



BEFORE THE ARIZONA CORPORATION COMMISSION

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JEFF HATCH-MILLER  
Chairman  
WILLIAM A. MUNDELL  
Commissioner  
MARC SPITZER  
Commissioner  
MIKE GLEASON  
Commissioner  
KRISTIN K. MAYES  
Commissioner

Arizona Corporation Commission

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IN THE MATTER OF THE APPLICATION )  
OF MCLEODUSA TELECOMMUNI- )  
CATIONS SERVICES, INC. FOR )  
EXPEDITED APPROVAL TO ENCUMBER )  
ASSETS AND ISSUE A GUARANTEE IN )  
CONNECTION WITH CERTAIN )  
FINANCING ARRANGEMENTS )

DOCKET NO. T-03267A-05-0731

DECISION NO. 68324

ORDER

Open Meeting  
December 6 and 7, 2005  
Phoenix, Arizona

BY THE COMMISSION:

On October 20, 2005, McLeodUSA Telecommunications Services, Inc. ("McLeodUSA") filed an application for expedited approval pursuant to Section 40-285 of the Arizona Revised Statutes and R14-2-804.B.1 of the Arizona Administrative Code, to permit McLeodUSA to consummate a consensual or "pre-packaged" Chapter 11 financial restructuring in the bankruptcy court.

FINDINGS OF FACT

The Company's Request

The Company in its Application represents the following:

1. McLeodUSA is an Iowa corporation with principal offices located at McLeodUSA Technology Park, 6400 C Street, SW, Cedar Rapids, Iowa 52406-3177. McLeodUSA provides integrated communications services, including local services, primarily in 25 Midwest, Southwest, Northwest, and Rocky Mountain states. McLeodUSA is a wholly owned subsidiary of McLeodUSA Holdings, Inc. which, in turn, is a wholly owned subsidiary of Parent.

1           2.     In Arizona, McLeodUSA is authorized to provide competitive resold and facilities-  
2 based local exchange and interexchange telecommunications service pursuant to CC&Ns granted  
3 in Decision Nos. 61001 and 62627.

4           3.     In Arizona, McLeodUSA, provides service to almost 4000 business customers and  
5 almost 1000 residential customers, primarily in the Phoenix and Tucson markets. McLeodUSA has  
6 invested in facilities in Arizona, including a switch and a fiber network.

7           4.     The Chapter 11 filing will: (i) extinguish the equity interest of the current  
8 shareholders in McLeodUSA's ultimate parent company, McLeodUSA Incorporated and (ii)  
9 extinguish the existing debt, presently secured/guaranteed by McLeodUSA, and convert certain  
10 secured creditors to shareholders of McLeodUSA Incorporated. McLeodUSA states that by  
11 extinguishing existing debt, McLeodUSA Incorporated and McLeodUSA will become financially  
12 stronger.

13           5.     McLeodUSA contends that this purely financial restructuring, will not change the  
14 overall business organization of both parties. McLeodUSA will continue to be wholly-owned by  
15 McLeodUSA Incorporated. The McLeodUSA Incorporated management team will remain intact.  
16 None of the new shareholders of the Parent will have a controlling interest in the Parent.  
17 Therefore, no new holding company will be created. The existing structure of McLeodUSA's  
18 parents will remain unchanged. Exhibit A for McLeodUSA's application provides an  
19 organizational chart. On this basis, McLeodUSA submits that Commission Rule R14-2-803 does  
20 not apply.

21           6.     McLeodUSA contends that the prepackaged Chapter 11 filing provides certainty to  
22 existing McLeodUSA customers with respect to their telecommunications service by enabling  
23 McLeodUSA's current operations to continue without interruption or any changes to the rates,  
24 terms and conditions of the services that its customers currently receive. To the extent that  
25 McLeodUSA has deposits or prepayments from its Arizona customers, those deposits and  
26 prepayments will not be affected. McLeodUSA believes the Chapter 11 filing will not affect in any  
27 way the \$600,000 performance bond already in place in Arizona to ensure the continuity of  
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1 McLeodUSA's service<sup>1</sup>. Because of the consensual nature of the Restructuring, the Chapter 11  
2 proceedings will take place on an expedited basis and are expected to conclude by November 28,  
3 2005.

4 7. The financial restructuring that McLeodUSA is requesting is part of a bankruptcy  
5 plan of reorganization under Chapter 11 of the United States Bankruptcy Code, 11 U.S.C. § 101-  
6 1330, that has been agreed upon by McLeodUSA Incorporated and a majority of its secured  
7 creditors. McLeodUSA Incorporated is currently soliciting its creditors' votes on the Plan  
8 consistent with the Bankruptcy Code, and intends to file the Plan with the United States  
9 Bankruptcy Court for the Northern District of Illinois (the "Bankruptcy Court") upon completion  
10 of the solicitation process, thereby commencing the Chapter 11 proceedings.

11 8. This "pre-packaged" plan should enable McLeodUSA to continue current  
12 operations without interruption or any change in the rates, terms or conditions of the services that  
13 its customers currently receive. The consensual plan will protect unsecured creditors and enable  
14 the Parties to emerge from Chapter 11 as soon as possible. Given the consensual nature of the  
15 plan, the Chapter 11 proceedings will take place on an expedited basis. The expedited process  
16 should ensure that McLeodUSA will be able to continue providing telecommunications service  
17 without protracted legal proceedings. McLeodUSA Incorporated and McLeodUSA anticipate that  
18 they will commence these cases on or about October 28, 2005, and that they will request that the  
19 Bankruptcy Court consider and approve the plan no later than November 28, 2005.

20 9. Pursuant to the consensual plan, debt owed to certain secured creditors will be  
21 extinguished and those creditors will become the shareholders of McLeodUSA Incorporated.  
22 Therefore, \$750 Million in debt, which was secured by encumbrances on McLeodUSA's assets  
23 (and related guarantees), as authorized by Decision No. 64657, will be eliminated. In addition, the  
24 current shareholders' existing equity in McLeodUSA Incorporated will be extinguished; however,  
25 the corporate structural organization will remain the same and direct ownership of McLeodUSA  
26 will not change.

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<sup>1</sup> See Decision No. 64657 (March 25, 2002).

1           10.     Although the precise equity ownership of McLeodUSA Incorporated will not be  
2 known until the Company emerges, the new shareholders will be major institutional investment  
3 companies, and McLeodUSA does not expect that any single entity or group of entities will hold  
4 working or actual control over McLeodUSA Incorporated and, thereby, no entity will have indirect  
5 control over McLeodUSA. Specifically, the following entities will be the six largest equity  
6 holders in McLeodUSA Incorporated and therefore are anticipated to be the five largest indirect  
7 owners of McLeodUSA following the Restructuring:

8                   Fidelity Investments (approximately 31%)  
9                   Wayzata Investment Partners LLC (approximately 15%)  
10                  Credit Suisse First Boston, Zurich (approximately 6%)  
11                  Odyssey Credit Investors (approximately 6%)  
12                  Secondary Loan & Distressed Credit Trading (approximately 5%)

13           11.     McLeodUSA currently guarantees, and has pledged all or substantially all of its  
14 assets, to secure McLeodUSA Incorporated's obligations under its existing credit facilities. As of  
15 September 1, 2005, obligations outstanding under the Senior Prepetition Credit Agreement totaled  
16 approximately \$100 million plus \$7.4 million in unfunded letters of credit. The obligations under  
17 the senior credit agreement will convert to "New Term Loan Notes" pursuant to the plan. As of  
18 September 1, 2005, obligations outstanding under the Junior Prepetition Credit Agreement totaled  
19 approximately \$677.3 million plus accrued and unpaid interest. The obligations under the Junior  
20 Prepetition Credit Agreement will be converted into equity pursuant to the Plan. Thus, the total  
21 debt currently guaranteed by McLeodUSA's pledge of all or substantially all of its assets is, as of  
22 September 1, 2005, approximately \$785 million plus accrued and unpaid interest.

23           12.     As part of the Restructuring, McLeodUSA will enter into a new post-bankruptcy  
24 "exit" credit facility which will provide for a secured, revolving credit facility in an amount not  
25 exceeding \$50 million, with a letter of credit sub facility in an amount not exceeding \$15 million.  
26 The exit facility credit agreement will also govern the New Term Loan Notes described above.  
27 The exit facility will provide the Parties with the financing necessary to provide liquidity for  
28 operational and working capital to allow them to emerge from the Restructuring as a financially  
stronger operation. After the Restructuring, the total debt guaranteed by McLeodUSA's pledge of

1 all or substantially all of its assets will be approximately \$150 million plus accrued and unpaid  
2 interest.

3 13. McLeodUSA will pledge all or substantially all of its assets to secure McLeodUSA  
4 Incorporated's obligations under the exit facility credit agreement. This pledge will replace the  
5 pledge that currently secures Parent's obligations under the Senior Prepetition Credit Agreement  
6 and Junior Prepetition Credit Agreement. Accordingly, the Parties request that the Commission  
7 approve the guarantee and pledge by McLeodUSA of all or substantially all of its assets to secure  
8 Parent's obligations under the exit facility credit agreement.

9 14. McLeodUSA's existing \$600,000 performance bond will remain in place and will  
10 be unaffected by the Chapter 11 proceeding. The proposed Chapter 11 Plan and post-bankruptcy  
11 credit facility should not involve any change in McLeodUSA's operations in Arizona and should  
12 be completely transparent to McLeodUSA's customers.

13 15. Finally, as of September 29, 2005, McLeodUSA held approximately \$53,000 in  
14 deposits and prepayments from Arizona customers. The Plan will not affect those funds in any  
15 way.

16 Prior Application Approved by Commission

17 16. On January 31, 2002, the Parent Company filed a voluntary petition in the United  
18 States Bankruptcy Court for the District of Delaware for reorganization relief under Chapter 11 of  
19 the United States Code, 11 U.S.C. §§101-1330. The Parent Company filed a pre-negotiated plan  
20 of reorganization ("Reorganization Plan") in its Chapter 11 bankruptcy proceeding. The  
21 Reorganization Plan was supported by the Parent Company's Board of Directors, its senior secured  
22 lenders, affiliates of Forstmann Little & Co., the ad hoc committee of holders of the Parent  
23 Company's unsecured notes, and certain of the Parent Company's preferred shareholders.

24 17. On March 25, 2002, the Commission granted McLeodUSA's application for  
25 Chapter 11 organization in Decision No. 64657, with conditions.

26 Staff's Analysis & Conclusions

27 18. Changes in McLeodUSA's annual report information from 2003 to 2004 do not  
28 point to a major change or problem in McLeodUSA's local exchange position. The access line,

1 revenue and asset figures have not changed substantially. A positive point is that net income for  
2 Arizona Operations increased substantially from 2003 to 2004 based on a near 50 percentage  
3 decline in operating expenses.

4 19. This bankruptcy plan does not create a new public utility holding company nor does  
5 the overall, corporate structure change.

6 20. No single shareholder gains control of the parent company; therefore, no single  
7 shareholder gains full control of McLeodUSA.

8 21. Three of McLeodUSA's current seven executive team members were present  
9 during the first Chapter 11 reorganization. Seven of McLeodUSA Incorporated's current thirteen  
10 board and executive team members were present during the first Chapter 11 reorganization. The  
11 members and executive teams of both organizations will remain in tact during this planned  
12 reorganization. Ms. Davis will be supplanted by a new Chairman when the new shareholders  
13 appoint a new Board of Directors upon emergence from the restructuring.

14 22. McLeodUSA has stated to Staff that customer relationships will not change. Most  
15 importantly, McLeodUSA's reorganization will not have disparate impacts across customer  
16 segments or geographic areas within Arizona.

17 23. The Commission's Consumer Services Section has found McLeodUSA to be in  
18 good standing.

19 24. The Commission's Compliance Section originally found McLeodUSA to be out of  
20 compliance with its 2003 and 2004 Rule 805 filings. McLeodUSA explained that the missing  
21 information was an oversight attributed to a change in personnel. The missing information has  
22 been provided and McLeodUSA is now in compliance.

23 25. Staff has been informed by McLeodUSA<sup>2</sup> that the Bankruptcy Court hearing  
24 thought to be on November 28, 2005 has been scheduled for December 15, 2005.

25 26. McLeodUSA is in compliance with Decision No. 64657 that required the  
26 procurement of a performance bond of \$600,000 and increased increments of \$300,000 when the  
27 total amount of the advances, deposits, and/or prepayments is within \$60,000 of the total amount.

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<sup>2</sup> Provided via email by Mike Patten on 11/01/05 and 11/10/05.

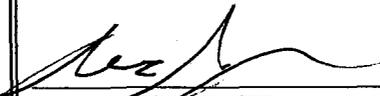
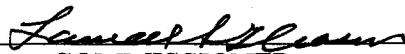
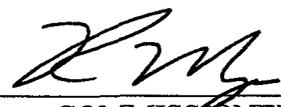


1 IT IS FURTHER ORDERED that McLeodUSA should provide a detailed plan within sixty  
2 days to the Commission's Compliance Section detailing process changes within McLeodUSA  
3 intended to ensure McLeodUSA's future compliance with Rule 805 filings.

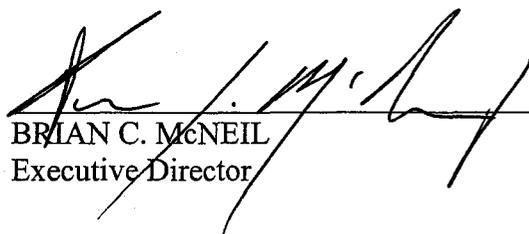
4 IT IS FURTHER ORDERED that this Decision shall be become effective immediately.

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**BY THE ORDER OF THE ARIZONA CORPORATION COMMISSION**

		
CHAIRMAN	COMMISSIONER	
		
COMMISSIONER	COMMISSIONER	COMMISSIONER

IN WITNESS WHEREOF, I BRIAN C. McNEIL, 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 9<sup>th</sup> day of December, 2005.

  
BRIAN C. McNEIL  
Executive Director

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

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

EGJ:AFF:lhm/MAS

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