

**ORIGINAL**



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MEMORANDUM

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THRU: Matthew Rowell  
Chief, Telecommunications and Energy Section  
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Wilfred Shand, Jr.  
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DATE: February 23, 2007

RE: **SUPPLEMENTAL STAFF REPORT - 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)**

2007 FEB 23 A 9:12

AZ CORP COMMISSION  
DOCUMENT CONTROL

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

Arizona Corporation Commission  
**DOCKETED**

**FEB 23 2007**

DOCKETED BY	<i>nr</i>
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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

FEBRUARY 23, 2007

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## 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.



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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 and facilities-based wholesale private line services, wholesale interexchange transport services, and switched access service 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 six additional sets of data requests with the last set mailed to NTA on January 25, 2007.

In its Amendment to its Application filed on January 10, 2007, NTA clarified the authority it is seeking in this docket. NTA indicated that since the filing of the application in 2004, NTA's business plan has evolved and Neutral Tandem will provide service only to other carriers. NTA seeks authority to provide wholesale private line service (which is effectively dedicated access or special access service), facilities-based and resold interexchange service, (which effectively provides wholesale transport service to other carriers) and facilities-based and resold switched access service.

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 intends to provide 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.

Because the telecommunications services being requested by NTA are wholesale services provided solely to other carriers, not retail customers, Staff does not believe a performance bond

or irrevocable sight draft Letter of Credit is necessary for any of the wholesale services the Applicant proposes to offer in Arizona

#### **4. ESTABLISHING RATES AND CHARGES**

The Applicant would initially be providing service in areas where an incumbent local exchange carriers ("ILEC"), along with various competitive local exchange carriers ("CLECs") and interexchange ("IXC") 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 in 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. Staff reviewed each of the three tariffs NTA filed on January 10, 2007. Staff believes NTA's rates are comparable to the rates charged by competitive local exchange carriers, local incumbent carriers and major long distance carriers operating in Arizona. Staff also believes that the rates charged for telecommunication services by NTA's affiliated companies in other jurisdictions are comparable to rates being proposed for similar services 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. 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.

##### *5.1 COMPETITIVE SERVICES ANALYSIS FOR SWITCHED ACCESS SERVICES*

5.1.1 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 Switched Access Service market. At locations where ILECs provide Switched Access Service, the Applicant will be entering the market as an alternative provider of Switched Access Service and, as such, the Applicant will have to compete with those companies in order to obtain customers.

5.1.2 The number of alternative providers of the service.

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

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

Since Qwest and the independent LECs are the primary providers of Switched Access Service in the State of Arizona, they have a large share of the market. The CLECs and local exchange resellers have limited market share.

5.1.4 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.

None.

5.1.5 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.

5.1.6 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 Switched Access 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 Switched Access Service. New entrants are also beginning to enter this market.
- b. 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.

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

5.2 *COMPETITIVE SERVICES ANALYSIS FOR WHOLESALE INTEREXCHANGE TRANSPORT SERVICES*

- 5.2.1 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 interexchange transport 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.

- 5.2.2 The number of alternative providers of the service.

There are a large number of interexchange transport 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.

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

The large facilities-based interexchange carriers (AT&T, Sprint, MCI, 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.

- 5.2.4 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.

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

Both wholesale interexchange transport 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.

- 5.2.6 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 wholesale interexchange transport service market is:

- a. One with numerous competitors and limited barriers to entry.
- b. One in which established wholesale interexchange transport 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.

### 5.3 *COMPETITIVE SERVICES ANALYSIS FOR PRIVATE LINE SERVICES*

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

The IXCs hold a substantial share of the private line services market. ILECs and CLECs provide private line services. The Applicant will be entering the market as an alternative provider of private line and, as such, the Applicant will have to compete with several existing companies in order to obtain customers.

- 5.3.2 The number of alternative providers of the service.

IXCs are providers of private line service in the Arizona. In addition, the ILECs and CLECs are also providers of private line services in Arizona.

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

The IXCs and ILECs hold a substantial share of the private line market. CLECs likely have a smaller share of the private line market.

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

None.

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

The IXCs and ILECs have the ability to offer same services that the Applicant has requested in their respective service territories. Similarly, many of the CLECs offer private line services.

## 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 have 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. RECOMMENDATIONS

The following sections contain the Staff recommendations on the Application for authority to requested telecommunications services and the Applicant's petition for a Commission determination that its proposed services should be classified as competitive.

### 7.1 RECOMMENDATIONS ON THE APPLICATION FOR CC&NS

Staff recommends that the Application for CC&Ns to provide resold and facilities-based wholesale private line services, wholesale interexchange transport services, and switched access service be granted. In addition, Staff further recommends the following:

1. That the Applicant comply with all the Commission rules, orders and other requirements relevant to the provision of intrastate telecommunications services;
2. That the Applicant be required to notify the Commission immediately upon changes to the Applicant's name, address or telephone number;
3. That the Applicant cooperates with Commission investigations including, but not limited to, customer complaints;

4. 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;
5. 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 tariffed 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.

*7.2 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 or interexchange service markets. Therefore, the Applicant currently has no market power in the local exchange or interexchange service markets where alternative providers of telecommunications services exist. Staff therefore recommends that the Applicant's proposed services be classified as competitive.