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Director
Utilities Division

AZ CORP COMMISSION
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Arizona Corporation Commission

DOCKETED

MAY 13 2005

DATE: May 13, 2005

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RE: IN THE MATTER OF THE APPLICATION OF QWEST COMMUNICATIONS CORPORATION TO HAVE ITS CERTIFICATE OF CONVENIENCE AND NECESSITY MODIFIED TO INCLUDE RESOLD LONG DISTANCE SERVICE AND FACILITIES-BASED LOCAL EXCHANGE SERVICE, IN ADDITION TO THE FACILITIES-BASED LONG DISTANCE AUTHORITY PREVIOUSLY GRANTED (DOCKET NO. T-02811BA-04-0313)

I. Introduction

On April 23, 2004, Qwest Communications Corporation ("QCC") filed an application for an Expanded CC&N to provide the following additional services:

- Resold Long Distance Services
- Resold Local Exchange Services
- Facilities-Based Local Exchange Services

Staff recommended that QCC's CC&N be expanded to modify the Applicant's Certificate of Convenience and Necessity to provide resold long distance services statewide, and resold local exchange services and facilities-based local exchange services outside of Qwest Corporation's ("QC's") service territory only.

In response to Staff data requests, the Applicant stated that they would be unwilling to limit the scope of their Application to certain segments of QC's market. Staff's original report thus did not address this alternative. Since that time, the Company and Staff have engaged in considerable discussion regarding the various segments of QC's market and how Staff's concerns might be addressed. While Staff and Qwest could not come to agreement, Staff is filing this supplement to its February 23, 2005, Staff Report in order to present an alternative recommendation which would allow QCC to provide resold and facilities-based local service to Large Business customers within QC's service territory. Staff believes that this approach would respond to the Company's concern about the ability to market services to Large Business customers through one entity yet would also address Staff's primary concerns which relate to the small business and residential markets.

II. Discussion

On February 23, 2005, Staff submitted its Report and Recommendation in this case. Staff's Report and Recommendation was in response to QCC's Application to provide competitive local exchange service unlimited in scope throughout Arizona, including within its affiliated ILEC's (Qwest Corporation or "QC") service territory.

Staff's February 23, 2005 Report presented five concerns¹ that remained unresolved.

1. The ability of QCC to leverage QC's ILEC position and engage in anti-competitive conduct including but not limited to cross-subsidization and, price-squeezing;
2. The potential for significant confusion on the part of customers given the similarity in names;
3. Use of QCC (the CLEC) to evade QC's (the ILEC) obligations within QC's service territory.
4. The potential for discrimination by QC
5. Whether it is in the public interest for an RBOC to have an affiliated CLEC operating within its territory, when the local market is not sufficiently competitive.

The paramount concern identified by Staff is the ability of QCC to leverage QC's ILEC position. This factor is fundamental to all of Staff's five discrete concerns. While Staff recognizes that QCC may have the right to operate affiliates with the same name within the same jurisdictions, Staff believes that Section 253(b) of the 96 Telecommunications Act is clear in its reasoning and intentions – "Nothing in this section shall affect the ability of a State to impose, on a competitively neutral basis and consistent with section 253, requirements necessary to preserve and advance universal service, protect the public safety and welfare, ensure the continued quality of telecommunications services, and safeguard the rights of consumers." In Staff's opinion, the Commission has the discretion to determine the nature and timing of the local exchange entry by a CLEC affiliate within the ILEC's service territory so this can be accomplished in a competitively neutral manner and without having competition harmed within the local market in QC's service area.

Since Staff filed its February 23, 2005 Report and Recommendation, QCC and Staff have engaged in discussions to determine whether the parties could resolve their differences. While the parties were ultimately unable to resolve all of their differences, Staff believes that the following supplementation of its Report is appropriate if the Commission is inclined to consider granting Qwest's application in part for certain segments of QC's local service market. Staff believes that such an approach as set forth herein would address Qwest's primary concern that customers have the ability for one-stop shopping while at the same time it addresses Staff's primary concern which is with the Small Business and Residential markets.

¹ Staff's February 23, 2005 Report, page 8

Under Staff's alternative proposal, QCC would be allowed to provide competitive resold and facilities-based local service within QC's service territory to business customers and/or business accounts with four or more switched access lines only. Limiting QCC's operations at this time to the Large Business market would alleviate the preponderance of Staff's concerns which had to do with the Small Business² and Residence markets. QCC's proposal to provide local exchange services to the Small Business and Residence markets remains an issue of high concern for Staff.

Limiting QCC's ability to only serve Enterprise customers within QC's service territory alleviates Staff's concerns for the following reasons:

Staff Concern 1 - The ability of QCC to leverage QC's ILEC position and engage in anti- competitive conduct including but not limited to cross-subsidization and, price- squeezing;

Discussion: The Enterprise Market is highly competitive. The level of competition by large participants, such as MCI and AT&T, should help temper the behavior of QC & QCC and limit the effectiveness of any attempts to leverage QC's ILEC position. While claims of cross-subsidization and price-squeezing could still occur, Enterprise customers and competitors are capable of bringing such issues before the Commission. Inappropriate behavior by QCC should therefore be infrequent and subject to direct regulation by the very market in which QCC will be participating.

Staff Concern 2 - The potential for significant confusion on the part of customers given the similarity in names;

Discussion: Enterprise customers have sufficient resources and are sufficiently self-reliant to minimize the confusion that QCC may add to the local exchange market by using the Qwest brand traditionally associated with ILEC services. Many of the Enterprise market competitors have well-established brands, if not even stronger brands in many niches. Enterprise customers used to managing the complexities of business-to-business and business-to-residence marketing will not be easily confused by more than one Qwest competitor.

Staff Concern 3 - Use of QCC (the CLEC) to evade QC's (the ILEC) obligations within QC's service territory.

Discussion: Enterprise customers have sufficient resources and impetus to bring before the Commission matters in which QC may have evaded its ILEC obligations. Any efforts by QC to evade its ILEC obligations stand the risk of being well-documented and supported by the very formalities of business-to-business sales, marketing and operations. QC retains the Carrier of Last Resort (COLR) within its service territories. Attempts by QC to evade its ILEC obligations will be further scrutinized by reports, available to Staff, that should highlight intended or unintended attempts by QC to migrate customers to QCC.

² Small business customers are defined as those with less than 4 lines.

Staff Concern 4 - The potential for discrimination by QC.

Discussion: Enterprise customers have sufficient resources and impetus to bring before the Commission matters in which they believe QC may have acted in a discriminatory manner. Any claims of discrimination by QC stand the risk of being well-documented and supported by the very formalities of business-to-business sales, marketing and operations. QC's chances of discriminating within a market segment in which it has diminished presence seem unlikely and of little consequence.

Staff Concern 5 - Whether it is in the public interest for an RBOC to have an affiliated CLEC operating within its territory, when the local market is not sufficiently competitive.

Discussion: While Staff does not take the position that the market is sufficiently competitive to warrant competitive relief for QC in the context of its current Price Cap application, the presence of an affiliated CLEC should not be injurious to the overall competitive situation given the known presence of strong business brands, such as MCI and AT&T. The Enterprise Market may, in fact, welcome another competitor since QC's presence in the Enterprise Market has substantially diminished. Staff also notes that no CLEC has filed objections to QCC's application. QCC has explained that it seeks to serve customers desirous of interlata solutions that cannot be offered by QC. Additional competitive alternatives for the Enterprise market appear to have more upside than downside.

Staff believes that Small Business and Residence Markets are sufficiently similar in characteristics to be treated as one in this proceeding. While their value propositions and profit margins may differ, the Small Business and Residence Markets are similar in line size, services and competitive attention. The Commission should not allow QCC to serve the Small Business and Residence Markets within QC's service areas for the following reasons:

Staff Concern 1 - The ability of QCC to leverage QC's ILEC position and engage in anti-competitive conduct including but not limited to cross-subsidization and, price-squeezing;

Discussion: While meaningful levels of competition can be seen in the Small Business and Residence Markets, the levels are not sufficient to relieve concerns that would be raised by ILEC and CLEC affiliates sharing the same brand, sharing advertising agencies, sharing corporate advertising programs, sharing resources and generally occupying the same mass market space.

Staff Concern 2 - The potential for significant confusion on the part of customers given the similarity in names;

Discussion: Small Business and Residence customers do not have the resources and impetus of Enterprise customers to minimize the confusion that QCC may add to the local exchange market by using the Qwest brand traditionally associated with ILEC services. The fragmented and distributed nature of Small

Business and Residence Markets would complicate bringing complaints before the Commission. QCC believes it is entitled to operate by the same affiliate rules as other CLECs, such as AT&T, however, QCC omits from consideration that no other CLECs are able to use the well-established name of the dominant ILEC in Arizona.

Staff Concern 3 - Use of QCC (the CLEC) to evade QC's (the ILEC) obligations within QC's service territory.

Discussion: Small Business and Residence customers do not have the resources and impetus available to Enterprise customers to bring before the Commission matters in which they feel QC has evaded its ILEC obligations. QC retains the Carrier of Last Resort ("COLR") responsibility; an obligation which Staff believes could be diluted by the presence of more than one Qwest entity. Discrimination on the part of QC will be substantially more injurious to the Small Business and Residence Markets than to the Enterprise Market. Within its ILEC service areas, QC has a responsibility to extend its services to all interested customers in compliance with established tariffs.

Staff Concern 4 - The potential for discrimination by QC.

Discussion: Small Business and Residence customers do not have the resources available to Enterprise customers to bring before the Commission matters in which they feel QC may have engaged in discriminatory conduct.

Staff Concern 5 - Whether it is in the public interest for an RBOC to have an affiliated CLEC operating within its territory, when the local market is not sufficiently competitive.

Discussion: Staff believes the presence of a Qwest CLEC would be injurious to the overall competitive situation given the reduced presence of such brands as exist in the Enterprise Market. Staff believes that the presence of a second Qwest entity, a CLEC affiliate, will result in further chilling competition at a time when major brands, such as MCI, AT&T, and Sprint, have announced efforts to reduce mass market efforts in local exchange competition.

The following table illustrates the degree of Staff concern by market segment:

	Residence	Small Business	Enterprise Business
1 - The ability of QCC to leverage QC's ILEC position and engage in anti-competitive conduct including but not limited to cross-subsidization and, price-squeezing	High Concern	High Concern	Low Concern
2 - The potential for significant confusion on the part of customers given the similarity in names	High Concern	High Concern	Low Concern
3 - Use of QCC (the CLEC) to evade QC's (the ILEC) obligations within QC's service territory.	High Concern	High Concern	Low Concern
4 - The potential for discrimination by QC	High Concern	High Concern	Low Concern
5 - Whether it is in the public interest for an RBOC to have an affiliated CLEC operating within its territory, when the local market is not sufficiently competitive.	High Concern	High Concern	Low Concern

In submitting its Supplemental Report, Staff has considered similar applications in other states including but limited to the jurisdictions listed below. Key points from those states are provided below, along with the conditions that were imposed:

Minnesota:

- On 10/13/99, disallowed QCC's application for statewide CLEC service. QCC's amended request for CLEC services in QC and GTE areas only was approved.
- QCC was required to fulfill 12 service standards, none of which limited the end-user services that can be offered.
- On 12/11/03, QCC CLEC authority was expanded to an additional 12 ILEC areas.
- Use of Feature Group C technology by QCC for interconnection was disallowed.
- Nine of 12 impacted ILECs intervened.

Nebraska:

- On 10/7/98, the Commission limited QCC's operations to the provision of basic local exchange service only to multi-location customers with locations inside and outside of QC's service areas.
- QCC and QC were required to provide the Commission access to documents, data and records pertaining to the inter-company transactions relating to in-region transactions.
- Several parties, including MCI and AT&T, intervened or filed comments. Cox did not intervene.
- On 4/19/05, the Commission lifted the limitations from its 10/7/98 order.
- The Commission opened a rulemaking docket as Rule and Regulation No. 164 to address rules regarding ILECs that have one or more affiliated CLEC(s) competing within the ILEC's incumbent service territory in Nebraska.
- Several parties, including Cox, intervened or filed comments.

Colorado:

- On 3/31/04, QCC was granted statewide authority without restrictions.
- Intervenors did not file comments.

Idaho:

- On 4/24/02, QCC filed an application for statewide CLEC authority.
- On 8/27/02, the Commission approved an amended application for QCC CLEC operation in Verizon areas only.
- QC and QCC were ordered to maintain separate records and accounts, and have separate officers, directors and employees and to keep transactions between the two companies on an arm's length basis and to reduce transactions (between QC and QCC) to writing.
- Intervenors did not file comments.
- On 6/7/04, QCC CLEC statewide authority is approved, except for rural ILEC areas.
- The Idaho Telephone Association intervened.

South Dakota:

- On 9/7/04, QCC CLEC statewide authority is approved, except for rural ILEC areas.
- The South Dakota Telecommunications Association intervened.

Texas:

- On 9/1/03, Public Utility Regulatory Act governing rules for CLECs in affiliated ILEC areas becomes effective.
- Rules apply to CLECs with ILEC affiliates having more than 5 millions access lines within the state.
- Sections 54.102, 58.051, 58.151 and 58.003 assert rules that limit CLECs in affiliated ILEC's service areas only on the basis of customer-specific contracts in which ILECs are not allowed.

Staff believes that while decisions made in other jurisdictions are worthy of consideration, they do not form the sole basis for a decision in Arizona. As such, Staff recommends the following.

III. Additional Staff Recommendations If the Scope of QCC's Authority in QC's Service Territory is Limited To the Large Business Market

Should the Commission find Staff's alternative recommendation to be appropriate, Staff would recommend the following additions to its recommendations contained in section 6.1 of its February 23, 2005 Report:

1. QCC should be approved to provide services in the areas as follows:
 - a. Resold long distance service on a statewide basis.

- b. Resold and facilities based local exchange service within QC's service territory for business customers and/or accounts with four or more switched access lines or their equivalent. For purposes of determining an eligible business account, all individual locations of a multi-location customer shall be added together to determine whether the four or more switched access lines or their equivalent threshold has been met for a given customer/account.
 - c. Resold and facilities based local exchange service for residence and business customers who are located outside of QC's service territory.
2. QC should acknowledge that the Commission's actions approving QCC's CLEC application for local exchange service in no way changes its ILEC obligations.
3. Notwithstanding the services and areas which Staff recommends for approval, QCC should not file an application to amend its certification to provide local exchange services to Residence and/or Small Business customers in the QC service area in Arizona for a period of 24 months from the date of the Commission's Order approving its request for an expanded CC&N. QCC may file an application for either the Small Business market or Residential market before the expiration of the 24 month period only if it can meet all of the following: 1) QC and QCC can demonstrate that there will be no adverse impact upon QC's operations, 2) QCC can demonstrate that the Staff's five concerns identified in its February 23, 2005 Staff Report can be successfully resolved, and 3) competitive conditions in the markets in which QCC seeks entry are sufficiently competitive so that sufficient alternatives are available. Any application by QCC shall be accompanied by at least 18 months of the data identified in paras. 8 and 9 below which period shall commence from the date the Commission issues its order in this case.
4. Should QCC file an application to amend its certification to provide local exchange services to Residence and/or Small Business customers in the QC service area upon expiration of the 24 month period, Staff will analyze all factors relevant to the application including but not limited to the competitive situation pertaining to Residence and Small Business markets. Staff's position in this Staff Report with respect to the Enterprise Market should not be construed as support for any subsequent application by Qwest. Similarly, Staff recommends that the order ultimately issued by the Commission in this case specifically state that the Commission's findings and rulings in this case with respect to the Enterprise Market should not be used or construed as precedent for any subsequent Staff recommendation or Commission order on any subsequent Qwest application.
5. QC will adhere to 47 U.S.C. Section 251 nondiscrimination standards in its dealings with QCC and CLECs.
6. QC and QCC should be required to comply with all Section 272 requirements for the provision of competitive local exchange service by QCC.
7. QC and QCC shall provide the Commission, on request, with access to documents, data and records pertaining to inter-company transactions relating to in-region transactions with respect to Arizona.

8. QC and QCC shall provide the following reports to Staff every six months for three years following approval of QCC's CLEC operations:
 - a. QCC Reports
 1. Qwest Communications Corporation Total Accounts In Service categorized by NPA are to be provided. The information shall be provided in excel file format using electronic media.
 2. Qwest Communications Corporation Total Lines In Service categorized by NPA are to be provided. The information shall be provided in excel file format using electronic media.
 - b. QC Reports
 1. The total number of business accounts that have moved from QC to QCC by QC wire center are to be provided in excel file format using electronic media.
 2. The total number of business lines that have moved from QC to QCC by QC wire center are to be provided in excel file format using electronic media.
 3. The total annualized revenues associated with total business accounts that have moved from QC to QCC by QC wire center are to be provided in excel file format using electronic media.
 4. State-wide summarized Listings Data should be provided. The information should contain all main listings and additional line listings by QC, QCC, CLECs, ILECs, Wireless Providers or Other for each NPA-NXX. This information should be separated by residence and business and include a count of all listings in QC's comprehensive database(s), not just those published in the white pages directories or available via directory assistance. All information should be rolled-up to the NPA-NXX level; no end-user specific information should be provided. The information shall be provided in excel file format using electronic media.
 5. State-wide summarized LERG Information should be provided. The report should contain the following column headings and be provided in excel file format using electronic media:
 - a. All Switch CLLIs
 - b. All Switch Locations (addresses)
 - c. All Switch Owner Names
 - d. All Switch Owner ID
 - e. All NPA NXXs, or thousands blocks where NPA NXXs are shared, assigned to each switch
 - f. All owner names corresponding to each NPA NXXs, or thousands block where NPA NXXs are shared.
9. Any of the above listed information can be used by Staff in future AFOR/Price Cap proceedings to assist in the evaluation of QC's revenue requirements.
10. QC and QCC should be considered to be one entity for the purposes of evaluating the local exchange services competitive situation in future AFOR/Price Cap proceedings.

11. Qwest's provision of local exchange service in the service territories of rural telephone companies is subject to any future proceedings under Section 251(f)(1) or (2) of the Telecommunications Act of 1996 (47 U.S.C. Section 251(f)(1) or (2)). Granting QCC's request to provide competitive local exchange service outside its service territory is not a ruling that affects the rights of specific rural telephone companies under 47 U.S.C. Section 251(f).
12. Staff's findings in this Docket should not be construed as a finding with respect to what Baskets any services(s) belong under Qwest's AFOR or as a finding with respect to what constitutes a competitive or sufficiently competitive marketplace for purposes of either QC's AFOR or future applications of QCC to expand its business to other markets.