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MEMORANDUM

TO: Docket Control

FROM: Ernest G. Johnson *EA for EGJ*
Director
Utilities Division

DATE: June 2, 2008

RE: STAFF REPORT FOR THE APPLICATION OF XO COMMUNICATIONS SERVICES, INC., FOR AUTHORITY TO PROVIDE ITS SECURITY IN CONNECTION WITH FINANCING TRANSACTIONS (DOCKET NO. T-04302A-08-0176)

Attached is the Staff Report for the joint application of XO Communications Services, Inc. for authority to provide its security in connection with financing transactions. Staff recommends conditional approval of the requested authorization.

Any party to this procedure who wishes may file comments to the Staff Report with the Commission's Docket Control by 4:00 p.m. on or before June 12, 2008.

EGJ:PMC:red

Originator: Pedro M. Chaves

Arizona Corporation Commission
DOCKETED

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Docket No. T-04302A-08-0176

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**STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION**

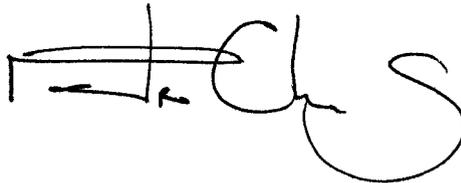
**XO COMMUNICATIONS SERVICES, INC.
DOCKET NO. T-04302A-08-0176**

**APPLICATION FOR AUTHORITY
TO PROVIDE ITS SECURITY IN
CONNECTION WITH FINANCING**

JUNE 2, 2008

STAFF ACKNOWLEDGMENT

The Staff Report for XO Communications Services, Inc., Docket No. T-04302A-08-0176, is the responsibility of the Staff member listed below: Pedro M. Chaves is responsible for the review and financial analysis of the Company's application.

A handwritten signature in black ink, appearing to read 'P. M. Chaves', with a large, stylized 'S' at the end.

PEDRO M. CHAVES
PUBLIC UTILITIES ANALYST III

EXECUTIVE SUMMARY
XO COMMUNICATIONS SERVICES INC.
DOCKET NOS. T-04302A-08-0176

On March 26, 2008, XO Communications Services, Inc. ("XOCS" or "Applicant"), filed an application with the Arizona Corporation Commission ("Commission") requesting that the Commission authorize it to pledge its assets in the State of Arizona in connection with a refinancing involving its parent company, XO Communications, LLC ("XO").

In Arizona, XOCS is authorized to provide intrastate telecommunication services. XO is also authorized to provide interstate and international telecommunication services. XOCS is wholly owned by XO, which in turn is wholly owned by XO Holdings, Inc. ("XO Holdings"), a publicly traded holding company.

The Applicant seeks authority to pledge its Arizona assets in connection with a Note Purchase Agreement ("Agreement") between XO and Arnos Corp. In the Agreement, XO intends to issue and sell up to \$145 million of its notes to Arnos Corp. The obligations under the notes will be guaranteed by XO Holdings, various subsidiaries of XO and, upon receipt of the required regulatory approvals, XOCS.

Staff concludes that a pledge of the Applicant's assets would not impair the availability of service to customers since XOCS provides competitive services that are available from alternate service providers. However, customers may still have exposure to losses to the extent they have prepaid for service or made deposits. Accordingly, any authorization for encumbrances should provide customer protection for prepayments and deposits.

Staff recommends that the Commission authorize the Applicant's request to encumber its assets in the State of Arizona pursuant to A.R.S. § 40-285 and R14-2-804 subject to the condition that all Arizona customer deposits and prepayments, if any, be excluded from encumbrance, or in the alternative, be secured by a bond or an irrevocable sight draft letter of credit which is not included in the pledged collateral.

Staff further recommends authorizing the Applicant to engage in any transaction and to execute any documents necessary to effectuate the authorizations granted.

Staff further recommends that the Applicant file with Docket Control within 60 days of the execution of any financing transaction authorized herein.

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Introduction

On March 26, 2008, XO Communications Services, Inc. ("XOCS" or "Applicant"), filed an application with the Arizona Corporation Commission ("Commission") requesting authorization pursuant to A.R.S. § 40-285 and R14-2-804 to guarantee and otherwise provide security in connection with a refinancing involving its parent company XO Communications, LLC ("XO").

Public Notice

On April 24, 2008, the Applicant filed an affidavit of publication verifying public notice of its financing application. The Applicant published notice of its financing application in the *Arizona Republic* on April 17, 2008. The *Arizona Republic* is a daily newspaper of general circulation in the county of Maricopa, State of Arizona. The affidavit of publication is attached along with a copy of the Notice.

Background

In Arizona, XOCS is authorized to provide intrastate telecommunication services.¹ The Applicant is also authorized to provide interstate and international telecommunication services. XOCS is wholly owned by XO, which in turn is wholly owned by XO Holdings, Inc. ("XO Holdings"), a publicly traded holding company.

Compliance

There are no compliance issues with XOCS.

Purpose and Description of the Requested Approval

On March 13, 2008, XO entered in a Note Purchase Agreement ("Agreement") with Arnos Corp. to refinance existing debt. In the Agreement, XO intends to issue and sell up to \$145 million of its notes to Arnos Corp. The obligations under the notes will be guaranteed by XO Holdings, various subsidiaries of XO and, upon receipt of the required regulatory approvals, XOCS.

XO states that "The financing arrangement will provide the XO companies with the financial resources needed to further grow and expand its business and to compete in today's highly competitive telecommunications environment."²

The Applicant also indicates that the financing arrangement will not require XOCS to increase its maximum rates for telecommunications services in Arizona.³

¹ See further, Decision No. 67460, dated January 4, 2005.

² XOCS Application, page 4.

³ *Ibid.* page 4.

Financial Analysis

The Applicant requests authorization to pledge assets as security for the Agreement. A.R.S. § 40-285 requires public service corporations to obtain Commission authorization to encumber certain utility assets. The statute serves to protect captive customers from a utility's act to dispose of any of its assets that are necessary for the provision of service, thus, it serves to preempt any service impairment due to disposal of assets essential for providing service. In this instance, a pledge of the Applicant's assets should not impair the availability of service to customers since the Applicant provides competitive services that are available from alternate service providers. However, customers may still have exposure to losses to the extent they have prepaid for service or made deposits. Therefore, any authorization for encumbrance should provide customer protection for prepayments and deposits.

R14-2-804(B) provides that a utility will not, without Commission approval, obtain a financial interest in any affiliate not regulated by the Commission, or guarantee, or assume the liabilities of such affiliate. Under R14-2-804(C), the Commission is to review the transaction to determine if it would impair the financial status of the public utility, otherwise prevent it from attracting capital at fair and reasonable terms, or impair the ability of the public utility to provide safe, reasonable and adequate service.

The transaction in this proceeding will not impair the financial status of the public utility, otherwise prevent it from attracting capital at fair and reasonable terms, or impair the ability of the public utility to provide safe, reasonable and adequate service. Furthermore, as the Applicant notes, "In the unlikely event that XOCS' capital structure becomes too costly and rates rise, customers may simply migrate to other carriers with preferred rates."⁴

Conclusion and Recommendations

Staff concludes that the Applicant's pledge of its assets in connection with its parent's refinancing would not impair the availability of service to customers since the Applicant provides competitive services that are available from alternate service providers. However, customers may still have exposure to losses to the extent they have prepaid for service or made deposits. Accordingly, any authorization for encumbrance should provide customer protection for prepayments and deposits.

Staff recommends that the Commission authorize the Applicant's request to encumber its assets in the State of Arizona pursuant to the Agreement in connection with its parent's refinancing. Such authorization should be subject to the condition that all Arizona customer deposits and prepayments, if any, be excluded from encumbrance, or in the alternative, be secured by a bond or an irrevocable sight draft letter of credit which is not included in the pledged collateral.

⁴ *Ibid.* page 5.

XO Communications Services, Inc.

Docket No. T-04302A-08-0176

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Staff further recommends authorizing the Applicant to engage in any transaction and to execute any documents necessary to effectuate the authorizations granted.

Staff further recommends that the Applicant file with Docket Control within 60 days of the execution of any financing transaction authorized herein.

BEFORE THE ARIZONA CORPORATION COMMISSION

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COMMISSIONERS

MIKE GLEASON – Chairman
WILLIAM A. MUNDELL
JEFF HATCH-MILLER
KRISTIN K. MAYES
GARY PIERCE

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APR 24 2008

AZ CORP COMM
Director Utilities

IN THE MATTER OF THE APPLICATION OF)	DOCKET NO. T-04302A-08-0176
XO COMMUNICATIONS SERVICES, INC.)	
FOR AUTHORITY TO PROVIDE ITS)	XO COMMUNICATIONS
SECURITY IN CONNECTION WITH)	SERVICES, INC.'S NOTICE OF
FINANCING)	FILING AFFIDAVIT OF
)	PUBLICATION

XO Communications Services, Inc., hereby files the attached Affidavit of Publication evidencing the public notice given on April 17, 2008, regarding the Application for Authority to Provide Its Security in Connection with Financing.

RESPECTFULLY SUBMITTED this 24th day of April 2008.

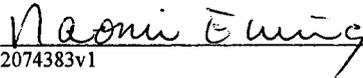
OSBORN MALEDON, P.A.

By Joan S. Burke
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Counsel for XO Communications Services, Inc.

Original and 13 copies of the foregoing filed this
24th day of April, 2008, with:

The Arizona Corporation Commission
Utilities Division - Docket Control
1200 W. Washington Street
Phoenix, Arizona 85007


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