

ORIGINAL

MEMORANDUM



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TO: Docket Control

FROM: Thomas M. Broderick
Director
Utilities Division

for

DATE: September 2, 2016

RE: IN THE MATTER OF THE APPLICATION OF CERETEL INCORPORATED FOR A CERTIFICATE OF CONVENIENCE AND NECESSITY TO PROVIDE RESOLD LONG DISTANCE TELECOMMUNICATIONS SERVICES. (DOCKET NO. T-20943A-15-0343)

Attached is the Staff Report for the above Application requesting approval for a Certificate of Convenience and Necessity ("CC&N") to provide Resold Long Distance Telecommunications Services.

Staff is recommending approval of the Application with conditions.

TMB:MAC:red/ML

Originator: Matt Connolly

Arizona Corporation Commission

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CERETEL INCORPORATED
DOCKET NO. T-20943A-15-0343

On this 2nd day of September 2016, the foregoing document was filed with Docket Control as a Staff Report, and copies of the foregoing were mailed on behalf of the Utilities Division to the following who have not consented to email service. On this date or as soon as possible thereafter, the Commission's eDocket program will automatically email a link to the foregoing to the following who have consented to email service.

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ARIZONA CORPORATION COMMISSION

CERETEL INCORPORATED
DOCKET NO. T-20943A-15-0343

IN THE MATTER OF THE APPLICATION OF CERETEL INCORPORATED FOR A
CERTIFICATE OF CONVENIENCE AND NECESSITY TO PROVIDE RESOLD LONG
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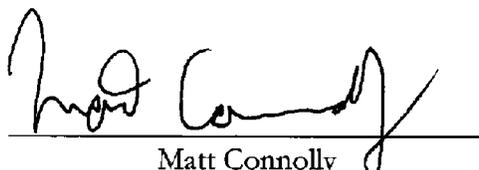
SEPTEMBER 2, 2016

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STAFF ACKNOWLEDGMENT

The Staff Report for CereTel Incorporated, Docket No. T-20943A-15-0343 was the responsibility of the Staff member listed below. Matt Connolly was responsible for the review and analysis of the CereTel Incorporated Application for a Certificate of Convenience and Necessity to provide Resold Long Distance Services within the State of Arizona, in addition to the petition for a determination that its proposed services should be classified as competitive.

A handwritten signature in black ink, appearing to read "Matt Connolly", is written over a horizontal line.

Matt Connolly
Executive Consultant II

1. INTRODUCTION

On October 1, 2015, CereTel Incorporated (“CereTel” or “Applicant” or “Company”) filed an Application for a Certificate of Convenience and Necessity (“CC&N”) to provide resold interexchange 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. CereTel’s October 1, 2015 Application included a proposed tariff for the services it is requesting the authority to provide.

On October 29, 2015, Utilities Division Staff (“Staff”) filed a Deficiency Letter in this matter stating the Company needed to file an affidavit of publication stating it had provided notice of its application in all counties in which it intends to provide services. On March 1, 2016, CereTel filed an Amendment to its Application that included a Notice of Filing Affidavit of Publication. On March 31, 2016, Staff filed a Sufficiency Letter stating the Company had met the sufficiency requirements as outlined in Arizona Administrative Code (“A.A.C.”) R14-2-502 and R-14-2-510(E). On June 3, 2016, Staff issued its First Set of Data Requests to CereTel. Responses to Staff’s First Set of Data Requests which included modified Application information and *pro forma* confidential financials were received from the Applicant on July 7, 2016. On July 19, 2016, Staff issued its Second Set of Data Requests to CereTel. Responses to Staff’s Second Set of Data Requests were received from the Applicant on August 11, 2016. On July 27, 2016, Staff requested, and on July 28, 2016, was granted, additional time to file its Report.

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

CereTel, formed on March 10, 2015, is a foreign C-corporation organized under the laws of the State of Delaware. CereTel’s headquarters is located at 185 Admiral Cochrane Drive, Suite 115, Annapolis, Maryland, 21401.

The Applicant indicated that it has already received authority to provide resale intrastate telecommunications services in Texas, Oregon and Kentucky. The Applicant also indicated it is in the process of obtaining authority to provide resale intrastate telecommunications services in California, Illinois and Washington.

In Arizona, CereTel is proposing to offer resold long distance telecommunications services to residential and business customers in Arizona under both the CereTel brand name and the brand name of STi. The latter name was acquired when CereTel purchased the STi brand in March of 2015. Service will be offered via the retail sale of prepaid calling cards. CereTel stated it will only be marketing international calling services in Arizona and not intrastate services. However, CereTel indicated to Staff that a customer could use a prepaid card to complete an intrastate long distance call in Arizona and such calls are not blocked. Therefore, while it may be only incidental, intrastate long distance will be provided in Arizona.

Calls originating from Arizona customers will be routed to XYN Communications, LLC (“XYN”).¹ XYN has a contract with Nuwave Communications (“Nuwave”). Nuwave, located in the State of Nevada, has a call routing agreement with CereTel. CereTel owns an IP-based softswitch located in New York through which it handles its call traffic. Therefore, calls will go from XYN to Nuwave to the CereTel softswitch. CereTel processes the call, and then routes it internationally using SIP trunks to its international carriers where the call is then terminated.

The key officers and management of CereTel have a combined (52) fifty-two years’ experience in the telecommunications industry. CereTel indicated it does not plan to have employees in Arizona. CereTel maintains customer support from its Annapolis, Maryland location and has available the toll free numbers of 800-514-3447, 877-282-4777, 877-880-0516 and 877-472-3123 for customers to call for rates or support. Customers will be able to reach a support representative Monday through Friday between the hours of 9:00 am and 9:00 pm Eastern Standard Time.

Based on the above information, Staff believes CereTel 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

A protective agreement was signed prior to the Applicant providing its financial statements. The Applicant provided *pro-forma* financial statements of CereTel for the years of 2016 and 2017. The financial statements for year ending 2016 list total assets of \$9,282,000; total equity of \$3,512,000 and net income of negative \$2,367,000. The financial statements for year ending 2017 list total assets of \$9,161,000; total equity of \$3,944,000 and net income of \$432,000.

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.

¹ XYN currently has a pending application before the Commission to provide resold and facilities-based telecommunications services. See *Docket No. T-20968A-16-0158*.

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. The Applicant indicated that at the end of the first twelve months of operation the net book value of all Arizona assets that could be used in the provision of telecommunications service to Arizona customers will be \$0. Accordingly, the company's fair value rate base is too small to be useful in a fair value analysis.

CereTel submitted its proposed Arizona Tariff No. 1 to support its Application. 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 company, the fair value rate base information provided should not be given substantial weight in this analysis.

5. REVIEW OF COMPLAINT INFORMATION

The Consumer Services Section of the Utilities Division reports that there have been no complaints, inquiries, or opinions filed against CereTel from January 1, 2012 to October 14, 2015. Consumer Services also reports that CereTel is in Good Standing with the Corporations Division of the Commission. Further, a search of the Federal Communications Commission's ("FCC") website found that there have been no complaints filed against CereTel.

The Applicant indicated in its Application and in response to Staff Data Request 1.13 that CereTel has not had an Application for authority to provide service denied in any state or jurisdiction. The Applicant indicated that none of its officers, directors or partners have been or are currently involved in any civil or criminal investigation or been convicted of any criminal acts within the past ten (10) years.

Staff contacted the Public Utility Commissions ("PUC") in Kentucky, Oregon and Texas to determine if CereTel has the authority to provide telecommunications services as stated by the Applicant. Staff also inquired whether there were any consumer complaints filed against the Applicant. Staff obtained information related to the Applicant from the PUCS in Kentucky, Oregon and Texas. The information Staff obtained indicates that CereTel is authorized to provide telecommunications services in these jurisdictions and no complaints have been filed.

6. 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.

6.1 *Competitive Services Analysis for Interexchange Services*

6.1.1 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 Voice over Internet Protocol ("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.

6.1.2 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.

6.1.3 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.

6.1.4 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.

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

6.1.5 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.

6.1.6 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 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. 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.

7.1 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 be required to notify the Commission immediately upon changes to the Applicant's name, address or telephone number;
3. That the Applicant cooperate with Commission investigations including, but not limited to customer complaints;
4. 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. The Applicant indicated that at the end of the first twelve months of operation the net book value of all Arizona assets that could be used in the provision of telecommunications service to Arizona customers will be \$0. 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;

5. The Commission's granting of the Applicant's CC&N be conditioned upon the successful granting of the XYN CC&N application request in Docket No. T-20968A-16-0158.

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 to its first customer, 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 its first end-user customer; 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).

7.2 *Recommendation on the Applicant's Petition to Have Its Proposed Service Classified as Competitive*

Staff believes that the Applicant's proposed service should be classified as competitive. There are alternatives to the Applicant's service. The Applicant will have to convince customers to purchase its service, and the Applicant has no ability to adversely affect the long distance service markets. Therefore, the Applicant currently has no market power in the long distance service market where alternative providers of telecommunications services exist. Staff therefore recommends that the Applicant's proposed service be classified as competitive.