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MEMORANDUM RECEIVED

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

*EA for EGJ*

2006 OCT 20 P 2: 39

AZ CORP COMMISSION  
DOCUMENT CONTROL

DATE: October 20, 2006

RE: STAFF REPORT FOR DIECA COMMUNICATIONS, INC.,  
AUTHORIZATION FOR APPROVAL TO ENCUMBER ASSETS IN  
CONNECTION WITH NEW FINANCING (DOCKET NO. T-03632A-06-0215)

Attached is the Staff Report for DIECA Communications, Inc., application for approval to incur debt as co-borrower with its parent company, Covad Communications Group, Inc., and to encumber its Arizona assets as security for new debt financing incurred by its parent company and/or itself as co-borrower. Staff recommends conditional approval to pledge assets as a guarantee for new parent debt and recommends denial of the request to incur debt.

EGJ:SPI:tdp

Originator: Steven Irvine

Arizona Corporation Commission  
DOCKETED

OCT 20 2006

DOCKETED BY	<i>NR</i>
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Docket No. T-03632A-06-0215

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**STAFF REPORT  
UTILITIES DIVISION  
ARIZONA CORPORATION COMMISSION**

**DIECA COMMUNICATIONS, INC.  
DBA  
COVAD COMMUNICATIONS COMPANY, INC.**

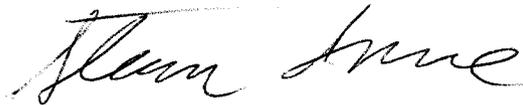
**DOCKET NO. T-03632A-06-0215**

**APPLICATION FOR APPROVAL  
TO ENCUMBER ASSETS  
IN CONNECTION WITH NEW FINANCING**

**OCTOBER 20, 2006**

## STAFF ACKNOWLEDGMENT

The Staff Report for DIECA Communications, Inc., Docket No. T-03632A-06-0215 was the responsibility of the Staff member listed below. Steven Irvine was responsible for the review and financial analysis of the Company's application.

A handwritten signature in cursive script that reads "Steven Irvine".

Steven Irvine  
Public Utilities Analyst III

**EXECUTIVE SUMMARY**  
**DIECA COMMUNICATIONS, INC.**  
**DBA**  
**COVAD COMMUNICATIONS COMPANY, INC.**  
**DOCKET NO. T-03632A-06-0215**

DIECA Communications, Inc. dba Covad Communications Company ("Covad" or "Company") filed an application with the Arizona Corporation Commission ("Commission") on April 3, 2006, requesting authorization to pledge assets and act as a guarantor to financings not to exceed \$200 million entered into by its parent company Covad Communications Group, Inc. ("Covad Group"). Covad also indicates that in some cases Covad may be a co-borrower. The Company asserts that the purpose of the financings is for equipment deployment, general corporate purposes not yet determined, and to potentially deploy new broadband and voice services within Arizona and to service interest payments.

Covad is a corporation organized and existing under the laws of the State of Virginia. Covad is a subsidiary of Covad Group and the principal business office for both is in San Jose, California.

Staff concludes that approval of the encumbrance of assets assists Covad and Covad Group as it facilitates the funding of operational activities and is unlikely to have any effect on Arizona customers of Covad. Additionally, Staff concludes that the pledge of Covad's assets (exclusive of customer deposits and prepayments) to secure the debt of Covad Group as requested in the application is within Covad'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 for Covad to pledge assets as a guarantee or to provide other forms of security for borrowings up to \$200 million by Covad Group, subject to the condition that all Arizona customer deposits and prepayments, if any, be excluded from encumbrance, or in the alternative, that they are secured by a bond which is not included in the pledged collateral.

Staff has evaluated financial statements provided under protective agreement and concluded that it is inappropriate for Covad to acquire any new debt. Accordingly, Staff recommends that Covad not be authorized to participate as a co-borrower or borrower in any new debt.

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## **Introduction**

DIECA Communications, Inc. dba Covad Communications Company ("Covad") filed an application with the Arizona Corporation Commission ("Commission") on April 3, 2006, requesting authorization to encumber its Arizona assets in connection with new financing by its parent Covad Communications Group, Inc. ("Covad Group"). The application also states that Covad may participate as a co-borrower.

## **Public Notice**

The Company has provided Staff with evidence that on September 21, 2006 it published notice of the financing application in the *Arizona Business Gazette*. *Arizona Business Gazette* is a newspaper of general circulation in Maricopa County. A copy of an affidavit attesting to publication of the notice is attached.

## **Background**

Covad, a wholly owned subsidiary of Covad Group, is a Virginia corporation headquartered in San Jose, California. Covad provides voice and data communications in 44 states. The Company offers DSL, VOIP, web hosting, managed security, IP and dial-up, and bundled voice and data services. Covad is certificated by the Commission to provide competitive resold and facilities-based local exchange and interexchange telecommunications services pursuant to Decision No. 61942.

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

Covad requests authorization to encumber its assets for financing arrangements of Covad Group up to \$200 million. The Company asserts that the financing is for equipment deployment, general corporate purposes not yet determined, and to potentially deploy new broadband and voice services within Arizona and to service interest payments. The application also states that in some cases Covad may be a co-borrower. A copy of a loan agreement with Earthlink, Inc. ("Earthlink") supplied to Staff by the Company includes a provision for Covad Group to transfer debt to a subsidiary through execution of a joinder agreement.

## **Financial Analysis**

Staff performed a review of the proposed transaction and determined that encumbrance of Covad's assets 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 telecommunications companies to operate effectively. Covad customers have alternative service providers and would not experience significant harm in the event that its parent has financial difficulties.

Staff has evaluated financial statements provided under protective agreement and concluded that it is inappropriate for Covad to acquire any new debt.

### **Compliance**

There are no compliance issues with the Company.

### **Staff Conclusions and Recommendations**

Staff concludes that Covad and Covad Group benefit from the pledge of assets and guarantee as it facilitates the funding of operational activities and is unlikely to have significant detrimental effect on Arizona customers of Covad.

Staff concludes that the proposed pledge of assets and guarantee (exclusive of customer deposits and prepayments) in support of Covad Group's financing up to \$200,000,000 is appropriate, is within the corporate powers of the applicant, is compatible with the public interest, is consistent with sound financial practices and would not impair Covad's ability to provide service.

Staff recommends approval for Covad to pledge assets as a guarantee or to provide other forms of security for the applied for borrowings up to \$200 million by Covad Group subject to the condition that all customer deposits and prepayments be excluded from encumbrance and equivalent amounts be retained by Covad, or in the alternative, that they are secured by a bond which is not included in the pledged collateral.

Staff further recommends denial of Covad's request for authorization to participate in any new debt as borrower or co-borrower.

Staff further recommends authorizing Covad to engage in any transactions and to execute any documents necessary to effectuate the authorizations granted.

Staff further recommends that Covad provide one copy of all notes, executed security documents and all other documents memorializing the transactions to the Compliance Section of the Utilities Division within 60 days of any loan closing.

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# Arizona Business Gazette

The business resource

PO BOX 194  
Phoenix, Arizona 85001-0194  
(602) 444-7315 FAX (602) 444-7364

**Public Notice of Filing of Approval to Encumber Assets in Connection with Potential Financing of Dieca Communications, Inc. D/B/A Covad Communications Company Docket No. T-03632A-06-0215**  
Dieca Communications, Inc. D/B/A Covad Communications Company (the "Applicant") filed an application with the Arizona Corporation Commission (the "Commission") to authorize Covad to encumber its assets in the State of Arizona in connection with its guarantee, or other provision of security, related to various financings of up to \$200 million being arranged for its parent company, Covad Communications Group, Inc. The Application is available for inspection during regular business hours at the office of the Commission located at 1200 West Washington Street, Phoenix, Arizona 85007 and at the office of Applicant's legal counsel, Michael Patten, Esq., Rosika DeWulf & Patten, PLLC, 400 East Van Buren Street, Suite 800, Phoenix, AZ 85004-2929. 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 or 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 language interpreter, as well as request this document in an alternative format, by contacting Linda Hogan, ADA Coordinator, by voice, phone number 502-242-3831; e-mail lhogan@arcc.gov. Requests should be made as early as possible to arrange the accommodation.  
Published: September 21, 2006

STATE OF ARIZONA  
COUNTY OF MARICOPA

} SS.

Kelly Howard, being first duly sworn, upon oath deposes and says: That he is a legal advertising representative of the Arizona Business Gazette, a newspaper of general circulation in the county of Maricopa, State of Arizona, published weekly at Phoenix, Arizona, and that the copy hereto attached is a true copy of the advertisement published in the said paper on the dates indicated.

9/21/2006

Sworn to before me this  
21ST day of  
SEPTEMBER 2006

Kelly Howard

Marilyn Greenwood  
Notary Public

