

ORIGINAL



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MEMORANDUM

TO: Docket Control

FROM: Ernest G. Johnson
Director
Utilities Division

DATE: September 19, 2008

RE: **AMENDED STAFF REPORT**-IN THE MATTER OF THE APPLICATION OF EXTELCOM INC. DBA EXPRESS TEL FOR CANCELLATION OF THEIR CERTIFICATE OF CONVENIENCE AND NECESSITY TO PROVIDE RESOLD LONG DISTANCE TELECOMMUNICATIONS SERVICES AND ALTERNATIVE OPERATOR SERVICE. (DOCKET NO. T-02543A-07-0147)

Attached is the Amended Staff Report for the above referenced application. The applicant is applying to cancel its Certificate of Convenience and Necessity ("CC&N") to provide the following services:

- Resold Long Distance Services
- Alternative Operator Service

Staff recommends cancellation of the CC&N.

EGJ:CA:tdp

Originator: Candrea Allen

Arizona Corporation Commission
DOCKETED
SEP 19 2008

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AZ CORP COMMISSION
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SERVICE LIST FOR: Extelcom, Inc. d/b/a Express Tel
DOCKET NO.: T-02543A-07-0147

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**AMENDED STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION**

**EXTELCOM INC. DBA EXPRESS TEL
DOCKET NO. T-02543A-07-0147**

**IN THE MATTER OF THE APPLICATION OF EXTELCOM, INC. DBA EXPRESS
TEL FOR CANCELLATION OF THEIR CERTIFICATE OF CONVENIENCE AND
NECESSITY TO PROVIDE RESOLD LONG DISTANCE TELECOMMUNICATIONS
SERVICES AND ALTERNATIVE OPERATOR SERVICE**

SEPTEMBER 19, 2008

STAFF ACKNOWLEDGEMENT

The Amended Staff Report for the application of Extelcom, Inc., Docket No.T-02543A-07-0147, for approval to cancel its Certificate of Convenience and Necessity to provide Resold Long Distance Telecommunications Services and Alternative Operator Service was the responsibility of the staff member listed below. Candrea Allen was responsible for the review and analysis of the application.

A handwritten signature in black ink, appearing to read 'Candrea Allen', written over a horizontal line.

Candrea Allen
Executive Consultant I

BACKGROUND

On January 12, 1995, the Arizona Corporation Commission ("Commission"), in Decision No. 58941, granted Extelcom a Certificate of Convenience and Necessity ("CC&N") to provide alternative operator service within the state of Arizona. On March 19, 1997, the Commission, in Decision No. 60108, granted Extelcom a CC&N to provide resold long distance telecommunications services within the state of Arizona. On October 7, 1998, the Commission issued Decision No. 61163, which granted a CC&N to Buyers United International, Inc. ("Buyers") to provide resold long distance telecommunications services within the state of Arizona.

On July 16, 2003, Buyers filed an application requesting Commission approval to change its name to Buyers Untied, Inc ("BUI"). Buyers filed tariffs with the commission reflecting the intended change. On August 28, 2003, Commission Staff filed a request to close the docket, indicating that the tariff had become effective by operation of law on August 14, 2003. On September 2, 2003, Commission Docket Control formally closed the docket with Administrative Closure Number 66228. On December 29, 2004, BUI filed an application requesting Commission approval to change its name from Buyers United, Inc. to UCN, Inc ("UCN"). BUI filed tariffs with the commission reflecting the intended change. On March 9, 2005, Commission Staff filed a request to close the docket, indicating that the tariff had become effective by operation of law on January 27, 2005. On March 21, 2005, Commission Docket Control formally closed the docket with Administrative Closure Number 67702.

On July 18, 2005, the Commission issued Decision No. 67979, which granted a CC&N to UCN, Inc. to provide resold and facilities-based local exchange telecommunications services in Arizona.

On March 8, 2007, UCN, Inc. ("UCN") on behalf of Extelcom, Inc. d/b/a Express Tel ("Extelcom" or "Applicant") filed an application to cancel its CC&N to provide resold long distance telecommunications services and alternative operator service within the State of Arizona. UCN requests Commission approval to cancel Extelcom's CC&Ns to provide long distance telecommunications services and alternative operator service and withdraw its tariff. The application also included the notification of an "asset purchase agreement" in which Extelcom had transferred its long distance customer base to UCN's service. A notice of that transaction had been received by docket control on May 23, 2005. However, the notification was not assigned a Docket No. and therefore at the time was not reviewed.

On May 16 2008, Staff filed a Staff Report recommending cancellation of Extelcom's CC&N. On July 21, 2008, the Administrative Law Judge ("ALJ") issued a Procedural Order requiring Staff to file an Amended Staff Report addressing the following statutory and regulatory issues:

- I. Applicability of A.R.S. § 40-285(A) to this matter, specifically whether Extelcom and UCN were required to obtain Commission approval before consummating the sale of Extelcom's assets to UCN;
- II. Compliance by Extelcom with the requirements of Arizona Administrative Code ("A.A.C.") R14-2-1107;
- III. Compliance by Extelcom with the requirements of A.A.C. R14-2-1901 through R14-2-1913 and A.A.C. R14-2-2001 through R14-2-2007 ("Slamming and Cramming Rules");
- IV. Compliance by Extelcom with the requirements of the A.A.C. R14-2-801 through R14-2-806 ("Public Utilities Holding Companies and Affiliated Interest Rules"); and
- V. Staff's recommendations regarding Extelcom's tariffs.

I. Applicability of A.R.S. § 40-285(A)

A.R.S. § 40-285(A), in relevant part, requires, public service corporations to secure Commission approval of any transaction involving the sale or assignment of any part of its "plant" or "system" which is "necessary or useful in the performance of its duties to the public". Essentially, the statute requires that a utility request permission before transferring any asset the utility needs to serve the public. Some confusion often arises in the cases where, as here, one telecommunications company transfers its existing customers to a second telecommunications company. The confusion stems from the concept of what constitutes an "asset".

Within the telecommunications industry, a customer base is an asset, having a definite value in terms of revenues generated by those customers. Telecommunications companies spend significant resources attempting to attract new customers and, once attracted, to retain those customers. When a company with a significant customer base can no longer remain in operation, it must find an alternative provider for that base. Often, the customer base is "sold".

Obviously, adding a new block of customers is highly desirable. If a company can add those new customers directly from a former competitor, it saves the costs associated with attracting those customers and the company can then concentrate on simply retaining those customers. Since the failing company is no longer going to be receiving the revenue stream generated by those customers, all of the costs associated with attracting those customers are lost to the company's shareholders. By arranging to transfer those customers directly to a competitor, the company is able to recover a portion of those costs. Thus, from a business perspective, the customer base is an "asset".

But it is important to remember that A.R.S. § 40-285(A) does not require Commission approval of *all* asset transfers. It only governs transactions involving those assets which comprise part of the utility's "plant" or "system" *and* which the utility needs to serve its customers. In this case, assets such as switches could be considered part of Extelcom's "plant". Switches, or more particularly the sale of switches, could potentially impair Extelcom's ability to serve customers. Sales of those assets would seem to fall squarely within the reach of A.R.S. § 40-285(A).

In contrast, the company's customer base is not part of Extelcom's "plant". And more importantly, the customer base does not constitute a plant or system component "necessary or useful in the performance of its duties to the public". While customers are essential to any business, Extelcom's customer base is not necessary for Extelcom to "perform its duties to the public". Extelcom would still be able to perform its duties without its customer base, it simply wouldn't have a reason to do so or make any profit when it did.

Therefore, the "sale" of Extelcom's customer base does not constitute a transaction to which A.R.S. § 40-285(A) would be applicable.

II. Compliance with Arizona Administrative Code R14-2-1107

Compliance with R14-2-1107(A) –

On May 23, 2005 Extelcom and UNC filed a notification that the parties had executed an asset purchase agreement. For the reasons stated above, execution of the agreement itself does not constitute a violation of A.R.S. § 40-285(A).

However, according to Extelcom, as of July 1, 2005, the company had no customers and no assets and had ceased operations in Arizona. Therefore, the result of the transaction was a discontinuance of service. R14-2-1107(A) is clear that the application and authorization come *before* the discontinuance of service. That did not happen in the instant matter. Plainly, Extelcom intended to discontinue service. Therefore, the instant application should have been filed before the agreement was executed, not because the transfer of the customer base itself was prohibited, but because the transaction effectively discontinued service. Therefore, Extelcom violated R14-2-1107(A).

At the time of the May 23, 2005 transfer, it is clear that Extelcom did not comply with the conditions set forth in A.A.C. R14-2-1107(A). The statute provides: "Any telecommunications company providing competitive local exchange or interexchange services on a resold or facilities-based basis that intends to discontinue service ... shall file an application for authorization with the Commission". The application must state:

- (1) Any reasons for the proposed discontinuance of service;
- (2) Verification that all affected customers have been notified of the proposed discontinuance, and that all affected customers

will have access to an alternative local exchange service provider;

- (3) A plan for the refund of any deposits collected; and
- (4) A list of alternative carriers providing the same or similar services within the geographical area.

Clearly, since Extelcom never filed an application to discontinue service in compliance with R14-2-1107(A), it did not file legal notice of the application in compliance with R14-2-1107(B). And while the instant application is a retroactive submission of the application, it is nonetheless impossible for the instant application to comply with R14-2-1107(A) because the underlying discontinuance has already occurred.

However, despite the fact that the timing of the application can not be cured, Staff still believes the application is nonetheless necessary to provide the Commission the opportunity to verify that Extelcom has complied with the remaining components of R14-2-1107(A). Staff believes Extelcom's instant application does so, albeit after the fact:

R14-2-1107(A)(1) requires that the application state the reasons for discontinuance of service. The instant application states that Extelcom is requesting authorization to discontinue service because the company does not have any customers and has ceased operations in Arizona.

R14-2-1107(A)(2) requires verification that all customers have been notified of the discontinuance, and that all customers will have access to an alternative provider. Extelcom has verified to Staff that prior to discontinuing service, Extelcom did notify its customers in writing that service was terminating. Extelcom has also verified that it transferred its customers to UCN, which had already been granted a CC&N to provide the same services.

R14-2-1107(A)(3) requires a company to provide a plan to refund all deposits. At no time has Extelcom ever required or accepted customer deposits.

R14-2-1107(A)(4) requires the company to list all alternative utilities providing the same or similar service within the affected geographic area. The instant application does contain that information. The instant application states that the long distance customers were transferred from Extelcom to UCN.

Thus, the instant application satisfies the requirements of R14-2-1107(A). The application's only shortcoming is that it was filed after-the-fact. While Staff is not intending to minimize the importance of obtaining Commission approval, it is Staff's opinion that Extelcom's instant application addresses the requirements of R14-2-1107(A).

Compliance with R14-2-1107(B)

Once a telecommunications company files an application requesting permission to discontinue service under R14-2-1107(B), no later than 20 days after such filing, the company is

required to file legal notice “in all counties affected by the application”, and “shall describe with particularity the substance of the application.”, according to R14-2-1107(B). This raises an additional issue.

Now that Extelcom has filed the application it was supposed to have filed, R14-2-1107(B) requires the company to file the required legal notice. The purpose of the notice is to provide the affected public with a chance to voice their concerns regarding the change in service providers or to possibly intervene in the matter. Certainly, the Commission would be within its authority to order that such notice be undertaken, but it is uncertain what such notice might accomplish. Since the actual change in service has already taken place, there are no remaining customers to voice their opinions. Ordering publication of legal notice at this point in the process would not accomplish the purpose behind notification.

As discussed in Decision No. 67404 (November 2, 2004) and Decision No. 70407 (July 3, 2008), the intent of R14-2-1107(B) is “to ensure that existing customers have advance notice of a provider’s pending plan to discontinue service such that they will be afforded an opportunity to procure service through an alternative provider prior to such discontinuance.” It should be noted that the Commission has at times waived the need to comply with R14-2-1107(B). While Staff is not suggesting such a course of action at this time, should the issue be raised in the future, Staff would not object to such a proposal.

While it is of concern that Extelcom’s customers never received a chance to voice any concerns to the Commission, in Staff’s view, there is no reason to believe that the public was in any way harmed or improperly affected by Extelcom’s failure to seek permission to discontinue service. Staff is unaware of any customer complaints related to the transaction.

Staff believes that the application should be approved, and takes no position regarding any potential consequences to Extelcom resulting from its failure to comply with the statute.

III. Compliance with Commission Rules on “Slamming” and “Cramming”

A.A.C. R14-2-1901 – 1913 are collectively govern the practice known within the telecommunications industry as “slamming”, while A.A.C. R14-2-2001 – 2007 govern the practice known as “cramming”. Slamming occurs when a telecommunication company transfers its customers to an alternative carrier without the customer’s knowledge. Cramming occurs when customers are transferred to an alternative carrier and subsequently receive an increase in their service fees as a result of being forced to accept new services which they did not request.

Slamming

While the practice of slamming is governed by multiple rules, of primary importance is R14-2-1904(A), which prohibits a telecommunications company from changing service providers “prior to obtaining authorization in accordance with R14-2-1905”.

R14-2-1905 provides that a telecommunications company shall not submit a change order unless it confirms the order by (1) obtaining the subscriber's written permission, (2) obtaining the subscriber's electronic or voice-recorded permission, or (3) obtaining from a 3rd party the subscriber's permission.

Extelcom has verified to Staff that, prior to the transfer of customers to UCN, it provided written notice to each of its subscribers. Extelcom did not indicate that it had received either written authorization or voice-recorded authorization. Staff does not believe that this satisfies the requirements of R14-2-1905. However, since the transaction occurred nearly three years ago, there is no remedy for this failure. The subscribers in question were transferred to a Commission-authorized service provider. Staff has received no complaints regarding the transfer of service and is therefore reasonably certain that the transaction did not result in hardship for many, if any, of Extelcom's previous subscribers.

As a result, Staff's position regarding approval of the instant application remains unchanged. Again, Staff is not suggesting that a failure to comply with the rules is insignificant, only that the underlying transaction should be approved. Staff takes no position regarding any possible Commission action in conjunction with Extelcom's failure to comply with the rules.

Cramming

When a telecommunications company transfers a subscriber's service to an alternative provider, the transfer should be as transparent to the subscriber as possible. Essentially, the subscriber should receive the substantially the same service for substantially the same price. When a subscriber is transferred to a new carrier with higher minimum service levels, together with the corresponding increase in the customer's bill, the practice is referred to as "cramming". R14-2-2001 through R14-2-2011 provide a framework within which subscribers can complain regarding any and all billing practices, including complaints relating to cramming.

In the instant matter, Extelcom transferred the services of its customer base to UCN. Extelcom asserts that its customers were made aware of the transaction beforehand and that the UCN provided essentially the same level of service as Extelcom, for the same price. While Staff is unable to compare the levels of service offered by the two companies, it should be noted that after the date the transaction was consummated, the Commission did not receive any complaints regarding the change in carriers or more specifically, about the service rates of UCN.

While Staff is unable to verify that Extelcom acted in compliance with the Commission's cramming rules, it would appear from the available records that UCN has not engaged in cramming.

IV. Compliance with Public Utility Holding Companies and Affiliated Interest Rules

Pursuant to R14-2-103(A)(3)(q), utilities are classified according to type and annual operating revenue. A telecommunications utility is classified as "Class A" if it produces annual

operating revenue of \$1,000,000 or more. R14-2-802(A) states that the Public Utility Holding Companies and Affiliated Interest Rules apply to "all Class A investor-owned utilities under the jurisdiction of the Commission".

According to the annual reports on file with the Commission neither Extelcom nor UCN have ever produced the required revenue, neither company qualifies as a Class A corporation. As a result, Extelcom was not and UCN is not subject to the restrictions imposed by the Affiliated Interest Rules.

The company also stated that Extelcom has never collected any advances, deposits, and/or prepayments from customers. According to the Compliance Section, Extelcom has no bond on file with the Commission. Therefore, there is no risk that any advances, deposits, and/or prepayments would be lost by canceling Extelcom's CC&N. The company also stated in its responses to Staff's data requests that it does not have any employees or facilities in Arizona.

Consumer Services Staff has indicated that from January 1, 2004 to current, there has been one billing complaint, zero inquiries, and zero opinions filed for Extelcom. The Corporations Division reports that as of March 26, 2007, Extelcom is in good standing. Since there are numerous other carriers offering the same or similar services as Extelcom and Extelcom does not have any customers in Arizona, Staff believes that approval of Extelcom's request to cancel its CC&N and withdraw its tariff is in the public interest.

V. RECOMMENDATIONS

Staff recommends the approval of Extelcom's application to cancel its CC&N. Extelcom is not conducting business nor providing services to customers in Arizona. Upon cancellation of its CC&N, Extelcom will no longer be authorized to provide resold long distance telecommunications services or alternative operator service in Arizona. Therefore, Extelcom will no longer be subject to the requirements of Decision Nos. 58941 and 60108. In addition, Staff recommends withdrawal of Extelcom's tariffs on file with the Commission.