



DEC 20 2004

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**STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION**

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Application for a Certificate of Convenience and Necessity to Provide Resold Interexchange Service and for Determination that Services of the Applicant are Competitive

Arizona Corporation Commission
DOCKETED

DEC 20 2004

**Applicant: A.R.C. Networks, Inc. d/b/a InfoHighway
Docket No.: T-04271A-04-0589**

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On August 9, 2004, A.R.C. Networks, Inc. d/b/a InfoHighway ("A.R.C.") filed an application for a Certificate of Convenience and Necessity ("CC&N") to provide resold interexchange services within the State of Arizona.

Staff's review of this application addresses the overall fitness of the Applicant to receive a CC&N to provide competitive resold intrastate interexchange telecommunications services. Staff's review considers the Applicant's technical and financial capabilities, and whether the Applicant's proposed rates will be just and reasonable.

REVIEW OF APPLICANT INFORMATION

Staff makes the following finding, indicated by an "X," regarding information filed by the Applicant:

- The necessary information has been filed to process this application, and the Applicant has authority to transact business in the State of Arizona.
- The Applicant has published legal notice of the application in all counties where service will be provided. On October 22, 2004, Applicant filed an Affidavit of Publication from the Arizona Republic that complies with the Commission's notice requirements.

REVIEW OF TECHNICAL INFORMATION

The Applicant has demonstrated sufficient technical capability to provide the proposed services for the following reasons, which are marked:

- The Applicant is currently providing service in Arizona.
- The Applicant is currently providing service in other states.
- The Applicant is a switchless reseller.

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In the event the Applicant experiences financial difficulty, end users can access other interexchange service providers.

The Applicant indicated that it currently offers resold interexchange service in the District of Columbia and in thirty-three states, excluding Arizona (see attachment A). Based on this information, Staff has determined that the Applicant has sufficient technical capabilities to provide resold interexchange telecommunications services.

REVIEW OF FINANCIAL INFORMATION

The Applicant is required to have a performance bond to provide resold interexchange service in the State of Arizona.

The Applicant did provide audited financial statements (of its parent company, Infohighway Communications Corporation.) for the twelve months ending December 31, 2003. These financial statements list assets in excess of \$26 million; equity in excess of \$9 million; and a net income in excess of \$4 million. The Applicant did provide notes related to the financial statements.

The Applicant stated in its Tariff, Section 2.6.8 on page 12, that it does not collect from its resold interexchange customers an advance, deposit, and/or prepayment. If at some future date, the Applicant wants to collect from its resold interexchange customers an advance, deposit, and/or prepayment, Staff recommends that the Applicant be required to file an application with the Arizona Corporation Commission ("Commission") for Commission approval. Such application must reference the decision in this docket and must explain the applicant's plans for procuring a performance bond.

If this Applicant experiences financial difficulty, there should be minimal impact to the customers of this Applicant because there are many companies that provide resold interexchange telecommunications service 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.

The Applicant indicated that none of its officers, directors or partners have been involved in any civil or criminal investigations. 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.

The Applicant indicated that it is currently the subject of a pending complaint before the Federal Communications Commission ("FCC"). In this complaint, a group of payphone providers ("plaintiffs") allege that A.R.C. violated the Communications Act of 1996 and FCC Rules by failing to make payments for dial-around calls that originated from the payphones of the plaintiffs. A.R.C. has taken the position that it made these payments to its underlying carrier, Global Crossing and A.R.C. believes Global Crossing is therefore responsible for these payments to the plaintiffs.

REVIEW OF PROPOSED TARIFF AND FAIR VALUE DETERMINATION

- The Applicant has filed a proposed tariff with the Commission.**
- The Applicant has filed sufficient information with the Commission to make a fair value determination.**

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 company and has determined that its fair value rate base is zero. Accordingly, the company'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 several long distance carriers operating in Arizona and comparable to the rates the Applicant charges in other jurisdictions. Therefore, while Staff considered the fair value rate base information submitted by the company, the fair value rate base information provided should not be given substantial weight in this analysis.

COMPETITIVE SERVICES' RATES AND CHARGES

Competitive Services

The Applicant is a reseller of services it purchases from other telecommunications companies. It is not a monopoly provider of service nor does it control a significant portion of the telecommunications market. The Applicant cannot adversely affect the intrastate interexchange market by restricting output or raising market prices. In addition, the entities from which the Applicant buys bulk services are technically and financially capable of providing alternative services at comparable rates, terms, and conditions. Staff has concluded that the Applicant has no market power and that the reasonableness of its rates will be evaluated in a market with numerous competitors. In light of the competitive market in which the Applicant will be providing its services, Staff believes that the Applicant's proposed tariffs for its competitive services will be just and reasonable.

Effective Rates

The Commission provides pricing flexibility by allowing competitive telecommunication service companies to price their services at or below the maximum rates contained in their tariffs as long as the pricing of those services complies with Arizona Administrative Code ("A.A.C.") R14-2-1109. The Commission's rules require the Applicant to file a tariff for each competitive service that states the maximum rate as well as the effective (actual) price that will be charged for the service. In the event that the Applicant states only one rate in its tariff for a competitive service, Staff recommends that the rate stated be the effective (actual) price to be charged for the service as well as the service's maximum rate. Any changes to the Applicant's effective price for a service must comply with A.A.C. R14-2-1109.

Minimum and Maximum Rates

A.A.C. R14-2-1109 (A) provides that minimum rates for the Applicant's competitive services must not be below the Applicant's total service long run incremental costs of providing the services. The Applicant's maximum rates should be the maximum rates proposed by the Applicant in its most recent tariffs on file with the Commission. Any future changes to the maximum rates in the Applicant's tariffs must comply with A.A.C. R14-2-1110.

STAFF RECOMMENDATIONS

Staff has reviewed the application for a Certificate of Convenience and Necessity to offer intrastate interexchange services as a reseller and the Applicant's petition to classify its intrastate interexchange services as competitive. Based on its evaluation of the Applicant's technical and financial capabilities to provide resold intrastate interexchange services, Staff recommends approval of the application. In addition, Staff further recommends that:

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. If at some future date, the Applicant wants to collect from its resold interexchange customers an advance, deposit, and/or prepayment, Staff recommends that the Applicant be required to file an

application with the Commission for Commission approval. Such application must reference the decision in this docket and must explain the applicant's plans for procuring a performance bond;

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 company and has determined that its fair value rate base is zero. Accordingly, the company'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 several distance carriers operating in Arizona and comparable to the rates the Applicant charges in other jurisdictions. Therefore, while Staff considered the fair value rate base information submitted by the company, 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 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 within 365 days from the date of an Order in this matter or 30 days prior to providing service, which ever comes first, and in accordance with the Decision.

This application may be approved without a hearing pursuant to A.R.S. § 40-282.

for Ernest G. Johnson

Date: 12/20/04

Director
Utilities Division

Originator: Adam Lebrecht

Attachment A

A.R.C. indicated that it is currently providing resold interexchange telecommunications service in the District of Columbia and the following states:

1. Arkansas
2. California
3. Colorado
4. Connecticut
5. Delaware
6. Florida
7. Georgia
8. Illinois
9. Indiana
10. Kansas
11. Kentucky
12. Louisiana
13. Massachusetts
14. Maryland
15. Maine
16. Michigan
17. Minnesota
18. Missouri
19. North Carolina
20. New Hampshire
21. New Jersey
22. Nevada
23. New York
24. Ohio
25. Oklahoma
26. Pennsylvania
27. Rhode Island
28. South Carolina
29. Tennessee
30. Texas
31. Utah
32. Vermont
33. Wyoming

SERVICE LIST FOR: A.R.C. Networks, Inc. d/b/a InfoHighway
DOCKET NO. T-04271A-04-0589

Mr. Glenn S. Richards
Shaw Pittman LLP
2300 North Street, North West
Washington, DC 20037-1128

Mr. Ernest G. Johnson
Arizona Corporation Commission
Utilities Division
1200 West Washington
Phoenix, Arizona 85007

Mr. Christopher C. Kempley
Arizona Corporation Commission
Legal Division
1200 West Washington
Phoenix, Arizona 85007

Ms. Lyn Farmer
Chief Administrative Law Judge
Arizona Corporation Commission
Hearing Division
1200 West Washington
Phoenix, Arizona 85007

Comparison of intrastate interexchange service rates

	Usage Rates				Operator Services		
	Each 6 second increment or fraction thereof				Each occurrence		
	Switched Inbound	Dedicated Inbound	Switched Outbound	Dedicated Outbound	Person to Person	Station to Station	Directory Assistance
Arizona	0.0169	0.0120	0.0118	0.0110	3.00	3.00	0.95
Arkansas	0.0120	0.0066	0.0118	0.0065	3.00	1.50	0.85
California	0.0052	0.0036	0.0050	0.0032	3.00	1.50	0.95
Colorado	0.0159	0.0091	0.0133	0.0084	3.00	1.50	0.95
Connecticut	0.0071	0.0049	0.0069	0.0043	3.00	1.50	0.85
Delaware	0.0075	0.0065	0.0069	0.0055	3.00	1.50	0.95
District of Columbia	NA	NA	NA	NA	NA	NA	NA
Florida	0.0120	0.0076	0.0119	0.0067	3.00	1.50	0.95
Georgia	0.0079	0.0054	0.0078	0.0051	3.00	1.50	0.95
Illinois	0.0045	0.0035	0.0044	0.0034	3.00	1.50	0.85
Indiana	0.0066	0.0053	0.0064	0.0037	3.00	1.50	0.85
Kansas	0.0119	0.0075	0.0117	0.0068	3.00	1.50	0.85
Louisiana	0.0071	0.0075	0.0051	0.0059	3.00	1.50	0.95
Kentucky	0.0047	0.0031	0.0046	0.0028	3.00	1.50	0.95
Massachusetts	0.0084	0.0073	0.0075	0.0067	3.63	1.35	0.95
Maryland	0.0051	0.0036	0.0045	0.0034	3.00	1.50	0.85
Maine	0.0075	0.0074	0.0069	0.0059	3.50	1.58	0.95
Michigan	0.0049	0.0038	0.0047	0.0031	3.00	1.50	0.95
Minnesota	0.0125	0.0100	0.0123	0.0084	3.00	1.50	0.85
Missouri	0.0184	0.0120	0.0183	0.0107	3.00	1.50	0.85
North Carolina	0.0123	0.0096	0.0121	0.0089	3.00	1.50	0.95
New Hampshire	0.0109	0.0086	0.0099	0.0075	3.20	1.80	0.95
New Jersey	0.0075	0.0057	0.0069	0.0052	3.00	1.50	0.95
Nevada	0.0082	0.0051	0.0080	0.0049	3.00	1.50	0.95
New York	0.0085	0.0059	0.0080	0.0055	3.00	1.50	0.95
Ohio	0.0069	0.0047	0.0067	0.0044	3.00	1.50	0.95
Oklahoma	0.0093	0.0070	0.0091	0.0069	3.00	1.50	0.95
Pennsylvania	0.0075	0.0061	0.0069	0.0055	3.00	1.50	0.95
Rhode Island	0.0089	0.0054	0.0079	0.0048	3.00	1.50	0.95
South Carolina	0.0110	0.0110	0.0109	0.0071	3.00	1.50	0.95
Tennessee	0.0095	0.0053	0.0092	0.0050	3.00	1.50	0.95
Texas	0.0142	0.0082	0.0095	0.0076	3.00	1.50	0.95
Utah	0.0090	0.0057	0.0089	0.0052	3.00	1.50	0.95
Vermont	0.0079	0.0065	0.0069	0.0059	3.00	1.50	0.85
Wyoming	0.0058	0.0038	0.0056	0.0040	3.00	1.50	0.95

INFOHIGHWAY COMMUNICATIONS CORPORATION

CONSOLIDATED BALANCE SHEETS

DECEMBER 31, 2003 AND 2002

ASSETS	2003	2002
CURRENT ASSETS:		
Cash and cash equivalents	\$ 6,225,063	\$ 2,340,037
Accounts receivable, net of allowances of \$977,802 in 2003 and \$570,263 in 2002	7,432,347	7,770,204
Earned revenue in excess of billings on uncompleted contracts	572,651	422,649
Prepaid expenses and other current assets	<u>1,240,336</u>	<u>442,000</u>
Total current assets	15,470,397	10,974,890
PROPERTY AND EQUIPMENT, Net	2,179,891	986,270
GOODWILL	8,074,706	8,271,684
OTHER ASSETS	<u>799,506</u>	<u>1,028,393</u>
TOTAL	<u>\$ 26,524,500</u>	<u>\$ 21,261,237</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	\$ 2,790,290	\$ 4,149,696
Accrued expenses	10,138,675	6,485,820
Notes payable to stockholder	3,750,000	-
Other current liabilities	<u>601,941</u>	<u>788,994</u>
Total current liabilities	17,280,906	11,424,510
LONG-TERM LIABILITIES:		
Notes payable to stockholder	-	3,750,000
Other long-term liabilities	<u>-</u>	<u>16,941</u>
Total long-term liabilities	-	3,766,941
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY:		
Class A redeemable convertible preferred stock - \$.001 par value, 170,000 shares authorized, 44,631 shares issued and outstanding in 2003 and 2002, liquidation preference \$44,631,000, plus accrued dividends of \$13,405,567 and \$8,985,817 at December 31, 2003 and 2002, respectively	45	45
Class B convertible preferred stock - \$.001 par value, 30,000 shares authorized, 6,728 shares issued and outstanding in 2003 and 2002, liquidation preference \$6,728,000, plus accrued dividends of \$ 2,047,656 and \$1,379,349 at December 31, 2003 and 2002, respectively	7	7
Class C redeemable convertible preferred stock - \$.001 par value, 50,000 shares authorized, 1,176 shares issued at December 31, 2002, liquidation preference of \$1,176,000 plus accrued dividends of \$34,607 at December 31, 2002	-	1
Class A common stock - \$.001 par value, 95,000,000 shares authorized, 29,156,318 and 28,756,318 shares issued and outstanding at December 31, 2003 and 2002, respectively	29,156	28,756
Class B convertible non-voting common stock - \$.001 par value, 40,000,000 shares authorized, 119,100 shares issued and outstanding at December 31, 2003 and 2002, respectively	119	119
Additional paid-in capital	39,944,929	40,940,333
Notes receivable from stockholders	(46,288)	(24,918)
Accumulated deficit	<u>(30,684,374)</u>	<u>(34,874,557)</u>
Total stockholders' equity	9,243,594	6,069,786
TOTAL	<u>\$ 26,524,500</u>	<u>\$ 21,261,237</u>

See notes to consolidated financial statements.

INFOHIGHWAY COMMUNICATIONS CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS YEARS ENDED DECEMBER 31, 2003, 2002 AND 2001

	2003	2002	2001
REVENUES	\$59,614,747	\$34,847,963	\$ 25,513,967
COST OF REVENUES	<u>30,965,131</u>	<u>20,491,464</u>	<u>20,121,314</u>
GROSS MARGIN	28,649,616	14,356,499	5,392,653
OPERATING EXPENSES:			
Selling expenses	7,981,231	3,680,156	3,955,895
General and administrative expenses	14,615,334	10,480,537	10,510,367
Abandoned acquisitions and related financing	967,733	399,399	-
Management fee income	<u>-</u>	<u>(966,199)</u>	<u>-</u>
OPERATING INCOME (LOSS)	5,085,318	762,606	(9,073,609)
OTHER (INCOME) EXPENSE:			
Interest income	(2,942)	(25,992)	(217,977)
Interest expense	<u>736,598</u>	<u>463,017</u>	<u>-</u>
INCOME (LOSS) FROM CONTINUING OPERATIONS	4,351,662	325,581	(8,855,632)
INCOME TAXES	161,479	-	-
LOSS FROM DISCONTINUED OPERATIONS	-	-	(2,050,343)
LOSS ON DISPOSAL OF DISCONTINUED OPERATIONS	<u>-</u>	<u>-</u>	<u>(12,699,180)</u>
NET INCOME (LOSS)	<u>\$ 4,190,183</u>	<u>\$ 325,581</u>	<u>\$ (23,605,155)</u>

See notes to consolidated financial statements.

RESOLD LONG DISTANCE CC&N CHECKLIST.

1.  Determine type of service(s) that the Applicant is requesting the authority to provide and find correct Staff Report Template. R-LD
2.  While filling in Applicant information, make sure Applicant's name is spelled correctly and that the correct docket # is used. T-04271A-04-0589
3.  If the Applicant is requesting a CC&N that is NOT for facilities-based local exchange service, make sure Applicant has proper affidavit of publication. When entering this information into the Staff Report, be sure to use the docket date of the affidavit. 10/22/04
4.  In Financial information section, be sure to note if the company has the authority to provide service in 6 or more states. If not, must have the total number of employees and their total combined years of experience in telecommunications industry. 33+ DC
5.  When looking at the financial information, make sure to note if the Applicant is using information from its parent company. Use the total assets, equity and net incomes (+/-) in the staff report. A- \$26M, E- \$9 M, NI-\$4M Audited Parent Company (InfoHighway)
6.  If (Resold Long Distance) Applicant needs accepts deposits and/or prepayments, a performance bond is needed. If not collecting Deposit and/or prepayments, no bond is needed. Be sure to detail the specific page and section in the applicant's tariff. No deposit, no bond
7.  If the Applicant is requesting the authority to provide local service (facilities-based or resold), a performance bond is needed regardless of whether or not the Applicant's tariff states deposits and/or prepayments are collected. N/A
8.  In the application, the Applicant is asked if customers will have access to dial 1010 (dial around) access codes. Make note of the Applicant's answer in section in the Staff Report.
Yes
9.  In the Application, the Applicant is asked to detail the value of all current assets in Arizona. Use this amount to answer the questions concerning Fair Value Rate Base in the Staff Report. Typically, this amount will be \$0. Zero
10.  After the information has been input into the Staff Report, READ THE STAFF REPORT for clarity and to find any/all spelling/grammatical mistakes. Once the Staff Report has been read, reread and all changes have been made, submit to supervisor.