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MEMORANDUM

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

EA for SMD

AZ CORP COMMISSION  
DOCKET CONTROL

DATE: August 19, 2010

RE: IN THE MATTER OF THE APPLICATION OF MCGRAW COMMUNICATIONS, INC. FOR APPROVAL OF A CERTIFICATE OF CONVENIENCE AND NECESSITY FOR RESOLD AND FACILITIES-BASED LOCAL EXCHANGE TELECOMMUNICATIONS SERVICES (DOCKET NO. T-04219A-09-0270)

Attached is the Staff Report for McGraw Communications, Inc.'s Application requesting approval for a Certificate of Convenience and Necessity ("CC&N") to provide the following services:

- Resold Local Exchange Telecommunications Services
- Facilities-Based Local Exchange Telecommunications Services

The original application asked for approval of the services described in the caption. Staff is recommending approval of the Application, with conditions.

SMO:LLM:kdh

Originator: Lori Morrison

Attachment: Original and Thirteen copies

Arizona Corporation Commission  
DOCKETED

AUG 19 2010

DOCKETED BY

SERVICE LIST FOR: MCGRAW COMMUNICATIONS, INC.  
DOCKET NO. T-04219A-09-0270

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STAFF REPORT  
UTILITIES DIVISION  
ARIZONA CORPORATION COMMISSION

MCGRAW COMMUNICATIONS, INC.

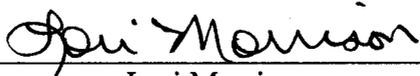
DOCKET NO. T-04219A-09-0270

IN THE MATTER OF THE APPLICATION OF MCGRAW COMMUNICATIONS, INC. FOR  
APPROVAL OF A CERTIFICATE OF CONVENIENCE AND NECESSITY FOR RESOLD  
AND FACILITIES-BASED LOCAL EXCHANGE TELECOMMUNICATIONS SERVICES

AUGUST 19, 2010

## STAFF ACKNOWLEDGMENT

The Staff Report for McGraw Communications, Inc., Docket No. T-04219A-09-0270, was the responsibility of the Staff member listed below. Lori Morrison was responsible for the review and analysis of McGraw Communications, Inc's Application requesting approval for a Certificate of Convenience and Necessity to provide Resold and Facilities-Based Local Exchange Telecommunications Service within the State of Arizona and a petition for a determination that its proposed services should be classified as competitive.

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

Lori Morrison  
Utilities Consultant

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## 1. INTRODUCTION

On May 29, 2009, McGraw Communications, Inc. ("McGraw" or "Applicant") filed an Application for a Certificate of Convenience and Necessity ("CC&N") to provide resold and 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. Included in its original application, McGraw also submitted a proposed tariff for the services it is requesting the authority to provide. McGraw currently holds a CC&N for resold long distance telecommunications services, granted April 6, 2004, in Decision No. 66906.

On June 15, 2009, Staff sent its First Set of Data Requests to McGraw. On September 15, 2009, McGraw filed its response to Staff's First Set of Data Requests. On October 5, 2009, Staff sent its Second Set of Data Requests to McGraw. McGraw filed its response to Staff's Second Set of Data Requests, which included revised tariff pages, on April 21, 2010. On June 11, 2010, McGraw filed an updated Certificate of Good Standing and revised tariff pages as requested by Staff.

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

McGraw is a privately held, foreign corporation organized under the laws of New York, headquartered in New York, New York. The Applicant requests the authority to provide resold and facilities-based basic local exchange services to business customers in Arizona. McGraw states that it will not have any employees located in Arizona. The Applicant has a 24/7 Customer Service Center located in New York, New York that handles all customer concerns, complaints and repair inquires.

The Applicant is currently providing local exchange services in 20 states and the District of Columbia<sup>1</sup>. The telecommunications experience of McGraw's top four executives exceeds a combined total of 60 years.

Based on the above information, Staff believes McGraw possesses the technical capabilities to provide the services it is requesting the authority to provide in Arizona.

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<sup>1</sup> California, Colorado, Connecticut, District of Columbia, Georgia, Illinois, Indiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, New Hampshire, New Jersey, New York, North Carolina, Oregon, Pennsylvania, Rhode Island, Virginia, and Washington.

### **3. FINANCIAL CAPABILITY TO PROVIDE THE REQUESTED SERVICES**

The Applicant provided financial statements for the twelve months ending December 31, 2007 and twelve months ending December 31, 2008. The unaudited financial statements ending December 31, 2007, list total assets of \$6,411,890; total equity of \$6,411,890; and a net loss of \$400,139. The audited financial statements ending December 31, 2008, list total assets of \$5,556,092; total equity of \$5,556,092; and a net income of \$305,503. The Applicant did not provide notes related to the financial statements.

The Applicant states in its proposed Arizona Tariff No.2, Original Page 33, Section 2.5.5 states that the Company does not collect deposits. On Original Page 32, Section 2.5.4, states that the Company will not collect advance payments. The Commission's current practice regarding the performance bond or irrevocable sight draft Letter of Credit ("ISDLC") requirements is \$10,000 for resold long distance (for those long distance service resellers who collect deposits, advances or prepayments), \$25,000 for resold local exchange, \$100,000 for facilities-based long distance, and \$100,000 for facilities-based local exchange services. Since the Applicant is requesting a CC&N for more than one kind of service, the amount of a performance bond or ISDLC for multiple services is an aggregate of the minimum bond or draft amount for each type of telecommunications service requested by the Applicant. The amount of performance bond or ISDLC coverage needed for each service is as follows: \$25,000 for resold local exchange service; and \$100,000 for facilities-based local exchange service. Based on the services the Applicant is requesting authority to provide, the minimum recommended performance bond or ISDLC should be \$125,000.

Staff recommends that the Applicant procure either a performance bond or an ISDLC equal to \$125,000. 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 ISDLC.

Staff recommends that proof of the above-mentioned performance bond or ISDLC be docketed 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. The original performance bond or ISDLC should be filed with the Commission's Business Office and 13 copies of the performance bond or ISDLC be filed with Docket Control, as a compliance item in this docket. The Commission may draw on the performance bond or ISDLC 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 bond or ISDLC 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.

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

The Applicant would initially be providing service in areas where an incumbent local exchange carrier ("ILEC"), along with various competitive local exchange carriers ("CLEC") and interexchange 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 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.

In general, rates for competitive services are not set according to rate of return regulation. As stated previously in this report, McGraw estimates its expected net book value or fair value rate base after the first twelve months of operation to be zero. The rates to be ultimately charged by the Applicant will be heavily influenced by the market. While Staff considered the fair value rate base information submitted by the Applicant, it did not accord that information substantial weight in its analysis.

The rates proposed by this filing are for competitive services. McGraw will not provide service to residential end users. McGraw will provide resold and facilities-based local exchange telecommunications services to business customers. McGraw's business customers that typically negotiate contract rates through a competitive process with the ultimate rates provided on an individual case basis ("ICB") by McGraw. Business customers who do not need individualized offerings and do not require an ICB contract to meet their needs will be able to purchase services at the rates contained in McGraw's proposed tariff.

Staff has reviewed the proposed rates to be charged by the Applicant. McGraw's proposed local rates are for highly competitive services. The proposed tariff rates are similar to those charged by McGraw in other states and are similar to the tariffed rates of other providers' resold and facilities-based local exchange services in Arizona. The rates charged for a service shall 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. Therefore, Staff believes that McGraw's proposed rates are just and reasonable.

#### **5. LOCAL EXCHANGE CARRIER SPECIFIC ISSUES**

Issues related to the provision of 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 thereunder 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 indicated it has not had an Application for service denied nor authority to provide service revoked in any state. Staff did not find any instances of denied applications or revocation of authority to provide service. The Applicant indicated that none of its officers, directors or partners have been or are currently involved any formal or informal complaints proceedings pending before any state or federal regulatory commission, administrative agency or law enforcement agency. Staff has found no instances of any formal or informal complaint proceedings involving the Applicant or any of its officers, directors or managers. The Applicant also indicated that none of its officers, directors or partners have been in or are currently involved in any civil or criminal investigations, or had judgments levied by any administrative or regulatory agency, or been convicted of any criminal acts in the past ten (10) years. Staff has found no instances of any civil or criminal investigations, judgments levied by any administrative or regulatory agency, or criminal convictions within the last ten (10) years involving the Applicant or any of its officers, directors or managers.

The Applicant is currently providing local exchange services in 20 states and the District of Columbia. Staff contacted six (6) state commissions<sup>2</sup> in the jurisdictions where the Applicant's affiliates are currently authorized to provide service to verify certification to provide service and to inquire about complaints. All six state commissions advised that the Applicant was indeed authorized to provide service in their jurisdiction and that no complaints had been received about the Applicant or its affiliates. The Corporations Division has indicated that McGraw is in good standing. The Consumer Services Section reports no complaints have been filed in Arizona from January 1, 2006 to June 10, 2009. A search of the Federal

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<sup>2</sup> California, Colorado, Indiana, Michigan, New York and Washington.

Communications Commission's website found that there have been no formal or informal complaint proceedings involving the Applicant.

## **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 MAKE 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 local exchange service market. At locations where ILECs provide 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.**

None.

**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 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 complies with federal laws, federal rules and A.A.C. R14-2-1308(A), to make number portability available;
3. 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;
4. 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;
5. That the Applicant 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 in accordance with A.A.C. R14-2-1201(6)(d) and Federal Communications Commission 47 CFR Sections 64.3001 and 64.3002;
6. That the Applicant be required to notify the Commission immediately upon changes to the Applicant's name, address or telephone number;
7. That the Applicant cooperates with Commission investigations including, but not limited to customer complaints;
8. 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 zero. 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 and local incumbent carriers 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;

9. 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;
10. That the Applicant offer Caller ID with the capability to toggle between blocking and unblocking the transmission of the telephone number at no charge;
11. That the Applicant offer Last Call Return service that will not return calls to telephone numbers that have the privacy indicator activated; and
12. Staff 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 be null and void after due process.

1. The Applicant shall docket conforming tariffs pages 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.
2. The Applicant shall:
  - a. Procure either a performance bond or an ISDLC equal to \$125,000;
  - b. Docket proof of the original performance bond or ISDLC with the Commission's Business Office and 13 copies of the performance bond or ISDLC 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. The performance bond or ISDLC must remain in effect until further order of the Commission. The Commission may draw on the performance bond or ISDLC 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 ISDLC 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.

- c. As a compliance filing, the Company shall notify the Commission that it has started providing service in Arizona within 30 days of the first customer being served.
  3. Abide by the Commission adopted rules that address Universal Service in Arizona. A.A.C. R14-2-1204(A) indicates that all telecommunications service providers that interconnect with 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).
- 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 or interexchange service markets. Therefore, the Applicant currently has no market power in the local exchange markets where alternative providers of telecommunications services exist. Staff therefore recommends that the Applicant's proposed services be classified as competitive.