

Decision 02-08-058 August 22, 2002

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application Pursuant to Public Utilities Code
Section 854 for Approval of the Indirect Transfer
of Control of XO California, Inc. (U 5553 C) and
XO Long Distance Services, Inc. (U 6272 C)

Application 02-05-018
(Filed May 3, 2002)

**OPINION GRANTING APPLICATION TO
INDIRECTLY TRANSFER OWNERSHIP AND CONTROL**

I. Summary

We authorize Applicants XO California, Inc. (XO California) and XO Long Distance Services, Inc. (XO Long Distance) to indirectly transfer ownership and control through their parent company, XO Communications, Inc. (XO), from Craig O. McCaw and the existing shareholders of XO to Forstmann Little & Co Equity Partnership-VII, L.P., Forstmann Little & Co. Subordinated Debt and Equity Management Buyout Partnership-VIII, L. P. (Forstmann Little), and to an indirect, wholly owned subsidiary of Telefonos de Mexico, S.A. de C.V. (Telmex) and 20% common stock divided between XO management (2%) and other holders (18%).

II. Categorization

Applicants have requested that this matter be categorized as ratesetting and that no hearings are necessary. By Resolution ALJ 176-3088, dated May 16, 2002, the Commission preliminary determined that this was a ratesetting proceeding, and that no hearings were expected.

Notice of this application appeared in the Commission's May 13, 2002, Daily Calendar. With no filed protests, there is no reason to hold a public hearing and no reason to change the preliminary determinations made in Resolution ALJ 176-3088.

III. Jurisdiction

The application has been filed pursuant to Pub. Util. Code § 854 and Rules 35 and 36 of the Commission's Rules of Practice and Procedure. Section 854 precludes any person or corporation from transferring control of any public utility organized and doing business in this state without first securing authorization to do so from this Commission upon a finding that the transfer of control is in the public interest. The purpose of this and related sections is to enable the Commission, before any transfer of public utility property is consummated, to review the situation and to take such action as the public interest may require. (*San Jose Water Co.* (1916) 10 CRC 56.)

Forstmann Little and Telmex are not parties to this application. Neither Forstmann Little nor Telmex will acquire 50% of XO, since neither entity will obtain a controlling interest. (*Gale v. Teel*, 87478, (1977) 81 CPUC 817.)

IV. The Parties

XO California is a Washington corporation and a wholly owned subsidiary of XO, a Delaware corporation. XO California (formerly NEXTLINK Communications) was granted a Certificate of Public Convenience and Necessity (CPCN) to provide facilities-based and resold competitive local exchange service in D.95-12-057 and D.96-02-072, respectively. D.95-12-057 assigned XO California, a nondominant telecommunications carrier, its U-5553-C corporate identification number.

XO Long Distance (formerly NEXTLINK Long Distance Services, Inc.) is a Washington corporation and a wholly owned subsidiary of XO. In D.99-11-061,

the Commission granted XO Long Distance authority to operate as a switchless reseller of inter-Local Access and Transport Area (LATA) service. That decision assigned XO Long Distance, a nondominant telecommunications carrier, its U-6272-C corporate identification number. In D.00-07-059, the Commission granted XO Long Distance authority to operate as a facilities-based carrier of interLATA and, to the extent authorized by D.94-09-065, intraLATA telecommunications services offered by communication common carriers in California subject to the conditions set forth in that decision.

Forstmann Little is a private equity firm formed in 1978 that has made 29 acquisitions and significant equity investments, including in XO, through several limited partnerships. The two Forstmann Little affiliates making the investment in XO, Forstmann Little & Co. Equity Partnership-VII (FLVII) and Forstmann Little & Co. Subordinated Debt and Equity Management Buyout Partnership-VIII (FLDEVIII), are Delaware limited partnerships. The general partners of these affiliates also are Forstmann Little limited partnerships. The general partners of those general partner entities are Theodore J. Forstmann, Sandra J. Horbach, Winston W. Hutchins, Thomas H. Lister, Jamie C. Nicholls, and Gordon A. Holmes. FLVII's limited partners are comprised primarily of institutional investors, with some individual investors. FLDEVIII's limited partners are comprised of various institutional investors.

Telmex, a Mexican corporation, has more than 13 million telephone lines in service, 1.43 million line equivalents for data transmission and more than 845,000 Internet accounts in Mexico. Privatized in 1990, Telmex is controlled by Carso Global Telecom, S.A. de C.V., a Mexican holding company.

V. The Transaction

Pursuant to the stock purchase agreement, XO will issue new common shares to the investors, each of whom will pay \$400 million in cash for the shares,

for a total aggregate investment in XO of \$800 million. Specifically, Forstmann Little will purchase 79,999,998 shares of Class A Common Stock, par value \$0.01 per share of XO, and two shares of a newly created class of Class D Common Stock, par value \$0.01 per share of XO. The Forstmann Little shares will equal approximately 40% of the total outstanding equity securities of XO. Telmex will purchase 80,000,000 shares of a newly created class of Class C Common Stock, par value \$0.01 per share, of XO. The Telmex shares will equal approximately 40% of the total outstanding equity securities of XO. The remaining approximately 20% will be common stock divided between XO's management (approximately 2%) and other holders (18%).

The purchase by and issuance of the new shares to the investors will occur at the closing of the contemplated transactions. In addition, Forstmann Little and Telmex each also will be entitled to designate persons to serve on the XO Board of Directors proportionate to the equity interests so long as they hold more than 10% of XO's common stock. The investors will hold their interests independently of one another and have no agreement to act in concert except with respect to the election of directors. Neither investor will participate in the day-to-day operations of XO California and XO Long Distance. XO currently plans to retain its existing senior management and it is not contemplated that there will be significant changes in XO's current management occasioned by the investment or restructuring.

On June 20, 2002, XO's attorneys, Kelley, Drye and Warren, wrote to the assigned Administrative Law Judge (ALJ) to inform the Commission that XO filed a petition with the U.S. Bankruptcy Court pursuant to Chapter 11 of the U.S. Bankruptcy Code on June 17, 2002. XO California and XO Long Distance were not included in that filing. The letter noted XO had no plans to terminate the transaction that is the subject of this application. Because this letter and the

application indicated a supplement might be filed, XO's in-house attorneys wrote to the ALJ on July 11, 2002 to indicate that XO did not intend to amend or supplement the application. In that letter, XO's attorneys requested that the Commission act expeditiously on the application, as the application had requested.

Where acquiring companies do not possess CPCNs, we apply the same requirements as an applicant seeking a CPCN to exercise the type of authority held by the company being acquired, a minimum of \$100,000 in case or cash equivalent, and technical expertise in telecommunications or a related business. FLVII and FLDEVIII, among other Forstmann Little entities, acquired McLeod USA Telecommunications Services Inc., a limited facilities-based and resale provider of local exchange and interexchange telecommunications services, and its CPCN in D.02-03-050. Telmex USA, L.L.C., a Delaware limited liability company and a subsidiary of Telmex, has a CPCN to provide inter- and intra-local access and transport area services, granted in D.00-09-045. The Forstmann Little acquiring entities were found to have sufficient resources to meet our financial requirements in D.02-03-050. With the granting of that acquisition, they now possess the technical expertise we require. XO California and XO Long Distance provided a Telmex audited financial statement, which demonstrates that Telmex has sufficient resources to meet our requirements. Telmex has the technical expertise we require, as evidenced by the CPCN granted to its subsidiary.

No new construction is being proposed. Accordingly, there is no possibility that the proposed transaction contemplated herein may have any significant impact on the environment.

VI. Public Interest

Applicants state that approval of this proposed transaction is in the public interest, because applicants will continue to operate under their same names and operating authorities as at present after consummation of the transaction. If XO cannot obtain new investment and restructure its balance sheet, XO's financial stability could be significantly compromised and services to California customers would be adversely affected. The proposed transaction will enable XO to continue to invest in the expansion of its network and to provide high quality local, long distance, and broadband services to its customer base in California and other states.

This is an uncontested matter in which the decision grants the relief requested. Accordingly, pursuant to Section 311(g)(2) of the Public Utilities Code, the otherwise applicable 30-day period for public review and comment is being waived.

Findings of Fact

1. Resolution ALJ 176-3088 determined that this was a ratesetting proceeding and that no hearings were expected.
2. Notice of this application appeared in the Commission's May 13, 2002 Daily Calendar.
3. No protests were filed.
4. This application has been filed pursuant to Pub. Util. Code § 854.
5. Pub. Util. Code § 854(b) and (c) are not applicable in this instance because none of the applicants has more than \$500 million in gross annual California revenues.
6. XO California and XO Long Distance will continue to operate as XO California and XO Long Distance.
7. No new construction is being proposed.

8. XO California and XO Long Distance are nondominant telecommunications carriers.

9. Forstmann Little and Telmex have sufficient financial resources to meet the Commission's requirements to provide facilities-based and resold local exchange and interexchange telecommunications services.

10. Forstmann Little and Telmex possess the necessary technical expertise required by the Commission.

Conclusions of Law

1. The proposed transfer of ownership and control of XO California and XO Long Distance from Craig O. McCaw and existing shareholders to Forstmann Little, Telmex, XO management and others is not adverse to the public interest.

2. It can be seen with certainty that the proposed transfer will not have any adverse impact on the environment.

3. Forstmann Little and Telmex meet the Commission's requirements for the issuance of a CPCN to provide facilities-based and resold local exchange and interexchange telecommunications services.

4. Public convenience and necessity require the granting of this application to be effective on the date signed.

O R D E R

IT IS ORDERED that:

1. Applicants XO California, Inc. (XO California) and XO Long Distance Services, Inc. (XO Long Distance) are authorized to indirectly transfer ownership and control through their parent company, XO Communications, Inc., (XO) from Craig O. McCaw and the existing shareholders of XO to Forstmann Little & Co Equity Partnership-VII, L.P., Forstmann Little & Co. Subordinated Debt and

Equity Management Buyout Partnership-VIII, L. P., an indirect, wholly owned subsidiary of Telefonos de Mexico, S.A. de C.V. and 20% common stock divided between XO management (2%) and other holders (18%), as set forth in the application.

2. XO California and XO Long Distance shall notify the Director of the Commission's Telecommunications Division in writing of the transfer of authority, as authorized herein, within 10 days of the date of consummation of such transfer.

3. The corporate identification numbers U-5553-C and U-6272-C assigned to XO California and XO Long Distance, respectively, shall continue to be used by XO California and XO Long Distance, which shall be included in all original filings with this Commission and in the titles of other pleadings filed in existing cases.

4. The application is granted as set forth above and the authority granted shall expire if not exercised within one year after the effective date of this order.

5. Application 02-05-018 is closed.

This order is effective today.

Dated August 22, 2002, at San Francisco, California.

LORETTA M. LYNCH
President
HENRY M. DUQUE
CARL W. WOOD
GEOFFREY F. BROWN
MICHAEL R. PEEVEY
Commissioners