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MEMORANDUM

TO: Docket Control

FROM: Ernest G. Johnson *EA for EGJ*  
Director  
Utilities Division

DATE: February 8, 2006

RE: STAFF REPORT FOR TIME WARNER TELECOM OF ARIZONA, LLC,  
AUTHORIZATION FOR APPROVAL OF CERTAIN TRANSACTIONS  
(DOCKET NO. T-03943A-05-0724)

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Attached is the Staff Report for Time Warner Telecom of Arizona's, application for approval of a guarantee and the encumbrance of its assets for the debt of its parent company, Time Warner Holdings, Inc. Staff recommends approval.

EGJ:CSB:red

Originator: Crystal Brown

Attachment: Original and sixteen copies

Service List for: Time Warner Telecom of Arizona LLC  
Docket No. T-03943A-05-0724

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**STAFF REPORT  
UTILITIES DIVISION  
ARIZONA CORPORATION COMMISSION**

**TIME WARNER TELECOM  
OF ARIZONA LLC**

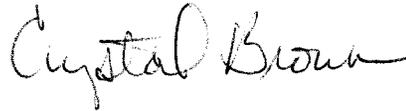
**DOCKET NO. T-03943A-05-0724**

**APPLICATION FOR APPROVAL  
OF CERTAIN TRANSACTIONS**

**FEBRUARY 8, 2006**

## STAFF ACKNOWLEDGMENT

The Staff Report for Time Warner Telecom of Arizona LLC, Docket No. T-03943A-05-0724 was the responsibility of the Staff member listed below. Crystal Brown was responsible for the review and financial analysis of the Company's application.

A handwritten signature in cursive script that reads "Crystal Brown".

Crystal Brown  
Public Utilities Analyst V

**EXECUTIVE SUMMARY**  
**TIME WARNER TELECOM OF ARIZONA LLC**  
**DOCKET NO. T-03943A-05-0724**

Time Warner Telecom of Arizona LLC ("TWT Arizona") filed an application with the Arizona Corporation Commission ("Commission") on October 18, 2005, asking authorization for approval of a guarantee and the encumbrance of its assets for a \$200 million term loan of its parent company, Time Warner Holdings, Inc. Additionally, TWT Arizona requested a reduction on its existing guarantee of its parent company's revolving credit facility from \$150 million to \$110 million. On October 28, 2005, TWT Arizona filed a supplement to its application that revised the amount of the requested guarantee on its parent company's revolving credit facility from \$110 million to an amount that would not exceed \$200 million.

TWT Arizona is a limited liability company organized and existing under the laws of the State of Delaware. TWT Arizona operates in Arizona with approximately 38 employees serving approximately 350 commercial and governmental accounts.

TWT Arizona is a subsidiary of TWT Holdings which in turn is a wholly owned subsidiary of Time Warner Telecom, Inc.

The purpose of TWT Arizona's request is to allow its parent company to redeem \$200 million of its 9.25 percent Senior Notes due in 2008 and to save approximately \$5 million per year in interest expense.

The change in the interest expense has a negligible affect on the times interest earned ratio and increases the debt service coverage ratio from 1.72 to 1.80 for the parent organization.

The capital structure does not change as a result of the redemption of the notes. Time Warner Telecom, Inc. remains a highly leveraged entity with long term debt equaling 77.2 percent of the capital structure. Concerns over Time Warner Telecom Inc.'s highly leveraged capital structure are mitigated by the alternative providers for service should it have service consequences for customers.

Staff considers that the guarantee of TWT Holdings debt by TWT Arizona is in the public interest due to interest savings and maturity extension and is unlikely to have any effect on Arizona customers of TWT Arizona.

Staff recommends the approval of TWT Arizona's request for authorization to guarantee and to encumber its assets for its parent company's \$200 million term loan. Staff further recommends approval of TWT Arizona's request for authorization to increase its guarantee on its parent's revolving credit facility to an amount not to exceed \$200 million subject to the terms and conditions described in the application.

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## **Introduction**

On October 18, 2005, Time Warner Telecom of Arizona, LLC ("TWT Arizona") filed an application with the Arizona Corporation Commission ("Commission") asking authorization to:

1. Guarantee<sup>1</sup> a term loan of its parent, Time Warner Telecom Holdings ("TWT Holdings") in an amount not to exceed \$200,000,000 and to
2. Reduce its current guarantee for its parent company's \$150 million revolving credit facility to \$110 million.

On October 28, 2005, TWT Arizona filed a supplement to its application requesting to increase the amount of its current guarantee for its parent company's revolving credit facility from \$150 million to \$200 million, with the condition that the guarantee on the term loan is changed by an amount that would allow the sum of the term loan and revolving credit facility guarantees to be no greater than \$310,000,000.

## **Public Notice**

TWT Arizona's customer base consists only of government and commercial customers, therefore, public notice is not necessary.

## **Background**

TWT Arizona is a limited liability company organized and existing under the laws of the State of Delaware. TWT Arizona operates in Arizona with approximately 38 employees serving approximately 350 commercial and government accounts.

TWT Arizona is a subsidiary of TWT Holdings which in turn is a wholly owned subsidiary of Time Warner Telecom Inc. Further, TWT Arizona is certificated by the Arizona Corporation Commission to provide competitive intrastate telecommunications services pursuant to Decision No. 63262.

## **Prior Commission Approvals**

In Decision No. 67108, dated July 4, 2004, the Commission authorized a guarantee by TWT Arizona and the encumbrance of TWT Arizona's assets for the following transactions:

1. The issuance by TWT Holdings of \$200 million of fixed-rate Senior Notes due in 2014 ("2014 Notes")

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<sup>1</sup> Secured by a pledge of TWT Arizona's stock, interests, and assets.

2. The issuance by TWT Holdings of \$240 million of Second Priority Senior Secured Floating Rate notes due in 2011 ("2011 Notes"), and
3. The issuance of a \$150 million senior secured revolving credit facility. TWT Arizona states that its parent company has not drawn any of the \$150 million revolving credit facility as of October 18, 2005.

In Decision No. 67815, dated May 5, 2005, the Commission authorized TWT Arizona to guarantee \$400 million in debt of its parent company, Time Warner Telecom Holdings. The Company states that as of October 18, 2005, only \$200 million of the \$400 million debt has been issued.

In total, the Commission has authorized TWT Arizona to guarantee \$990 million for its parent company's borrowings.

### **Purpose and Description of Proposed Financing**

TWT Arizona requests authorization to guarantee a new \$200 million term loan of its parent company, TWT Holdings. TWT Holdings plans to redeem \$200 million of its 9.25 percent Senior Notes due in 2008 and to save approximately \$5 million per year in interest expense.<sup>2</sup> TWT Arizona also proposes to increase the amount of its guarantee for its parent company's revolving credit facility from \$150 million to an amount not to exceed \$200 million.<sup>3</sup> Both guarantees will be secured by a pledge of TWT Arizona's stock, interests, and assets.

### **Financial Analysis**

Staff performed no financial analysis of the state operating subsidiary because no change is expected in TWT Arizona's operating results due to the transactions. However, the request, if authorized would increase the maximum potential guarantee by \$160 million.

Staff prepared Schedule CSB-1 using information from Time Warner Telecom, Inc.'s Form 10-K. The pro forma information shows the impact of the anticipated \$5 million per year interest savings without recognition of the extended loan term. The change in the interest expense has a negligible affect on the times interest earned ratio ("TIER") and increases the debt service coverage ratio ("DSC") from 1.72 to 1.80.

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<sup>2</sup> Company's application page 3, beginning at line 17 and Company's response to data request CSB 1-7.

<sup>3</sup> The changes that TWT Arizona proposes to make to its current guarantee for its parent company's revolving credit facility is to increase the maximum guarantee from \$150 million to \$200 million, with the condition that the guarantee on the term loan is changed by the same amount such that the sum of the term loan and revolving credit facility guarantees do not exceed \$310,000,000. In the two extreme cases, if the loan is \$200 million, then the revolving credit facility would be \$110 million; or if the revolving credit facility is \$200 million then the loan would be \$110 million.

The DSC represents the number of times internally generated cash will cover required principal and interest payments on long-term debt. A DSC greater than 1.0 indicates that operating cash flow is sufficient to cover debt obligations.

The TIER represents the number of times earnings will cover interest expense on long-term debt. A TIER greater than 1.0 means that operating income is greater than interest expense. A TIER less than 1.0 is not sustainable in the long term but does not necessarily mean that debt obligations cannot be met in the short term.

The capital structure does not change as a result of the re-issuance of the notes. Time Warner Telecom, Inc. remains a highly leveraged entity with long term debt equaling 77.2 percent of the capital structure. Concern over Time Warner Telecom Inc.'s highly leveraged capital structure is mitigated by the availability of alternative providers for service should it have service consequences for customers.

### **Compliance**

There are no outstanding compliance delinquencies for this company.

### **Staff Conclusions and Recommendations**

Staff concludes that the guarantee in support of an affiliates financing is within the corporate powers of TWT Arizona, compatible with the public interest, and will not impair its ability to perform service.

Staff further concludes that authorization of the guarantee is warranted because the refinancing benefits TWT Holdings by extending maturities on its debt obligations, resulting in enhanced ability to repay existing debt, and increasing its financial flexibility.

Staff recommends the approval as required by AAC R-14-2-804(B) of TWT Arizona's request for authorization to guarantee and to encumber its assets for its parent company's \$200 million term loan. Staff further recommends approval of TWT Arizona's request for authorization to increase its guarantee on its parent's revolving credit facility to an amount not to exceed \$200 million for a combined amount not to exceed \$310 million.

Staff further recommends approval of granting of liens in favor of the lender as required to secure the borrowings authorized.

Staff further recommends authorizing TWT Arizona to engage in any transaction and to execute any documents necessary to effectuate the authorizations granted.

## FINANCIAL ANALYSIS

### Selected Financial Information for Time Warner Holding, Inc. (Parent Company of Time Warner Telecom of Arizona, LLC)

From the December 31, 2004, Form 10-K Filing with the Securities Exchange Commission  
Pro forma Includes Immediate Effects of the Expected \$5 Million Interest Expense Savings  
( in 000's)

	[A]		[B]	
	<u>12/31/2004</u>		<u>Pro Forma</u> <u>Includes Expected</u> <u>\$5 Million Interest Exp Savings</u>	
1	Operating Income	\$ (17,203)	\$ (17,203)	
2	Depreciation & Amortization Expense	\$ 230,688	\$ 230,688	
3	Income Tax Expense	\$ -	\$ -	
4	Interest Expense on Debt	\$ 122,391	\$ 117,391 (a)	
5	Repayment of Principal	\$ 1,387	\$ 1,387	
<b>TIER</b>				
6	[1+3] ÷ [4]	(0.14)	(0.15)	
<b>DSC</b>				
7	[1+2+3] ÷ [4+5]	1.72	1.80	
8	Short-term Debt	\$ 1,387	\$ 1,387	0.09%
9	Long-term Debt	\$ 1,249,197	\$1,249,197	77.22%
10	Equity	\$ 367,158	\$ 367,158	22.70%
11	Total Capital	\$ 1,617,742	\$1,617,742	100.00%

(a) The pro forma interest expense was calculated by reducing the actual interest expense by \$5,000,000.