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NEW APPLICATION



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BEFORE THE ARIZONA CORPORATION COMMISS

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In the Matter of the Application of **XO**)
Communications Services, Inc. and its Affiliates) DOCKET NO. T-04302A-12-0456
for a Limited Waiver of the Rules Governing)
Public Utility Holding Companies and Affiliated)
Interests.)
))
))

APPLICATION FOR LIMITED WAIVER

XO Holdings (“XO Holdings”), XO Communications, LLC (“XO LLC”) and XO Communications Services, Inc. (“XOCS”) hereby apply to the Arizona Corporation Commission (“Commission”) pursuant to A.A.C. R14-2-806, for a limited waiver of the rules governing public utility holding companies and affiliated interests, R14-2-801, *et seq.* (the “Rules”). This limited waiver would be used in the event any future transaction to which XO LLC and XO Holdings are parties meets the definition of a Reorganization under Rule 14-2-801(5) and in the event XOCS intends to consummate a transaction otherwise subject to A.A.C. R14-2-804(B). XOCS is not requesting a waiver of A.A.C. R14-2-805 (Annual Filing Requirements of Diversification Activities and Plans).

INTRODUCTION

XOCS is 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 LLC is the parent company to XOCS and a number of similar subsidiaries. XO LCC is a

leading provider of local and long distance telecommunications to businesses, large enterprises and telecommunications carriers. XO LLC is a direct wholly owned subsidiary of XO Holdings, a Delaware general partnership. Given today's market conditions, and the opportunity for new funding and refinancing for competitive telecommunications networks, it is very likely XO Holdings and XO LLC will be parties to future transactions that would be considered "Reorganizations," as that term is broadly defined by the Rules. Additionally, XO LLC and XO Holdings will continue to adjust the assets and debts of all of its subsidiaries and affiliates to maximize network quality, reach and efficiency. Financing and refinancing growth is an integral part of forward-looking strategic planning. A waiver of R14-2-803 and R13-2-804(B) will permit XO LLC and XO Holdings to enter into certain transactions without first seeking ACC approval. XOCS seeks a waiver that would be applicable to it (XOCS) 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. The 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 XOCS is a Class A public utility and, as a result, is subject to the Rules. XOCS is a wholly owned subsidiary of XO LLC, which is in turn a wholly owned subsidiary of XO Holdings. XO LLC and XO holdings are affiliates (as well as Public Utility Holding Companies) that

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).

control XOCS. Under the Rules, Commission approval is required whenever a utility or an affiliate intends to reorganize an existing public utility holding company. A.A.C. R14-2-803(A). "Reorganize" is broadly defined 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). Prior approval is also required under R14-2-804(B) if a public utility wishes to "obtain a financial interest in any affiliate not regulated by the Commission, or guarantee, or assume the liabilities of such affiliate" or lend to any affiliate not regulated by the Commission \$100,000 or more for over one year. In sum, whenever XO LLC or XO Holdings (entities controlling assets and network facilities spread across the nation) add or replace an investor or participate in any sort of merger, financing, refinancing, reconfiguration, or consolidation, the Rules appear to require Arizona Commission approval.

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).

The Commission has recognized that Rule 806 waivers, such as the one requested here, are particularly appropriate in the telecommunications arena. As the list which follows demonstrates, the Commission has granted waivers to many of the larger telecommunications companies in Arizona:

- (1) Qwest/CenturyLink
Decision No. 72493 (July 25, 2011) reaffirming and extending to CenturyLink, Inc. Qwest's limited waiver of the Affiliated Interest Rules previously granted to Qwest Communications Corporation, Qwest Corporation, and their affiliates and their parent Qwest Communications International Inc. in Decision No. 64654 (March 25, 2002);
- (2) AT&T Communications of the Mountain States, Inc. (AT&T)
Decision No. 58258 (April 8, 1993) granting AT&T a limited waiver of the Affiliated Interest Rules. AT&T is required to file a notice of intent to organize or reorganize "only for those organizations or reorganizations that are likely to have a material adverse impact on AT&T's Arizona public utilities."
- (3) Teleport Communications Group and AT&T Corp.
Decision No. 60728 (March 23, 1998) extending waiver held by AT&T to recently acquired Teleport Communications Group ("TCG"). TCG is "required to file a notice of intent to organize or reorganize only for the organizations or reorganizations that are likely to have a material adverse impact on the Arizona jurisdictions operations."
- (4) American Communications Services of Pima County, Inc.
Decision No. 62616 (June 9, 2000) granting limited waiver of Affiliated Interest Rules. ACSI and affiliates are "required to file a notice of intent to enter into the transactions listed in A.A.C. R14-2-803 when a transaction is likely to result in 1.) significant increased capital costs of the Arizona operations; 2.) significant additional costs allocated or charged directly to the Arizona jurisdiction; or 3.) a significant reduction of net income to the Arizona operations."
- (5) MCI
Decision No. 62072 (June 30, 2000) granting a limited waiver to MCI WorldCom Communications, Inc., MCIMetro Access Transmission Services and affiliates. Under this waiver, MCI and affiliates are required to "file a notice of intent to enter into the transactions listed in A.A.C. R14-2-803 when a transaction is likely to result in 1.) significant increased capital costs of the Arizona operations; 2.) significant additional costs allocated or charged directly to the Arizona jurisdiction; or 3.) a significant reduction of net income to the Arizona operations."
- (6) Cox
Decision No. 62582 (May 17, 2000) granting a limited waiver to Cox Arizona Telecom L.L.C. Under this waiver, Cox and its affiliates are required to "file a notice

of intent to enter into the transactions listed in A.A.C. R14-2-803 when a transaction is likely to result in 1.) significant increased capital costs of the Arizona operations; 2.) significant additional costs allocated or charged directly to the Arizona jurisdiction; or 3.) a significant reduction of net income to the Arizona operations.”

(7) tw telecom

Decision No. 73245 (June 26, 2012) granting a limited waiver to tw telecom of arizona llc. Under this waiver, tw telecom and its affiliates are required to “file a notice of intent to enter into the transactions listed in A.A.C. R14-2-803 when a transaction is likely to result in 1.) significant increased capital costs of the Arizona operations; 2.) significant additional costs allocated or charged directly to the Arizona jurisdiction; or 3.) a significant reduction of net income to the Arizona operations.”

While the above list of limited waivers granted by the Commission is not exhaustive, the carriers listed serve the vast majority of telephone customers in Arizona. XOCS requests the limited waiver language used in Decision No. 58258 (No. 2 and 3 above), as it would be more appropriate for a competitive local exchange carrier. If granted, the waiver would waive the requirements of R14-2-804 completely and require XOCS to file a notice of intent only for those organizations or reorganizations that are likely to have a material adverse impact on XOCS’s Arizona public utilities.

REQUEST FOR WAIVER

XOCS submits the following arguments in support of this request for a limited waiver, any one of which would justify issuance of a waiver. First, XOCS is a national telecommunications provider with only a fraction of its revenues and investments in Arizona. In the coming years, XOCS will enter into transactions all over the United States that have no impact on Arizona operations. The sheer size of XOCS dictates that transactions (*e.g.* new investment, debt refinance, mergers, and 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, XOCS is a non-dominant carrier and, as such, does not 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 XOCS, application of the Rules to any Reorganization by XO Holdings or XO LLC is not necessary.

Third, XOCS 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 XOCS faces competition in all of the retail services it provides to Arizona customers, there exists virtually no incentive or opportunity for XOCS 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 XOCS. This conclusion is consistent with this Commission’s rules governing Competitive Telecommunications Services, R14-2-1101, *et seq.*

Fourth, approval of a limited waiver will allow the market to realize the benefits of future Reorganizations without a separate application 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 reaches a much broader range of transactions. The Rules should be waived by the Commission for entities such as XOCS which: (1) operate nationally with many affiliates; (2) compete in end-user retail markets with alternative service providers; (3) have no guaranteed source of revenue; and (4) are subject to strong competitive pressures to keep prices low and service quality high.

CONCLUSION

For all the foregoing reasons, XOCS respectfully requests that the Commission grant XOCS and its affiliates a Rule 806 limited waiver pursuant of R14-2-803 and R14-2-804 of the Rules.

RESPECTFULLY SUBMITTED this 6th day of November, 2012.

By:



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ORIGINAL and thirteen (13) copies of the foregoing filed this 6th day of November 2012 with:

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