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MEMORANDUM

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TO: Docket Control

FROM: Ernest G. Johnson
Director
Utilities Division

EA for EGJ

AZ CORP COMMISSION
DOCKET CONTROL

DATE: September 07, 2007

RE: IN THE MATTER OF THE APPLICATION OF FRONTIER COMMUNICATIONS OF AMERICA, INC. FOR APPROVAL OF A CERTIFICATE OF CONVENIENCE AND NECESSITY TO OPERATE AS A FACILITIES-BASED COMPETITIVE LOCAL EXCHANGE (CARRIER DOCKET NO. T-04036A-07-0108)

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

- Facilities Based Local Exchange Services

Staff is recommending approval of the application.

AFF:kdh

Originator: Armando Fimbres

Arizona Corporation Commission
DOCKETED

SEP -7 2007

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SERVICE LIST FOR: FRONTIER COMMUNICATIONS OF AMERICA, INC.
DOCKET NO. T-04036A-07-0108

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STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION

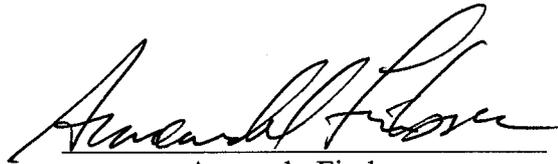
FRONTIER COMMUNICATIONS OF AMERICA, INC.
DOCKET NO. T-04036A-07-0108

IN THE MATTER OF THE APPLICATION OF FRONTIER COMMUNICATIONS OF
AMERICA, INC. FOR APPROVAL OF A CERTIFICATE OF CONVENIENCE AND
NECESSITY TO OPERATE AS A FACILITIES-BASED COMPETITIVE LOCAL
EXCHANGE

September 07, 2007

STAFF ACKNOWLEDGMENT

The Staff Report for Frontier Communications Of America, Inc., Docket No. T-04036A-07-0108, was the responsibility of the Staff member listed below. Armando Fimbres was responsible for the review and analysis of the application for a Certificate of Convenience and Necessity to provide facilities-based local exchange services and petition for a determination that its proposed services should be classified as competitive.

A handwritten signature in black ink, appearing to read "Armando Fimbres", written over a horizontal line.

Armando Fimbres
Public Utility Analyst V

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1. INTRODUCTION

On February 20, 2007, Frontier Communications of America, Inc. ("FCA" or "Applicant") filed an application for a Certificate of Convenience and Necessity ("CC&N") to provide facilities-based local exchange telecommunications services within the State of Arizona. The Applicant petitioned the Arizona Corporation Commission ("Commission") for a determination that its proposed services should be classified as competitive.

On April 11, 2007, FCA responded to Staff's Data Request No. 1 and submitted an amended tariff as Supplemental Attachment B.

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

On August 22, 2002, Decision No. 65105 granted FCA a CC&N to operate as a long-distance reseller in Arizona. FCA subsequently received approval in Decision No. 65644, dated February 18, 2003, to be merged into Citizens Telecommunications Company ("Citizens").

FCA does not currently offer services similar to those proposed in Arizona in other States. However, FCA has obtained facilities-based authority to provide local exchange services in California, Idaho, Montana, Nevada and Oregon.

FCA seeks local exchange operating authority within all Qwest exchanges in Arizona, however, will initially confine its operations to the Qwest exchanges in Cottonwood, Flagstaff, Joseph City, Payson, Prescott, Sedona, Williams and Winslow.

FCA plans to provide local exchange services to residence customers. No plans exist to serve local exchange business customers.

FCA will rely on the resources of its parent, Citizens.

FCA has four affiliates operating in Arizona - three rural incumbent local exchange carriers (ILECs) and one Commercial Mobile Radio Service (CMRS) provider. The three rural ILECs are (1) Citizens Utilities Rural Company, d/b/a Frontier Citizens Utilities Rural, (2) Citizens Telecommunications Company of the White Mountains, dba Frontier Communications of the White Mountains, and (3) Navajo Communications Company, Inc. The CMRS affiliate is Mohave Cellular. FCA and the four affiliates are subsidiaries of Citizens.

Based on the information submitted by the Applicant, Staff believes that FCA possesses the technical capabilities to provide the services it is requesting the authority to provide.

3. FINANCIAL CAPABILITY TO PROVIDE THE REQUESTED SERVICES

FCA will rely on the financial capability of its parent, Citizens, however, Balance Sheets and Income Statements for FCA have been provided to Staff with Annual Reports in compliance with Decision No. 65644. For year ending December 31, 2006, FCA lists Total Assets of \$4,414,365, Total Shareowners' Equity of (\$8,810,833) and Net Income of \$375,424. For year ending December 31, 2006, Citizens, lists Total Assets of \$6.8 Billion, Total Shareowners' Equity of \$1.1 Billion and Net Income of \$345 Million, in its publicly available Form 10-K.

The Applicant's proposed tariff – AZ C.C. Tariff No. 2 – specifies in Section 2.4.2 that deposits will not be collected and in Section 2.4.3 that payments in advance will not be required.

Staff believes that local exchange customers should be protected by the procurement of either a performance bond or an irrevocable sight draft Letter of Credit. The Applicant should be granted the discretion to procure either the performance bond or the irrevocable sight draft Letter of Credit. The amount of the performance bond or the irrevocable sight draft Letter of Credit coverage needed for facilities-based local exchange is \$100,000. If, at a later date, the Applicant receives approval to collect advances, deposits or prepayments, the performance bond or the irrevocable sight draft Letter of Credit coverage needs to increase in increments equal to 50 percent of the total minimum performance bond or the irrevocable sight draft Letter of Credit amount when the total amount of the advances, deposits, and prepayments is within 10 percent of the total minimum performance bond or the irrevocable sight draft Letter of Credit 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 or the irrevocable sight draft Letter of Credit equal to \$100,000. The minimum performance bond or the irrevocable sight draft Letter of Credit amount of \$100,000 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 performance bond or the irrevocable sight draft Letter of Credit amount should be increased in increments of \$50,000. This increase should occur when the total amount of the advances, deposits, and prepayments is within \$10,000 of the performance bond or the irrevocable sight draft Letter of Credit amount. If the Applicant desires to discontinue service, it must file an application with the Commission pursuant to A.A.C. R14-2-1107. Additionally, the Applicant must notify each of its customers and the Commission 60 days prior to filing an application to discontinue service. Failure to meet this requirement should result in forfeiture of the Applicant's performance bond or the irrevocable sight draft Letter of Credit. Staff further recommends that the original performance bond or the irrevocable sight draft Letter of Credit be sent directly to the Commission Business Office and that 14 copies be provided to Docket Control, simultaneously, 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.

4. ESTABLISHING RATES AND CHARGES

The Applicant would initially be providing service in areas where an incumbent local exchange carrier ("ILEC") is providing local exchange service and where various competitive local exchange carriers ("CLECs") are approved to provide 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 actual rate and a maximum rate may be listed for each competitive service offered. The rate charged for a service may not be less than the Company'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. Staff obtained confidential information from the company indicating that its fair value rate base is less than \$1.5 Million. Accordingly, the company's fair value rate base is too small to be useful in a fair value analysis.

FCA submitted AZ C.C. Tariff No. 2 with its application. A revised AZ C.C. Tariff No. 2 was submitted on April 11, 2007. Staff has reviewed these rates and believes they are comparable to the rates charged by competitive local carriers, local incumbent carriers and major long distance carriers operating in the State of Arizona. Therefore, while Staff considered the fair value rate base information submitted by the company, 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 that 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 service 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 a 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 service providers that interconnect into the public switched 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 has 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 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 telephone numbers that have the privacy indicator activated, indicating that the number has been blocked, must be offered.

6. **REVIEW OF COMPLAINT INFORMATION**

The Applicant has neither had an application for service denied, nor revoked in any state. There are, and have been, no formal complaint proceedings involving the Applicant. There have not been any civil or criminal proceedings against the Applicant. Consumer Services reports no complaint history within Arizona.

The Applicant indicated that none of its officers, directors or partners have 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.

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.

Some of the local exchange markets that the Applicant seeks to enter may have one or more CLECs that 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, excluding locations where Frontier's affiliates are the ILECs that provides 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. 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, 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.

1. Citizens Utilities Rural Company, d/b/a Frontier Citizens Utilities Rural
2. Citizens Telecommunications Company of the White Mountains, d/b/a Frontier Communications of the White Mountains
3. Navajo Communications Company, Inc.
4. Mohave Cellular

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.

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 Applicant's 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 complies with all Commission Rules, Orders and other requirements relevant to the provision of intrastate telecommunications services;
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. 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 company and has determined that its fair value rate base is less than \$1.5 Million. Staff has reviewed the rates to be charged by the Applicant and believes they are just and reasonable as they are comparable to other competitive local carriers, local incumbent carriers and major long distance companies offering service in Arizona and comparable to the rates the Applicant charges in other jurisdictions. 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 company, the fair value information provided was not given substantial weight in this analysis;
7. That the Applicant offer Caller ID with the capability to toggle between blocking and unblocking the transmission of the telephone number at no charge;
8. That the Applicant offer Last Call Return service that will not return calls to telephone numbers that have the privacy indicator activated;
9. That Frontier be authorized to provide local exchange service to customers only in service areas outside of those served by its ILEC affiliates in Arizona. (Note: the reason that QCC was authorized to provide service to business customers in the ILEC service territory is that there were competitive alternatives available to business customers within its service territory. Until Citizens can show that there are competitive alternatives available to its business customers, the authority for local exchange service should be limited to areas outside its ILEC affiliate service territories.);
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;

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 become null and void after due process.

1. The Applicant shall docket conforming tariffs 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 not collect advances, deposits and/or prepayments from its customers.
2. The Applicant shall:
 - a. Procure a performance bond or the irrevocable sight draft Letter of Credit equal to \$100,000. The minimum performance bond or the irrevocable sight draft Letter of Credit amount of \$100,000 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 performance bond or the irrevocable sight draft Letter of Credit

amount should be increased in increments of \$50,000. This increase should occur when the total amount of the advances, deposits, and prepayments is within \$10,000 of the performance bond or the irrevocable sight draft Letter of Credit amount.

- b. Docket proof of the performance bond or the irrevocable sight draft Letter of Credit 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 or the irrevocable sight draft Letter of Credit 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 outside of areas served by ILEC affiliates in Arizona therefore, the Applicant currently has no market power in the local exchange service market where alternative providers of telecommunications services exist. Staff therefore recommends that the Applicant's proposed services be classified as competitive.