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MEMORANDUM

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TO: Docket Control
FROM: Ernest G. Johnson ^{EGJ}
Director
Utilities Division

AZ CORP COMMISSION
DOCUMENT CONTROL

DATE: April 15, 2002

RE: IN THE MATTER OF THE JOINT APPLICATION OF TOUCH AMERICA SERVICES, INC. AND TOUCH AMERICA, INC. FOR APPROVAL OF ASSIGNMENT OF ASSETS AND TRANSFER OF A CERTIFICATE OF CONVENIENCE AND NECESSITY TO PROVIDE INTRASTATE TELECOMMUNICATIONS SERVICES TO TOUCH AMERICA, INC. AND WAIVER (DOCKET NOS. T-04011A-01-0303 AND T-03911A-01-0303)

Attached is the Staff Report for the joint application of Touch America Services, Inc. and Touch America, Inc. for approval to transfer Touch America Services, Inc.'s utility assets and Certificate of Convenience and Necessity to provide facilities-based interexchange services and alternative operator services to Touch America, Inc. The Applicants are also requesting a waiver of customer notification to change subscriber's designated telecommunications provider.

Staff is recommending approval of the application following a hearing. Staff also believes that no waiver of customer notification is necessary.

EGJ:LAJ:nms

Originator: Linda A. Jaress

Attachment: Original and Ten Copies

Arizona Corporation Commission
DOCKETED

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Service List for Touch America Services, Inc. Et. Al.
Docket Nos. T-03911A-01-0303 and T-04011A-01-0303

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**STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION**

**TOUCH AMERICA SERVICES, INC AND
TOUCH AMERICA, INC.**

(DOCKET NOS. T-03911A-01-0303 AND T-04011A-01-0303)

**APPROVAL OF ASSIGNMENT
OF ASSETS AND TRANSFER OF A
CERTIFICATE OF CONVENIENCE AND NECESSITY
TO PROVIDE INTEREXCHANGE
TELECOMMUNICATION SERVICE AND
WAIVER OF CUSTOMER NOTIFICATION**

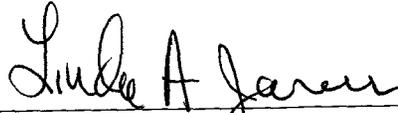
APRIL 2002

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STAFF ACKNOWLEDGMENT

The Staff Report for Touch America Services and Touch America, Inc. was the responsibility of the Staff member listed below.

A handwritten signature in cursive script that reads "Linda A. Jares". The signature is written in black ink and is positioned above a horizontal line.

Linda A. Jares
Executive Consultant III

EXECUTIVE SUMMARY

Touch America Services, Inc., ("TASI") provided facilities-based, interexchange service in Arizona. On June 30, 2001, TASI transferred its assets to its parent, Touch America, Inc. ("Touch America") as part of a larger restructuring of their ultimate parent, Montana Power. Since then, Montana Power has gone out of existence.

The application requests approval to transfer the assets and CC&N of TASI to Touch America. Because Touch America is already using the assets and providing the services at issue and the complaints regarding its service have been minimal, Staff believes that Touch America is a fit and proper entity to receive TASI's assets and CC&N and recommends approval.

The TASI tariff, which Touch America adopted, provides for the collection of deposits and prepayments under certain circumstances. Staff recommends a performance bond of \$100,000 be procured by Touch America in keeping with Staff's performance bond guidelines.

The Applicants also requested a waiver of A.R.S. Section 44-1572 that requires customer notification to change a subscribers designated telecommunications company. The Commission has not completed its rulemaking necessary to implement A.R.S. Section 44-1572. Therefore, no waiver is required by the Commission.

Staff recommends approval of the transfer of the assets and CC&N of Touch America Services, Inc. to Touch America, Inc.

Introduction and Background

On April 11, 2001 Touch America Services, Inc. ("TASI") filed an application for approval of the assignment of assets and transfer of its Certificate of Convenience and Necessity ("CC&N") to provide resold facilities-based interexchange telecommunications services and alternative operator services to Touch America, Inc. ("the Company" or "Touch America") and for approval of a waiver of the customer notification required by A.R.S. Section 44-1572.

On June 30, 2001 the transfer transaction closed and Touch America began serving Arizona customers.

TASI received a CC&N to provide resold, facilities based long distance telecommunications services and alternative operator services in Arizona in Decision No. 62672 dated June 30, 2000. TASI originated as TeleDistance, Inc. TeleDistance, Inc. was formed by Qwest, Inc. to facilitate the federally mandated divestiture of Qwest Communications, Inc.'s ("Qwest") interLATA business prior to the merger of Qwest, Inc. and U S West, Inc. Qwest transferred its interLATA customers and assets and those of Qwest affiliates LCI International Telecom, Inc., Phoenix Network, Inc. and USLD Communications, Inc. to TeleDistance. Qwest then changed the name of TeleDistance to TASI and sold TASI to Touch America

Touch America, TASI's former parent, is a Montana corporation that, until recently, was wholly owned by Entech, Inc. a wholly owned subsidiary of Montana Power. In February, 2002, Montana Power divested all of its energy business, including its electric and gas utility and invested the proceeds in Touch America. The sales of the oil and gas business to a Canadian company for \$475.0 million, the independent power business to CES Acquisition Corp. for \$84.5 million and the coal business to Westmoreland Coal Co. for \$138.0 million have all been completed. The sale of the electric and gas utility operations to NorthWestern Corp. for \$602 million in cash and the assumption of up to \$488 million in debt closed on February 15, 2002.

Touch America now owns an 18,000-mile fiber-optic network and provides long distance service, Internet access, and frame relay/ATM services and provides other services such as the design, installation and maintenance of PBX and key systems, and construction management oversight. Touch America has operated the TASI network since its divestiture from Qwest.

Touch America currently serves approximately 28,000 customers in Arizona.

The Application for the transfer of the CC&N

Touch America seeks authority to provide telecommunications services throughout the State of Arizona. The Company provides facilities-based interexchange telecommunications services and alternative operator services. Touch America is incorporated under the laws of the State of Montana and has authority to transact business in Arizona.

Technical Ability to Provide Service

Touch America is authorized to provide switched and dedicated interexchange services in thirty-five states and has applications pending in the remaining contiguous United States. In many of those states it provides intraLATA, interLATA, intrastate, interstate and international 1+ dialing, dedicated access lines, WATS lines and DS1 service. Touch America also offers Internet services, calling cards and conference calling.

TASI and Touch America have shared services from the outset. TASI has never had any of its own employees as all marketing, administrative, network and support functions were conducted by Touch America employees. Based on Touch America's experience providing service, it has the technical ability to provide service.

Financial Ability to Provide Service

The total consideration under Montana Power's four contracts to sell its non-telecommunications businesses was \$1.78 billion including the assumption of \$488.0 million of debt by NorthWestern. No amounts from these sales were distributed to the shareholders of Montana Power but are being used to grow the telecommunications business. Thus, Touch America has inherited a capital structure comprised primarily of equity.

According to the unaudited, pro forma condensed consolidated financial statements of Touch America filed within Montana Power's July 17, 2001 SEC Form S-4, Touch America should be profitable. The pro forma financial statements reflect a full 12-months of Touch America's operations including the effects of the merger, acquisition of Qwest's customers and the sale of the coal and energy business. The pro forma results for the year ending December 31, 2000 showed operating revenues of \$478.0 million generating net income of \$38.0 million. The company expects assets to total \$1.0 billion. Thus, Touch America should have the financial capability to provide continued service in Arizona.

However, Touch America reported a negative return on its Arizona jurisdictional assets of \$8.0 million at December 31, 2001. Operating expenses incurred to serve Arizona customers slightly exceeded the \$27.3 million of Arizona jurisdictional revenue.

Although the TASI tariff adopted by Touch America provides for the collection of advances, deposits and/or prepayments from interexchange customers under certain circumstances, a representative of Touch America informed Staff that the Company does not currently collect deposits or prepayments. Staff believes that since the tariff allows such collections, Touch America's customers should be protected by the procurement of a performance bond. Pursuant to Staff's performance bond guidelines, Staff recommends a performance bond of \$100,000 be acquired by Touch America. Staff further recommends that proof of the procurement of the bond be docketed within 60 days of the effective date of the Order on this matter.

Rates and Charges

Touch America is providing service in areas where an incumbent local exchange carrier along with various competitive local exchange and interexchange carriers are providing telephone service. Touch America is competing with those providers in order to obtain and retain subscribers to its services. Therefore, it is not be able to exert market power. Thus, the competitive process should result in rates that are just and reasonable.

The rates charged by the Company were set in various decisions related to its predecessors and are for competitive services. In general, rates for competitive services are not set according to rate of return regulation. Staff obtained information from the company and has determined that its fair value rate base approximates the net book value of its Arizona jurisdictional assets of \$8.0 million at December 31, 2001. Operating expenses incurred to serve Arizona customers slightly exceeded the \$27.3 million of Arizona jurisdictional revenue resulting in a negative return on fair value rate base.

Obviously, the rates being charged by the company are heavily influenced by the market or the Company would raise them. Therefore, while Staff considered the fair value rate base information submitted by the company, it did not accord that information substantial weight in its analysis.

Request for a Waiver of A.R.S. Section 44-1572

TASI and Touch America also request a waiver of A.R.S. Section 44-1572; a statute that requires customer authorization before a telecommunications company changes the service of a customer to another service provider. The Commission does not have the authority to waive the provisions of a statute, as the Company requests.

The transaction between TASI and TouchAmerica is virtually transparent to the customer in all regards, including no change to the rates and no change to the terms and conditions of service. The receipt of service from the parent, rather than its affiliate and the receipt of service from the same company employees as before the transaction further illustrate the fact that there is no practical difference to the service of the TASI customers.

Further, the Commission is currently in the formative stages of the process of adopting rules to implement A.R.S. Section 44-1572. Therefore, Staff believes that no waiver is required by the Commission at this time.

Complaint Record

According to the complaint records of the Commission's Consumer Services Section, five complaints against Touch America have been logged since the transfer of assets transaction closed. The complaints are primarily billing disputes or misunderstandings and have all been resolved.

Recommendations

Touch America is incorporated under the laws of the State of Montana. It is currently offering facilities-based and resold interexchange service in thirty-five states, including Arizona. By providing adequate service it has demonstrated that it has the capability to provide its proposed services and is a fit and proper entity to receive TASI's assets and CC&N.

Therefore, Staff recommends that the application to transfer the assets and CC&N of TASI to Touch America be approved subject to the following recommendations:

Unless it provides services solely through the use of its own facilities, Touch America should procure an Interconnection Agreement, within 90 days of the effective date of the order in this matter and the agreement should remain in effect until further order of the Commission.

Touch America should be required to notify the Commission immediately upon changes to its address or telephone number.

Touch America should comply with all Commission rules, orders, and other requirements relevant to the provision of intrastate telecommunications service.

Touch America should maintain its accounts and records as required by the Commission.

Touch America should file with the Commission all financial and other reports that the Commission may require, and in a form and at such times as the Commission may designate.

Touch America should maintain on file with the Commission all current tariffs and rates, and any service standards that the Commission may require.

Touch America should cooperate with Commission investigations of customer complaints. Touch America should procure a performance bond equal to \$100,000 and file proof of the procurement of the performance bond with Docket Control within 60 days of the effective date of the Decision on this matter.

Staff further recommends that Touch America should be subject to the Commission's rules governing interconnection and unbundling and the 1996 Telecommunications Act and the rules promulgated thereunder. In the event that Touch America provides essential services or facilities that potential competitors need in order to provide their services, Touch America should be required to offer those facilities or services to those providers on non-discriminatory terms and conditions pursuant to federal laws, federal rules, and state rules.

Staff recommends that a hearing be held on these matters.