

OPEN MEETING



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MEMORANDUM
Arizona Corporation Commission

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TO: THE COMMISSION

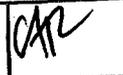
DOCKETED

FROM: Utilities Division

DEC 01 2004

2004 DEC -1 P 4: 19

DATE: December 1, 2004

DOCKETED BY 

AZ CORP COMMISSION
DOCUMENT CONTROL

RE: IN THE MATTER OF THE JOINT APPLICATION OF XO ARIZONA, INC., ALLEGIANCE TELECOM OF, ARIZONA, INC., AND XO COMMUNICATIONS SERVICES, INC. FOR APPROVAL OF AN INTERNAL CORPORATE REORGANIZATION AND FOR APPROVAL AS NECESSARY OF RELATED TRANSACTIONS (DOCKET NOS.

T-04302A-04-0583

T-03601A-04-0583

T-03789A-04-0583

T-04150A-04-0583

On August 6, 2004, XO Arizona, Inc. ("XO Arizona"), Allegiance Telecom of Arizona, Inc. ("ALGX Arizona") and XO Communications Services, Inc. ("XO Communications") (collectively "Applicants" or "XO Subsidiaries"), all subsidiaries of XO Communications, Inc. ("XO"), the ultimate parent corporation, by their attorneys and pursuant to Arizona Administrative Code ("A.A.C.") R14-2-803 and Arizona Revised Statutes ("A.R.S.") §40-285, requested the Commission to approve or grant such authority as may be necessary for an internal corporate reorganization whereby the existing operating subsidiaries of XO in Arizona will be merged into a single operating subsidiary, XO Communications. Upon consummation of this reorganization, XO Communications will provide service to the existing customers of XO Arizona and ALGX Arizona. This internal reorganization will simplify the XO corporate structure, streamline XO's operations in Arizona, eliminate administrative redundancy and improve overall efficiency. The Applicants stated that the consolidation in Arizona will occur after receipt of the required regulatory approvals in Arizona. The Applicants also requested that the Commission take any action necessary to approve this Application at its earliest possible convenience.

In the Application, the following information was provided about the parent company, XO, and each Applicant:

- a) XO is a Delaware corporation. XO is publicly traded on the Over the Counter Bulletin Board under the symbol "XOCM.OB" and is a leading facilities-based provider of broadband telecommunications services. The company offers a complete set of telecommunications services including local and long distance voice, Internet access, Virtual Private Networking (VPN), Ethernet, Wavelength, Web Hosting and Integrated voice and data services. XO provides service through its facilities-based broadband networks and Tier One Internet peering relationships. The company also is one of the nation's largest holders of fixed wireless spectrum, covering 95% of the population of the 30 largest U.S. cities. XO currently offers facilities-based broadband telecommunications services within and between more than 70 markets throughout the United States. XO is authorized by the Federal Communications Commission ("FCC") to provide interstate and international telecommunications services and, through one or

more of its subsidiaries, is authorized to provide intrastate interexchange services virtually nationwide, and is authorized to provide competitive local exchange services in 47 states. XO is ultimately controlled by Carl C. Icahn, a U.S. citizen, through his ultimate control and ownership of various companies;

- b) In Arizona, XO Arizona is authorized to provide competitive local exchange and interexchange services pursuant to its authorization issued by the Commission in Decision No. 61373. XO Arizona and its corporate parent, XO, have been found by this Commission to possess the requisite financial and technical qualifications necessary to operate as a provider of intrastate telecommunications services in Arizona.
- c) ALGX Arizona is a corporation organized under the laws of the State of Delaware. In furtherance of the reorganization of Allegiance Telecom, Inc., Debtor-in-Possession ("Allegiance"), and subsidiaries, including ALGX Arizona, under chapter 11 of the U.S. Bankruptcy Code, the parties agreed that XO would acquire substantially all of the assets of Allegiance, including the stock of ALGX Arizona. In Decision No. 67006, the Commission approved the transfer of control on May 24, 2004, and the transaction was consummated on June 23, 2004. As a result, ALGX Arizona became a direct, wholly owned subsidiary of XO; and
- d) Like ALGX Arizona and XO Arizona, XO Communications is a direct, wholly owned subsidiary of XO. XO Communications, currently being renamed from XO Domestic Holdings, Inc., has an Application pending to transact business in Arizona as a foreign corporation, but it is not licensed to provide telecommunications services in any state at this time.¹

Based on the Application, the following identifies and describes the merger transactions needed to effect the proposed reorganization and consolidation of XO subsidiaries into a single operating entity known as XO Communications:

- a) Attached as Exhibit A is an organizational chart of the "Existing Corporate Structure" of XO and each of its subsidiaries before the reorganization and consolidation of the proposed transactions. The Applicants propose to transfer XO Arizona's intrastate customer base, tariff, and Certificate of Convenience and Necessity ("CC&N") to XO Communications through a merger of XO Arizona into XO Communications. XO Arizona's customers will continue to receive high quality services from the same qualified personnel, at substantially similar rates, terms and conditions. XO Communications will assume all of XO Arizona's assets and operations and will provide telecommunications services to XO Arizona's customers. XO Arizona's tariff will be changed to reflect the new name XO Communications. The proposed transaction will be virtually transparent to consumers in Arizona. XO will remain the parent corporation, and the name that customers see on their telecommunications invoice will remain "XO";

¹ XO Communications has applied with the Commission for a license to do business in Arizona.

- b) The Applicants propose to transfer ALGX Arizona's intrastate customer base to XO Communications through a merger of ALGX Arizona into XO Communications. XO Communications will assume all of ALGX Arizona's assets and operations and will provide telecommunications services to ALGX Arizona's customers. The Applicants intend to grandfather ALGX Arizona's existing tariff, amended with the new name XO Communications, so that existing ALGX Arizona customers will continue to receive the same services at the same rates, terms and conditions. Upon completion of the transfer, ALGX Arizona will surrender its CC&N. In accordance with applicable FCC and state carrier change requirements, advance written notice will be sent to affected customers informing them of the proposed transaction and giving them an opportunity to switch to another service provider without penalty. Further, to prevent customer confusion, XO Communications will include the Allegiance name in addition to the XO name on customer bills for the existing ALGX Arizona customers for a few months immediately following the restructuring; and
- c) XO intends to collapse both ALGX Arizona and XO Arizona into XO Communications. After completing the consolidation, XO will remain the ultimate corporate parent and have one subsidiary, XO Communications, operating in Arizona. The end result of the proposed reorganization is shown in the attached Exhibit A chart titled "Corporate Structure After the Restructuring".

On January 29, 1999, in Decision No. 61373, NEXTLINK Arizona, Inc. was granted a CC&N to provide facilities-based and resold local exchange, toll and access services in Arizona. On November 17, 2000, NEXTLINK Arizona, Inc. changed its name to XO Arizona, Inc.

On July 24, 2000, in Decision No. 62737, the Commission granted ALGX Arizona a CC&N to provide facilities-based and resold long distance and local exchange telecommunications services.

On January 14, 2003, XO was reorganized in Decision No. 65520. In that decision, XO was order to procure a performance bond equal to \$235,000 and to increase the amount if at any time it would be insufficient to cover prepayments or deposits collected from the customers of XO Arizona, Inc. and XO Long Distance Services, Inc. The bond amount is to increase in increments of \$117,500. The increase is to will occur when the total amount of the advances, deposits and prepayments is within \$23,500 of the bond amount. On August 13, 2003, the Commission approved the cancellation of the CC&N held by XO Long Distance Services, Inc.

On May 24, 2004, in Decision No. 67006, the Commission ordered XO to procure a performance bond for ALGX Arizona equal to \$235,000 and to increase the amount if at any time it would be insufficient to cover advances, deposits, or prepayments collected from the customers of ALGX Arizona. The bond amount is to increase in increments of \$117,500. The increase is to occur when the total amount of the advances, deposits and prepayments is within \$23,500 of the bond amount.

Staff presents two options regarding the appropriate performance bond for XO Communications. As Option 1, Staff suggests that the current bond policy be applied. Under

THE COMMISSION

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this policy, based on the Applicants' responses to Data Requests JFB 1-27, JFB 1-33 and JFB 1-34, Staff determined that the total amount of customer advances and deposits held by ALGX Arizona and XO Arizona is \$3.4 million. Assuming all of ALGX Arizona's customers migrate to XO Communications and the proposed reorganization is granted, XO Communications will need a performance bond of \$3.4 million. Under current policy, XO Communications will need to increase the amount of the performance bond if at any time it would be insufficient to cover advances, deposits, and/or prepayments collected from its customers. The bond amount is to increase in increments of \$1.7 million. The increase will occur when the total amount of the advances, deposits, and prepayments is within \$340,000 of the bond amount. As Option 2, Staff suggests that the current level of bonds held by XO Arizona and ALGX Arizona may be sufficient. The sum of the current bonds held by XO Arizona and ALGX Arizona is \$352,500. Staff notes that XO's subsidiaries serve only business customers under contract. Further, Staff notes that XO's subsidiaries have \$18.6 million dollars in assets in Arizona. XO provided a list of major assets in Arizona, which is attached as Exhibit D. In light of the XO's substantial investment in Arizona, and the nature of its customers, Staff suggests as Option 2 that that XO Communications be required to obtain a fixed bond of \$352,500, which is equal to the sum of the current bonds held by XO Arizona and ALGX Arizona. We believe that Option 2 is appropriate in this case.

In its Application, the Applicants stated that the proposed transaction is not expected to result in any loss or impairment of service to either XO Arizona or ALGX Arizona customers. Also, the Applicants addressed the transactions listed in A.A.C. R14-2-804 (C) as requested by Staff. The proposed reorganization is not expected to impair the financial status of XO Communications. XO Communications will be the public utility that will combine and replace XO Arizona and ALGX Arizona. This reorganization should increase efficiencies and profitability and allow XO to achieve better financial health as a telecommunications company. Overall, the reorganization will improve XO's ability to attract capital at fair and reasonable terms and to provide safe, reasonable, and adequate service.

XO seeks a limited waiver of the Commission's slamming and cramming rules for purposes of this reorganization. XO seeks the Commission's assurance that each transfer of ALGX Arizona's customers to XO Communications is not an "unauthorized change" of the telecommunications services provider. According to the response Data Request JFB 1-24, XO Arizona and ALGX Arizona have made the necessary filings at the FCC regarding this transaction and are in the process of complying with 47 C.F.R. § 64.1120 with respect to the affected ALGX Arizona customers. The holding company and/or public utility will conform to all FCC rules and regulations concerning the transfer of customers from carrier to carrier and subscriber bases for XO Arizona and ALGX Arizona.

As indicated in the Application, the Applicants intend to grandfather ALGX Arizona's existing tariff. Basically, all contracts with existing ALGX Arizona customers will be honored by XO Communications until the contracts expire. When the contract expires, the customers will have the option of signing a new contract with XO Communications or obtaining services with a new service provider. Customers will not have an option of signing a new contract with ALGX Arizona. ALGX Arizona tariffs will be withdrawn when all current customers have transitioned to the XO Communications tariffs.

In accordance with A.A.C. R14-2-1107, the Applicants provided in their Application the following information:

- ALGX Arizona will discontinue service to customers because it was acquired by XO and XO plans to serve all customers via a new single corporate subsidiary;
- All ALGX Arizona customers have been notified of the XO acquisition and all will again be notified of their ability to remain with XO Communications or choose another provider, without penalty. The initial notice letter is attached as Exhibit B.
- ALGX Arizona does not collect customer deposits. Customer prepayments are credited directly to a customer's account and used during the term of the contract;
- Attached as Exhibit C is a list of the alternative utilities providing local exchange and interexchange service in the ALGX Arizona's service area; and
- On September 9, 2004, Staff received a copy of the Affidavit of Publication that Applicants published legal notice of their Joint Application. The legal notice indicated existing XO Arizona customers will be served by XO Communications and that ALGX Arizona will discontinue service to its customers in Arizona.

The Applicants have complied with all the steps to discontinue telecommunications services according to A.A.C. R14-2-1107. Staff has not received objections to this filing. In addition to the requirements of A.A.C. R14-2-1107, the Commission requires companies that discontinue telecommunications services to inform their customers that after receiving notice, the customer has a 90-day period in which the customer may switch to another service provider, in the customer's discretion, without prejudice or regard to existing contractual obligation. The 90-day notice for customers to select a new telecommunications carrier is supported by Commission Decision Nos. 64740, 65124, and 66105.

If all of ALGX Arizona's customers elect to continue service with XO Arizona and the proposed reorganization is approved, XO Communications will provide telecommunications services to approximately 5,700 business customers in Arizona. XO Arizona and ALGX Arizona stated in response to Staff's data request that they do not provide telecommunications services to residential customers in Arizona.

As of July 31, 2004, the total asset value of XO Arizona and ALGX Arizona amounts to approximately \$18.6 million. Consequently, this represents the total value of the assets that will be held by XO Communications if the proposed merger and consolidation is approved by the Commission.

XO Arizona and ALGX Arizona combined have 79 resident employees that oversee daily operations. There are 8 management employees, 31 technical employees, and 40 employees involved in sales, finance, human resources and real estate. Four resident customer service

employees are supported by 400 additional customer care representatives and 68 management staff located in call centers in Dallas, Texas; Salt Lake City, Utah; and Saginaw, Michigan. If the proposed reorganization is approved, XO does not anticipate a material change to current staffing levels.

The Affiliated Interests Rule

With respect to information about this transaction required under A.A.C. R14-2-802, the Public Utility Holding Companies and Affiliated Interests Rules apply to all Class A investor-owned utilities. A telecommunications carrier that has Arizona jurisdictional revenues of more than \$1 million is considered to be a Class A utility. In the 2003 Annual Report filed with the Commission, ALGX Arizona and XO Arizona each generated more than \$1 million of Arizona jurisdictional revenue. The proposed merger/consolidation of XO Arizona and ALGX Arizona into XO Communications will create an entity that is considered a Class A investor-owned utility. As a result, the Joint Application is subject to A.A.C. R14-2-801 through 805 of the Public Utility Holding Companies and Affiliated Interests Rules.

Staff reviewed the Applicants' Joint Application and responses to Staff data requests. The following information obtained from the Applicants addresses A.A.C. R14-2-803 (A) items 1 through 11:

- a) The following is a list of the officers and directors of the holding company, XO:

Carl J. Grivner – Chief Executive Officer
Wayne Rehberger – Chief Operating Officer
Lee Weiner – Senior Vice President and General Counsel
Bill Garrahan – Acting Chief Financial Officer and Senior Vice President,
Corporate Development
Doug Sobieski – Vice President, Fixed Broadband Wireless Services
Terri Burke – Vice President, Human Resources
Rob Geller – Chief Information Officer
Heather Burnett Gold – Senior Vice President, Government Relations
Tom Cady – Chief Marketing Officer
Mark Faris – Senior Vice President, Network Operations
Matt Harty – President, Commercial Sales
Ernie Ortega – President, Indirect Sales
Rob Westervelt – President, Indirect Sales
Ron Scott Senior – Vice President, XO Communications and President, XO

One

The following is a list of the directors of the holding company, XO:

Carl C. Icahn – Director
Carl J. Grivner – Chief Executive Officer
Vincent Intrieri – Director
Adam Dell – Director
Keith Meister – Director

Andrew R. Cohen – Director
Fredrik Gradin – Director
Robert Knauss – Director

The business address of the officers and directors of the holding company, XO, is 11111 Sunset Hills Road, Reston, Virginia 20190. The Applicant provided information required in A.A.C. R14-2-803 (A) 1;

- b) The purpose of reorganizing the holding company is to create a more efficient corporate structure for XO and its subsidiaries. The stated purpose of XO meets the reporting requirements of A.A.C. R14-2-803 (A) 2;
- c) The Applicant reported the financing of the holding company's proposed acquisition and the resultant capital structure of A.A.C. R14-2-803 (A) 3. The new holding company will be financed by XO through inter-company debt and capital contributions;
- d) In accordance with A.A.C. R14-2-803 (A) 4, the proposed transaction will not have any effect on the capital structure of XO Arizona. XO Communications will be funded exclusively through inter-company debt issued by its parent XO to the degree it is not financially self sufficient. No material change is expected to the capital structure of XO;
- e) Attached as Exhibit A in the Application is the organization chart titled "Corporate Structure After Restructuring". It identifies the holding company and the public utility affiliate in Arizona as required by A.A.C. R14-2-803 (A) 5;
- f) Based on the requirements of A.A.C. R14-2-803 (A) 6, XO will allocate federal and state income taxes according to the methods provided in the Federal Internal Revenue Code and attendant tax regulations;
- g) XO does not anticipate a change in the cost of service or cost of capital due to this reorganization. This reorganization is simply the consolidation of a number of state regulated subsidiaries into a single entity to create a more efficient corporate structure. XO has provided information required of A.A.C. R14-2-803 (A) 7;
- h) There are no current diversification plans for affiliates of the holding company. XO is focused for the foreseeable future on its core mission of providing telecommunications and web services. Reporting the diversification plans of the affiliates comply with A.A.C. R14-2-803 (A) 8;
- i) Copies of all relevant documents and filings with the United States Securities and Exchange Commission and other federal or state agencies are required by A.A.C. R14-2-803 (A) 9 to be filed with the Commission. Copies of XO filings with the United States Securities and Exchange Commission are enumerated in the table below and may be accessed by going to <http://www.xo.com/about/investors/financials/secfilings.html>.

Form	Description	Filing Date
<u>8-K/A</u>	[Amend]Current report, items 2.01 and 9.01	2004-09-07
<u>SC 13D</u>	General statement of acquisition of beneficial ownership	2004-09-07
<u>3</u>	Initial statement of beneficial ownership of securities	2004-09-07
<u>4</u>	Statement of changes in beneficial ownership of securities	2004-08-26
<u>4</u>	Statement of changes in beneficial ownership of securities	2004-08-10
<u>SC 13D/A</u>	[Amend]General statement of acquisition of beneficial ownership	2004-08-10
<u>10-Q</u>	Quarterly report [Sections 13 or 15(d)]	2004-08-09
<u>3</u>	Initial statement of beneficial ownership of securities	2004-07-22
<u>8-K</u>	Current report, item 5	2004-07-20
<u>3</u>	Initial statement of beneficial ownership of securities	2004-07-20
<u>3</u>	Initial statement of beneficial ownership of securities	2004-07-19
<u>8-K</u>	Current report, items 2 and 7	2004-06-29
<u>SC 13G/A</u>	[Amend]Statement of acquisition of beneficial ownership by individuals	2004-06-25
<u>4</u>	Statement of changes in beneficial ownership of securities	2004-06-24
<u>425</u>	Prospectuses and communications, business combinations	2004-06-24
<u>4</u>	Statement of changes in beneficial ownership of securities	2004-06-22
<u>SC 13D/A</u>	[Amend]General statement of acquisition of beneficial ownership	2004-06-22

- j) As required by A.A.C. R14-2-803 (A) 10, XO provided information on the contemplated annual and cumulative investment in each affiliate for the next five years, in dollars and as a percentage of projected net utility plant, and an explanation of the reasons supporting the level of investment and the reasons this level will not increase the risks of investment in the public utility. XO is not proposing in this Application to invest funds in an unregulated business interest such as a real estate holding company or a venture capital fund, rather XO is reorganizing corporate subsidiaries which are existing public utilities. Going forward, XO will continue investing in its operating subsidiaries, thus decreasing, not increasing, the risk to its public utility subsidiaries. This reorganization should increase efficiencies and profitability, thereby allowing XO to achieve financial health as a telecommunications company; and
- k) In response to the information needed to address A.A.C. R14-2-803 (A) 11, the proposed reorganization does not involve investment in a non-utility affiliate, and therefore will not diminish the amount of capital available for new utility plant or other improvements. Indeed, the reorganization is intended to improve XO's overall profitability which could, in turn, decrease the cost of capital available for system improvements.

In summary, Staff believes that the Applicants have not complied with the Affiliated Interest Rules.

The Public Interest

Based upon the information received from the Applicants, it is Staff's view that the proposed merger and consolidation transactions will serve the public interest. In the Application, the Applicants point out that the proposed consolidation will provide significant reductions in legal and tax administrative burdens. The simplification of XO companies' corporate structure will eliminate administrative redundancy and improve overall efficiency. This will enhance the XO Communications' ability to compete in Arizona. Consumers in Arizona will benefit from a greater number of product and service options and efficient prices from the enhanced competitive ability of the streamlined company.

Utilities Division Consumer Services Staff has reported that from January 1, 2002 through November 16, 2004, XO Arizona and ALXG Arizona combined had a total of 14 complaints in 2002, 9 complaints in 2003, and 19 complaints in 2004. During this review period, customers from XO Arizona and ALGX Arizona registered 42 complaints with the Commission. Among the 42 complaints, 45 percent pertained to billing issues, 19 percent involved installation/service delays, 17 percent dealt with service issues, 10 percent complained about porting of phone numbers, 7 percent received misinformation, and one complaint related to about directory advertising. Both XO Arizona and ALGX Arizona are in "Good Standing" with the Corporation Division of the Commission.

On November 22, 2004, Compliance Staff received a response from the Applicants' Legal Representative, Joan Burke, concerning four compliance delinquencies relating to XO and ALGX Arizona. Three of the four delinquencies pertained to ALGX Arizona and one involved XO. The following identifies the status of each compliance issue:

- a) ALGX Arizona had an obligation to send an annual Diversification Activities and Plans Filing to the Commission by April 15, 2003. XO acquired ALGX Arizona on June 23, 2004. It was not aware that ALGX Arizona had not submitted the annual Diversification Activities and Plans Filing to the Commission. XO executives are not able to aver to activities that occurred at ALGX Arizona in 2003. Staff agrees that XO is not able to provide the filing due in 2003. Staff recommends that this item not be considered a delinquent compliance matter;
- b) In Decision No. 67006, ALGX Arizona was order to file copies of all relevant documents and filings with the United States Securities and Exchange Commission and other federal and state agencies pertaining to the proposed sale and purchased with the Commission by August 23, 2004. According to the Joan Burke, the required copies were filed on July 23, 2004. The Applicants failed to note that the filing was on behalf of both XO and its new subsidiary ALGX Arizona. Based on Staff's review of that compliance filing, Staff recommends that this item not be considered a delinquent compliance item;
- c) For the first two years from May 26, 2004, the effective date of Decision No. 67006, ALGX Arizona is required to file a quarterly report with the Director of the Utilities Division of the Commission. These reports are to be filed within thirty days of the end of each calendar quarter. Compliance Staff notes that the quarter ending September 2004 is

not the first calendar quarter after May 29, 2004. Decision No 67006 did not call for the quarterly reports to begin in September 2004 so the initial quarterly report filed is a partial quarter ending June 30, 2004. Based on the most recent filing, the quarterly report ending June 30, 2004 has not been sent by ALGX Arizona. Also, the quarterly report ending September 2004 is incomplete. The report has only two months of information. Staff recommends that quarterly service complaint rate reports for ALGX of Arizona be filed as required in Decision No 67006; and

- d) XO was ordered in Decision No. 65520 to file quarterly reports on the rate of service complaints. Compliance Staff notes that the quarterly reports have been sent as required with only the current quarter missing. The quarterly report that was sent in a recent filing provided complaint information for only July and August. Service complaint information in September 2004 was not included in the report. Joan Burke stated that the Applicants gradually transitioned from two distinct systems for customer support and tracking to a single combined customer support system. Since complaint information is available for reporting purposes, Staff recommends that XO use its best efforts to estimate or allocate service complaints of each entity in order to complete the quarterly report as ordered by the Commission.

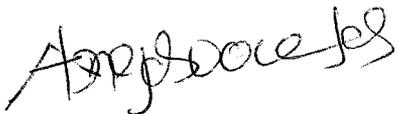
Staff recommends that the Commission approve the transfer of XO Arizona's customers, tariff and CC&N to XO Communications and the merger of ALGX Arizona's assets into XO Communications subject to the following conditions:

- a) ALGX Arizona's retail customers must receive notification that they may be allowed to elect, within 90 days of receiving notice, to continue or discontinue service XO Communications, without prejudice or regard to contractual obligation. The requested asset transfer of ALGX Arizona's assets to XO Communications will be conditioned upon XO docketing of proof that ALGX Arizona's retail customers have received notification that they may be allowed to elect, within 90 days of receiving the notice, to continue or discontinue service with XO Communications, without prejudice or regard to contractual obligation;
- b) ALGX Arizona should provide written confirmation to Staff that all funds held as prepayments have been refunded or credited to customers who want to discontinue service with ALGX Arizona. The requested transfer of ALGX Arizona's assets to XO Communications will be conditioned upon docketing proof, within 90 days of the effective date of the Order, that all funds held as prepayments have been refunded or credited to the customers who want to discontinue service with ALGX Arizona;
- c) XO Communications shall obtain a performance bond consistent with Staff Option 2. XO Communications shall file proof of the performance bond in this docket within 60 days of the effective date of this Decision. If such proof is not filed within 60 days of the effective date of this Decision, the approvals granted herein shall be automatically void without further order of the Commission;

- d) XO shall file proof with Staff that XO Communications is authorized to transact business in Arizona. In addition, it shall provide Staff with written confirmation that XO Arizona's assets, including its CC&N, have been transferred to XO Communications;
- e) XO shall provide Staff with written confirmation that it has merged ALGX Arizona's assets into XO Communications and that ALGX Arizona's CC&N has been cancelled by the Commission. By providing Staff with documentation that the merger has been completed, ALGX Arizona will no longer be responsible for the requirements of Decision No. 62737;
- f) Staff recommends that quarterly service complaint report on ALGX Arizona and XO be complete and filed as requested in Decision No. 67006 and Decision No. 65520 respectively. The June 30, 2004, quarterly service complaint report for ALGX Arizona needs to be provided to the Commission. The quarterly service complaint report for September 2004 needs to be completed by XO and ALGX Arizona and filed with the Commission; and
- g) XO shall not allow the reorganization of the merger/consolidation of XO Arizona and ALGX Arizona that created XO Communications to result in service degradation. The rate of service complaints should not increase, the response time to service complaints should not increase, and service interruptions should not increase as a result of the reorganization. For the first two years from the effective date of this order, XO Communications shall file quarterly reports with the Director of the Utilities Division describing the rate of service complaints. Such reports will be filed within thirty days of the end of each calendar quarter.

Staff further recommends that the Commission approve the Applicants' request for a limited waiver of the Commission's slamming and cramming rules for purposes of this reorganization. The transfer of ALGX Arizona's customers to XO Communications will not be an "unauthorized change" of the telecommunications services provider.

Staff believes the proposed reorganization of XO Arizona and ALGX Arizona into XO Communications is in the public interest, if Staff's conditions are met, and should be approved with the conditions recommended by Staff.



for Ernest G. Johnson
Director
Utilities Division

EGJ:JFB:rdp/TS

ORIGINATOR: John F. Bostwick

1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

2 MARC SPITZER
Chairman
3 WILLIAM A. MUNDELL
Commissioner
4 JEFF HATCH-MILLER
Commissioner
5 MIKE GLEASON
Commissioner
6 KRISTIN K. MAYES
Commissioner
7

8 IN THE MATTER OF THE JOINT APPLICATION) DOCKET NOS. T-03601A-04-0583
9 OF XO ARIZONA, INC., ALLEGIANCE TELECOM) T-03789A-04-0583
10 OF, ARIZONA, INC., AND XO COMMUNICATIONS) T-04150A-04-0583
11 SERVICES, INC. FOR APPROVAL OF AN)
INTERNAL CORPORATE REORGANIZATION) DECISION NO. _____
12 AND FOR APPROVAL, AS NECESSARY, OF)
RELATED TRANSACTIONS) ORDER

13 Open Meeting
December 14 and 15, 2004
14 Phoenix, Arizona

15 **BY THE COMMISSION:**

16 **INTRODUCTION**

17 On August 6, 2004, XO Arizona, Inc. ("XO Arizona"), Allegiance Telecom of Arizona,
18 Inc. ("ALGX Arizona") and XO Communications Services, Inc. ("XO Communications")
19 (collectively "Applicants" or "XO Subsidiaries"), all subsidiaries of XO Communications, Inc.
20 ("XO"), the ultimate parent corporation, by their attorneys and pursuant to Arizona
21 Administrative Code ("A.A.C.") R14-2-803 and Arizona Revised Statutes ("A.R.S.") §40-285,
22 requested the Commission to approve or grant such authority as may be necessary for an
23 internal corporate reorganization whereby the existing operating subsidiaries of XO in Arizona
24 will be merged into a single operating subsidiary, XO Communications. Upon consummation
25 of this reorganization, XO Communications will provide service to the existing customers of
26 XO Arizona and ALGX Arizona. This internal reorganization will simplify the XO corporate
27 structure, streamline XO's operations in Arizona, eliminate administrative redundancy and
28 improve overall efficiency. The Applicants stated that the consolidation in Arizona will occur

1 after receipt of the required regulatory approvals in Arizona. The Applicants also requested
2 that the Commission take any action necessary to approve this Application at its earliest
3 possible convenience.

4 FINDINGS OF FACT

5 1. In the Application, the following information was provided about the parent
6 company, XO, and each Applicant:

- 7 a) XO is a Delaware corporation. XO is publicly traded on the Over the Counter Bulletin
8 Board under the symbol "XOCM.OB" and is a leading facilities-based provider of
9 broadband telecommunications services. The company offers a complete set of
10 telecommunications services including local and long distance voice, Internet access,
11 Virtual Private Networking ("VPN"), Ethernet, Wavelength, Web Hosting and
12 Integrated voice and data services. XO provides service through its facilities-based
13 broadband networks and Tier One Internet peering relationships. The company also is
14 one of the nation's largest holders of fixed wireless spectrum, covering 95 percent of
15 the population of the 30 largest U.S. cities. XO currently offers facilities-based
16 broadband telecommunications services within and between more than 70 markets
17 throughout the United States. XO is authorized by the Federal Communications
18 Commission ("FCC") to provide interstate and international telecommunications
19 services and, through one or more of its subsidiaries, is authorized to provide intrastate
20 interexchange services virtually nationwide, and is authorized to provide competitive
21 local exchange services in 47 states. XO is ultimately controlled by Carl C. Icahn, a
22 U.S. citizen, through his ultimate control and ownership of various companies;
- 23 b) In Arizona, XO Arizona is authorized to provide competitive local exchange and
24 interexchange services pursuant to its authorization issued by the Commission in
25 Decision No. 61373. XO Arizona and its corporate parent, XO, have been found by this
26 Commission to possess the requisite financial and technical qualifications necessary to
27 operate as a provider of intrastate telecommunications services in Arizona.
- 28 c) ALGX Arizona is a corporation organized under the laws of the State of Delaware. In
furtherance of the reorganization of Allegiance Telecom, Inc., Debtor-in-Possession
("Allegiance"), and subsidiaries, including ALGX Arizona, under chapter 11 of the U.S.
Bankruptcy Code, the parties agreed that XO would acquire substantially all of the
assets of Allegiance, including the stock of ALGX Arizona. In Decision No. 67006, the
Commission approved the transfer of control on May 24, 2004, and the transaction was
consummated on June 23, 2004. As a result, ALGX Arizona became a direct, wholly
owned subsidiary of XO; and
- d) Like ALGX Arizona and XO Arizona, XO Communications is a direct, wholly owned
subsidiary of XO. XO Communications, currently being renamed from XO Domestic
Holdings, Inc., has an Application pending to transact business in Arizona as a foreign

1 corporation, but it is not licensed to provide telecommunications services in any state at
2 this time.¹

3 2. Based on the Application, the following identifies and describes the merger
4 transactions needed to effect the proposed reorganization and consolidation of XO subsidiaries
5 into a single operating entity known as XO Communications:

- 6 a) Attached as Exhibit A is an organizational chart of the "Existing Corporate Structure"
7 of XO and each of its subsidiaries before the reorganization and consolidation of the
8 proposed transactions. The Applicants propose to transfer XO Arizona's intrastate
9 customer base, tariff, and Certificate of Convenience and Necessity ("CC&N") to XO
10 Communications through a merger of XO Arizona into XO Communications. XO
11 Arizona's customers will continue to receive high quality services from the same
12 qualified personnel, at substantially similar rates, terms and conditions. XO
13 Communications will assume all of XO Arizona's assets and operations and will
14 provide telecommunications services to XO Arizona's customers. XO Arizona's tariff
15 will be changed to reflect the new name XO Communications. The proposed
16 transaction will be virtually transparent to consumers in Arizona. XO will remain the
17 parent corporation, and the name that customers see on their telecommunications
18 invoice will remain "XO";
- 19 b) The Applicants propose to transfer ALGX Arizona's intrastate customer base to XO
20 Communications through a merger of ALGX Arizona into XO Communications. XO
21 Communications will assume all of ALGX Arizona's assets and operations and will
22 provide telecommunications services to ALGX Arizona's customers. The Applicants
23 intend to grandfather ALGX Arizona's existing tariff, amended with the new name XO
24 Communications, so that existing ALGX Arizona customers will continue to receive the
25 same services at the same rates, terms and conditions. Upon completion of the transfer,
26 ALGX Arizona will surrender its CC&N. In accordance with applicable FCC and state
27 carrier change requirements, advance written notice will be sent to affected customers
28 informing them of the proposed transaction and giving them an opportunity to switch to
another service provider without penalty. Further, to prevent customer confusion, XO
Communications will include the Allegiance name in addition to the XO name on
customer bills for the existing ALGX Arizona customers for a few months immediately
following the restructuring; and
- c) XO intends to collapse both ALGX Arizona and XO Arizona into XO Communications.
After completing the consolidation, XO will remain the ultimate corporate parent and
have one subsidiary, XO Communications, operating in Arizona. The end result of the
proposed reorganization is shown in the attached Exhibit A chart titled "Corporate
Structure After the Restructuring".

26 ...
27 ...
28 _____
¹ XO Communications has applied with the Commission for a license to do business in Arizona.

1 3. On January 29, 1999, in Decision No. 61373, NEXTLINK Arizona, Inc. was
2 granted a CC&N to provide facilities-based and resold local exchange, toll and access services
3 in Arizona. On November 17, 2000, NEXTLINK Arizona, Inc. changed its name to XO
4 Arizona, Inc.

5 4. On July 24, 2000, in Decision No. 62737, the Commission granted ALGX
6 Arizona a CC&N to provide facilities-based and resold long distance and local exchange
7 telecommunications services.

8 5. On January 14, 2003, XO was reorganized in Decision No. 65520. In that
9 decision, XO was order to procure a performance bond equal to \$235,000 and to increase the
10 amount if at any time it would be insufficient to cover prepayments or deposits collected from
11 the customers of XO Arizona, Inc. and XO Long Distance Services, Inc. The bond amount is
12 to increase in increments of \$117,500. The increase is to will occur when the total amount of
13 the advances, deposits and prepayments is within \$23,500 of the bond amount. On August 13,
14 2003, the Commission approved the cancellation of the CC&N held by XO Long Distance
15 Services, Inc.

16 6. On May 24, 2004, in Decision No. 67006, the Commission ordered XO to
17 procure a performance bond for ALGX Arizona equal to \$235,000 and to increase the amount
18 if at any time it would be insufficient to cover advances, deposits, or prepayments collected
19 from the customers of ALGX Arizona. The bond amount is to increase in increments of
20 \$117,500. The increase is to occur when the total amount of the advances, deposits and
21 prepayments is within \$23,500 of the bond amount.

22 7. Staff presents two options regarding the appropriate performance bond for XO
23 Communications. As Option 1, Staff suggests that the current bond policy be applied. Under
24 this policy, based on the Applicants' responses to Data Requests JFB 1-27, JFB 1-33 and JFB
25 1-34, Staff determined that the total amount of customer advances and deposits held by ALGX
26 Arizona and XO Arizona is \$3.4 million. Assuming all of ALGX Arizona's customers migrate
27 to XO Communications and the proposed reorganization is granted, XO Communications will
28 need a performance bond of \$3.4 million. Under current policy, XO Communications will

Decision No. _____

1 need to increase the amount of the performance bond if at any time it would be insufficient to
2 cover advances, deposits, and/or prepayments collected from its customers. The bond amount
3 is to increase in increments of \$1.7 million. The increase will occur when the total amount of
4 the advances, deposits, and prepayments is within \$340,000 of the bond amount. As Option 2,
5 Staff suggests that the current level of bonds held by XO Arizona and ALGX Arizona may be
6 sufficient. The sum of the current bonds held by XO Arizona and ALGX Arizona is \$352,500.
7 Staff notes that XO's subsidiaries serve only business customers under contract. Further, Staff
8 notes that XO's subsidiaries have \$18.6 million dollars in assets in Arizona. XO provided a list
9 of major assets in Arizona, which is attached as Exhibit D. In light of the XO's substantial
10 investment in Arizona, and the nature of its customers, Staff suggests as Option 2 that that XO
11 Communications be required to obtain a fixed bond of \$352,500, which is equal to the sum of
12 the current bonds held by XO Arizona and ALGX Arizona. We believe that Option 2 is
13 appropriate in this case.

14 8. In its Application, the Applicants stated that the proposed transaction is not
15 expected to result in any loss or impairment of service to either XO Arizona or ALGX Arizona
16 customers. Also, the Applicants addressed the transactions listed in A.A.C. R14-2-804 (C) as
17 requested by Staff. The proposed reorganization is not expected to impair the financial status
18 of XO Communications. XO Communications will be the public utility that will combine and
19 replace XO Arizona and ALGX Arizona. This reorganization should increase efficiencies and
20 profitability and allow XO to achieve better financial health as a telecommunications company.
21 Overall, the reorganization will improve XO's ability to attract capital at fair and reasonable
22 terms and to provide safe, reasonable, and adequate service.

23 9. XO seeks a limited waiver of the Commission's slamming and cramming rules
24 for purposes of this reorganization. XO seeks the Commission's assurance that each transfer of
25 ALGX Arizona's customers to XO Communications is not an "unauthorized change" of the
26 telecommunications services provider. According to the response Data Request JFB 1-24, XO
27 Arizona and ALGX Arizona have made the necessary filings at the FCC regarding this
28 transaction and are in the process of complying with 47 C.F.R. § 64.1120 with respect to the

1 affected ALGX Arizona customers. The holding company and/or public utility will conform to
2 all FCC rules and regulations concerning the transfer of customers from carrier to carrier and
3 subscriber bases for XO Arizona and ALGX Arizona.

4 10. As indicated in the Application, the Applicants intend to grandfather ALGX
5 Arizona's existing tariff. Basically, all contracts with existing ALGX Arizona customers will
6 be honored by XO Communications until the contracts expire. When the contract expires, the
7 customers will have the option of signing a new contract with XO Communications or
8 obtaining services with a new service provider. Customers will not have an option of signing a
9 new contract with ALGX Arizona. ALGX Arizona tariffs will be withdrawn when all current
10 customers have transitioned to the XO Communications tariffs.

11 11. In accordance with A.A.C. R14-2-1107, the Applicants provided in their
12 Application the following information:

- 13 • ALGX Arizona will discontinue service to customers because it was acquired by XO
14 and XO plans to serve all customers via a new single corporate subsidiary;
- 15 • All ALGX Arizona customers have been notified of the XO acquisition and all will
16 again be notified of their ability to remain with XO Communications or choose another
17 provider, without penalty. The initial notice letter is attached as Exhibit B.
- 18 • ALGX Arizona does not collect customer deposits. Customer prepayments are credited
19 directly to a customer's account and used during the term of the contract;
- 20 • Attached as Exhibit C is a list of the alternative utilities providing local exchange and
21 interexchange service in the ALGX Arizona's service area; and
- 22 • On September 9, 2004, Staff received a copy of the Affidavit of Publication that
23 Applicants published legal notice of their Joint Application. The legal notice indicated
24 existing XO Arizona customers will be served by XO Communications and that ALGX
25 Arizona will discontinue service to its customers in Arizona.

26 12. The Applicants have complied with all the steps to discontinue
27 telecommunications services according to A.A.C. R14-2-1107. Staff has not received
28 objections to this filing. In addition to the requirements of A.A.C. R14-2-1107, the
Commission requires companies that discontinue telecommunications services to inform their
customers that after receiving notice, the customer has a 90-day period in which the customer

1 may switch to another service provider, in the customer's discretion, without prejudice or
2 regard to existing contractual obligation. The 90-day notice for customers to select a new
3 telecommunications carrier is supported by Commission Decision Nos. 64740, 65124, and
4 66105.

5 13. If all of ALGX Arizona's customers elect to continue service with XO Arizona
6 and the proposed reorganization is approved, XO Communications will provide
7 telecommunications services to approximately 5,700 business customers in Arizona. XO
8 Arizona and ALGX Arizona stated in response to Staff's data request that they do not provide
9 telecommunications services to residential customers in Arizona.

10 14. As of July 31, 2004, the total asset value of XO Arizona and ALGX Arizona
11 amounts to approximately \$18.6 million. Consequently, this represents the total value of the
12 assets that will be held by XO Communications if the proposed merger and consolidation is
13 approved by the Commission.

14 15. XO Arizona and ALGX Arizona combined have 79 resident employees that
15 oversee daily operations. There are 8 management employees, 31 technical employees, and 40
16 employees involved in sales, finance, human resources and real estate. Four resident customer
17 service employees are supported by 400 additional customer care representatives and 68
18 management staff located in call centers in Dallas, Texas; Salt Lake City, Utah; and Saginaw,
19 Michigan. If the proposed reorganization is approved, XO does not anticipate a material
20 change to current staffing levels.

21 **The Affiliated Interests Rule**

22 16. With respect to information about this transaction required under A.A.C. R14-2-
23 802, the Public Utility Holding Companies and Affiliated Interests Rules apply to all Class A
24 investor-owned utilities. A telecommunications carrier that has Arizona jurisdictional revenues
25 of more than \$1 million is considered to be a Class A utility. In the 2003 Annual Report filed
26 with the Commission, ALGX Arizona and XO Arizona each generated more than \$1 million of
27 Arizona jurisdictional revenue. The proposed merger/consolidation of XO Arizona and ALGX
28 Arizona into XO Communications will create an entity that is considered a Class A investor-

1 owned utility. As a result, the Joint Application is subject to A.A.C. R14-2-801 through 805 of
2 the Public Utility Holding Companies and Affiliated Interests Rules.

3 17. Staff reviewed the Applicants' Joint Application and responses to Staff data
4 requests. The following information obtained from the Applicants addresses A.A.C. R14-2-
5 803 (A) items 1 through 11:

6 a) The following is a list of the officers and directors of the holding company, XO:

7 Carl J. Grivner – Chief Executive Officer
8 Wayne Rehberger – Chief Operating Officer
9 Lee Weiner – Senior Vice President and General Counsel
10 Bill Garrahan – Acting Chief Financial Officer and Senior Vice President,
11 Corporate Development
12 Doug Sobieski – Vice President, Fixed Broadband Wireless Services
13 Terri Burke – Vice President, Human Resources
14 Rob Geller – Chief Information Officer
15 Heather Burnett Gold – Senior Vice President, Government Relations
16 Tom Cady – Chief Marketing Officer
17 Mark Faris - Senior Vice President, Network Operations
18 Matt Harty – President, Commercial Sales
19 Ernie Ortega – President, Indirect Sales
20 Rob Westervelt – President, Indirect Sales
21 Ron Scott Senior – Vice President, XO Communications and President, XO
22 One

23 The following is a list of the directors of the holding company, XO:

24 Carl C. Icahn – Director
25 Carl J. Grivner – Chief Executive Officer
26 Vincent Intrieri – Director
27 Adam Dell – Director
28 Keith Meister – Director
29 Andrew R. Cohen – Director
30 Fredrik Gradin – Director
31 Robert Knauss – Director

32 The business address of the officers and directors of the holding company, XO, is 11111
33 Sunset Hills Road, Reston, Virginia 20190. The Applicant provided information
34 required in A.A.C. R14-2-803 (A) 1;

35 b) The purpose of reorganizing the holding company is to create a more efficient corporate
36 structure for XO and its subsidiaries. The stated purpose of XO meets the reporting
37 requirements of A.A.C. R14-2-803 (A) 2;

38 c) The Applicant reported the financing of the holding company's proposed acquisition
and the resultant capital structure of A.A.C. R14-2-803 (A) 3. The new holding
company will be financed by XO through inter-company debt and capital contributions;

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- 1 d) In accordance with A.A.C. R14-2-803 (A) 4, the proposed transaction will not have any
2 effect on the capital structure of XO Arizona. XO Communications will be funded
3 exclusively through inter-company debt issued by its parent XO to the degree it is not
4 financially self sufficient. No material change is expected to the capital structure of
5 XO;
- 6 e) Attached as Exhibit A in the Application is the organization chart titled "Corporate
7 Structure After Restructuring". It identifies the holding company and the public utility
8 affiliate in Arizona as required by A.A.C. R14-2-803 (A) 5;
- 9 f) Based on the requirements of A.A.C. R14-2-803 (A) 6, XO will allocate federal and
10 state income taxes according to the methods provided in the Federal Internal Revenue
11 Code and attendant tax regulations;
- 12 g) XO does not anticipate a change in the cost of service or cost of capital due to this
13 reorganization. This reorganization is simply the consolidation of a number of state
14 regulated subsidiaries into a single entity to create a more efficient corporate structure.
15 XO has provided information required of A.A.C. R14-2-803 (A) 7;
- 16 h) There are no current diversification plans for affiliates of the holding company. XO is
17 focused for the foreseeable future on its core mission of providing telecommunications
18 and web services. Reporting the diversification plans of the affiliates comply with
19 A.A.C. R14-2-803 (A) 8;
- 20 i) Copies of all relevant documents and filings with the United States Securities and
21 Exchange Commission and other federal or state agencies are required by A.A.C. R14-
22 2-803 (A) 9 to be filed with the Commission. Copies of XO filings with the United
23 States Securities and Exchange Commission are enumerated in the table below and may
24 be accessed by going to <http://www.xo.com/about/investors/financials/secfilings.html>.

Form	Description	Filing Date
<u>8-K/A</u>	[Amend]Current report, items 2.01 and 9.01	2004-09-07
<u>SC 13D</u>	General statement of acquisition of beneficial ownership	2004-09-07
<u>3</u>	Initial statement of beneficial ownership of securities	2004-09-07
<u>4</u>	Statement of changes in beneficial ownership of securities	2004-08-26
<u>4</u>	Statement of changes in beneficial ownership of securities	2004-08-10
<u>SC 13D/A</u>	[Amend]General statement of acquisition of beneficial ownership	2004-08-10
<u>10-Q</u>	Quarterly report [Sections 13 or 15(d)]	2004-08-09
<u>3</u>	Initial statement of beneficial ownership of securities	2004-07-22
<u>8-K</u>	Current report, item 5	2004-07-20
<u>3</u>	Initial statement of beneficial ownership of securities	2004-07-20
<u>3</u>	Initial statement of beneficial ownership of securities	2004-07-19
<u>8-K</u>	Current report, items 2 and 7	2004-06-29
<u>SC 13G/A</u>	[Amend]Statement of acquisition of beneficial ownership by individuals	2004-06-25

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4	Statement of changes in beneficial ownership of securities	2004-06-24
425	Prospectuses and communications, business combinations	2004-06-24
4	Statement of changes in beneficial ownership of securities	2004-06-22
SC 13D/A	[Amend] General statement of acquisition of beneficial ownership	2004-06-22

- j) As required by A.A.C. R14-2-803 (A) 10, XO provided information on the contemplated annual and cumulative investment in each affiliate for the next five years, in dollars and as a percentage of projected net utility plant, and an explanation of the reasons supporting the level of investment and the reasons this level will not increase the risks of investment in the public utility. XO is not proposing in this Application to invest funds in an unregulated business interest such as a real estate holding company or a venture capital fund, rather XO is reorganizing corporate subsidiaries which are existing public utilities. Going forward, XO will continue investing in its operating subsidiaries, thus decreasing, not increasing, the risk to its public utility subsidiaries. This reorganization should increase efficiencies and profitability, thereby allowing XO to achieve financial health as a telecommunications company; and
- k) In response to the information needed to address A.A.C. R14-2-803 (A) 11, the proposed reorganization does not involve investment in a non-utility affiliate, and therefore will not diminish the amount of capital available for new utility plant or other improvements. Indeed, the reorganization is intended to improve XO's overall profitability which could, in turn, decrease the cost of capital available for system improvements.

In summary, Staff believes that the Applicants have not complied with the Affiliated Interest Rules.

The Public Interest

18. Based upon the information received from the Applicants, it is Staff's view that the proposed merger and consolidation transactions will serve the public interest. In the Application, the Applicants point out that the proposed consolidation will provide significant reductions in legal and tax administrative burdens. The simplification of XO companies' corporate structure will eliminate administrative redundancy and improve overall efficiency. This will enhance the XO Communications' ability to compete in Arizona. Consumers in Arizona will benefit from a greater number of product and service options and efficient prices from the enhanced competitive ability of the streamlined company.

19. Utilities Division Consumer Services Staff has reported that from January 1, 2002 through November 16, 2004, XO Arizona and ALXG Arizona combined had a total of 14

1 complaints in 2002, 9 complaints in 2003, and 19 complaints in 2004. During this review
2 period, customers from XO Arizona and ALGX Arizona registered 42 complaints with the
3 Commission. Among the 42 complaints, 45 percent pertained to billing issues, 19 percent
4 involved installation/service delays, 17 percent dealt with service issues, 10 percent complained
5 about porting of phone numbers, 7 percent received misinformation, and one complaint related
6 to about directory advertising. Both XO Arizona and ALGX Arizona are in "Good Standing"
7 with the Corporation Division of the Commission.

8 20. On November 22, 2004, Compliance Staff received a response from the
9 Applicants' Legal Representative, Joan Burke, concerning four compliance delinquencies
10 relating to XO and ALGX Arizona. Three of the four delinquencies pertained to ALGX
11 Arizona and one involved XO. The following identifies the status of each compliance issue:

- 12 a) ALGX Arizona had an obligation to send an annual Diversification Activities and Plans
13 Filing to the Commission by April 15, 2003. XO acquired ALGX Arizona on June 23,
14 2004. It was not aware that ALGX of Arizona had not submitted the annual
15 Diversification Activities and Plans Filing to the Commission. XO executives are not
16 able to aver to activities that occurred at ALGX Arizona in 2003. Staff agrees that XO
17 is not able to provide the filing due in 2003. Staff recommends that this item not be
18 considered a delinquent compliance matter;
- 19 b) In Decision No. 67006, ALGX Arizona was order to file copies of all relevant
20 documents and filings with the United States Securities and Exchange Commission and
21 other federal and state agencies pertaining to the proposed sale and purchased with the
22 Commission by August 23, 2004. According to the Joan Burke, the required copies
23 were filed on July 23, 2004. The Applicants failed to note that the filing was on behalf
24 of both XO and its new subsidiary ALGX Arizona. Based on Staff's review of that
25 compliance filing, Staff recommends that this item not be considered a delinquent
26 compliance item;
- 27 c) For the first two years from May 26, 2004, the effective date of Decision No. 67006,
28 ALGX Arizona is required to file a quarterly report with the Director of the Utilities
Division of the Commission. These reports are to be filed within thirty days of the end
of each calendar quarter. Compliance Staff notes that the quarter ending September
2004 is not the first calendar quarter after May 29, 2004. Decision No 67006 did not
call for the quarterly reports to begin in September 2004 so the initial quarterly report
filed is a partial quarter ending June 30, 2004. Based on the most recent filing, the
quarterly report ending June 30, 2004 has not been sent by ALGX Arizona. Also, the
quarterly report ending September 2004 is incomplete. The report has only two months
of information. Staff recommends that quarterly service complaint rate reports for
ALGX of Arizona be filed as required in Decision No 67006; and

1 d) XO was ordered in Decision No. 65520 to file quarterly reports on the rate of service
2 complaints. Compliance Staff notes that the quarterly reports have been sent as
3 required with only the current quarter missing. The quarterly report that was sent in a
4 recent filing provided complaint information for only July and August. Service
5 complaint information in September 2004 was not included in the report. Joan Burke
6 stated that the Applicants gradually transitioned from two distinct systems for customer
support and tracking to a single combined customer support system. Since complaint
information is available for reporting purposes, Staff recommends that XO use its best
efforts to estimate or allocate service complaints of each entity in order to complete the
quarterly report as ordered by the Commission.

7 21. Staff recommends that the Commission approve the transfer of XO Arizona's
8 customers, tariff and CC&N to XO Communications and the merger of ALGX Arizona's assets
9 into XO Communications subject to the following conditions:

10
11 a) ALGX Arizona's retail customers must receive notification that they may be allowed to
12 elect, within 90 days of receiving notice, to continue or discontinue service XO
13 Communications, without prejudice or regard to contractual obligation. The requested
14 asset transfer of ALGX Arizona's assets to XO Communications will be conditioned
15 upon XO docketing of proof that ALGX Arizona's retail customers have received
notification that they may be allowed to elect, within 90 days of receiving the notice, to
continue or discontinue service with XO Communications, without prejudice or regard
to contractual obligation;

16 b) ALGX Arizona should provide written confirmation to Staff that all funds held as
17 prepayments have been refunded or credited to customers who want to discontinue
18 service with ALGX Arizona. The requested transfer of ALGX Arizona's assets to XO
19 Communications will be conditioned upon docketing proof, within 90 days of the
effective date of the Order, that all funds held as prepayments have been refunded or
credited to the customers who want to discontinue service with ALGX Arizona;

20 c) XO Communications shall obtain a performance bond consistent with Staff Option 2.
21 XO Communications shall file proof of the performance bond in this docket within 60
22 days of the effective date of this Decision. If such proof is not filed within 60 days of
23 the effective date of this Decision, the approvals granted herein shall be automatically
void without further order of the Commission;

24 d) XO shall file proof with Staff that XO Communications is authorized to transact
25 business in Arizona. In addition, it shall provide Staff with written confirmation that
26 XO Arizona's assets, including its CC&N, have been transferred to XO
Communications;

27 e) XO shall provide Staff with written confirmation that it has merged ALGX Arizona's
28 assets into XO Communications and that ALGX Arizona's CC&N has been cancelled
by the Commission. By providing Staff with documentation that the merger has been

completed, ALGX Arizona will no longer be responsible for the requirements of Decision No. 62737;

f) Staff recommends that quarterly service complaint report on ALGX Arizona and XO be complete and filed as requested in Decision Nos. 67006 and 65520 respectively. The June 30, 2004, quarterly service complaint report for ALGX Arizona needs to be provided to the Commission. The quarterly service complaint report for September 2004 needs to be completed by XO and ALGX Arizona and filed with the Commission; and

g) XO shall not allow the reorganization of the merger/consolidation of XO Arizona and ALGX Arizona that created XO Communications to result in service degradation. The rate of service complaints should not increase, the response time to service complaints should not increase, and service interruptions should not increase as a result of the reorganization. For the first two years from the effective date of this order, XO Communications shall file quarterly reports with the Director of the Utilities Division describing the rate of service complaints. Such reports will be filed within thirty days of the end of each calendar quarter.

22. Staff further recommends that the Commission approve the Applicants' request for a limited waiver of the Commission's slamming and cramming rules for purposes of this reorganization. The transfer of ALGX Arizona's customers to XO Communications will not be an "unauthorized change" of the telecommunications services provider.

23. Staff believes the proposed reorganization of XO Arizona and ALGX Arizona into XO Communications is in the public interest, if Staff's conditions are met, and should be approved with the conditions recommended by Staff.

CONCLUSIONS OF LAW

1. ALGX Arizona, XO Arizona, and XO Communications are Arizona public service corporations within the meaning of Article XV, Section 2, of the Arizona Constitution and A.R.S. § 40-285.

2. The Commission has jurisdiction over the subject matter in this proceeding.

3. The Commission, having reviewed the filing and Staff's Memorandum dated, November 23, 2004, concludes that it is in the public interest to approve this filing as conditioned by Staff's recommendations.

...

...

1 *et seq.*, for the purposes of transferring customers to XO Communications as described in the
2 Application.

3 IT IS FURTHER ORDERED that, subject to conditions in Finding of Fact No. 21, the
4 transaction described in the Application is approved under A.A.C. R14-2-803.

5 IT IS FURTHER ORDERED that, subject to conditions in Finding of Fact No. 21,
6 termination of service by XO Arizona and ALGX Arizona is approved under A.A.C R14-2-
7 1107.

8 IT IS FURTHER ORDERED that, subject to conditions in Finding of Fact No. 21, the
9 Certificates of Convenience and Necessity currently held by XO Arizona and ALGX Arizona
10 are transferred to XO Communications.

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IT IS FURTHER ORDERED that, subject to conditions in Finding of Fact No. 21, the transfer of assets to XO Communications described in the Application is approved under A.R.S. § 40-285.

IT IS FURTHER ORDERED that this Order shall be effective immediately.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION

CHAIRMAN	COMMISSIONER	COMMISSIONER
COMMISSIONER	COMMISSIONER	

IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive Secretary of the Arizona Corporation Commission, have hereunto, set my hand and caused the official seal of this Commission to be affixed at the Capitol, in the City of Phoenix, this ____ day of _____ 2004.

BRIAN C. McNEIL
Executive Secretary

DISSENT: _____

DISSENT: _____

EGJ:JFB:rdp/TS

1 SERVICE LIST FOR: XO ARIZONA, INC., ALLEGIANCE TELECOM OF ARIZONA,
INC. AND XO COMMUNICATIONS SERVICES, INC.

2 DOCKET NOS. T-03601A-04-0583, T-03789A-04-0583, AND T-04150A-04-0583

3 Ms. Joan S. Burke
4 Osborn Maledon, P.A.
5 2929 North Central Avenue, Suite 2100
Phoenix, Arizona 85012

6 Mr. Brad E. Mutschelknaus
7 Erin W. Emmott, Esq.
8 Ms. Melissa Smith Conway, Esq.
9 Kelley Drye & Warren LLP
1200 19th Street, N.W., Suite 500
Washington, DC 20036

10 Mr. Christopher C. Kempley, Esq.
11 Chief Counsel, Legal Division
12 Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

13 Mr. Ernest G. Johnson, Esq.
14 Director, Utilities Division
15 Arizona Corporation Commission
1200 West Washington Street
16 Phoenix, Arizona 85007

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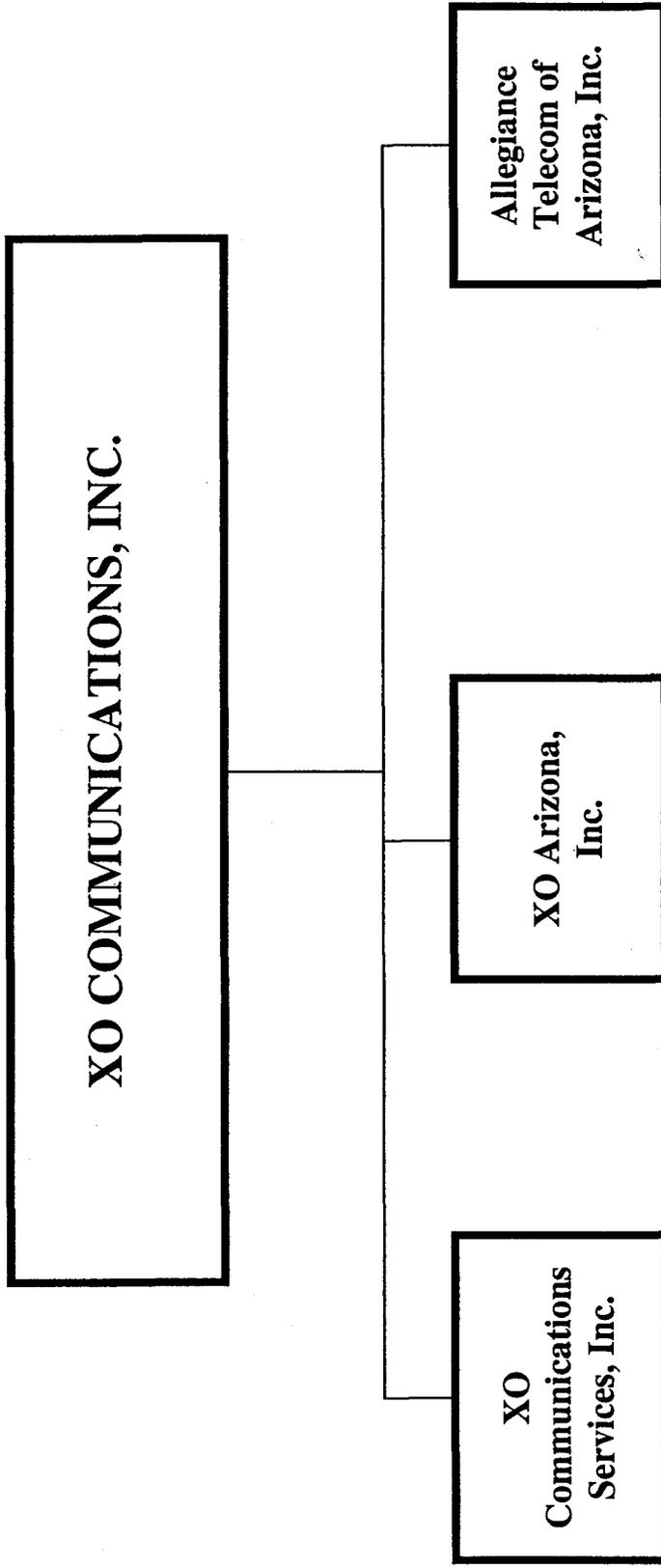
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28

EXHIBIT A

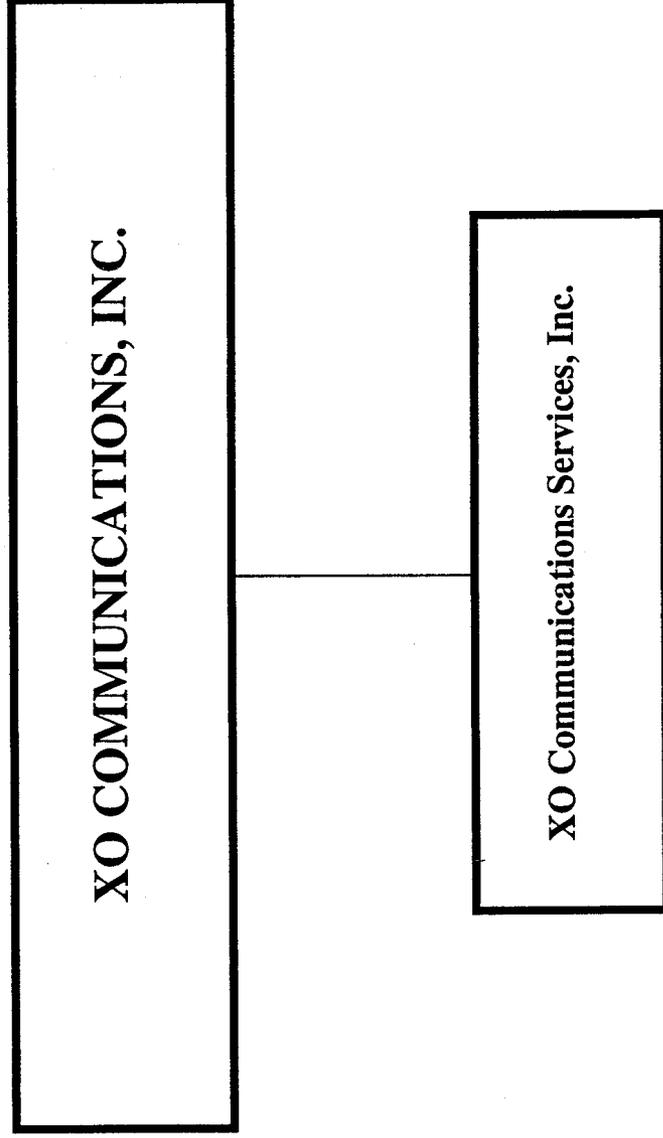
CORPORATE ORGANIZATIONAL CHARTS

EXISTING CORPORATE STRUCTURE¹



¹ Each entity is 100% owned by the entity immediately above it..

CORPORATE STRUCTURE AFTER RESTRUCTURING¹



¹ Each entity is 100% owned by the entity immediately above it..

EXHIBIT B

NOTICE LETTER



June 23, 2004

Welcome to XO™!

Dear Valued Customer:

XO is proud to announce the successful completion of our Allegiance Telecom acquisition. With the addition of Allegiance's network assets and valued customers like you, XO is now one of the nation's premier national local telecommunications services providers – giving you a choice in facilities-based providers beyond the regional Bell operating companies (RBOCs).

XO now has more nationwide connections to the RBOCs than any other Competitive Local Exchange Carrier (CLEC). XO can serve more businesses – and more of your business locations – than ever before. And all with one-stop shopping for maximum simplicity. In short, you can now think of XO as the National Local Exchange Carrier™.

What This Means for You

Now, XO is bringing together the strengths of both companies and creating synergies that will help to benefit you – the customer. Joint XO-Allegiance teams are working to bring together the best from both companies in terms of people, network facilities, technology and business processes.

XO will honor your existing Allegiance contract, and we look forward to bringing you new and enhanced XO services like DSL and conferencing.

As we finalize the integration of our two companies, XO will continue to offer, support and bill services under the Allegiance name for approximately 60 to 90 days. You will even be able to access the online tools you use today at the same URLs.

XO is Focused on its Customers

During this transition period, we remain focused on our commitment to serve your current business telecommunications needs with the quality of service that you have come to expect. We are thankful for your continued commitment to us, and we look forward to servicing your business as it grows into the future.

To read more about the value that the new XO brings to customers like you, please visit www.xo.com.

Sincerely,

A handwritten signature in black ink that reads "Carl J. Grivner". The signature is fluid and cursive.

Carl J. Grivner
Chief Executive Officer

XO Communications, Inc. • 11111 Sunset Hills Road • Reston, VA 20190

Allegiance Telecom is a subsidiary of XO Communications, Inc. XO, the XO design logo, Concentric, Allegiance and all related marks are registered trademarks of XO Communications, Inc.. All other trademarks are property of their respective owners.

EXHIBIT C

ALTERNATIVE PROVIDER LIST

ALTERNATE PROVIDER LIST¹

Air Band Communications, Inc.
AT&T Local Network Services, Inc.
Broadwing Local Service Inc.
Cox Arizona Telcom, Inc.
DSLNET Communications
E.L.I. Inc.
Eschelon Telecom of Arizona, Inc.
Jet Stream Unlimited
Mcleod Telecommunications Services, Inc.
M.T.I., Inc.
Sprint Communications
Time Warner Telecom of Arizona LLC
SBC Communications, Inc.
Verizon Communications, Inc.
Worldcom Network Services, Inc.

¹ This is a non-exhaustive list of possible alternate providers.

COMMISSIONERS
MARC SPITZER - Chairman
WILLIAM A. MUNDELL
JEFF HATCH-MILLER
MIKE GLEASON
KRISTIN K. MAYES



BRIAN C. MCNEIL
Executive Secretary

ARIZONA CORPORATION COMMISSION

November 23, 2004

Joan S. Burke
OSBORN MALEDON, P.A.
2929 North Central Avenue, Suite 2100
Phoenix, AZ 85012

Dear Ms. Burke:

Enclosed are the Commission Staff's transmittal memorandum and proposed order for the matter of the joint application of XO Arizona, inc. ("XO Arizona"), Allegiance Telecom of Arizona, Inc. ("ALGX Arizona), and XO Communications Services, Inc. (XO Communications") all subsidiaries of XO Communications, Inc. ("XO") for approval to reorganize. The internal corporate reorganization is to merge the existing regulated operating subsidiaries of XO in Arizona into a single operating subsidiary, XO Communications under Docket Nos. T-03601A-04-0583, T-03789A-04-0583, and T-04150A-04-0583. This is only a Staff recommendation to the Commission; it has not yet become an order of the Commission. The Commission can decide to accept, amend or reject Staff's proposed order.

This matter is scheduled for Commission deliberation at its Open Meetings scheduled December 14, 2004, at 10:00 a.m. and December 15, 2004, at 10:00 a.m.

If you have any questions about this matter, please contact John Bostwick of our Staff at (602) 542-0856, or me, at (602) 542-0745.

Sincerely,

Ernest G. Johnson
Director
Utilities Division

EGJ:JFB:

Enclosure

EXHIBIT D

XO MAJOR ASSETS LIST

**Joint Application of XO Arizona, Inc., Allegiance Telecom of Arizona, Inc
and XO Communications Services, Inc. for
Approval of an Internal Corporation Reorganization
Docket Nos.: T-03601A-04-0583; T-03789A-04-0583; T-04150A-04-0583.**

XO owns and operates the following two switches in Arizona:

DMS 500 – Nortel Switch
Suite 200
3930 E. Watkins
Phoenix, AZ 85034

Lucent 5ESS
120 E. Van Buren
Phoenix, AZ 85004

In addition to these switches, XO has constructed and owns approximately fifty-five miles of fiber optic cable that encircles the Phoenix metro area.