

ORIGINAL



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MEMORANDUM

TO: Docket Control  
FROM: Steven M. Olea  
Director  
Utilities Division

*EA for SMD*

DATE: October 23, 2009

RE: IN THE MATTER OF THE APPLICATION OF IBASIS RETAIL, INC. DBA  
IBASIS FOR APPROVAL OF A CERTIFICATE OF CONVENIENCE AND  
NECESSITY TO PROVIDE RESOLD LONG DISTANCE  
TELECOMMUNICATIONS SERVICES (DOCKET NO. T-20618A-08-0469)

Attached is the Staff Report for the above referenced Application. The Applicant is applying for approval of its petition for a Certificate of Convenience and Necessity ("CC&N") to provide the following services:

- Resold Long Distance Telecommunications Services

Staff is recommending approval of the CC&N.

SMO:PJG:red

Originator: Pamela J. Genung

Attachment: Original and Thirteen Copies

Arizona Corporation Commission

**DOCKETED**

OCT 23 2009

DOCKETED BY	<i>[Signature]</i>
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AZ CORP COMMISSION  
DOCKET CONTROL

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**STAFF REPORT  
UTILITIES DIVISION  
ARIZONA CORPORATION COMMISSION**

**Application for a Certificate of Convenience and Necessity to Provide Resold  
Interexchange Service and for Determination that Services of the Applicant are Competitive**

**Applicant: iBasis Retail, Inc.**  
**Docket No.: T-20618A-08-0469**

On September 8, 2008, iBasis Retail, Inc. ("iBasis" or "Applicant") filed an Application for a Certificate of Convenience and Necessity ("CC&N") to provide resold interexchange long distance services within the State of Arizona.

On October 31, 2008, Staff issued its First Set of Data Requests to iBasis. On December 5, 2008, iBasis provided Responses to Staff's First Set of Data Requests. Included in the December 5, 2008 response, at Exhibit B, was an amended proposed Arizona CC Tariff No. 1 in its entirety. On April 10, 2009, Staff issued its Second Set of Data Requests to iBasis. On May 11, 2009, iBasis provided Responses to Staff's Second Set of Data Requests. Included in its May 11, 2009 response, at Exhibit B, was an amended proposed Arizona CC Tariff No. 1 in its entirety. On June 23, 2009, Staff issued its Third Set of Data Requests to iBasis. On July 17, 2009, iBasis provided Responses to Staff's Third Set of Data Requests along with an amended proposed Arizona CC Tariff No. 1, in its entirety.

Staff's review of this Application addresses the overall fitness of the Applicant to receive a CC&N to provide competitive resold intrastate interexchange long distance telecommunications services. Staff's review considers the Applicant's technical and financial capabilities, and whether the Applicant's proposed rates will be just and reasonable.

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**REVIEW OF APPLICANT INFORMATION**

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Staff makes the following finding, indicated by an "X," regarding information filed by the Applicant:

- The necessary information has been filed to process this Application, and the Applicant has authority to transact business in the State of Arizona.**
  
- The Applicant has published legal notice of the Application in all counties where service will be provided. On October 27, 2008, Applicant filed an Affidavit of Publication in the counties where the authority to provide resold long distance telecommunications services is requested.**

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## REVIEW OF TECHNICAL INFORMATION

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The Applicant has demonstrated sufficient technical capability to provide the proposed services for the following reasons, which are marked:

- The Applicant is not currently providing service in Arizona.**
- The Applicant is currently providing service in other states.**
- The Applicant is a switchless reseller.**
- In the event the Applicant experiences financial difficulty, end users can access other interexchange service providers.**

The Applicant indicated that it has obtained authority to provide resold interexchange services in thirteen states, excluding Arizona. iBasis indicated that it is also currently providing resold long distance service in those thirteen states which include: California, Colorado, Delaware, Florida, Idaho, Illinois, Massachusetts, New York, Oregon, Texas, Utah, Washington, and West Virginia. Staff has contacted the thirteen state Public Utility Commissions to verify whether iBasis is certificated or registered to provide resold long distance telecommunications services in the states listed in the Application. Staff also inquired whether there were any consumer complaints filed against iBasis. The information that Staff has obtained indicates that there have been no consumer complaints filed against iBasis.

A search of the Federal Communications Commission website found that there have been no complaints filed against iBasis. The Consumer Services Section of the Utilities Division reports no complaints, inquiries, or opinions filed within Arizona from January 2005 through August 26, 2009. A review of iBasis' 2008 Confidential Annual Report includes intrastate interexchange revenue from its Arizona operations.

The Applicant has not had an Application for service denied in any state. The Applicant indicated that none of its officers, directors or partners have been involved in any civil or criminal investigations, 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 Consumer Services Section of the Utilities Division reports that iBasis is in good standing with the Corporations Division of this Commission.

In the Company's 10-Q, which was provided with the Applicant's initial Application, several court related investigations and/or proceedings against iBasis, Inc., the parent entity, were identified. In response to Staff's First Set of Data Requests, iBasis provided updates to those matters. The matters, as updated by iBasis described below.

In 2001, class action complaints were filed in the United States District Court for the Southern District of New York against iBasis, Inc. and its investment banking firms related to the Company's 1999 initial public common stock offering and its 2000 secondary common stock

offering. Settlement negotiations occurred and in August 2005, the district court issued a preliminary order approving further modifications to the settlement certifying the settlement classes and scheduled a fairness hearing. Plaintiffs continue to pursue their claims against the underwriters. iBasis, Inc. expects that additional settlement negotiations will occur.

In 2001, World Access, Inc., WorldxChange Communications, Inc., and Facilicom International, LLC, together with other related debtors (collectively, the "Debtors"), filed voluntary petitions for relief under Chapter 11 of Title 11 of the United States Code in the United States Bankruptcy Court for the Northern District of Illinois. In 2003, the Debtors asserted claims against iBasis, Inc. because of allegedly preferential transfers and nonpayment of overdue amounts owed by iBasis, Inc. to the Debtors totaling approximately \$2.1 million. iBasis, Inc. asserted defenses to the claims, invoked statutory defenses, and filed proofs of claim for approximately \$0.5 million to which the trustee for the Debtors has objected. iBasis, Inc. expects to engage in mediation to attempt to resolve the claims during the first quarter of 2009. Neither iBasis Retail, Inc. nor its officers were named in the petitions. There have been no civil judgments rendered.

In 2006, two derivative actions, relative to iBasis Inc.'s stock options, were filed in the United States District Court of Massachusetts. On December 5, 2007, the Court issued a formal order dismissing the entire action since it concluded that there was no basis for federal court jurisdiction over the case. The plaintiffs have appealed the dismissal to the Circuit Court of Appeals for the First Circuit. The appeal is currently pending.

In 2006, the Security and Exchange Commission ("SEC") contacted iBasis, Inc. as part of an informal inquiry, and later a formal inquiry, into its grant of the Company's stock options from 1999 through 2007. The SEC tentatively indicated that it had taken all of the investigative testimony that it planned to take. On November 24, 2008, the SEC notified iBasis, Inc. that it is considering recommending that the Commission bring a civil injunction against iBasis, Inc. and certain of its officers. iBasis, Inc. continues to cooperate fully with the SEC inquiry.

In 2007, J & J Communications, Inc. ("J & J") filed a suit against Abdul Communications, Inc. ("Abdul") and later added iBasis, Inc. and another defendant to the case involving a contract dispute between J & J and Abdul and calling cards that iBasis, Inc. sold to Abdul. On June 2, 2008, the Court granted iBasis, Inc.'s motion to dismiss three counts of J & J's complaint. According to an update provided by iBasis to Staff via email on October 1, 2009, the "fact" discovery phase of the proceeding has been completed and the "expert" discovery phase of the proceeding will close in early November 2009. None of iBasis' officers or directors are named in this suit and iBasis Retail, Inc. is not a party to the suit. No civil judgments have been rendered. iBasis, Inc. anticipates filing for summary judgment of all claims against it in December 2009.

iBasis has indicated in its Application that it intends to resell long distance services in Arizona from Verizon, Sprint, and Global Crossing. Currently, the vast majority of all iBasis' services are international or interstate. iBasis stated that it currently provides a small amount of prepaid calling card services in Arizona. In 2008, approximately 98.3% of iBasis' traffic was international, 1.66% was interstate, and the remainder was intrastate. iBasis' 2008 revenues were more than \$1.1 billion, and \$2,719 or about 2/10,000<sup>th</sup> of 1% of its revenues were derived from Arizona intrastate calls. iBasis distributes its prepaid calling cards by entering into contracts with

retail distributors. The retail distributors purchase sets of cards in bulk and sell the cards to retailers for individual sale to consumers. iBasis markets its prepaid calling cards primarily through retail point of sale displays and posters. Because iBasis is actually the underlying provider of the calling card services, its 800 number is printed on the back of the cards so that customers may contact iBasis should there be any problems or issues with the cards.

iBasis' management team currently consists of four employees with a combination of over thirty-two years experience in the telecommunications industry.

Based on the above information, Staff has determined that the Applicant has sufficient technical capabilities to provide resold interexchange long distance telecommunications services in Arizona.

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### REVIEW OF FINANCIAL INFORMATION

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**The Applicant is required to have a performance bond to provide resold interexchange service in the State of Arizona.**

In its initial Application, the Applicant provided audited financial statements of iBasis, Inc., the parent entity, for the twelve months ending December 31, 2006 and December 31, 2007. The 2007 financial statements list total assets of \$659,873,000; total equity of \$334,490,000; and net income of \$16,123,000. The 2006 financial statements list total assets of \$233,269,000; total equity of \$23,978,000 and net income of \$42,490,000. The Applicant provided notes stating that it will rely on the financial resources of its parent company.

The Applicant stated in its revised proposed Arizona CC Tariff No. 1, at Sections 2.7 and 2.8 on Original Page 18, that it does not collect advances or deposits from its resold interexchange customers. iBasis has indicated in its proposed Arizona CC Tariff No. 1, at 3.1.1 and 3.1.2 on Original Pages 21 and 22, respectively that it intends to offer Prepaid Calling Cards.

The Commission's current bond or irrevocable sight draft Letter of Credit ("ISDLC") requirements are \$10,000 for resold long distance (for those resellers who collect advances, prepayments, deposits, or are offering prepaid calling services). Based on the services the Applicant is requesting authority to provide, the minimum recommended performance bond or ISDLC should be equal to \$10,000.

If this Applicant experiences financial difficulty, there should be minimal impact to the customers of this Applicant because there are many companies that provide resold interexchange telecommunications service or the customers may choose a facilities-based provider.

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### REVIEW OF PROPOSED TARIFF AND FAIR VALUE DETERMINATION

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**The Applicant has filed a proposed tariff with the Commission.**

X

**The Applicant has filed sufficient information with the Commission to make a fair value determination.**

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 and has determined 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. Staff has reviewed the rates to be charged by the Applicant and believes they are just and reasonable as they are comparable to several long distance carriers operating in Arizona and comparable to the rates the Applicant charges in other jurisdictions. 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.

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## COMPETITIVE SERVICES' RATES AND CHARGES

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### Competitive Services

The Applicant is a reseller of services it purchases from other telecommunications companies. It is not a monopoly provider of service nor does it control a significant portion of the telecommunications market. The Applicant cannot adversely affect the intrastate interexchange market by restricting output or raising market prices. In addition, the entities from which the Applicant buys bulk services are technically and financially capable of providing alternative services at comparable rates, terms, and conditions. Staff has concluded that the Applicant has no market power and that the reasonableness of its rates will be evaluated in a market with numerous competitors. In light of the competitive market in which the Applicant will be providing its services, Staff believes that the Applicant's proposed tariffs for its competitive services will be just and reasonable.

### Effective Rates

The Commission provides pricing flexibility by allowing competitive telecommunication service companies to price their services at or below the maximum rates contained in their tariffs as long as the pricing of those services complies with Arizona Administrative Code ("A.A.C.") R14-2-1109. The Commission's rules require the Applicant to file a tariff for each competitive service that states the maximum rate as well as the effective (actual) price that will be charged for the service. In the event that the Applicant states only one rate in its tariff for a competitive service, Staff recommends that the rate stated be the effective (actual) price to be charged for the service as well as the service's maximum rate. Any changes to the Applicant's effective price for a service must comply with A.A.C. R14-2-1109.

## **Minimum and Maximum Rates**

A.A.C. R14-2-1109 (A) provides that minimum rates for the Applicant's competitive services must not be below the Applicant's total service long run incremental costs of providing the services. The Applicant's maximum rates should be the maximum rates proposed by the Applicant in its most recent tariffs on file with the Commission. Any future changes to the maximum rates in the Applicant's tariffs must comply with A.A.C. R14-2-1110.

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## **STAFF RECOMMENDATIONS**

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Staff has reviewed the Application for a Certificate of Convenience and Necessity to offer intrastate interexchange long distance services as a reseller and the Applicant's petition to classify its intrastate interexchange services as competitive. Based on its evaluation of the Applicant's technical and financial capabilities to provide resold intrastate interexchange long distance services, Staff recommends approval of the Application. In addition, Staff further recommends that:

1. The Applicant should be ordered to comply with all Commission rules, orders, and other requirements relevant to the provision of intrastate telecommunications service;
2. The Applicant should be ordered to maintain its accounts and records as required by the Commission;
3. The Applicant should be ordered to 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;
4. The Applicant should be ordered to maintain on file with the Commission all current tariffs and rates, and any service standards that the Commission may require;
5. The Applicant should be ordered to comply with the Commission's rules and modify its tariffs to conform to these rules if it is determined that there is a conflict between the Applicant's tariffs and the Commission's rules;
6. The Applicant should be ordered to cooperate with Commission investigations including, but not limited to customer complaints;
7. The Applicant should be ordered to participate in and contribute to the Arizona Universal Service Fund, as required by the Commission;
8. The Applicant should be ordered to notify the Commission immediately upon changes to the Applicant's name address or telephone number;
9. The Applicant's intrastate interexchange service offerings should be classified as competitive pursuant to A.A.C. R14-2-1108;

10. The maximum rates for these services should be the maximum rates proposed by the Applicant in its proposed tariffs. The minimum rates for the Applicant's competitive services should be the Applicant's total service long run incremental costs of providing those services as set forth in A.A.C. R14-2-1109;
11. In the event that the Applicant states only one rate in its proposed tariff for a competitive service, the rate stated should be the effective (actual) price to be charged for the service as well as the service's maximum rate;
12. 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 and has determined 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. Staff has reviewed the rates to be charged by the Applicant and believes they are just and reasonable as they are comparable to several long distance carriers operating in Arizona and comparable to the rates the Applicant charges in other jurisdictions. 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;
13. In the event the Applicant requests to discontinue and/or abandon its service area it must provide notice to both the Commission and its customers. Such notice(s) shall be in accordance with A.A.C. R14-2-1107.

Staff recommends that the CC&N granted to the Applicant be considered Null and Void after due process if the Applicant fails to meet the conditions stated below:

1. The Applicant shall file conforming tariffs within 365 days from the date of an Order in this matter or 30 days prior to providing service, which ever comes first, and in accordance with the Decision.
2. The Applicant shall:
  - a. Procure either a performance bond or an irrevocable sight draft Letter of Credit equal to \$10,000.
  - b. Docket proof of the original performance bond or irrevocable sight draft Letter of Credit with the Commission's Business Office and copies of the performance bond or irrevocable sight draft Letter of Credit with Docket Control, as a compliance item in this docket, within 90 days of the effective date of a Decision in this matter or 10 days before the first customer is served, whichever comes earlier. iBasis shall notify the Commission when its first customer is served. The performance bond or irrevocable sight draft Letter of Credit must remain in effect until further order of the Commission. The Commission may draw on the performance bond or irrevocable sight draft Letter of Credit, on behalf of, and for the sole benefit of the Company's customers, if the Commission finds, in its discretion, that the Company is in default of its obligations arising from its Certificate. The Commission may use the performance bond or irrevocable sight draft Letter of

Credit funds, as appropriate, to protect the Company's customers and the public interest and take any and all actions the Commission deems necessary, in its discretion, including, but not limited to returning prepayments or deposits collected from the Company's customers.

This Application may be approved without a hearing pursuant to A.R.S. § 40-282.

for Abrepecc  
Steven M. Otea  
Director  
Utilities Division

Date: 10/23/09

Originator: Pamela J. Genung

SERVICE LIST FOR: iBasis Retail, Inc.  
DOCKET NO. T-20618A-08-0469

Ms. Ellen Schmidt  
Senior Counsel  
20 Second Avenue  
Burlington, Massachusetts 01803

Mr. Kemal Hawa  
Mintz, Levin, Cohn, Ferris, Glovasky, and Popeo, PC  
701 Pennsylvania Avenue, NW  
Suite 900  
Washington, DC 20009

Ms. Janice Alward  
Chief Counsel, Legal Division  
Arizona Corporation Commission  
1200 West Washington Street  
Phoenix, Arizona 85007

Mr. Steven M. Olea  
Director, Utilities Division  
Arizona Corporation Commission  
1200 West Washington Street  
Phoenix, Arizona 85007

Ms. Lyn Farmer  
Chief Administrative Law Judge, Hearing Division  
Arizona Corporation Commission  
1200 West Washington Street  
Phoenix, Arizona 85007