

ORIGINAL



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MEMORANDUM

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TO: Docket Control  
FROM: Ernest G. Johnson  
Director  
Utilities Division

*EA for EGJ*

DATE: July 17, 2006

RE: STAFF REPORT FOR AUTHORIZATION FOR ESCHELON TELECOM OF ARIZONA, INC.'S APPROVAL TO ENCUMBER ASSETS (DOCKET NO. T-03406A-06-0260)

Attached is the Staff Report for Eschelon Telecom of Arizona, Inc.'s application to pledge Arizona assets to secure indebtedness of its parent, Eschelon Operating Company. Staff recommends conditional approval.

EGJ:GWB:tdp

Originator: Gerald Becker

Arizona Corporation Commission  
**DOCKETED**

JUL 18 2006

DOCKETED BY	<i>nr</i>
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AZ CORP COMMISSION  
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Docket No. T-03406A-06-0260

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**STAFF REPORT  
UTILITIES DIVISION  
ARIZONA CORPORATION COMMISSION**

**ESCHELON TELECOM OF ARIZONA, INC**

**DOCKET NO. T-03406A-06-0260**

**APPLICATION FOR APPROVAL  
OF CERTAIN TRANSACTIONS**

**JULY 2006**

## STAFF ACKNOWLEDGMENT

The Staff Report for Eschelon Telecom of Arizona, Inc, Docket No. T-03406A-06-0260 was the responsibility of the Staff member listed below. Gerald Becker was responsible for the review of the Company's application.

A handwritten signature in cursive script that reads "Gerald Becker".

Gerald Becker  
Public Utilities Analyst IV

**EXECUTIVE SUMMARY**  
**ESCHELON TELECOM OF ARIZONA, INC**  
**DOCKET NO. T-03406A-06-0260**

Eschelon Telecom of Arizona, Inc. ("Eschelon") filed an application with the Arizona Corporation Commission ("Commission") on April 19, 2006, asking approval to pledge Arizona assets to secure \$48,000,000 of 8 3/8 Senior Second Secured Notes due 2010 of its parent Eschelon Operating Company ("Eschelon Operating"). This additional debt for Eschelon Operating is an extension of the \$165,000,000 for which the Commission has already approved a pledge of assets by Eschelon. First, Eschelon Operating issued \$165,000,000; then, it redeemed \$40,000,000; and subsequently, it issued another \$48,000,000. Thus, upon Commission approval of the current request, Eschelon would have approval to pledge assets to secure \$173,000,000 of Eschelon Operating indebtedness.

Eschelon Telecom of Arizona, Inc is a subsidiary of Eschelon Operating Company which is a corporation formed under the laws of the state of Minnesota.

The purpose of Eschelon's request is to authorize the use of Eschelon's assets to secure indebtedness issued by Eschelon Operating. Eschelon Operating states that it will use the proceeds for general corporate purposes, which may include repaying indebtedness, increasing working capital, funding future acquisitions or any other purpose deemed appropriate by Eschelon Operating. In its application, Eschelon also states that this transaction will help Eschelon to continue to offer competitive services in Arizona and that it may allow Eschelon to expand its service offerings and facilities in Arizona and that it is in the public interest.

In Decision Nos. 67885 and 67977, the Commission approved the encumbrance of Arizona assets to secure notes of Eschelon Operating in the amounts of \$65 million and \$100 million, respectively, provided that Eschelon obtain a performance bond and that the assets used to collateralize the bond are to remain unencumbered. Company management has represented that Eschelon is in full compliance with this requirement. Company management also represents that the Arizona assets represent less than 10 percent of the collateral being pledged for this debt. Previous rate cases indicate that the value of Arizona assets to be approximately \$4,400,000<sup>1</sup> as compared with the \$48,000,000 of debt requested for approval.

Staff concludes that the pledge of Eschelon assets to secure the debt of Eschelon Operating as requested in the application is lawful and within Eschelon's corporate powers, is compatible with the public interest, does not impair its ability to provide services and is consistent with sound financial practices.

Staff recommends approval of Eschelon's request for authorization to pledge its Arizona assets, provided that Eschelon remains in full conformity with both the maintenance of a performance bond and that the underlying related assets remain unencumbered, as set forth in Decision No. 67885.

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<sup>1</sup> Decision No. 67885.

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**ATTACHMENT**

**COPY OF PUBLIC NOTICE**

## **Introduction**

On April 19, 2006, Eschelon Telecom of Arizona, Inc. ("Eschelon") filed an application with the Arizona Corporation Commission ("Commission") asking authorization to pledge its assets to secure debt obtained by its parent company Eschelon Operating Company ("Eschelon Operating"). The pledge of these assets is to secure additional debt issued by Eschelon Operating in the amount of \$48,000,000 of Senior Second Secured Notes due 2010. This additional debt for Eschelon Operating is an extension of the \$165,000,000 for which the Commission has already approved a pledge of assets by Eschelon Operating. First, Eschelon Operating issued \$165,000,000; then, it redeemed \$40,000,000; and subsequently, it issued another \$48,000,000. Thus, upon Commission approval of the current request, Eschelon would have approval to pledge assets to secure \$173,000,000 of Eschelon Operating indebtedness.

The present application seeks to specify the amount of debt for which Arizona assets are pledged. Previous decisions have required the procurement and maintenance of a performance bond secured by assets not otherwise encumbered.

## **Public Notice**

Notice of the financing application was published in *The Arizona Republic* on May 8, 2006. A copy of the notice is attached.

## **Background**

Eschelon is a subsidiary of Eschelon Operating which is a corporation formed under the laws of the state of Minnesota.

## **Prior Commission Approvals**

In Decision No. 67977, dated July 18, 2005, and Decision No. 67885, dated June 1, 2005, the Commission authorized Eschelon to pledge its assets to secure the debt of Eschelon Operating in the amount of \$100,000,000 and \$65,000,000, respectively, provided that Eschelon obtain a performance bond and that the assets used to collateralize the bond are to remain unencumbered. Company management has represented that Eschelon is in full compliance with this requirement. Company management also represents that the Arizona assets represent less than 10 percent of the collateral being pledged for this debt. Previous rate cases indicate that the value of Arizona assets to be approximately \$4,400,000<sup>2</sup> as compared with the \$48,000,000 of debt requested for approval and to be issued by Eschelon Operating. The obligations of the notes will be guaranteed by operating subsidiaries of each state, including Eschelon, and each subsidiary wishes to grant a security interest in its plant and equipment.

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<sup>2</sup> Decision No. 67885.

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

Eschelon requests authorization to pledge its assets to secure \$48,000,000 of debt already issued by Eschelon Operating. The purpose of Eschelon's request is to authorize the use of Eschelon's assets to secure indebtedness issued by Eschelon Operating. Eschelon Operating states that it will use the proceeds for general corporate purposes, which may include repaying indebtedness, increasing working capital, funding future acquisitions or any other purpose deemed appropriate by Eschelon Operating. In its application, Eschelon also states that this transaction will help Eschelon to continue to offer competitive services in Arizona and that it may allow Eschelon to expand its service offerings and facilities in Arizona and that it is in the public interest.

### **Financial Analysis**

Staff performed a limited review of the proposed transaction and determined that the transaction would not impair the financial status of the Company, would not impair its ability to attract capital, nor would it impair the ability of the Company to provide safe, reasonable, and adequate service. This application is similar to previous requests to secure affiliate debt as previously approved by the Commission in order to assist the affiliated companies to operate effectively. Eschelon customers have alternative service providers and would not experience significant harm in the event that its parent has financial difficulties.

### **Compliance**

There are no outstanding compliance delinquencies for this Company.

### **Staff Conclusions and Recommendations**

Staff concludes that approval of this application assists Eschelon Telecom of Arizona, Inc. and Eschelon Operating to maintain and improve its Arizona operations and to serve Arizona ratepayers. Granting authorization to collateralize the debt is beneficial as it reduces borrowing costs and does not impair Eschelon Operating's ability to attract capital or Eschelon's ability to serve its customers.

Staff recommends approval of the application provided that Eschelon Operating is in full conformity with the performance bond requirements established by Decision No. 67885.

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

Staff further recommends that the Commission order Eschelon to file, as a compliance item in this docket, any available proof of the existence of performance bonds within 90 days of the decision in this matter.

# THE ARIZONA REPUBLIC

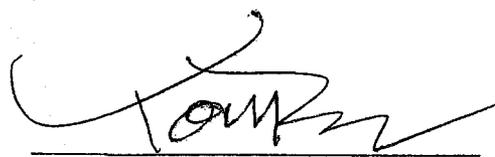
**Public Notice of Filing of Eschelon Telecom of Arizona, Inc. for Approval of Encumbrance of Assets**  
 Docket No. T-03205A-06-0260  
 Eschelon Telecom of Arizona, Inc. ("Eschelon"), filed an Application with the Arizona Corporation Commission ("Commission") on April 19, 2006, seeking approval pursuant to A.R.S. § 40-285 of the encumbrance of certain of Eschelon's assets in relation to the issuance of \$49 million of Senior Second Secured Notes that will mature on March 15, 2010 (the "Notes") by its affiliated entity, Eschelon Operating Company ("Eschelon Operating"). The Application is available for inspection during regular business hours at the offices of the Commission located at 1200 West Washington Street, Phoenix, Arizona 85007, and at the office of Eschelon's legal counsel, Lewis and Roca LLP, 40 North Central Avenue, Suite 1900, Phoenix, Arizona 85004. The Commission may grant the Application without a hearing.  
 If you have any questions concerning this Application, have objections to its approval, or want information on intervention, you may contact the Consumer Services Section of the Commission at 1200 West Washington Street, Phoenix, Arizona 85007, or call 1-800-222-7000. The Commission does not discriminate on the basis of disability in admission to its public meetings. Persons with a disability may request a reasonable accommodation such as a sign language interpreter, as well as request this document in an alternative format, by contacting Linda Hogan, ADA Coordinator, voice phone number 602-542-3931, e-mail LHogan@cc.state.az.us. Requests should be made as early as possible to allow time to arrange the accommodation.  
 06306-May 6, 2006

STATE OF ARIZONA }  
 COUNTY OF MARICOPA } SS.

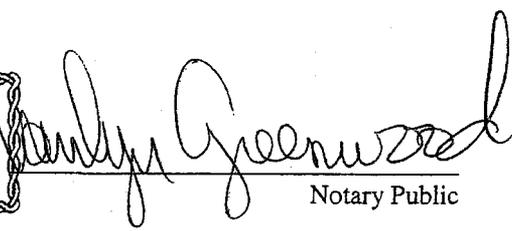
TOM BIANCO, being first duly sworn, upon oath deposes and says: That he is the advertising manager of the Arizona Business Gazette, a newspaper of general circulation in the county of Maricopa, State of Arizona, published at Phoenix, Arizona, by Phoenix Newspapers Inc., which also publishes The Arizona Republic, a newspaper of general circulation in the State of Arizona, and that the copy hereto attached is a true copy of the advertisement published in the said paper, named below, on the dates as indicated below:

The Arizona Republic

May 8, 2006



Sworn to before me this  
 8<sup>TH</sup> day of  
 May A.D. 2006

Notary Public