

NEW APPLICATION
ORIGINAL



0000010014

BEFORE THE ARIZONA CORPORATION COMMISSION

_____)
In The Matter Of The Application Of)
EVERCOM SYSTEMS, INC.)
In Connection With An Indirect Transfer)
Of Control And The Provision Of Certain Secure)
And Unsecured Guarantees)
_____)

T-03479A-04-0549

DOCKET NO. T-03479A-04-

Arizona Corporation Commission

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APPLICATION

Evercom Systems, Inc. ("ESI"), by its undersigned counsel and pursuant to the Commission's Public Utility Holding Companies and Affiliated Interests Rules, A.A.C. R14-2-801 et seq. ("Affiliated Interest Rules") and Section 40-285 of the Arizona Revised Statutes ("Section 40-285") and hereby requests Commission to (a) expeditiously waive the application of Affiliated Interest Rules to the indirect transfer of control and the guarantees described herein or (b) in the alternative, expeditiously approve those transactions under the Affiliated Interest Rules without a hearing. ESI further requests expeditious Commission approval, under Section 40-285, to encumber its assets in Arizona pursuant to the secured guarantee described herein..

I. THE APPLICANT

1. ESI is certificated in Arizona to provide Customer Owned Pay Telephone ("COPT") services pursuant to its Certificate of Convenience and Necessity ("CCN") authorized in Docket No. T-03479A (see Decision No. 60924). It provides inmate telecommunications services in Arizona and forty-three other jurisdictions, offering local, intrastate, interstate and international calling services to inmates in more than 2000 correctional facilities nationwide.

2. ESI is a privately held company incorporated under the laws of the State of Delaware. Its principal offices are located at 8201 Tristar Drive, Irving, Texas 75063. Petitioner is a wholly-owned subsidiary of Evercom, Inc. (“EI”), also a Delaware corporation, which is in turn a wholly owned subsidiary of Evercom Holdings, Inc. (“EHI”). Over 90% of the ownership interests in EHI is currently held by five investment partnerships or funds.

II. THE TRANSACTIONS

3. This Application concerns two related transactions. The first is an ultimate parent-level transfer of control of ESI. The second is ESI’s provision of certain guarantees in connection with that transfer of control.

A. The Indirect Parent-Level Transfer Of Control

4. EHI has entered into a merger agreement, dated July 10, 2004, with (a) TZ Holdings, Inc. (“TZ”), a State of Delaware corporation, and (b) New Mustang Acquisition, Inc. (“Mustang”), another State of Delaware corporation which is a wholly-owned subsidiary of TZ (“Agreement”). A detailed description of the terms of the Agreement are set out below, but upon the completion of the proposed transaction EHI will be a wholly-owned subsidiary of TZ.

5. **Details of Transaction** – The description of the merger below outlines the following:

- a. The current ownership structure of ESI and its affiliates.
- b. The acquiring entities involved in the merger.
- c. The merger process.
- d. The resulting ownership structure of ESI and its affiliates.

a. **Current Ownership** – As noted previously, EHI is a Delaware corporation, which is the sole shareholder of EI, also a Delaware corporation. EI has three wholly-owned, direct subsidiaries that are all Delaware corporations – ESI, Everconnect, Inc. and FortuneLinx, Inc.

ESI has no other affiliated entities. For purposes of this Application only ESI is relevant because it is the entity authorized by this Commission to provide inmate telephone services and the only EHI-related entity providing those or any other telecommunications services in the State. **Attachment A** hereto shows the existing ownership structure of ESI.

b. **Acquiring Entities** – Under the terms of the proposed transaction, TZ will hold all of the stock of EHI. TZ is majority-owned by H.I.G.-TNetix, Inc., an affiliate of H.I.G. Capital, LLC (“HIG”), a Miami-based a private equity firm, which has over \$1 billion under management. Investors in HIG-managed funds include leading financial institutions, insurance companies, pension funds and university endowments. TZ has no other operational purpose other than to hold ownership interests in various enterprises in which HIG has invested.¹ Neither TZ nor HIG are direct providers of certificated telecommunications services.

c. **The Merger Process** – The proposed transfer will be accomplished through a merger process which will include the following steps:

(i) TZ has formed a wholly-owned subsidiary, Mustang, a Delaware corporation. Mustang was formed solely for the purpose of effecting the proposed merger and upon its completion will be merged out of existence.

(ii) Mustang shall merge with and into EHI in accordance with Delaware law, with the surviving corporation being EHI, which will operate under the Certificate of Incorporation and Bylaws previously adopted by Mustang.

(iii) As part of the merger of EHI into Mustang, all of the current stock and stock options of EHI shall be converted or retired by virtue of the merger. Such retirement or conversion will be accomplished through TZ’s purchase, under the terms of the Agreement, of

¹ TZ is the parent corporation of T-NETIX, Inc. another certificated COPT provider in the State of Arizona.

the existing EHI stock or options from the current shareholders, and the former EHI treasury stock will be retired.

(iv) Simultaneous with the closing of the merger, certain former stockholders of EHI will acquire certain stock of TZ in an aggregate amount so that the ratio of TZ common stock owned by HIG (or its affiliates) to TZ common stock owned by such former EHI stockholders is not greater than 65:35 immediately after giving effect to the merger.

d. **The Resulting Ownership Structure** – Upon completion of the merger, *the current existing, intercorporate relationships between ESI, EI and EHI shall remain totally unchanged.* ESI's immediate parent (and EHI, which is the parent of its parent) will remain the same. However, EHI will become a wholly-owned subsidiary of TZ, which will be majority owned by H.I.G-TNetix, Inc., an affiliate of HIG, a Miami-based private equity firm. **Attachment B** hereto shows the post-merger-closing ownership structure of ESI.

6. **Transparency Of Transaction** – ESI shall remain a separately certificated entity providing the services that it currently offers. The transaction will be transparent to the customers of ESI. There will be no immediate changes in the terms and conditions of the services provided by ESI, pursuant to the applicable tariffs or price lists that ESI currently has on file as approved by the Commission. ESI will continue to market, brand and bill its services as it has been doing. There are no current definitive plans to change the management structure of ESI.

B. The Guarantees

7. TZ expects to finance the parent-level transaction described above through debt financing obtained by TZ as issuer/borrower, with ESI and the other subsidiaries of TZ providing both secured and unsecured guarantees of the debt issued by TZ.

8. **ESI's Current Debt Structure** – In Decision No. 66639 (Docket No. T-03479A-03-

0622), dated December 18, 2003, and Decision No. 66942 (Docket No. T-03479A-04-0038), dated April 21, 2004, this Commission approved ESI's borrowing of up to \$59.5 million through secured credit facilities from a General Electric Capital Corporation ("GECC") and a number of other lenders. The debt took the form of a \$25.5 million revolving credit agreement and \$34 million in term loans. The debt was secured by ESI's assets and stock. In addition, ESI's immediate parent, EI and certain other affiliates of ESI were guarantors of that debt. This financing package repaid and replaced similarly-structured credit facilities of up to \$72.5 million that the Commission had previously-approved in Decision No. 64741 (Docket No. T-03479-02-0067), dated April 17, 2002.

9. **The Guarantees** – Under the terms of the proposed revised debt structure all of the outstanding obligations of ESI under the current credit facilities previously-approved by the Commission shall be repaid in their entirety. Those facilities will be terminated.

10. The current \$25.5 million revolving credit facility shall be replaced with a comparable \$30.0 million syndicated revolving credit facility incurred by TZ, guaranteed by ESI (among others) and again secured, in part, by ESI's assets and stock (the "Credit Facility"). ING Capital LLC will be the agent and lender under the Credit Facility. The final maturity date of the Credit Facility will be July 31, 2009. The proceeds of the Credit Facility will be used for ongoing working capital needs of TZ (and its subsidiaries), and for general corporate purposes, which would include the funding of ESI's ongoing operations in Arizona and 43 other jurisdictions, as was the prior revolving credit facility. The interest terms under this replacement facility are comparable to those most-recently approved by the Commission in Decision No. 66639 (Docket No. T-03479A-03-0622), dated December 18, 2003, and Decision No. 66942 (Docket No. T-03479A-04-0038), dated April 21, 2004.

11. In addition, ESI, along with its affiliates, shall be an unsecured guarantor of up to \$200 million in senior notes to be issued by TZ, in connection with TZ's acquisition of all of the stock of EHI. This guarantee will be totally unsecured from ESI's perspective (i.e., it will not be secured by any of the assets or stock of ESI). These same obligations will also be guaranteed, on a similar basis, by EI, EHI and the other affiliates of ESI. The proceeds of these unsecured obligations shall be used to repay the previously-approved ESI debt obligations in the amount of \$40 million, pay the purchase price of the EHI stock in the amount of approximately \$87 million, with the balance to be used for working capital in support of ESI's operations and TZ's other inmate telecommunications operations through its other subsidiary, T-NETIX, Inc.

12. The guarantees do not involve a transfer of the Applicant's certificates; nor do they involve a modification to the Petitioner's management or rates, terms and conditions of service to the confinement facilities that it serves in Arizona. The transaction therefore will be seamless and transparent to the confinement facility administrators and inmate customers that ESI serves in the State of Arizona.

III. REQUEST FOR WAIVER OF AFFILIATED INTEREST RULES

13. Pursuant to Section R14-2-806 of Affiliated Interest Rules, ESI hereby requests waiver of the application of Affiliated Interest Rules to the foregoing transactions. A waiver is in the public interest for the following reasons:

a. As noted above, the parent-level transfer of control is totally transparent to the customers of ESI and will not involve any changes in the rates, terms or conditions of service pursuant to the applicable tariffs or price lists that ESI currently has on file as approved by the Commission. ESI will continue to market, brand and bill its services as it has been doing. There are no current definitive plans to change the management structure of ESI.

b. ESI is a privately-held foreign corporation with a very modest presence and a very specialized set of customers in the State of Arizona. As established in previous proceedings involving ESI's encumbrance of its assets in the State of Arizona, approximately 1% of its assets are located in the State. Its Arizona intrastate revenues represent less than 5% of its total revenues in 2003. ESI provides services to inmates in confinement facilities in the state; its services are not offered to the general business or residential public in the state.

c. The COPT business in the State of Arizona is competitive. There are other competitive service providers who seek to serve confinement facilities, usually through participation in competitive bids sought by facility administrators. ESI respectfully submits that the inmate calling services provided by ESI cannot be categorized as essential services comparable to those provided by large domestic electricity, water or gas utilities with many customers and very significant revenues in Arizona.

d. ESI does not contest the authority of the Commission to assess and approve the contemplated secured guarantee under Section 40-285. Therefore, the grant of the requested waiver would not exempt that portion of the proposed transaction from the Commission's oversight. As noted above, the guarantee relating to the senior notes to be issued by TZ is unsecured by any assets of ESI in the State of Arizona. Nor would grant of the waiver otherwise affect the Commission's jurisdiction over ESI as a public service corporation which has been granted a certificate by the Commission.

e. ESI is not seeking a permanent waiver of application of Affiliated Interest Rules. In the event that there is some further consolidation of ESI, the Commission will again have the opportunity to assess once again whether it is appropriate to apply the provisions of Affiliated Interest Rules to any other transaction.

f. ESI hopes to expeditiously consummate the proposed transactions so that it can reap the benefits of elimination of all of its direct debt and access to the financial resources of TZ and HIG, which access would be in the public interest. ESI seeks to consummate the transactions by no later than mid-September 2004.

IV. IN THE ALTERNATIVE, THE COMMISSION SHOULD APPROVE THE PARENT LEVEL TRANSFER OF CONTROL AND THE GUARANTEES UNDER AFFILIATED INTEREST RULES

14. In the event that the Commission is not prepared to grant the foregoing requested waiver, ESI respectfully requests that the Commission approve the transactions described above. The transactions will be transparent and seamless to all customers of ESI. There will be no changes in the rates, terms or conditions of ESI's services as part of or as a result of this transaction; those services will continue on their current bases. In addition, the management and relevant contact information for ESI will remain the same as the Commission's records currently reflect.

15. This transaction will provide ESI with potential access to the substantial financial assets of TZ and HIG. The financing will eliminate all secured debt directly issued by ESI and limit the encumbrance of its assets in Arizona to \$30 million, substantially less than the \$59.5 million most-recently authorized by the Commission and far less than the \$72.5 million authorized before that. The completion of these transactions will help ESI to continue to provide services to its customers and potentially expand or enhance those services at new facilities in the State of Arizona. In further support of grant of the requisite approval, ESI submits the following responses to Section R 14-2-803.A.1-11:

a. **The names and business addresses of the current officers and directors of TZ Holdings, Inc.**

Brian Schwartz, President and Director, c/o H.I.G. Capital, LLC, 1001 Brickell Bay Drive, 27th Floor, Miami, Florida 33131

Lewis Schoenwetter, Secretary and Director (at same address)

b. The business purposes for establishing or reorganizing the holding company

TZ is acquiring indirect controlling interest in ESI and its affiliates.

c. The proposed method of financing the holding company and the resultant capital structure

The proposed method of financing and resulting capital structure is described in Section II.B above.

d. The resultant effect on the capital structure of the public utility.

The effect on the capital structure of ESI is described in Section II.B above.

e. An organization chart of the holding company that identifies all affiliates and their relationships within the holding company.

See attachment C, which reflects post-closing relationships.

f. The proposed method for allocating federal and state income taxes to the subsidiaries of the holding company.

The method has not yet been established but will be in accordance with GAAP.

g. The anticipated changes in the utility's cost of service and cost of capital attributable to the reorganization.

As noted above, there will be no changes in the rates, terms or conditions of service provided by ESI as a result of the parent-level transfer of control. The cost of capital for ESI is expected to be comparable to current levels.

h. A description of diversification plans of affiliates of the holding company.

There are currently no such plans.

i. Copies of relevant documents and filings with the United States Securities and Exchange Commission and other federal or state agencies.

There have been no filings with the United States Securities and Exchange Commission. The ESI has sought regulatory approvals in the states of New York, Wyoming, Georgia, Indiana, Pennsylvania, West Virginia, Alaska, and Louisiana

and from the Federal Communications Commission. TZ and EHI made a Hart-Scott-Rodino notification to the Federal Trade Commission. On April 21, 2004, the Department provided an early termination of the waiting period. ESI will provide copies of these materials if the Commission remains interested.

j. **The Contemplated Annual and Cumulative Investment in each Affiliate for the Next 5 Years, in Dollars and as a Percentage of Projected Net Utility Plant, and an Explanation of the Reasons Supporting the Level of Investment and the Reasons this Level will not Increase The Risks of Investment in the Public Utility.**

The financial strength and other resources of TZ and HIG will position ESI to have access to adequate capital for the current and expected future service needs of its customers. TZ at this point has no specific plan for investment of specific amounts in ESI.

k. **An Explanation of the Manner in Which the Utility Can Assure that Adequate Capital Will Be Available for the Construction of Necessary New Utility Plant and For Improvements In Existing Utility Plant At No Greater Cost than if the Utility or its Affiliate Did Not Organize or Reorganize a Public Utility Holding Company.**

As noted above, the contemplated transaction will eliminate all of ESI's issued debt. It will become a guarantor of debt issued by TZ. TZ, which is investing substantial assets to acquire an indirect controlling interest in ESI, is committed to invest the sums necessary for ESI to maintain and enhance its level of services in the State of Arizona. The \$30 million revolving line of credit would be available for that purpose (among others).

V. **THE SECURED GUARANTEE SHOULD BE APPROVED UNDER SECTION 40-285**

16. The Commission also should approve the secured guarantee under Section 40-285. As noted above as a result of the transactions, all of ESI's current debt obligations, approximately

\$40 million, will be repaid and the facilities terminated. ESI will be exposed on a secured guaranteed basis to a maximum of \$30 million, far less than the \$59.5 million and, before that, \$72.5 million encumbrance that the Commission previously approved.

VI. DESIGNATED CONTACTS

17. Questions or correspondence concerning this Application should be directed to the following attorneys of record:

Michael W. Patten
Roshka Heyman & DeWulf, PLC
One Arizona Center
400 East Van Buren Street, Suite 800
Phoenix, Arizona 85004
(602) 256-6100 (Telephone)
(602) 256-6800 (Facsimile)
Email address: mpatten@rhd-law.com

and

Paul C. Besozzi
Patton Boggs LLP
2550 M Street, N.W.
Washington, D.C. 20037
(202) 457-5292 (Telephone)
(202) 457-6315 (Facsimile)
Email address: pbesozzi@pattonboggs.com

with a copy to:

Jennifer P. Gaines
General Counsel
Evercom Systems, Inc.
8201 Tristar Drive
Irving, Texas 75063
(972) 953-4812 (Telephone)
(972) 953-4289 (Facsimile)
Email address: jgaines@evercom.net

VII. REQUEST FOR EXPEDITED TREATMENT

18. ESI is requesting expedited action on this Application. As noted above, it is non-controversial and transparent to ESI's customers. For the other reasons outlined above it is in the public interest. The parties seek to consummate this transaction as soon as possible, but in any case no later than mid-September, 2004. Therefore, ESI respectfully requests expedited action to ensure that this time frame can be met.

WHEREFORE, ESI respectfully requests that the Commission (a) waive the application of Affiliated Interest Rules or (b) in the alternative, approve the contemplated parent-level transfer of control and guarantees thereunder or (c) approve the encumbrance of assets as contemplated herein.

Respectfully submitted this 29th day of July, 2004,

EVERCOM SYSTEMS, INC.

By: 
Michael W. Patten
Roshka Heyman & DeWulf, PLC
One Arizona Center
400 East Van Buren Street, Suite 800
Phoenix, Arizona 85004
(602) 256-6100 (Telephone)
(602) 256-6800 (Facsimile)
Email address: mpatten@rhd-law.com

Of Counsel

Paul C. Besozzi
Patton Boggs LLP
2550 M Street, N.W.
Washington, D.C. 20037
(202) 457-5292 (Telephone)
(202) 457-6315 (Facsimile)
Email Address: pbesozzi@pattonboggs.com

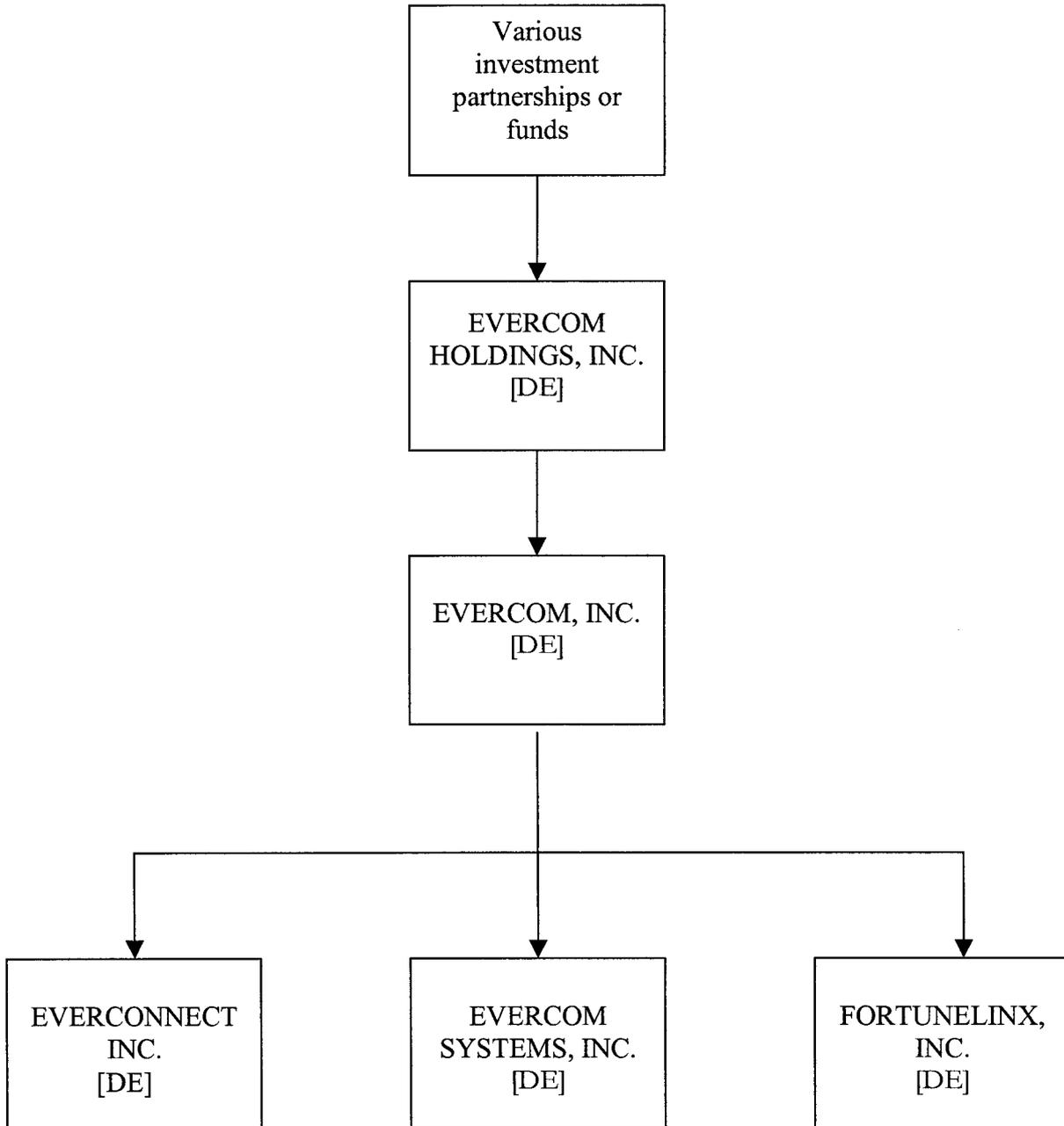
Original and 13 copies filed this 29th
day of July, 2004 with:

Docket Control
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

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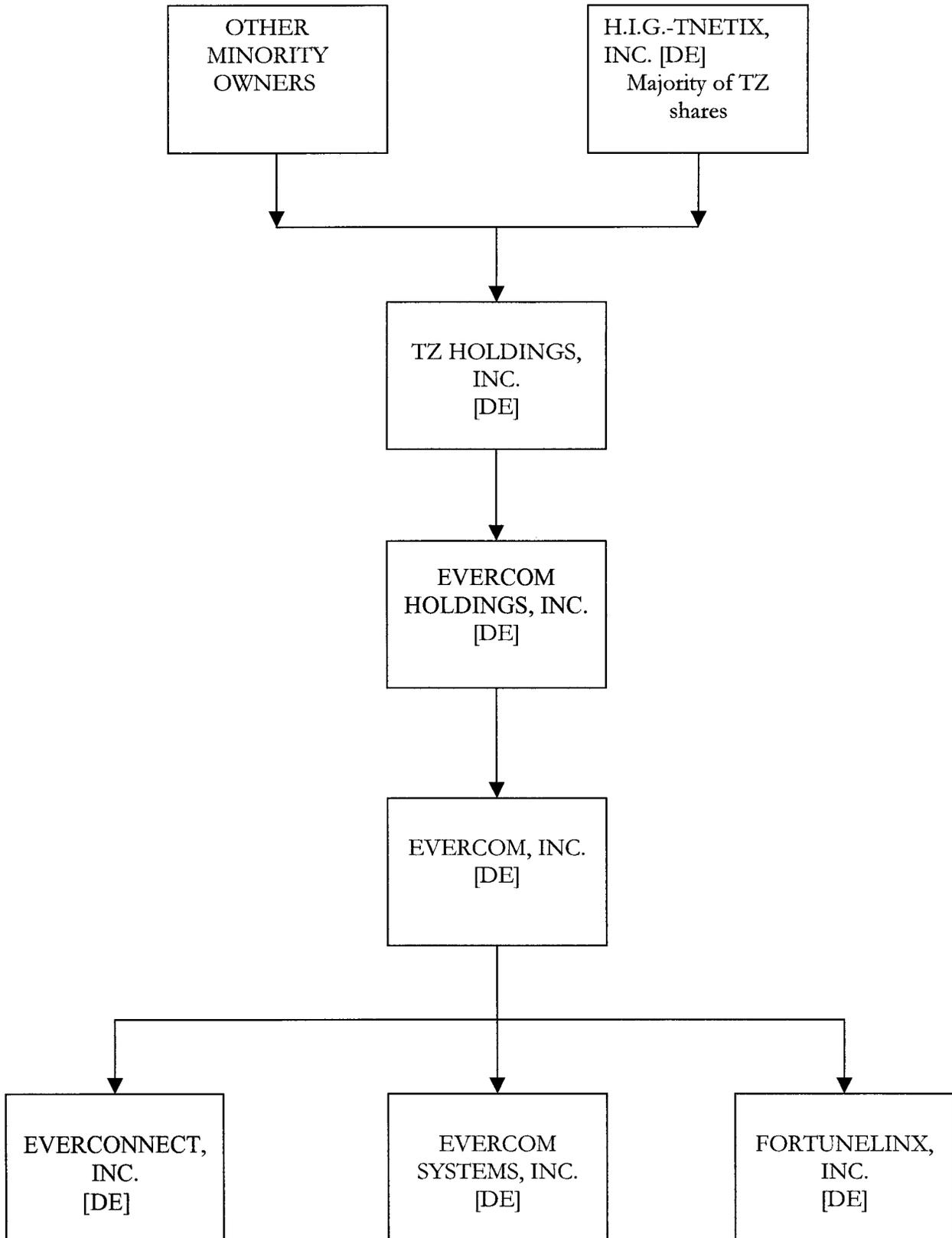
ATTACHMENT A

Current Ownership Structure

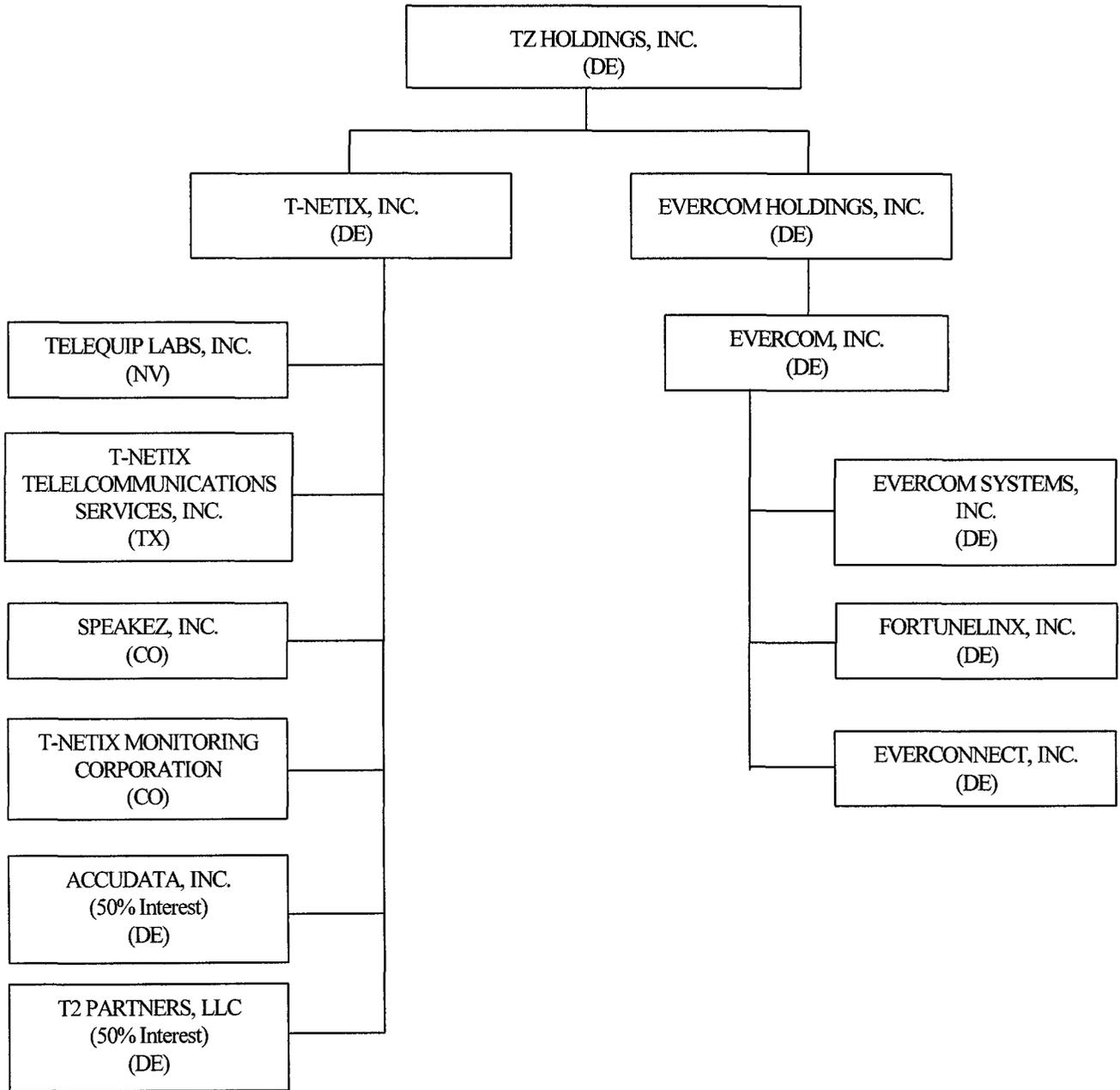


ATTACHMENT B

Post-Transfer Ownership Structure



ATTACHMENT C



VERIFICATION

I, Jennifer P. Gaines am the Secretary of Evercom Holdings, Inc. and I am authorized to make this verification on its behalf. Except as otherwise specifically attributed, the statements in the foregoing document relating to Evercom Systems, Inc. and Evercom Holdings, Inc. are true of my own knowledge, other than as to matters that are stated therein on information on behalf, and as to those matters, I believe them to be true. I hereby so declare under penalty of perjury.

J.P. Gaines

Subscribed and sworn to before me this 24th day of July, 2004.

Cindy A. Perry
Notary Public

My Commission Expires: 9-7-2005



VERIFICATION

I, Lewis Schoenwetter am the Secretary of TZ Holdings, Inc. The factual statements and representations made in the foregoing Application by and concerning TZ Holdings, Inc. and the transactions described therein are true and correct to the best of my knowledge and belief.

Name: [Signature]
Title: Secretary

County of Dade)
State of Florida)

Subscribed and sworn to before me by Lewis Schoenwetter this 26 day of July, 2004.

 Ellen Rodriguez
My Commission CC972601
Expires October 03, 2004

[Signature]
Notary Public

My Commission Expires: _____