Common shares issued (\$1 par value)	3,433	3,433
Capital in excess of par value	12,941	13,010
Retained earnings	28,670	27,635
Treasury shares (at cost)	(4,390)	(4,698)
Additional minimum pension liability adjustment	(1,132)	(1,132)
Accumulated other comprehensive income	(242)	-
Total shareowners' equity	39,280	38,248
Total Liabilities and Shareowners' Equity	\$ 100,422	\$ 100,166