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Deborah R. Scott
Director
Utilities Division

DATE: June 12, 2000

RE: STAFF REPORT ON THE APPLICATION OF ADVANCED TELCOM GROUP, INC. FOR A CERTIFICATE OF CONVENIENCE AND NECESSITY TO PROVIDE COMPETITIVE INTRASTATE TELECOMMUNICATIONS SERVICES AS A FACILITIES-BASED PROVIDER AND RESELLER, AND PETITION FOR A DETERMINATION THAT ITS SERVICES SHOULD BE CLASSIFIED AS COMPETITIVE. (DOCKET NO. T-03842A-00-0130)

Attached is the Staff Report for the above referenced application. Staff is recommending approval of the application following a hearing.

Originators: Rodney Moore and Kevin Mosier

Attachment: Original and Eleven Copies

STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION

ADVANCED TELCOM GROUP, INC.

DOCKET NO. T-03842A-00-0130

APPLICATION FOR A CC&N TO PROVIDE
COMPETITIVE INTRASTATE TELECOMMUNICATIONS
SERVICES AS A FACILITIES-BASED PROVIDER
AND RESELLER IN ARIZONA
AND
PETITION FOR A DETERMINATION THAT ITS SERVICES
SHOULD BE CLASSIFIED AS COMPETITIVE

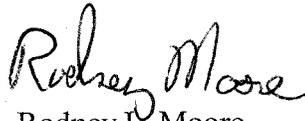
June 12, 2000

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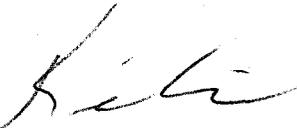
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STAFF ACKNOWLEDGMENT

The Staff Report for Advanced TelCom Group, Inc., Docket No. T-03842A-00-0130, was the responsibility of the Staff members listed below. Rodney L. Moore and Kevin D. Mosier were responsible for the review and analysis of the Company's application for a Certificate of Convenience and Necessity to provide facilities-based and resold interexchange, local exchange and access telecommunications service and petition for a determination that its services should be classified as competitive.



Rodney L. Moore
Auditor II



Kevin D. Mosier
Economist II

1. INTRODUCTION

On February 29, 2000, Advanced TelCom Group, Inc. ("ATGI" or "Company") filed an application for a Certificate of Convenience and Necessity ("CC&N") to provide resold and facilities-based local exchange, interexchange and access telecommunications service within the State of Arizona. ATGI petitioned the Arizona Corporation Commission ("Commission") for a determination that the services it seeks to offer should be classified as competitive.

Article XV, Section 2 of the Arizona Constitution and the Arizona statutes governing public service corporations give the Commission full power to regulate the State's public service corporations. Inherent in those powers is the authority to certificate public service corporations to provide competitive telecommunication services and establish just and reasonable rates for these services. The Commission has rules, Title 14, Chapter 2, Articles 11, 12, 13, 14, and 15 of the Arizona Administrative Code, ("Competitive Telecommunications Services rules") that serve as a framework for processing applications to provide competitive telecommunications services, provide for intraLATA equal access, and establish guidelines for interconnection between carriers. Additionally, the Telecommunications Act of 1996 ("1996 Act"), and the rules adopted thereunder by the Federal Communications Commission and this Commission, provide a framework within which to evaluate this application.

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

2. ATGI'S APPLICATION FOR A CERTIFICATE OF CONVENIENCE & NECESSITY

This section of the Staff Report contains descriptions of the geographic market to be served by ATGI, the requested services, and ATGI's technical and financial capability to provide the requested services. In addition, this section contains the Staff evaluation of ATGI's rates and charges and Staff's recommendation regarding the requirements of A.A.C. R14-2-1104(A)(3).

2.1 DESCRIPTION OF THE GEOGRAPHIC MARKET TO BE SERVED

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

2.2 DESCRIPTION OF REQUESTED SERVICES

ATGI proposes to provide a range of facilities-based and resold local exchange, interexchange, exchange access and dedicated access data transmission services.

2.3 THE ORGANIZATION

ATGI 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

ATGI is approved to offer interexchange service and facilities-based local exchange service in 15 states.

2.5 FINANCIAL CAPABILITY TO PROVIDE SERVICES

ATGI has submitted its financial statements for the fiscal year ending November 30, 1999. These financials list total assets of \$151.24 million, total stockholder's equity of \$4.63 million and a net loss of (\$20.00 million) on revenues of \$0.27 million. Since ATGI does not appear to have sufficient financial resources, Staff believes that any deposits, prepayments and advances received from ATGI's customers should be protected. Further, measures should be taken to ensure that ATGI will not discontinue service to its customers without first complying with A.A.C. R14-2-1107.

To that end, Staff recommends that ATGI procure a performance bond equal to a minimum of 120 days intrastate telecommunications revenue, and any prepayments and deposits collected from the Company's customers. The amount of the performance bond must be increased if at any time it would be insufficient to cover 120 days intrastate telecommunications revenue, and any prepayments and deposits collected from the Company's customers. If ATGI desires to discontinue service it must file an application with the Commission pursuant to A.A.C. R14-2-1107. Additionally, ATGI must notify each of its customers and the Commission 60 days prior to filing an application pursuant to A.A.C. R14-2-1107. Failure to meet this requirement will result in forfeiture of ATGI's performance bond. Staff further recommends that proof of the above mentioned performance bond be docketed at least 30 days prior to the provision of service.

After one year of operation under the CC&N granted by the Commission, ATGI should be allowed to file a request for cancellation of its established surety bond. Such request should be accompanied by information demonstrating ATGI's financial viability. Upon receipt of such filing and after review, Staff will forward its recommendations to the Commission for a Decision.

2.6 ESTABLISHING RATES AND CHARGES

ATGI 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, ATGI will have to compete with those providers in order to obtain subscribers to its services. ATGI 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, ATGI will generally not be able to exert market power. Thus, the competitive process should result in rates that are just and reasonable.

Pursuant to A.A.C. R14-2-1109 and A.A.C. R14-2-1104(A)(3), 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. However, ATGI has requested a waiver of its filing of a local exchange tariff until resale/interconnection negotiations are completed. Therefore, Staff recommends that ATGI be required to file its tariffs within 30 days of an Order in this matter, in accordance with the Decision and at least 30 days before it provides service to any customer.

3. LOCAL EXCHANGE CARRIER SPECIFIC ISSUES

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

3.1 INTERCONNECTION

ATGI has applied for a CC&N to become a local exchange company. As such, ATGI 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 ATGI and other telephone service providers will take place (Decision No. 59761, dated July 22, 1996, in Docket No. RT-00000F-96-0001). The 1996 Act has also set forth general guidelines for interconnection. Staff therefore recommends that, unless it provides services solely through the use of its own facilities, ATGI procure an Interconnection Agreement that is consistent with these guidelines before being allowed to offer local exchange service.

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 ATGI. 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 ATGI 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 ATGI'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 ATGI 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, ATGI 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 ATGI's application for a CC&N be conditioned upon ATGI'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

ATGI has not indicated in its application that it will abide by the Quality of Service rules that are developed for telecommunications companies in compliance with A.A.C. R14-2-1114. Staff believes that ATGI should comply with those rules when they are developed, but Staff also believes that, in the interim, ATGI should also abide by the quality of service standards that were approved by the Commission for U S WEST Communications, Inc. ("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 ATGI. In the competitive market that ATGI wishes to enter, ATGI 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 ATGI 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 ATGI installs the only local exchange service facilities, ATGI will be a monopoly service provider. In the interest of providing competitive alternatives to ATGI's local exchange service customers, Staff recommends that ATGI provide customers served in these areas with access to alternative local exchange service providers so that they may be served by them if they desire. With this requirement in place, ATGI will not be able to exert monopoly power over customers who are located in areas where ATGI is the only provider of facilities to serve the customer. Access to other providers should be provided pursuant to the provisions of the 1996 Act, the rules promulgated thereunder and Commission rules on interconnection and unbundling.

3.7 911 SERVICE

ATGI has indicated in its application it will provide all customers with 911 and E911 service, where available, and will coordinate with ILECs and emergency service providers to provide the service. Staff believes that ATGI 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 ATGI 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. 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 ATGI 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 ATGI to engage in the educational program that was ordered for USWC as long as customers in the areas, where ATGI 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 ATGI did 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 ATGI be required to comply with A.A.C. R14-2-1111, which requires local exchange companies to provide 2-PIC equal access.

4. COMPETITIVE SERVICES ANALYSIS

ATGI has petitioned the Commission for a determination that the services it is seeking to provide should be classified as competitive. ATGI is required to provide notice of its application to each person on the service list in the Competitive Telecommunications Services Rulemaking proceeding (Docket No. RT-00000J-94-0424). The parties include the telecommunications companies that provide the same or similar services or group of services for which ATGI has requested competitive service classification. At the time of this Staff Report, ATGI had not yet certified that all notification requirements have been completed.

Staff's analysis and recommendations are as follows:

4.1 COMPETITIVE SERVICES ANALYSIS FOR ATGI'S REQUESTED LOCAL EXCHANGE 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 analysis of the market for local exchange service that ATGI 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 ATGI 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, ATGI will be entering the market as an alternative provider of local exchange service and, as such, ATGI will have to compete with those companies in order to obtain customers. In areas where ILECs do not serve customers, ATGI may have to convince developers to allow it to provide service to their developments. Staff recommends that, in those instances where the Company provides the only facilities used to provide telecommunications service, that the Company 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.

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

USWC 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.

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

Since USWC 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.

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

None.

4.1.5 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 ATGI has requested in their respective service territories. Similarly many of the CLECs and local exchange resellers also offer substantially similar 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 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 USWC 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 ATGI, should provide USWC--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 ATGI will not have the capability to adversely affect prices or restrict output to the detriment of telephone service subscribers.

4.2 **COMPETITIVE SERVICES ANALYSIS FOR ATGI'S REQUESTED INTEREXCHANGE SERVICES**

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

4.2.2 **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.

4.2.3 **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.

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

None.

4.2.5 **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 ATGI has requested in their respective service territories. Similarly many of the ILECs offer similar intraLATA toll services.

4.2.6 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 ATGI will not have the capability to adversely affect prices or restrict output to the detriment of telephone service subscribers.

4.3 COMPETITIVE SERVICES ANALYSIS FOR ATGI'S REQUESTED ACCESS SERVICES

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

The market for telecommunications service in which ATGI 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 ATGI may be reliant upon ILECs to access customers in order to provide competitive access services.

4.3.2 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.

4.3.3 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.

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

None.

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

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

4.3.6 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 USWC, 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 USWC, that have existed over a number of years.
- c. The fact that the ILECs, such as USWC, 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.

5. RECOMMENDATIONS

The following sections contain the Staff recommendations on ATGI's Application for a CC&N and ATGI's Petition for a Commission Determination that its Proposed Services should be classified as competitive.

5.1 RECOMMENDATIONS ON ATGI'S APPLICATION FOR A CC&N

ATGI is incorporated under the laws of the State of Delaware, and is approved to offer facilities-based local exchange services in 15 states. ATGI 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. Therefore, Staff recommends that ATGI'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 conditions:

- a. That ATGI be required to abide by the additional financial requirements as stated in Section 2.5 of this Report.
- b. That ATGI be required to file its tariffs within 30 days of an Order in this matter, and in accordance with the Decision.
- c. That, unless it provides services solely through the use of its own facilities, ATGI procure an Interconnection Agreement before being allowed to offer local exchange service.
- d. That ATGI file with the Commission its plan to have its customers' telephone numbers included in the incumbent's Directories and Directory Assistance databases within 30 days of an Order in this matter.
- e. That ATGI pursue permanent number portability arrangements with other LECs pursuant to Commission rules, federal laws and federal rules.
- f. That ATGI 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).
- g. That ATGI abide by the quality of service standards that were approved by the Commission for USWC in Docket No. T-01051B-93-0183.
- h. That in areas where ATGI is the sole provider of local exchange service facilities, ATGI will provide customers with access to alternative providers of service pursuant to the provisions of Commission rules, federal laws and federal rules.

- i. That ATGI 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.
- j. That ATGI be required to abide by all the Commission decisions and policies regarding CLASS services.
- k. That ATGI be required to comply with A.A.C. R14-2-1111, which requires local exchange companies to provide 2-PIC equal access.
- l. That ATGI be required to certify that all notification requirements have been completed prior to a final determination in this proceeding.
- m. That ATGI be required to notify the Commission immediately upon changes to ATGI's address or telephone number.
- n. That ATGI be required to abide by all Commission rules and regulations.

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

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

Therefore, Staff recommends that ATGI's proposed services be classified as competitive. Initially, ATGI will be providing service in areas where a number of telecommunications companies are providing one or more of these services. Therefore, ATGI will have to compete with existing telephone service providers in order to obtain subscribers to its services. Because ATGI will face competition in providing service to its potential customers, ATGI will generally not be able to exert monopoly power and, thus, the existence of competitive local exchange, interexchange and access service.

Staff further recommends that ATGI be subject to the Commission's rules governing interconnection and unbundling and the 1996 Act and the rules promulgated thereunder. In the event that ATGI provides essential services or facilities that potential competitors need in order to provide their services, ATGI 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.