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BEFORE THE ARIZONA CORPORATION COMMISSION

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2 KRISTIN K. MAYES  
Chairman  
3 GARY PIERCE  
Commissioner  
4 PAUL NEWMAN  
Commissioner  
5 SANDRA D. KENNEDY  
Commissioner  
6 BOB STUMP  
Commissioner  
7

Arizona Corporation Commission

DOCKETED

JAN - 6 2010

DOCKETED BY  
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8 IN THE MATTER OF THE NOTICE OF )  
9 INTENT OF MCLEODUSA )  
10 TELECOMMUNICATIONS SERVICES, )  
11 INC. DBA PAETEC BUSINESS SERVICES )  
12 PURSUANT TO A.A.C. R14-2-803 )  
13 REGARDING PRO FORMA )  
14 INTRACORPORATE REORGANIZATION, )  
15 OR IN THE ALTERNATIVE, )  
16 APPLICATION FOR A LIMITED WAIVER )  
17 OF A.A.C. R14-2-803 )

DOCKET NO. T-03267A-09-0536

DECISION NO. 71450

ORDER

16 Open Meeting  
17 December 22, 2009  
Phoenix, Arizona

18 BY THE COMMISSION:

19 FINDINGS OF FACT

20 1. On November 20, 2009, McLeodUSA Telecommunications, Inc. ("McLeodUSA")  
21 d/b/a PAETEC Business Services ("PAETEC", "Applicant" or "Company") submitted an  
22 application seeking approval to complete a reorganization by the end of the year due to significant  
23 benefits for the company and requests expedited review and approval of this transaction without a  
24 hearing under A.A.C. R14-2- 803(B). Alternatively, pursuant to A.A.C. R14-2-806, Applicant  
25 requests a limited waiver of A.A.C. R14-2-803.

26 Background of Applicants

27 2. The Company in its Application represents the following:  
28 ...

- 1           •     PAETEC Business is an Iowa corporation with principal offices located at  
2                     One Martha's Way, Hiawatha, Iowa 52233. PAETEC Business is an  
3                     indirect wholly-owned subsidiary of PAETEC Holding Corp. ("PAETEC  
4                     Holding"). In Arizona, PAETEC Business is authorized to provide resold  
5                     and facilities-based local exchange and access services pursuant to Decision  
6                     No. 62627, granted on June 9, 2000. PAETEC Business is also authorized  
7                     to provide resold interexchange telecommunications services pursuant to  
8                     Decision No. 61001, granted on July 16, 1998. According to its 2008  
                   Annual Report filed with the Commission, the Applicant generated more  
                   than \$1 million of Arizona jurisdictional revenue. The Applicant therefore  
                   is a Class A investor owned public service corporation subject to the  
                   Arizona Corporation Commission's ("Commission") Public Utility Holding  
                   Companies and Affiliated Interest Rules, A.A.C. R14-801 et seq.

9           3.     PAETEC Holding is a publicly traded Delaware corporation (NASDAQ GS:  
10           PAET) with principal offices located at One PAETEC Plaza, 600 Willow Brook Office Park,  
11           Fairport, New York 14450. In Arizona, PAETEC Holding provides regulated communications  
12           services through two wholly owned subsidiaries: PAETEC Business, and PAETEC  
13           Communications, Inc. ("PCI").

14           The Applicant's Transaction

15           4.     The Applicants represent the following:

- 16           •     PAETEC Business will be included as part of a pro forma intracorporate  
17                     reorganization of entities that all currently have PAETEC Holding as their  
18                     ultimate parent. There will be no combination of unaffiliated entities.  
19                     Currently, the Applicant is held by PAETEC Holding through the  
20                     McLeodUSA Inc. and McLeodUSA Holdings, Inc. subsidiaries.<sup>1</sup> The  
21                     Applicant intends to execute a pro forma corporate reorganization whereby  
22                     PAETEC Business will become an indirect wholly-owned subsidiary of  
23                     PAETEC Holding under the PAETEC Corp. and PAETEC  
24                     Communications, Inc. subsidiaries, rather than through its current  
25                     intervening parent companies. McLeodUSA Inc. will be collapsed into  
26                     PAETEC Holding Corp., and McLeodUSA Holdings, Inc.'s stock will be  
27                     contributed to PAETEC Communications, Inc. There will be no changes in  
28                     the corporate form, name, or manner in which PAETEC Communications,  
                   Inc. is held or operated<sup>2</sup>.
- In connection with the pro forma reorganization, PAETEC Business intends  
                   to undertake a change in corporate form whereby PAETEC Business will be

<sup>1</sup> A diagram of the pre-reorganization structure of the company showing those entities is attached to the Application and here as Exhibit A.

<sup>2</sup> A diagram of the post-reorganization structure of the company is attached to the Application and here as Exhibit B.

1 converted from an Iowa business corporation to an Iowa limited liability  
2 company.

3 5. The conversion will not involve the merger of Applicant with any other entity.  
4 Rather, the conversion will be accomplished simply through the filing of Articles of Organization  
5 including Articles of Conversion, or similar documents, with the Iowa Secretary of State. This is  
6 similar to changing the name of a corporation under Arizona by filing revised Articles of  
7 Incorporation – the entity remains legally the same.

8 6. Under Iowa law, an entity that converts to a limited liability company is recognized  
9 as the same entity. When the conversion takes effect, the cessation of the existence of the  
10 converting business entity in its prior form of organization does not constitute dissolution or  
11 termination of the converting business entity. The converting business entity ceases its prior form  
12 of organization and continues in existence as the resulting limited liability company. As a result,  
13 there is no legal transfer of assets or a CC&N and no Commission approval is required.

14 7. The pro forma reorganization will not result in a transfer of control of PAETEC  
15 Business because its ultimate parent, PAETEC Holding, will remain the same. Furthermore, the  
16 day-to-day operations of the Company will continue to be managed by the same personnel, and the  
17 transaction will not affect Applicant's current rates or services. The transaction will enhance the  
18 overall operational efficiency and competitive position of the Company because it expects to gain  
19 significant benefits as a result of the pro forma reorganization, which will ultimately inure to the  
20 benefit of the Companies' subscribers. Consequently, the transaction is consistent with the public  
21 interest, and will promote competition among telecommunications carriers in the state.

22 8. According to the Applicant, the structure changes are anticipated to produce the  
23 following benefits:

- 24 • Result in more than \$800,000 in annual income tax savings by utilizing  
25 forecasted losses of certain subsidiaries against the forecasted profits of other  
26 subsidiaries;
- 27 • Result in substantial administrative efficiencies to be achieved in the form of  
28 fewer income tax filings;

- 1 • Mitigate current risks associated with limitations imposed on the ability to  
2 utilize net operating losses (i.e., Section 382 IRS loss limitations imposed on  
3 companies that have incurred an ownership change); and  
4 • Mitigate current transfer pricing risks associated with the accuracy of reporting  
5 inter-company transactions (e.g., meeting the arms length pricing standard for  
6 inter-company services incurred between affiliates – for example, the routing of  
7 an affiliate’s calls over another affiliate’s switch).”

8 Staff’s Analysis & Recommendations

9 9. The proposed transaction constitutes reorganization under the Commission’s Public  
10 Utility Holding Companies and Affiliated Interests Rules. Accordingly, information responsive to  
11 A.A.C. R14-2-803.A.1-11 was provided by the Applicant in its filed application.

12 10. Additionally, at Staff’s requests, the Applicant clarified the benefits stated in its  
13 application.

- 14 • The “\$800,000 in annual tax savings” is an estimated aggregate of annual state  
15 tax savings. No federal savings are anticipated from the restructuring. The  
16 majority of the state savings will be in Pennsylvania, Massachusetts, New  
17 Hampshire and New York. The Arizona portion of tax saving is forecasted to  
18 be less than \$1,000 annually.
- 19 • The “substantial administrative efficiencies” are not forecasted to be monetary  
20 savings as much as administrative efficiencies for in-house staff who prepare  
21 the vast majority of the tax filings for the Applicant and affiliates. Fewer tax  
22 filings as a result of the conversion and reorganization will relieve in-house staff  
23 of some of the burden of preparing many forms.
- 24 • The “current risks” that will be mitigated associated with limitations imposed  
25 on the ability to utilize net operating losses were clarified as follows:
- 26 – IRC Section 382 imposes an annual limitation on a corporation’s ability to  
27 utilize Net Operating Loss (“NOL”) carryovers if the company has incurred  
28 an “ownership change” within the meaning of Section 382 which was  
enacted in order to prevent companies from “loss shopping”. PAETEC  
Corp and its subsidiaries incurred an ownership change as a result of a  
recapitalization in 2006. Therefore, the NOL carryovers of the USLEC,  
McLeodUSA and PAETEC legal entities that arose before the respective  
ownership change dates (“pre-change NOLs”) are all subject to annual  
limitations with respect to the ability to offset taxable income arising after  
the ownership change date.

- 1                   – The proposed reorganization converts a number of legal entities to LLC’s  
2                   (which are disregarded for federal and state income tax purposes) and  
3                   results in the companies being considered as one filing entity for income tax  
4                   purposes. This lessens, if not completely eliminates the potential impact of  
5                   Section 382 at the state level as it allows for the inherent “netting” of  
6                   McLeodUSA and USLEC forecasted Losses with PAETEC’s forecasted  
7                   income without requiring the utilization of any of the pre-existing NOL’s.
- 8                   • The “current transfer pricing risks” that will be mitigated associated with the  
9                   accuracy of reporting inter-company transactions were clarified as follows:
- 10                  – The Internal Revenue Code Section 482 regulations specify that transactions  
11                  between commonly controlled or related parties must adhere to the arm’s-  
12                  length standard. The majority of states apply the 482 regulations.
- 13                  – To test whether transactions are conducted on an arm’s-length basis, the  
14                  regulations have identified different methods according to the type of  
15                  transaction. The requirement to prepare an economic analysis for each inter-  
16                  company transaction can, in the aggregate, become a huge administrative  
17                  undertaking requiring the dedication of limited internal resources and  
18                  corporate personnel that could be better used on the company’s core mission  
19                  of providing high quality telecommunications service to the public.
- 20                  – The proposed reorganization converts a number of legal entities to LLC’s  
21                  which are disregarded for federal and state income tax purposes. As a result,  
22                  the administrative burden with regard to the arms length standard for inter-  
23                  company transactions will be lessened, as the companies will be considered  
24                  one filing entity for income tax reporting purposes.

25                  11. Staff has reviewed the information provided by the Applicant and concluded that  
26                  the information is in compliance with the Commission’s Public Utility Holding Companies and  
27                  Affiliated Interests Rules and concurs that the proposed pro forma reorganization will not change  
28                  the financial status of PAETEC Business, its ability to attract capital at fair and reasonable terms,  
29                  or its ability to provide its authorized services.

30                  12. The Applicant has been found to be in compliance and good standing by the  
31                  Commission’s Compliance and Consumer Services sections.

32                  13. Staff does not believe the reorganization proposed in this application will materially  
33                  change the operations of PAETEC Business Services. Additionally, the nature of the  
34                  reorganization is not sufficiently complex to require an evidentiary hearing. Staff, therefore,  
35

1 recommends that the application of McLeodUSA Telecommunications, Inc. d/b/a PAETEC  
2 Business Services be approved without a hearing under A.A.C. R14-2-803(B).

3 CONCLUSIONS OF LAW

4 1. McLeodUSA Telecommunications, Inc. d/b/a PAETEC Business Services is a  
5 public service corporation within the meaning of Article XV of the Arizona Constitution.

6 2. The Commission has jurisdiction over McLeodUSA Telecommunications, Inc.  
7 d/b/a PAETEC Business Services and of the subject matter in this filing.

8 3. The Commission, having reviewed the filing and Staff's Memorandum dated  
9 December 10, 2009, concludes that it is in the public interest to grant the joint application of  
10 McLeodUSA Telecommunications, Inc. d/b/a PAETEC Business Services to approve of this  
11 transaction without a hearing under A.A.C. R14-2-803(B).

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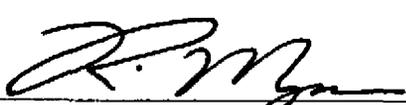
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ORDER

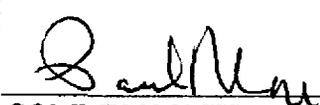
IT IS THERFORE ORDERED that the application of McLeodUSA Telecommunications, Inc. d/b/a PAETEC Business Services seeking an order authorizing an intracorporate reorganization be and hereby is approved as discussed herein.

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

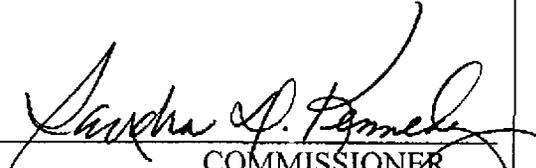
BY THE ORDER OF THE ARIZONA CORPORATION COMMISSION

  
CHAIRMAN

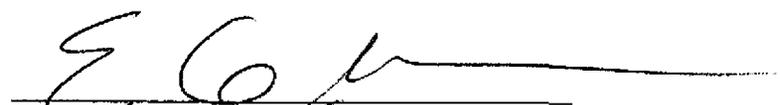
  
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IN WITNESS WHEREOF, I, ERNEST G. JOHNSON, Executive Director of the Arizona Corporation Commission, have hereunto, set my hand and caused the official seal of this Commission to be affixed at the Capitol, in the City of Phoenix, this 6th day of JANUARY, 2010.

  
ERNEST G. JOHNSON  
EXECUTIVE DIRECTOR

DISSENT: \_\_\_\_\_

DISSENT: \_\_\_\_\_

SMO:AFF:lhm\MAS

1 SERVICE LIST FOR: McLeodUSA Telecommunications Services, Inc.  
2 dba Paetec Business Services

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Exhibit A

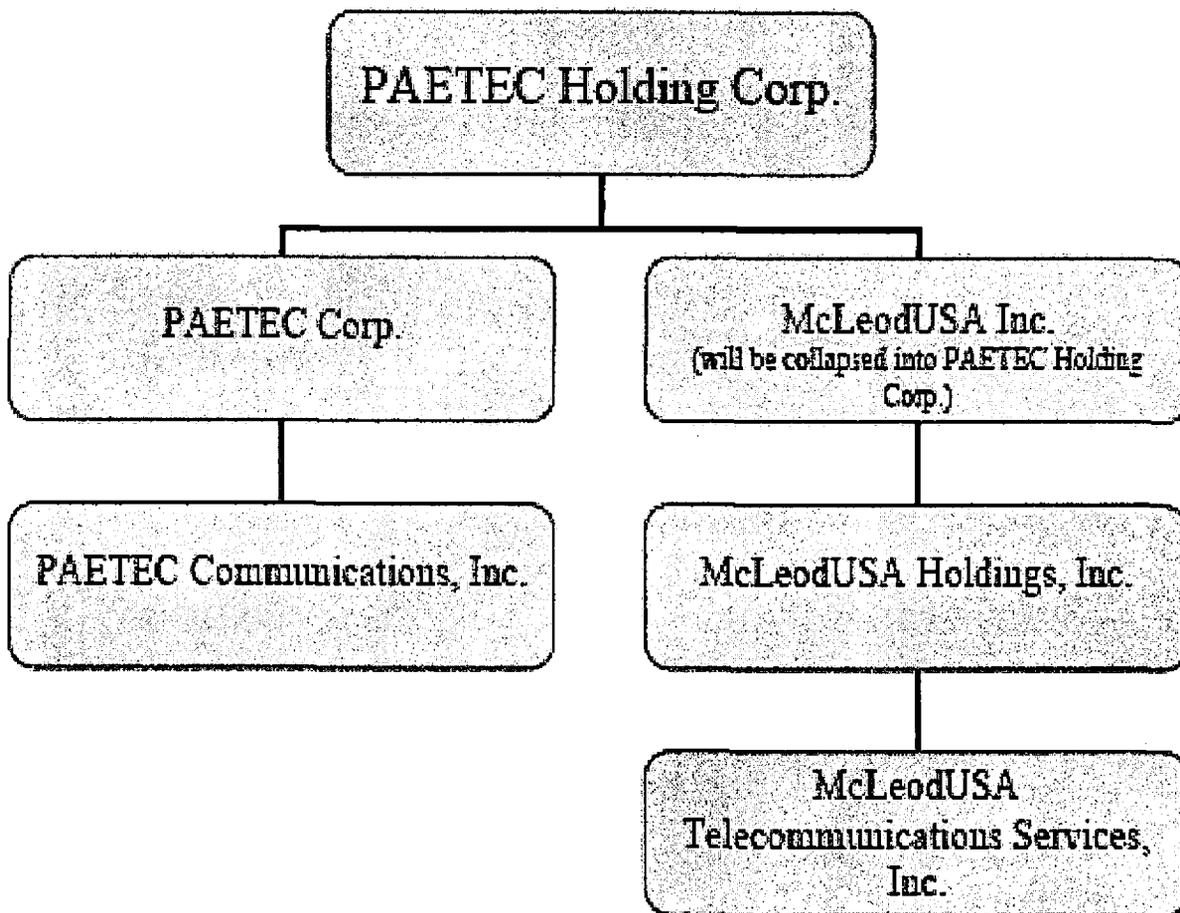


Exhibit B

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