

MEMORANDUM



0000156134

TO: Docket Control

FROM: Steven M. Olea
Director
Utilities Division

DATE: September 29, 2014

ORIGINAL

RE: IN THE MATTER OF THE APPLICATION OF THRESHOLD COMMUNICATIONS, INC. FOR APPROVAL OF A CERTIFICATE OF CONVENIENCE AND NECESSITY TO PROVIDE RESOLD LONG DISTANCE, LOCAL EXCHANGE TELECOMMUNICATIONS SERVICES AND VOIP SERVICES (DOCKET NO. T-20888A-13-0273)

Attached is the Staff Report for the above Application requesting approval for a Certificate of Convenience and Necessity ("CC&N") to provide the following services:

- Resold Long Distance Telecommunications Services
- Resold Local Exchange Telecommunications Services
- VoIP Services
- Private Line Telecommunications Services

Arizona Corporation Commission

DOCKETED

SEP 29 2014

Staff is recommending approval of the Application with conditions.

DOCKETED BY

SMO:PJG:vsc\BES

Originator: Pamela J. Genung

Attachment: Original and Thirteen copies

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STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION

THRESHOLD COMMUNICATIONS, INC.

DOCKET NO. T-20888A-13-0273

IN THE MATTER OF THE APPLICATION OF THRESHOLD COMMUNICATIONS, INC.
FOR APPROVAL OF A CERTIFICATE OF CONVENIENCE AND NECESSITY TO
PROVIDE RESOLD LONG DISTANCE, LOCAL EXCHANGE TELECOMMUNICATIONS
SERVICES AND VOIP SERVICES

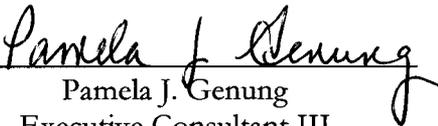
SEPTEMBER 29, 2014

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STAFF ACKNOWLEDGMENT

The Staff Report for Threshold Communications, Inc., Docket No. T-20888A-13-0273, was the responsibility of the Staff member listed below. Pamela J. Genung was responsible for the review and analysis of the Applicant's application for a Certificate of Convenience and Necessity to provide Resold Long Distance, Resold Local Exchange, VoIP, and Private Line Telecommunications Services within the State of Arizona, in addition to the petition for a determination that its proposed services should be classified as competitive.



Pamela J. Genung
Executive Consultant III

1. INTRODUCTION

On August 9, 2013, Threshold Communications, Inc. ("Threshold" or "Applicant") filed an Application for a Certificate of Convenience and Necessity ("CC&N") to provide resold long distance, resold local exchange, and Voice over Internet Protocol ("VoIP") telecommunications services within the State of Arizona. The Applicant also petitioned the Arizona Corporation Commission ("Commission") for a determination that its proposed services should be classified as competitive. On August 9, 2013, Threshold submitted proposed tariffs for the services it is requesting the authority to provide.

On October 7, 2013, Staff issued its First Set of Data Requests to Threshold. Responses to Staff's First Set of Data Requests were received from Threshold on March 24, 2014. Included in the Applicant's Responses to Staff's First Set of Data Requests were replacement tariffs, in entirety, to Threshold's proposed A.C.C. No. 1 and A.C.C. No. 2 tariffs. In response to Staff Data Request PJG 1-2¹, Threshold indicated that it will also be providing private line telecommunications services. On July 28, 2014, Threshold provided a supplement to its March 24, 2014, Responses to Staff's First Set of Data Requests, in addition to two revised tariff pages.

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

Threshold, founded in 2001, is a foreign corporation organized under the laws of the State of Washington. Threshold's headquarters is located at 16541 Redmond Way, #245C, Redmond, Washington 98052.

The Applicant indicated that it is authorized and currently offering telecommunications services similar to those that it will or intends to offer in Arizona in the following states: California, Indiana, New York, North Carolina, Oregon, Texas, Virginia, and Washington. Staff contacted the Public Utility Commissions in those eight (8) states/jurisdictions to determine if Threshold is certificated or registered to provide competitive local exchange, interexchange, and private line telecommunications services in the states listed by the Applicant. Staff also inquired whether there were any consumer complaints filed against the Applicant in those jurisdictions. The information Staff obtained indicates that Threshold is authorized to provide local exchange and interexchange services in at least (6) six states/jurisdictions and there have been no consumer complaints filed against Threshold in any of those states/jurisdictions.

The three members of the Applicant's senior management team each average over sixteen years' experience in the telecommunications industry. Threshold presently has a total

¹ Supplement to Application of Threshold Communications, Inc., Docket No. T-20888A-13-0273, filed August 1, 2014.

of twelve (12) employees. The Applicant plans to have between one (1) and ten (10) employees in Arizona.

Threshold will be providing services to small and medium business end users in Arizona. Threshold states that it will be installing its own facilities, including servers and routers, in a collocation facility in the Phoenix area. Threshold intends to lease lines from existing carriers in Arizona, including CenturyLink. The Applicant will provide customer service to its Arizona subscribers on a 24x7x365 basis. Customer Service may be reached at 1-877-820-8900. If dispatch is required, Threshold will work with the service provider that Threshold leases services from to dispatch a technician. Threshold will not have a customer service center in Arizona.

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

3. FINANCIAL CAPABILITY TO PROVIDE THE REQUESTED SERVICES

On June 3, 2014, a confidentiality agreement was signed by the Applicant and Staff. On July 30, 2014, Threshold provided unaudited financial statements for the two years ending December 31, 2012 and December 31, 2013. The financial statements for year ending 2012 list total assets of \$945,254; total equity of \$549,825 and a net income of \$486,003. The financial statements for year ending 2013 list total assets of \$1,132,788; total equity of \$698,296 and a net income of \$279,575. The Applicant did not provide notes related to the financial statements.

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 ("CLECs") 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 must be listed for each competitive service offered, provided that the rate for the service is not 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 information from the Applicant indicating that its fair value rate base is zero. Accordingly, Applicant's fair value rate base is too small to be useful in a fair value analysis.

Threshold submitted its proposed A.C.C. No. 1 and A.C.C. No. 2 tariffs to support its Application. Threshold has also provided additional rate comparison information of other CLECs in the State of Arizona. Staff has reviewed the proposed rates and believes they are comparable to the rates charged by competitive local carriers and local incumbent carriers operating in the State of Arizona. The rate to be ultimately charged by the Applicant will be heavily influenced by the market. 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.

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 CLEC'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

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 the Applicant should be ordered to abide by the same quality of service standards that were approved by the Commission for Qwest d/b/a CenturyLink QC ("CenturyLink") in Docket No. T-01051B-13-0199 (Decision No. 74208).

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 ("FCC") 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 not had an Application for authority to provide service denied in any state. The Consumer Services Section of the Utilities Division ("Consumer Services") reports that there have been no complaints, inquiries, or opinions filed against Threshold through July 31, 2014. Consumer Services also reports that Threshold is in Good Standing with the Corporations Division of the Commission.

A search of the FCC's website reveals a Notice of Apparent Liability for Forfeiture ("NAL") issued by the Enforcement Bureau of the FCC to Threshold Communications, Inc. released February 24, 2009.² The NAL imposed a monetary forfeiture in the amount of one thousand dollars (\$1,000) for Threshold's failure to submit an annual Customer Proprietary Network Information ("CPNI") compliance certificate that was signed by an officer of the company. Threshold provided an Order³ issued by the Enforcement Bureau, released November 14, 2011, that removed the proposed forfeiture issued to Threshold, and five other companies, based upon additional information provided by the companies.

The Applicant indicated that none of its officers, directors or partners has been convicted of any criminal acts in the past ten (10) years. The Applicant also indicated that

² FCC DA 09-298, Adopted: February 24, 2009; Released: February 24, 2009.

³ FCC DA 11-1877, Adopted November 10, 2011; Released: November 14, 2011.

none of its officers, directors or partners has been involved in any civil or criminal investigations, or any informal complaints.

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 statewide local exchange market that the Applicant seeks to enter is one in which a number of CLECs have been authorized to provide local exchange service in areas previously served only by ILECs. 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, will have to compete with those existing 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. The areas served by CenturyLink that the Applicant seeks to enter are served by wireless carriers and VoIP service providers. This may also be the case in areas served by independent ILECs.

7.1.2 The number of alternative providers of the service.

CenturyLink and various independent ILECs provide local exchange service in the State. CLECs and local exchange resellers are also providing local exchange service. The areas served by CenturyLink that the Applicant seeks to enter are served by wireless carriers and VoIP service providers. This may also be the case in portions of the independent ILECs' service territories.

7.1.3 The estimated market share held by each alternative provider of the service.

CenturyLink and CLECs are the primary providers of local exchange service in CenturyLink's Service territories. Independent ILECs are the primary providers of local exchange service in their service territories.

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.

Threshold does not have any affiliates that are alternative providers of local exchange service in Arizona.

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 the authority to provide in their respective service territories. Similarly, many of the CLECs, local exchange service resellers, wireless carriers and VoIP service providers also offer substantially the same 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. Competition exists in most urban markets, but to a lesser degree in rural areas of the state.
- b. One in which new entrants will be dependent upon ILECs and other CLECs:
 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 existing ILECs and CLECs have had an existing relationship with their customers that the Applicant will have to overcome if it wants to compete in the market and one in which the Applicant will not have a history in the Arizona local exchange service market.
- d. One in which the Applicant will not have the capability to adversely affect prices or restrict output to the detriment of telephone service subscribers.

7.2 *Competitive Services Analysis For Interexchange Services*

7.2.1 A description of the general economic conditions that exist, which makes the relevant market for the service one that, is competitive.

The statewide interexchange market that the Applicant seeks to enter is one in which numerous facilities-based interexchange carriers and resellers of interexchange service have been authorized to provide service throughout the State. The market the Applicant seeks to enter is also served by wireless carriers and VoIP providers. The Applicant will be a new entrant in this market and, as such, will have to compete with those existing companies in order to obtain customers.

7.2.2 The number of alternative providers of the service.

There are a large number of facilities-based interexchange carriers and resellers providing interexchange service throughout the State. The market the Applicant seeks to enter is also served by wireless carriers and VoIP service providers.

7.2.3 The estimated market share held by each alternative provider of the service.

Facilities-based interexchange carriers, interexchange service resellers, independent ILECs, CLECs, wireless carriers and VoIP providers all hold a portion of the interexchange market.

7.2.4 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.

Threshold does not have any affiliates that are alternative providers of interexchange service in Arizona.

7.2.5 The ability of alternative providers to make functionally equivalent or substitute services readily available at competitive rates, terms and conditions.

Both facilities-based interexchange carriers and interexchange service resellers have the ability to offer the same services that the Applicant has requested in their respective service territories. Similarly, many of the ILECs and CLECs offer similar interexchange services. The market the Applicant seeks to enter is also served by wireless carriers and VoIP service providers.

7.2.6 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 interexchange service market is:

- a. One with numerous competitors and limited barriers to entry.
- b. One in which established interexchange carriers have had an existing relationship with their customers that the new entrants will have to overcome if they want to compete in the market.
- c. One in which the Applicant will not have the capability to adversely affect prices or restrict output to the detriment of telephone service subscribers.
- d. One in which the share of the market held by wireless carriers has increased over time, while that held by wireline carriers has declined.

7.3 Competitive Services Analysis For Private Lines Services

7.3.1 Private Line Services

Threshold proposes to provide private line service. Private line service is a direct circuit or channel specifically dedicated to the use of an end user organization for the purpose of directly connecting two or more sites in a multi-site enterprise. Private line service provides a means by which customers may transmit and receive messages and data among various customer locations over facilities operated and provided by the Applicant.

7.3.2 A description of the general economic conditions that exist that make the relevant market for the service one that is competitive.

IXCs, ILECs and CLECs each hold a substantial share of the private line market. The Applicant will be entering the market as an alternative provider of private line service and, as such, the Applicant will have to compete with the existing providers of the service in order to obtain customers.

7.3.3 The number of alternative providers of the service.

IXCs are providers of private line service in the State of Arizona. In addition, ILECs and CLECs also provide private line service.

7.3.4 The estimated market share held by each alternative provider of the service.

IXCs, ILECs and CLECs each hold a substantial share of the private line market.

7.3.5 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.

Threshold does not have any affiliates that are alternative providers of private line service in Arizona.

7.3.6 The ability of alternative providers to make functionally equivalent or substitute services readily available at competitive rates, terms and conditions.

IXCs, ILECs and CLECs have the ability to offer the same services that the Applicant has requested in their respective service territories.

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 comply with all Commission Rules, Orders and other requirements relevant to the provision of intrastate telecommunications services;
2. That the Applicant abide by the quality of service standards that were approved by the Commission for Qwest in Docket No. T-01051B-13-0199;
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 Applicant 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;
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 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 tariff 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 notify the Commission through a compliance filing within 30 days of the commencement of service to end-user customers; and
3. The Applicant shall 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 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).

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 or interexchange service markets where alternative providers of telecommunications services exist. Staff therefore recommends that the Applicant's proposed services be classified as competitive.