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MEMORANDUM

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TO: Docket Control

FROM: Ernest G. Johnson
Director
Utilities Division

EA for EGJ

THRU: Matthew Rowell
Chief, Telecommunications and Energy Section
Utilities Division

Arizona Corporation Commission

DOCKETED

NOV - 9 2006

Wilfred Shand, Jr.
Manager, Telecommunications and Energy Section
Utilities Division

DOCKETED BY	NR
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DATE: November 9, 2006

RE: IN THE MATTER OF THE APPLICATION OF NEUTRAL TANDEM-ARIZONA, LLC FOR A CERTIFICATE OF CONVENIENCE AND NECESSITY TO PROVIDE RESOLD AND LOCAL EXCHANGE, FACILITIES-BASED LONG DISTANCE AND LOCAL EXCHANGE TELECOMMUNICATIONS SERVICES (DOCKET NO. T-04298A-04-0930)

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

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

Staff is recommending approval of the application.

EGJ:JFB:red

Originator: John F. Bostwick

Attachment: Original and Thirteen Copies

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SERVICE LIST FOR: Neutral Tandem-Arizona, LLC.
DOCKET NO. T-04298A-04-0930

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STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION

NEUTRAL TANDEM-ARIZONA, LLC

DOCKET NO. T-04298A-04-0930

IN THE MATTER OF THE APPLICATION OF NEUTRAL TANDEM-ARIZONA, LLC FOR
A CERTIFICATE OF CONVENIENCE AND NECESSITY TO PROVIDE RESOLD AND
LOCAL EXCHANGE, FACILITIES-BASED LONG DISTANCE AND LOCAL EXCHANGE
TELECOMMUNICATIONS SERVICES

NOVEMBER 9, 2006

TABLE OF CONTENTS

	PAGE
1. INTRODUCTION	1
2. TECHNICAL CAPABILITY TO PROVIDE THE REQUESTED SERVICES	1
3. FINANCIAL CAPABILITY TO PROVIDE THE REQUESTED SERVICES	1
4. ESTABLISHING RATES AND CHARGES.....	2
5. LOCAL EXCHANGE CARRIER SPECIFIC ISSUES	3
5.1 NUMBER PORTABILITY.....	3
5.2 PROVISION OF BASIC TELEPHONE SERVICE AND UNIVERSAL SERVICE	3
5.3 QUALITY OF SERVICE.....	3
5.4 ACCESS TO ALTERNATIVE LOCAL EXCHANGE SERVICE PROVIDERS.....	4
5.6 CUSTOM LOCAL AREA SIGNALING SERVICES	4
6. REVIEW OF COMPLAINT INFORMATION.....	4
7. COMPETITIVE SERVICES ANALYSIS	5
7.1 COMPETITIVE SERVICES ANALYSIS FOR LOCAL EXCHANGE SERVICES.....	5
8. RECOMMENDATIONS.....	8
8.1 RECOMMENDATIONS ON THE APPLICATION FOR A CC&N	8
8.2 RECOMMENDATION ON THE APPLICANT'S PETITION TO HAVE ITS PROPOSED SERVICES CLASSIFIED AS COMPETITIVE.....	9

STAFF ACKNOWLEDGMENT

The Staff Report for the application for Neutral Tandem-Arizona, LLC, Docket No. T-04298A-04-0930, was the responsibility of the Staff member listed below. John F. Bostwick was responsible for the review and analysis of Neutral Tandem-Arizona, LLC application for a Certificate of Convenience and Necessity to provide resold long distance and local exchange, facilities-based local exchange and long distance and private line telecommunication services and petition for a determination that its proposed services should be classified as competitive.



John F. Bostwick
Administrative Services Officer II

1. INTRODUCTION

On December 27, 2004, Neutral Tandem-Arizona, LLC (“NTA” or “Applicant”) filed an application for a Certificate of Convenience and Necessity (“CC&N”) to provide resold long distance and local exchange, facilities-based local exchange and long distance and private line telecommunication services in Arizona. The Applicant petition the Arizona Corporation Commission (“Commission”) that its proposed services should be classified as competitive.

On January 4, 2005, Staff determined that the Application was insufficient and sent its first set of data requests to NTA. Staff sent four additional sets of data requests with the last set mailed to NTA on June 15, 2006.

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. TECHNICAL CAPABILITY TO PROVIDE THE REQUESTED SERVICES

NTA plans to provide both retail and wholesale services in Arizona. NTA is not authorized to provide service in any state. NTA indicated that nine (9) affiliated companies (who are also subsidiaries of Neutral Tandem, Inc., NTA’s parent) currently provide telecommunications services to customers in twelve (12) states, excluding Arizona. The Applicant states that it has four key employees with combined experience of 108 years in the telecommunications industry. Staff believes NTA has the technical capabilities to provide the services it is requesting the authority to provide.

3. FINANCIAL CAPABILITY TO PROVIDE THE REQUESTED SERVICES

The Applicant provided audited financial statements of its parent company, Neutral Tandem, Inc., for the year ending December 31, 2005. These financial statements list assets in excess of \$31.2 million; equity in excess of \$20.2 million and a net income of \$208,000. Notes related to the financial statements were provided. NTA indicated in its Application that it will initially rely on the financial resources of its parent company, Neutral Tandem, Inc.

The Applicant states in its proposed Arizona Tariff No. 2 (reference Sections 2.8.7 on page 27) that it will not collect advances and/or deposits from its customers receiving resold interexchange telecommunications services. There were no prepayments listed in NTA’s proposed Arizona Tariff No. 2. Staff believes that advances and/or deposits received from the Applicant’s customers should be protected by the procurement of a performance bond. Since the Applicant is requesting a CC&N for more than one kind of service, the amount of a performance bond for multiple services is an aggregate of the minimum bond amount for each type of telecommunications service requested by the Applicant. The amount of bond coverage needed for each service is as follows: resold local exchange \$25,000; facilities-based long distance \$100,000; and facilities-based local exchange \$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. Further, measures should be taken to ensure that the Applicant will not discontinue service to its customers without first complying with Arizona Administrative Code (“A.A.C.”) R14-2-1107.

To that end, Staff recommends that the Applicant procure a performance bond equal to \$225,000. The minimum bond amount of \$225,000 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 \$112,500. This increase should occur when the total amount of the advances, deposits, and prepayments is within \$22,500 of the bond amount. If the Applicant desires to discontinue service, it must file an application with the Commission pursuant to A.A.C. R14-2-1107. 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 at some time in the future the Applicant wants to collect advances, deposits and/or prepayments from its resold interexchange telecommunications service customers receiving, Staff recommends that the Applicant file information with the Commission for Staff’s review. Such filing must reference the docket and the decision numbers in this matter. Upon the receipt of such filing and after Staff’s review, Staff would forward its recommendation to the Commission.

4. ESTABLISHING RATES AND CHARGES

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

Both an initial rate (the actual rate to be charged) and a maximum rate must be listed for each competitive service offered, provided that the rate for the service is not less than the Applicant’s total service long-run incremental cost of providing the service pursuant to A.A.C. R14-2-1109.

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. NTA has indicated 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. NTA reported that its tariff actual maximum and actual minimum

rates for services were calculated using general market analysis based on experience for each of the company's services. NTA filed its Arizona Tariff No. 1 which contains rates for private line telecommunications services on December 27, 2004. On February 17, 2005, NTA submitted a revised Arizona Tariff No. 2 for interexchange services. The Applicant filed its tariff for competitive local exchange telecommunications services (Arizona Tariff No. 3) on April 17, 2006. Staff has reviewed NTA's rates and believes they are comparable to the rates charged by competitive local exchange carriers, local incumbent carriers and major long distance carriers operating in Arizona. Staff has also reviewed the rates charged by NTA's affiliated companies in other jurisdictions and believes the rates charged for similar services are comparable to those proposed in Arizona. Therefore, while Staff considered the fair value rate base of information submitted by the Applicant, the fair value rate base information provided should not be given substantial weight in this analysis.

5. LOCAL EXCHANGE CARRIER SPECIFIC ISSUES

Issues related to the provision of local exchange service are discussed below.

5.1 NUMBER PORTABILITY

The Commission has adopted rules to address number portability in a competitive telecommunications services market. 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 offerings. Consistent with federal laws, federal rules and A.A.C. R14-2-1308 (A), the Applicant shall make number portability available to facilitate the ability of the customer to switch between authorized local carriers within a given wire center without changing their telephone number and without impairment to quality, functionality, reliability or convenience of use.

5.2 PROVISION OF BASIC TELEPHONE SERVICE AND UNIVERSAL SERVICE

The Commission has adopted rules to address universal telephone service in Arizona. A.A.C. R14-2-1204(A) indicates that all telecommunications services providers that interconnect into the public network shall provide funding for the Arizona Universal Service Fund ("AUSF"). The Applicant will make the necessary monthly payments required by A.A.C. R14-2-1204(B).

5.3 QUALITY OF SERVICE

Staff believes that the Applicant should be ordered to abide by the quality of service standards that were approved by the Commission for Qwest (f/k/a USWC) in Docket No. T-01051B-93-0183 (Decision No. 59421). Because the penalties developed in that docket were initiated because Qwest's level of service was not satisfactory and the Applicant does not have a similar history of service quality problems, Staff does not recommend that those penalties apply to the Applicant. In the competitive market that the Applicant wishes to enter, the Applicant 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 the Applicant to those penalties at this time.

5.4 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. There may be areas where the Applicant installs the only local exchange service facilities. In the interest of providing competitive alternatives to the Applicant's local exchange service customers, Staff recommends that the Applicant be prohibited from barring access to alternative local exchange service providers who wish to serve such areas. This way, an alternative local exchange service provider may serve a customer if the customer so desires. Access to other providers should be provided pursuant to the provisions of the 1996 Telecommunications Act, the rules promulgated there under and Commission rules on interconnection and unbundling.

5.5 911 SERVICE

The Commission adopted rules to address 911 and E911 services in a competitive telecommunications services market. The Applicant has certified that in accordance with A.A.C. R14-2-1201(6)(d) and Federal Communications Commission 47 CFR Sections 64.3001 and 64.3002, it will provide all customers with 911 and E911 service, where available, or will coordinate with the ILECs and emergency service providers to provide 911 and E911 service.

5.6 CUSTOM LOCAL AREA SIGNALING SERVICES

Consistent with past Commission decisions, the Applicant may offer Caller ID provided that per call and line blocking, with the capability to toggle between blocking and unblocking the transmission of the telephone number, are provided as options to which customers could subscribe with no charge. Also, Last Call Return service that will not return calls to the telephone numbers that have the privacy indicator activated, indicating the number has been blocked, must be offered.

6. REVIEW OF COMPLAINT INFORMATION

The Applicant indicated that none of its officers, directors or partners has 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 has been convicted of any criminal acts in the past ten (10) years.

The Applicant indicated that it has neither had an application for service denied, nor revoked in any state. There have not been any civil or criminal proceedings against the Applicant. There are, and have been, no formal complaint proceedings involving the Applicant.

Staff contacted twelve (12) state Public Utilities Commissions (“PUCs”) to determine whether the NTA’s nine (9) affiliated companies are certificated or registered to provide telecommunications services in the states listed by NTA. Staff also inquired whether there were any consumer complaints against the NTA’s affiliated companies. Based on this information, Staff has determined that the Applicant has adequate capabilities to provide the telecommunications services it is requesting authority to provide.

7. 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.

7.1 COMPETITIVE SERVICES ANALYSIS FOR LOCAL EXCHANGE SERVICES

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

The local exchange market that the Applicant 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, the Applicant will be entering the market as an alternative provider of local exchange service and, as such, the Applicant will have to compete with those companies in order to obtain customers. In areas where ILECs do not serve customers, the Applicant may have to convince developers to allow it to provide service to their developments.

7.1.2 The number of alternative providers of the service.

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

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

Since Qwest and the independent LECs are the primary providers of local exchange service in the State of Arizona, 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.

7.1.4 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.

The Applicant does not have any affiliated companies operating in Arizona.

- 7.1.5 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 the Applicant has requested in their respective service territories. Similarly many of the CLECs and local exchange resellers also offer substantially similar services.

- 7.1.6 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 most customers have few, if any choices since there is generally only one provider of local exchange service in each service territory.
- e. One in which the Applicant will not have the capability to adversely affect prices or restrict output to the detriment of telephone service subscribers.

7.2 COMPETITIVE SERVICES ANALYSIS FOR INTEREXCHANGE SERVICES

- 7.2.1 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 the Applicant seeks to enter is one in which a 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.

7.2.2 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.

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

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

The Applicant does not have any affiliated companies operating in Arizona.

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

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

8. RECOMMENDATIONS

The following sections contain the Staff recommendations on the application for a CC&N and the Applicant's petition for a Commission determination that its proposed services should be classified as competitive.

8.1 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 this report, be granted. In addition, Staff further recommends:

1. That the Applicant comply with all Commission rules, orders, and other requirements relevant to the provision of intrastate telecommunications service;
2. That the Applicant abides by the quality of service standards that were approved by the Commission for Qwest in Docket No. T-01051B-93-0183;
3. That the Applicant be prohibited from barring access to alternative local exchange service providers who wish to serve areas where the Applicant is the only provider of local exchange service facilities;
4. That the Applicant be required to notify the Commission immediately upon changes to the Applicant's name, address or telephone number;
5. That the Applicant cooperate with Commission investigations including, but not limited to, customer complaints;
6. That 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 indicating that its fair value rate base is zero. Staff has reviewed NTA's rates and believes they are comparable to the rates charged by competitive local exchange carriers, local incumbent carriers and major long distance carriers operating in Arizona. Staff has reviewed the rates charged by NTA's affiliated companies in other jurisdictions and believes the rates charged for similar services are comparable to those proposed in Arizona. The rate to be ultimately charged by the company will be heavily influenced by the market. 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;
7. If at some time in the future the Applicant wants to collect advances, deposits and/or prepayments from its resold interexchange service customers, Staff recommends that the Applicant file information with the Commission for Staff's review. Such filing

must reference the docket and the decision numbers in this matter. Upon the receipt of such filing and after Staff's review, Staff would forward its recommendation to the Commission;

8. That the Applicant offer Caller ID with the capability to toggle between blocking and unblocking the transmission of the telephone number at no charge;
9. That the Applicant offer Last Call Return service that will not return calls to telephone numbers that have the privacy indicator activated;
10. Staff further recommends that the Commission authorize the Applicant to discount its rates and service charges to the marginal cost of providing the services; and

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 after due process.

1. The Applicant shall docket conforming tariffs with Docket Control as a compliance item in this matter for each service within its CC&N within 365 days from the date of an Order in this matter or 30 days prior to providing service, whichever comes first. The tariffs submitted shall coincide with the application and state that the Applicant does collect advances, deposits, and/or prepayment from its customers;
2. The Applicant shall:
 - a. Procure a performance bond equal to \$225,000. The minimum bond amount of \$225,000 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 \$112,500. This increase should occur when the total amount of the advances, deposits, and prepayments is within \$22,500 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 performance bond must remain in effect until further order of the Commission.

8.2 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 local exchange service markets. Therefore, the Applicant currently has no market power in the local

Neutral Tandem – Arizona, LLC

Docket No. T-04298A-04-0930

Page 10

exchange service markets where alternative providers of telecommunications services exist. Staff therefore recommends that the Applicant's proposed services be classified as competitive.