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ARIZONA CORPORATION COMMISSION
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BEFORE THE ARIZONA CORPORATION COMMISSION

WILLIAM A. MUNDELL
CHAIRMAN
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COMMISSIONER

DOCKET NO. T-03601A-01-0965

IN THE MATTER OF THE VERIFIED)
APPLICATION OF XO)
COMMUNICATIONS, INC. FOR A)
GENERAL WAIVER OF THE RULES)
GOVERNING PUBLIC UTILITY)
HOLDING COMPANIES AND)
AFFILIATED INTERESTS.)

DOCKET NO. _____

APPLICATION FOR GENERAL WAIVER

XO Communications, Inc. ("XO"), through its undersigned counsel, hereby applies to the Arizona Corporation Commission ("Commission") pursuant to A.A.C. R14-2-806, for a general waiver of the rules governing public utility holding companies and affiliated interests, R14-2-801, *et seq.* (the "Rules"). This general waiver would be used in the event any future transaction to which XO is a party meets the definition of a Reorganization under Rule 14-2-801(5).

INTRODUCTION

XO is the parent company of XO Arizona, Inc. ("XO Arizona"), a non-dominant carrier authorized by the Commission to provide competitive local exchange services (including switched and dedicated access services), intraLATA toll services and intrastate interexchange telecommunications services within the State of Arizona. XO is also the parent company of XO Long Distance Services, Inc. a long distance carrier certified to provide inter-exchange service in

Arizona. Given today's market conditions, and the scarcity of funding for competitive telecommunications networks, it is very likely XO will be a party to future transactions that would be considered "Reorganizations," as that term is broadly defined by the Rules. XO seeks a waiver that would be applicable to it (XO Communications, Inc.) and all of its current and future affiliated entities.

BACKGROUND INFORMATION

By Decision Nos. 56844 and 58063, the Commission adopted A.A.C. R14-2-801 through 806. Generally, these Rules (the "Rules" or the "Affiliated Interest Rules") regulate the formation of public utility holding companies and require that a public service corporation obtain Commission approval before entering into a business transaction with an unregulated affiliate.

Under the definitions set forth in R14-2-801(4), a "Holding Company" or "Public Utility Holding Company" is defined as any affiliate that controls a public utility. A "Utility" or "Public Utility" is defined as any Class A investor-owned public service corporation subject to the jurisdiction of the Arizona Corporation Commission.¹ XO Arizona is now a Class A public utility and, as a result, is subject to the Rules. XO Communications, Inc. is the affiliate (as well as a Public Utility Holding Company) that controls XO Arizona, Inc. as well as XO Long Distance Services, Inc. Under the Rules, Commission approval is required whenever a utility or an affiliate intends to reorganize an existing public utility holding company. "Reorganize" is defined very broadly under the Rules to include "[t]he acquisition or divestiture of a financial interest in an affiliate or a utility, or reconfiguration of an existing affiliate or utility's position in the corporate structure or the merger or consolidation of an affiliate or a utility." A.A.C. R14-2-801(5). In sum, whenever XO Communications, Inc. gains or loses investors or participates in

¹ For telephone utilities, a Class A public service corporation is defined as one that has annual intrastate operating revenues in excess of \$1 million. A.A.C. R14-2-103(A).

any sort of merger, reconfiguration, or consolidation, Commission approval appears to be required.

As described by the Commission, the purpose of the Rules is fourfold: (i) to prevent the commingling of “utility funds” with “non-utility funds;” (ii) to prohibit the cross-subsidization of non-utility activities by utility ratepayers; (iii) to avert any negative impact of non-utility activities on a utility’s financial credit; and (iv) to ensure that the utility and its affiliates provide the Commission with the information necessary to “carry out its regulatory responsibility.” See Concise Explanatory Statement, proposed Rules Docket No. R-0000-89-194. When the Rules were adopted, the Commission understood that the requirements contained in the Rules would not be applicable in some instances and, as a result, authorized waiver of the Rules if to do so would be in the public interest. A.A.C. R14-2-806(A).

The Rules were enacted in response to a diversification movement by Arizona’s electric utilities into areas such as savings and loan companies and hotel investments. At the time of the adoption of the Rules, there was no competitive pricing for electric companies and no competition for the provision of electric service to customers. In adopting the Rules, the Commission was attempting to protect captive customers of the monopoly utilities from having to bear the costs of such non-utility investments. See Arizona Corp. Comm’n v. State ex rel Woods, 171 Ariz. 286, 289-290, 830 P.2d. 807, 810-811 (1992).

REQUEST FOR WAIVER

XO submits the following arguments in support of this request for a general waiver, any one of which would justify issuance of a waiver. First, XO is a national telecommunications provider with only a fraction of its revenues and investments in Arizona. In the coming years, XO will enter into transactions all over the United States that have no impact on Arizona

operations. The sheer size of XO dictates that transactions (*e.g.* new investment, debt acquisition, mergers, acquisitions) will occur outside Arizona and will not affect Arizona customers. These transactions -- “Reorganizations” under the rules -- will not result in any fundamental change in the affiliate entity that operates in Arizona and should not be subject to a Commission approval requirement.

Second, XO is a non-dominant carrier and, as such, does not (and cannot even following culmination of any Reorganization subject to the Rules) exercise monopoly power over a captive service territory or guaranteed revenue base. The Rules were promulgated to protect captive utility ratepayers from rates that “include costs associated with holding company structure, financially beleaguered affiliates, or sweetheart deals with affiliates.” See Concise Explanatory Statement. Because the regulatory environment anticipated by the Rules does not exist for XO, application of the Rules to XO Reorganizations is not necessary.

Third, XO operates in a competitive environment. Once again, this is entirely different than the regulated monopoly contemplated by the Rules. XO today participates in a telecommunications services industry that is energized by market forces such as consumer demand, competitive pricing and the drive to increase market share through added value and technological innovation. Given that XO Arizona faces competition in all of the services it provides to Arizona customers, there exists virtually no incentive or opportunity for XO to attempt to extract from customers unduly high or above-market prices that could be used to subsidize unregulated, affiliated interests. The market effectively provides a natural safeguard against the improper exploitation of telecommunication service profits by XO. This conclusion is consistent with this Commission’s rules governing Competitive Telecommunications Services, R14-2-1101, *et seq.*

Fourth, approval of a general waiver will allow the market to realize the benefits of future Reorganizations without separate applications to this Commission for each Reorganization subject to the Rules. If every certified carrier in Arizona (and each national and international affiliate thereof) sought Commission approval before acquiring new debt, accepting new investment, or purchasing additional assets, the Commission Staff would be inundated by Reorganization approval applications. Most of these transactions do not impact Arizona consumers and should not occupy scarce Commission resources. The Commission promulgated the Affiliate Interest Rules to protect against cross-subsidization by a utility in the traditional monopoly environment when that cross-subsidization would affect Arizona consumers. Unfortunately the text of the Rules reach a much broader range of transactions. The Rules should be waived by the Commission for entities such as XO which: (1) operate nationally with many affiliates; (2) compete in markets with numerous alternative service providers; (3) have no guaranteed source of revenue; and (3) are subject to strong competitive pressures to keep prices low and service quality high.

CONCLUSION

For all the foregoing reasons, XO respectfully requests that the Commission grant it a general waiver of application of the rules to any future Reorganization involving XO or an XO affiliate.²

Respectfully submitted this _____ day of December 2001.

OSBORN MALEDON, P.A.

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² XO asks that the Commission Staff use ACC Decision No. 58258 (granting a limited waiver to AT&T Communications of the Mountain States, Inc.) as a guide in this case if a limited waiver, rather than a general waiver, is ordered. Recent CLEC waivers (e.g. ACSI, MCI and Cox) contain conditions pulled from ACC Decision No. 58087 (granting a limited waiver to US WEST Communications, Inc.). A number of the conditions included in the US WEST waiver are designed to address issues that could arise should a monopoly provider enter into an affiliate transaction. These same conditions are not meaningful when applied to competitive local exchange carriers.