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ARIZONA CORPORATION COMMISSION

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AZ CORP COMMISSION
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DATE: AUGUST 13, 2002

DOCKET NOS: T-03601A-01-0965 and T-03775A-02-0389

TO ALL PARTIES:

Enclosed please find the recommendation of Administrative Law Judge Teena Wolfe. The recommendation has been filed in the form of an Order on:

XO COMMUNICATIONS, INC.
(WAIVER OF RULES)

Pursuant to A.A.C. R14-3-110(B), you may file exceptions to the recommendation of the Administrative Law Judge by filing an original and ten (10) copies of the exceptions with the Commission's Docket Control at the address listed below by 4:00 p.m. on or before:

COMPANY WAIVED TIME TO FILE EXCEPTIONS

The enclosed is NOT an order of the Commission, but a recommendation of the Administrative Law Judge to the Commissioners. Consideration of this matter has tentatively been scheduled for the Commission's Working Session and Open Meeting to be held on:

AUGUST 20, 2002 and AUGUST 21, 2002

For more information, you may contact Docket Control at (602)542-3477 or the Hearing Division at (602)542-4250.

Arizona Corporation Commission
DOCKETED

AUG 13 2002

DOCKETED BY 

BRIAN C. McNEIL
EXECUTIVE SECRETARY

1 Arizona, Inc.

2 On June 17, 2002, XO filed a petition with the U.S. Bankruptcy Court for the Southern
3 District of New York ("Bankruptcy Court") pursuant to Chapter 11 of the U.S. Bankruptcy Code,
4 seeking temporary protection from the claims of its creditors while it reorganizes its operations and
5 restructures its finances.¹

6 On June 27, 2002, XO and its affiliates filed the above-captioned Application of XO Arizona,
7 Inc. and Affiliates for Expedited Approval of Transaction ("Application for Transaction Approval")
8 pursuant to A.A.C. R14-2-803.

9 On July 17, 2002, the Commission's Utilities Division Staff filed in these dockets a Motion to
10 Consolidate, stating that the two applications present related issues, and that it would be appropriate
11 that the matters be considered together.

12 On July 23, 2002, XO filed a letter in these dockets addressing the impact of the proposed
13 transaction on an existing guaranty and pledge of assets approved by this Commission in Decision
14 No. 62617 (June 9, 2000).

15 Staff filed an Amended Staff Report on August 8, 2002, in which it continued to recommend
16 that XO be granted a limited waiver of the Rules, and presented two alternatives for waiver language.
17 Staff further recommended that if the Commission does not grant XO a waiver, that the Commission
18 conditionally approve the Application for Transaction Approval.

19 By Procedural Order of August 12, 2002, the above-captioned matters were consolidated.

20 On August 13, 2002, XO filed a letter in these dockets indicating that the Bankruptcy Court
21 has scheduled a hearing for August 26, 2002, on XO's request for confirmation of the reorganization
22 plan described in the Application for Transaction Approval. The August 13, 2002 letter states that
23 XO has reviewed the Amended Staff Report and would accept either of Staff's recommended waiver
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28 ¹ XO's May 24, 2002 filing indicated that the process of restructuring might include a reorganization of XO's capital structure through a Chapter 11 proceeding.

1 proposals, and that if no waiver is granted, XO seeks approval of the transaction as described in the
2 Amended Staff Report.

3 * * * * *

4 Having considered the entire record herein and being fully advised in the premises, the
5 Commission finds, concludes, and orders that:

6 **FINDINGS OF FACT**

7
8 1. XO is the parent company of XO Arizona, Inc. ("XO Arizona") and XO Long
9 Distance Services, Inc. ("XO Long Distance").

10 2. XO Arizona is an Arizona public service corporation authorized to provide
11 competitive facilities-based and resold intraLATA toll services and intrastate interexchange
12 telecommunications services in Arizona. XO Arizona provides these services pursuant a Certificate
13 of Convenience and Necessity ("CC&N") granted to NEXTLINK Arizona, Inc. in Decision No.
14 61373 (January 29, 1999). NEXTLINK Arizona, Inc. changed its name to XO Arizona, Inc. on
15 January 17, 2000. XO Arizona is classified as a Class A Utility under Commission Rules.
16

17 3. XO Long Distance is an Arizona public service corporation authorized to provide
18 interexchange service in Arizona. XO Long Distance provides these services pursuant to a CC&N
19 granted to NEXTLINK Long Distance Services, Inc. in Commission Decision No. 62770 (August 2,
20 2000). NEXTLINK Long Distance Services, Inc. changed its name to XO Long Distance Services,
21 Inc. on October 18, 2000. XO Long Distance is not classified as a Class A Utility under Commission
22 Rules.
23

24 4. On December 11, 2001, XO filed the Waiver Application with the Commission.

25 5. On January 31, 2002, the Commission issued Decision No. 64399 in Docket No. T-
26 03601A-01-0965, suspending the Waiver Application.

27 6. In the Waiver Application, XO requests that if the Commission orders a limited
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1 waiver, that it use Commission Decision No. 58258 (April 8, 1993), which granted a limited waiver
2 to AT&T Communications of the Mountain States, Inc., as a guide, instead of Commission Decision
3 No. 58087, which granted a limited waiver to US WEST Communications, Inc. XO states that a
4 number of the conditions in Decision No. 58087 are designed to address issues that could arise should
5 a monopoly provider enter into an affiliate transaction, and that those conditions are not meaningful
6 when applied to competitive local exchange carriers.

7
8 7. In support of the Waiver Application, XO states that in the coming years, XO will
9 enter into transactions that would fall under the definition of "reorganizations" under the Rules that
10 will have no impact on Arizona operations, and that the sheer size of XO dictates that the transactions
11 (*e.g.* new investment, debt acquisition, mergers, acquisitions) will occur outside Arizona and will not
12 affect Arizona customers. XO asserts that these transactions will not result in any fundamental
13 change in the affiliate entity that operates in Arizona and should not be subject to a Commission
14 approval requirement.

15
16 8. XO also states in support of the Waiver Application that it does not exercise monopoly
17 power over a captive service territory or guaranteed revenue base. XO further asserts that because
18 XO faces competition in all of the services it provides to Arizona customers, there exists virtually no
19 incentive or opportunity for XO to attempt to extract from customers unduly high or above-market
20 prices that could be used to subsidize unregulated, affiliated interests, and that the market effectively
21 provides a natural safeguard against the improper exploitation of telecommunication service profits
22 by XO.

23
24 9. On March 5, 2002, Staff filed a Staff Report on XO's Waiver Application. In the Staff
25 Report, Staff recommended that the Commission approve a partial waiver of the Rules without a
26 hearing.

27 10. In the Staff Report, Staff also made the following recommendations:
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- 1 a. that the Commission should grant XO Arizona a waiver from A.A.C. R14-2-
2 803 unless organization or reorganization could directly or indirectly result in
3 or cause an increase in XO Arizona's maximum rate on file with the
4 Commission for any competitive service;
- 5 b. that the Commission should grant XO Arizona a waiver from A.A.C. R14-2-
6 804(B), (C), and (D), except for transactions that could directly or indirectly
7 result in or cause an increase in XO Arizona's maximum rate on file with the
8 Commission for any competitive service; and
- 9 c. that the Commission grant XO Arizona a waiver of A.A.C. R14-2-805 unless
10 diversification plans could directly or indirectly result in or cause an increase
11 in XO Arizona's maximum rate on file with the Commission for any
12 competitive service.

13 11. On May 24, 2002, XO filed with the Commission a Notification Regarding the
14 Transfer of Control of XO Communications, Inc., Sole Shareholder of XO Long Distance Services,
15 Inc., and XO Arizona, Inc.

16 12. On June 17, 2002, XO filed a petition with the Bankruptcy Court pursuant to Chapter
17 11 of the U.S. Bankruptcy Code, seeking temporary protection from the claims of its creditors while
18 it reorganizes its operations and restructures its finances.

19 13. On June 27, 2002, XO and its affiliates filed the Application for Transaction
20 Approval, pursuant to A.A.C. R14-2-803.

21 14. On July 17, 2002, the Commission's Utilities Division Staff filed in these dockets a
22 Motion to Consolidate, stating that the two applications present related issues, and that it would be
23 appropriate that the matters be considered together.

24 15. On July 23, 2002, XO filed a letter in these dockets addressing the impact of the
25 proposed transaction on an existing guaranty and pledge of assets approved by this Commission in
26 Decision No. 62617 (June 9, 2000).

27 16. On August 8, 2002, Staff filed an Amended Staff Report.

28 17. By Procedural Order of August 12, 2002, the above-captioned matters were
consolidated.

18. On August 13, 2002, XO filed a letter in these dockets indicating that the Bankruptcy
Court has scheduled a hearing for August 26, 2002, on XO's request for confirmation of the

1 reorganization plan described in the Application for Transaction Approval.

2 19. In the Amended Staff Report, Staff continued to recommend the granting of a limited
3 waiver to XO with the language set forth in Findings of Fact No. 10 above. Staff also stated that, as
4 an alternative, the Commission could grant to XO the same limited waiver currently held by Qwest
5 Corporation ("Qwest"), which would read as follows:

6 XO Arizona, Inc., its parent XO Communications, Inc. and all affiliates of XO
7 Arizona Inc. not regulated by the Commission shall file a notice of intent to organize
8 or reorganize a public utility holding company only for those organizations or
9 reorganizations where XO Arizona, Inc. is directly involved, and in all
reorganizations or organizations that are likely to:

- 10 (a) result in increased capital costs to XO Arizona, Inc.;
- 11 (b) result in additional costs allocated to the Arizona jurisdiction; or
- (c) result in a reduction of XO Arizona, Inc.'s net operating income.

12 No cumulative threshold or "exempt" amount shall apply to any organization or
13 reorganization planned by XO Arizona, Inc., its parent XO Communications, Inc., or
14 any affiliate of XO Arizona, Inc. which would result in any or all of the three
impacts listed above.

15 20. XO's August 13, 2002 letter states that it has reviewed the Amended Staff Report and
16 would accept either of Staff's recommended waiver proposals, and that if no waiver is granted, XO
17 seeks approval of the transaction as described in the Amended Staff Report.

18 21. Staff believes that that the waiver language as set forth in Findings of Fact No. 10
19 above provides stronger consumer safeguards than the language in Findings of Fact No. 19 above,
20 because the former deals directly with competitive rates and charges on file with the Commission.
21 Staff believes that in the case of XO, a limited waiver such as that held by Qwest would not provide
22 customer protections to the same extent as the language recommended in Findings of Fact No. 10
23 above. Staff therefore recommended that the Commission grant XO a waiver consistent with the
24 language in Findings of Fact No. 10 above.

25 22. The Application for Transaction Approval requests approval, pursuant to A.A.C. R14-
26 2-803, of a change in ultimate ownership of XO. The restructuring contemplates the completion of
27 transactions that would result in XO having no more than \$1 billion of outstanding senior secured
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1 debt in addition to other existing capital lease and secured obligations, and equity consisting of an
2 approximately 40 percent each common stock interest held by Forstmann Little and Telmex, as more
3 fully described in the Application for Transaction Approval, with the remaining 20 percent equity
4 divided between management (approximately 2 percent) and other holders (18 percent).² Forstmann
5 Little and Telmex will each pay approximately \$400 million in cash for their shares, resulting in a
6 capital infusion of \$800 million. Modifications to XO's credit facility will extend the scheduled
7 maturity dates of outstanding loans by three years.

8 23. XO asserts that after consummation of the transaction described in the Application for
9 Transaction Approval, XO will continue to operate under its same names and operating authorities as
10 at present, and that the transaction does not involve any transfer of authorizations or change in
11 carriers providing service to customers or any change in the rates, terms or conditions of service. XO
12 believes that the proposed transaction will provide sufficient funds to enable it to continue to provide
13 high quality local, long distance, and broadband services to its customer base, but that without
14 additional funding, XO may be forced to decrease services and investment, and perhaps cease
15 operations altogether.

16 24. Staff stated in the Amended Staff Report that it believes that the proposed
17 reorganization and re-capitalization of XO would not impair the operating subsidiaries from
18 providing their authorized telecommunications services in the competitive market. Staff believes that
19 because the operating subsidiaries are operating in a competitive market, consumers will be protected
20 from high or unfair prices. Therefore, Staff states, complete information regarding the anticipated
21 changes in the utility's cost of service and the cost of capital attributable to the reorganization, *see*
22 A.A.C. R14-2-803(A)(7), is not required in order to determine whether the reorganization is in the
23 public interest.³

24 25. Staff recommended that if the Commission does not grant XO a waiver of the Rules,
25 that the Commission grant the relief requested in the Application for Transaction Approval,

26 _____
27 ² The current ownership of XO is as follows: Craig O. McCaw (51 percent), Forstmann Little (8 percent), other
shareholders (41 percent).

28 ³ Staff notes that if the operating subsidiaries were operating as monopoly providers, then complete information under
A.A.C. R14-2-803(A)(7) would be required to determine if the reorganization would be in the public interest.

1 approving the planned reorganization and re-capitalization of the public utility holding company.
2 Staff further recommended that approval of the Application for Transaction Approval be conditioned
3 upon XO filing, within 30 days of a Decision in this matter, the information required by A.A.C. R14-
4 2-803(A)(1) and (6) - (11), and that if the required filing is not timely made, that approval of the
5 Application for Transaction Approval be automatically made null and void without further order of
6 this Commission.

7 26. If XO receives a limited waiver of the Rules, Commission approval of the
8 reorganization plan described in the Application for Transaction Approval would not be required.

9 27. The reorganization plan described in the Application for Transaction Approval will
10 not directly or indirectly result in or cause an increase in the maximum rates on file with the
11 Commission for any competitive service provided by XO Arizona or XO Long Distance, XO's
12 Arizona affiliates.

13 28. XO Arizona is a non-dominant carrier in Arizona that competes locally with Qwest,
14 the incumbent local exchange carrier, as well as with numerous other competitive local exchange and
15 interexchange carriers, such as AT&T, MCI and Sprint.

16 29. XO Long Distance is a non-dominant carrier in Arizona that competes with numerous
17 interexchange carriers, such as AT&T, MCI and Sprint.

18 30. XO Arizona and XO Long Distance have no captive customers.

19 31. The waiver language recommended by Staff as set forth in Findings of Fact No. 10
20 above is consistent with waivers the Commission has granted to other non-dominant carriers in
21 Arizona that compete locally with Qwest, the incumbent local exchange carrier, as well as with
22 numerous other competitive local exchange and interexchange carriers, such as AT&T, MCI and
23 Sprint.⁴

24 32. Although the competitive nature of the telecommunications market may reduce the
25 need for Commission oversight over XO's affiliate relationships to the extent contemplated by the
26 Rules, it is not reasonable for the Commission to grant XO a complete waiver of the Rules at this

27 ⁴ See Decision No. 64655 (March 25, 2002) (granting a limited waiver of the Rules to Touch America Services, Inc.,
28 Montana Power Company, and Touch America, Inc.) and Decision No. 64737 (April 17, 2002) (granting a limited waiver
of the Rules to Eschelon Telecom of Arizona, Inc.).

1 time.

2 33. It is reasonable to grant to XO and its affiliates a partial waiver of the Rules in
3 accordance with Staff's recommendations as set forth in Findings of Fact Nos. 9 and 10 above,
4 subject to the condition that XO must notify the Commission, and file in advance for approval of, any
5 future proposed organization or reorganization, transaction, or diversification plan of XO or its
6 affiliates that could directly or indirectly result in or cause an increase in their maximum rates on file
7 with the Commission for any competitive service.

8 CONCLUSIONS OF LAW

9 1. XO Arizona and XO Long Distance are public service corporations within the
10 meaning of Article 15 of the Arizona Constitution and Title 40 of the Arizona Revised Statutes.

11 2. The Commission has jurisdiction over this matter and has authority to issue this Order
12 pursuant to A.A.C. R14-2-801 *et seq.*

13 3. A.A.C. R14-2-806(A) provides that the Commission may waive compliance with any
14 of the provisions of the Rules upon a finding that such waiver is in the public interest.

15 4. Absent a waiver of A.A.C. R14-2-803, XO and its affiliates would be required to
16 provide notice to the Commission for every internal reorganization they undertake.

17 5. It is in the public interest to grant XO and its affiliates a limited waiver of the Rules in
18 accordance with Staff's recommendations as set forth in Findings of Fact Nos. 9 and 10 above,
19 subject to the condition that XO must notify the Commission, and file in advance for approval of, any
20 future proposed organization or reorganization, transaction, or diversification plan of XO or its
21 affiliates that could directly or indirectly result in or cause an increase in their maximum rates on file
22 with the Commission for any competitive service.

23 6. The proposed reorganization and recapitalization described in XO's Application for
24 Transaction Approval, Docket No. T-03775A-02-0389, is in the public interest.

25 7. With the limited waiver granted herein, Commission approval is not required for the
26 proposed reorganization and recapitalization described in XO's Application for Transaction Approval
27 in Docket No. T-03775A-02-0389.

28 . . .

ORDER

1
2 IT IS THEREFORE ORDERED that the application of XO Communications, Inc. for a
3 general waiver of application of the Commission's Affiliated Interests Rules to any future
4 reorganization involving XO Communications, Inc. or an XO Communications, Inc. affiliate is
5 hereby denied.

6 IT IS FURTHER ORDERED that XO Communications, Inc. and its affiliates shall be
7 required to file a notice of intent to enter into the transactions listed in A.A.C. R14-2-803 only when
8 an organization or reorganization could directly or indirectly result in or cause an increase in their
9 maximum rates on file with the Commission for any competitive service.

10 IT IS FURTHER ORDERED that XO Communications, Inc. and its affiliates are hereby
11 granted a waiver from A.A.C. R14-2-804(B), (C), and (D), except for those transactions that could
12 directly or indirectly result in or cause an increase in their maximum rates on file with the
13 Commission for any competitive service.

14 IT IS FURTHER ORDERED that XO Communications, Inc. and its affiliates are hereby
15 granted a waiver from A.A.C. R14-2-805 except for those diversification plans that could directly or
16 indirectly result in or cause an increase in their maximum rates on file with the Commission for any
17 competitive service.

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1 IT IS FURTHER ORDERED that XO Communications, Inc. and its affiliates are granted the
2 above-described waivers subject to the condition that they must notify the Commission, and file in
3 advance for approval of, any proposed organization or reorganization, transaction, or diversification
4 plan that could directly or indirectly result in or cause an increase in their maximum rates on file with
5 the Commission for any competitive service.

6 IT IS FURTHER ORDERED that Docket No. T-03775A-02-0389 is hereby closed.

7 IT IS FURTHER ORDERED that this Decision shall become effective immediately.

8 BY ORDER OF THE ARIZONA CORPORATION COMMISSION.
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11 CHAIRMAN

COMMISSIONER

COMMISSIONER

12
13 IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive
14 Secretary of the Arizona Corporation Commission, have
15 hereunto set my hand and caused the official seal of the
16 Commission to be affixed at the Capitol, in the City of Phoenix,
17 this ____ day of _____, 2002.

18 _____
BRIAN C. McNEIL
EXECUTIVE SECRETARY

19 DISSENT _____
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1 SERVICE LIST FOR: XO COMMUNICATIONS, INC.
2 DOCKET NOS. : T-03601A-01-0965 and T-03775A-02-0389

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