

ORIGINAL



0000066072

30

MEMORANDUM

TO: Docket Control
FROM: Ernest G. Johnson
Director
Utilities Division
DATE: January 30, 2007

EA for EGJ

RE: STAFF REPORT FOR THE JOINT APPLICATION OF TIME WARNER TELECOM OF ARIZONA, LLC, XSPEDIUS MANAGEMENT COMPANY SWITCHED SERVICES, LLC AND XSPEDIUS MANAGEMENT COMPANY OF PIMA COUNTY, LLC FOR APPROVAL TO ENCUMBER ASSETS IN CONNECTION WITH NEW FINANCING (DOCKET NOS. T-03943A-06-0691, T-04112A-06-0691 AND T-04113A-06-0691)

Attached is the Staff Report for the joint application of Time Warner Telecom of Arizona; LLC; Xspedius Management Company Switched Services, LLC; and Xspedius Management Company of Pima County, LLC, for approval to encumber Arizona assets as security for Time Warner Telecom Holdings, Inc.'s proposed debt financing. Staff recommends conditional approval.

EGJ:All:red

Originator: Alexander Ibhade Igwe

Attachment: Original and sixteen copies

RECEIVED
2007 JAN 30 A 8:42
AZ CORP COMMISSION
DOCUMENT CONTROL

Arizona Corporation Commission
DOCKETED

JAN 30 2007

DOCKETED BY *NR*

Service List for: Time Warner Telecom of Arizona, LLC, et al
Docket Nos. T-03943A-06-0691, et al

Ms. Joan S. Burke
Osborn Maledon, P.A.
2929 North Central Avenue, Suite 2100
Phoenix, Arizona 85012

Mr. Brian D. Thomas
VP of Regulatory Affairs West
Time Warner Telecom
223 Taylor Avenue North
Seattle, Washington 98109

Mr. Christopher C. Kempley
Chief Counsel, Legal Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Mr. Ernest G. Johnson
Director, Utilities Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Ms. Lyn Farmer
Chief Administrative Law Judge, Hearing Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

**STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION**

**TIME WARNER TELECOM OF ARIZONA, LLC; XSPEDIUS MANAGEMENT
COMPANY SWITCHED SERVICES, LLC; AND XSPEDIUS MANAGEMENT
COMPANY OF PIMA COUNTY, LLC
DOCKET NOS. T-03943A-06-0691, T-04112A-06-0691 & T-04113A-06-0691**

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

JANUARY 30, 2007

STAFF ACKNOWLEDGMENT

The Staff Report for the joint application of Time Warner Telecom of Arizona, LLC; Xspedius Management Company Switched Services, LLC; and Xspedius Management Company of Pima County, LLC; (Docket Nos. T-03943A-06-0691, T-04112A-06-0691 & T-04113A-06-0691) was the responsibility of the Staff member listed below. Alexander Ihade Igwe was responsible for the financial review and analysis of this application.

A handwritten signature in black ink, appearing to read 'Ihade Igwe', with a long, sweeping horizontal line extending to the right.

Alexander Ihade Igwe
Executive Consultant III

EXECUTIVE SUMMARY
TIME WARNER TELECOM OF ARIZONA LLC, ET AL
DOCKET NO. T-03943A-06-0691, ET AL

On October 26, 2006, Time Warner Telecom of Arizona, LLC (“TWT Arizona”); Xspedius Management Company Switched Services, LLC; and Xspedius Management Company of Pima County, LLC (collectively “Applicants”) filed a joint application with the Arizona Corporation Commission (“Commission”) for authorization to provide guarantees and pledge assets as security for a \$600 million senior secured bank term loan and a \$100 million secured bank revolving credit facility on behalf of their parent, Time Warner Telecom Holdings, Inc. (“TWT Holdings”). Also, the Applicants request Commission authorization for Xspedius Management Company Switched Services, LLC; and Xspedius Management Company of Pima County, LLC to act as guarantors and pledge assets as security for the Senior Notes previously issued by TWT Holdings.

TWT Arizona; Xspedius Management Company Switched Services, LLC; and Xspedius Management Company of Pima County, LLC are certificated¹ by the Arizona Corporation Commission to provide competitive intrastate telecommunications services. Xspedius Management Company Switched Services, LLC and Xspedius Management Company of Pima County, LLC are jointly known as (the “Xspedius Certificated Subsidiaries”). TWT Arizona and Xspedius Certificated Subsidiaries are wholly owned subsidiaries of TWT Holdings, which in turn, is wholly owned by Time Warner Telecom, Inc. (“Time Warner”). TWT Arizona provides broadband data, voice, dedicated Internet access, and dedicated web hosting to business customers in the Phoenix and Tucson metropolitan areas. Xspedius Certificated Subsidiaries are competitive local exchange providers of local, long distance, integrated and Internet access solutions to small and medium-sized business customers. The Applicants are non-dominant telecommunications carriers in Arizona.

The Applicants seek Commission authorization to issue guarantees and pledge Arizona assets as security for TWT Holdings’ proposed debt financing, which consist of a \$600 million term loan facility and a \$100 million secured revolving credit facility. The proposed debt financing will restructure Time Warner’s debt portfolio and increase its aggregate amount by a maximum of \$231 million. The loans proceeds would be used to liquidate certain debt instruments currently held by TWT Holdings, including redemption of the entire \$240 million note (due in 2011) and to refinance \$200 million Term B Loan due in 2010. In addition, the proposed financing would enable TWT Holdings to replace its existing \$110 million revolving loan (due in 2009) with a new \$100 million revolving loan (due in 2011). The Applicants state that the above proposal is in the public interest because it refinances over \$440 million of existing debt at more favorable terms, make funds available for ongoing operations and finance the cash portion of the Xspedius Certificated Subsidiaries’ acquisition. Finally, the Applicants claim that the proposed loans will not impair their financial status, or inhibit their ability to

¹ Xspedius Management Co. Switched Services, LLC and Xspedius Management Company are Delaware entities, certificated as competitive local exchange carriers by the Arizona Corporation Commission in Decision No. 65124 dated August 23, 2002.

attract capital at favorable terms, or hinder their ability to provide safe, reasonable and adequate service.

As previously indicated above, the Applicants seek Commission authorization for the Xspedius Certificated Subsidiaries to issue guarantees and pledge their assets as security for the Senior Notes previously issued by TWT Holdings. The Applicants contend that the referenced loans were approved by the Commission in Decision No. 67815, which authorized TWT Arizona to guarantee TWT Holdings' debt up to \$400 million. Finally, the Applicants state that since Xspedius Certificated Subsidiaries and TWT Arizona are in the same organizational position, relative to their common parent, TWT Holdings, it would be appropriate that they provide the same guarantees and securities for the referenced debt.

Staff finds that the Applicants request for authorization to issue guarantees and pledge assets as security for debt issuance should not impair the availability of service to customers since the Applicants provide competitive services that are available from alternate service providers. Also, Staff concurs with the Applicants assertion that receipt of Commission authorization to pledge Arizona assets should not impair their financial status, further impair their ability to attract capital at fair and reasonable terms or impair their ability to provide safe, reasonable and adequate service (See A.A.C. R14-2(804)(C)). However, Staff finds that customers may still have exposure to losses to the extent they have prepaid for service or made deposits. Accordingly, any authorization for encumbrances should provide customer protection for prepayments and deposits.

Staff recommends approval of the Applicants' request for authorization to issue guarantees and pledge Arizona assets or other forms of security for a \$600 million term loan facility and a \$100 million secured revolving credit facility, subject to the condition that all Arizona customer deposits and prepayments, if any, are secured by a performance bond that is excluded from the pledged assets. Finally, Staff recommends that Xspedius Certificated Subsidiaries be authorized to act as guarantors and pledge Arizona assets as security for TWT Holdings' existing debt, previously guaranteed and encumbered by the assets of TWT Arizona.

TABLE OF CONTENTS

	<u>PAGE</u>
INTRODUCTION	1
PUBLIC NOTICE	1
BACKGROUND	1
THE TRANSACTION	1
PRIOR COMMISSION APPROVALS	2
FINANCIAL ANALYSIS.....	2
COMPLIANCE ISSUES.....	3
CONCLUSIONS AND RECOMMENDATIONS.....	3

ATTACHMENT

AFFIDAVIT OF PUBLICATION.....	
-------------------------------	--

Introduction

On October 26, 2006, Time Warner Telecom of Arizona, LLC (“TWT Arizona”), Xspedius Management Company Switched Services, LLC and Xspedius Management Company of Pima County, LLC (collectively “Applicants”) filed a joint application with the Arizona Corporation Commission (“Commission”) requesting authorization to issue guarantees and pledge their Arizona assets as security for a \$600 million senior secured term loan (“Term Loan”) and a \$100 million secured bank revolving credit facility (collectively referred to as “the Loans”), on behalf of Time Warner Telecom Holdings (“TWT Holdings”).

Public Notice

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

Background

TWT Arizona; Xspedius Management Company Switched Services, LLC; and Xspedius Management Company of Pima County, LLC are limited liability companies organized and existing under the laws of the State of Delaware. The Applicants are certificated to provide competitive intrastate telecommunications services in Arizona. Xspedius Management Company Switched Services, LLC; and Xspedius Management Company of Pima County, LLC are jointly known as (the “Xspedius Certificated Subsidiaries”). Xspedius Certificated Subsidiaries and TWT Arizona are wholly owned subsidiaries of TWT Holdings, which in turn, is a subsidiary of Time Warner Telecom, Inc. (“Time Warner”).

TWT Arizona provides broadband data, voice, dedicated Internet access, and dedicated web hosting to business customers in the Phoenix and Tucson metropolitan areas. Xspedius Certificated Subsidiaries offer local, long distance, integrated, and Internet access solutions to small and medium-sized business customers.

The Transaction

The Applicants seek Commission authorization to issue guarantees and pledge their Arizona assets as collateral for TWT Holdings’ proposed debt financing, consisting of a new \$600 million term loan facility and a \$100 million secured revolving credit facility. Time Warner and all its affiliates, including the Applicants, will issue guarantees and encumber their assets as security for the proposed loans. The loan proceeds would be utilized by Time Warner to pay off certain existing debt instruments of TWT Holdings, including redemption of \$240 million principal amount of senior secured floating rate notes (due in 2011) and to refinance the \$200 million Term B Loan due in 2010. Further, the existing \$110 million revolving loan (due in 2009) will be substituted with a new \$100 million revolving loan (due in 2011).

Also, Xspedius Certificated Subsidiaries request the Commission authorization to guarantee and encumber their Arizona assets in conjunction with the Senior Notes previously issued by TWT Holdings. The Applicants state that the Commission in prior decisions, discussed below, authorized TWT Arizona to provide guarantees and secure TWT Holdings' debt. The Applicants contend that since Xspedius Certificated Subsidiaries are in the same organizational position as TWT Arizona, Xspedius Certificated Subsidiaries should be authorized by the Commission to provide similar guarantees and security in conjunction with TWT Holdings' existing debt.

The Applicants state that the proposed debt restructuring is in the public interest because it results in more favorable interest rates, fund ongoing operations, and finance the cash portion of Xspedius Certificated Subsidiaries' acquisition. The proposed financing will enhance Applicants ability to grow as facilities-based competitive service providers. Further, Applicants contend that the proposed loan will not negatively impact their ability to attract capital at fair and reasonable terms or hinder their ability to provide safe, reasonable and adequate services. Finally, the Applicants state that the proposed financing will have no impact on their current rates or services in Arizona.

Prior Commission Approvals

The Applicants state that the Commission had in the past authorized TWT Arizona, one of the Applicants, to provide guarantees and security similar to those contemplated in this proceeding for over one billion dollars of TWT Holdings' debt. Decision No. 68662, dated April 12, 2006, authorized TWT Arizona to pledge its Arizona assets as security for TWT Holdings' \$200 million term loan and adjust its guarantees on a \$110 million revolving credit facility. Further, Decision No. 67815, dated May 05, 2005, authorized TWT Arizona to guarantee TWT Holdings' issuance of long-term debt up to \$400 million in Senior Notes due in 2014. Finally, Decision No. 67108, dated July 09, 2004, authorized TWT Arizona to encumber its assets and guarantee TWT Holdings' debt, including the issuance of \$240 million of Second Priority Senior Secured Floating Rate notes due in 2011.

Financial Analysis

The Applicants' filing for Commission authorization to pledge Arizona assets as security for debt issuance is consistent with A.R.S. §40-285, which requires public service corporations to obtain Commission authorization to encumber certain utility assets. The statute serves to protect captive customers from a utility's act to dispose of any of its assets that are necessary for the provision of service, thus, it serves to preempt any service impairment due to disposal of assets essential for providing service. In this instance, a pledge of the Applicants' assets should not impair the availability of service to customers since the Applicants provide competitive services that are available from alternate service providers. However, customers may still have exposure to losses to the extent they have prepaid for service or made deposits. Accordingly, any authorization for encumbrances should provide customer protection for prepayments and deposits. Staff finds that Decision No. 67108 ordered TWT Arizona to maintain a performance

bond equal to \$1.7 million and to increase the amount if at any time it would be insufficient to cover advances, deposits or prepayments collected from Arizona customers. Further, Decision No. 68662 ordered TWT Arizona to retain the performance bond ordered in Decision No. 67108. Staff agrees with the previous decisions that retention of sufficient performance bond is necessary for continued protection of Applicants' customers in Arizona. Staff recommends that TWT Arizona and Xspedius Certificated Subsidiaries maintain adequate performance bond(s) that is consistent with Decision No. 67108.

The Applicants claims that upon approval of this application, Time Warner's DSC would increase from 3.44 to 3.54. 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. Although Staff's recommendation to approve the Applicants' request is not primarily driven by sound financial practices, a DSC of 3.54 indicates that Applicants' encumbered Arizona assets might be protected by Time Warner's ability to meet the corporate debt obligations.

Compliance Issues

On November 14, 2006, the Records Section of the Corporation Division of the Arizona Corporation Commission reported that the Applicants were in good standing.

Staff's search of Consumer Services database from January 1, 2003, to November 14, 2006, indicates that TWT Arizona and Xspedius Management Company Switched Services, LLC had no complaints, inquiries, or opinions. However, Xspedius Management Company of Pima County had twelve complaints, during this period, two of which were in 2006; three inquiries; and zero opinions. All of complaints have been resolved and closed.

Conclusions and Recommendations

Staff agrees with the Applicants' assertion that the proposed financing arrangements should not further impair their financial status, further hinder their ability to attract capital at fair and reasonable terms or inhibit their ability to provide safe, reasonable and adequate service. However, Staff finds that customers may still have exposure to losses to the extent they have prepaid for service or made deposits.

Staff recommends approval of the Applicants' request for Commission authorization to issue guarantees and pledge Arizona assets as security for TWT Holdings' new \$600 million term loan facility and a \$100 million secured revolving credit facility.

Also, Staff recommends approval of Xspedius Certificated Subsidiaries requests for Commission authorization to pledge Arizona assets as security for TWT Holdings' existing debt.

Staff recommends that the Applicants' customer deposits and prepayments in Arizona be secured by a performance bond, which is excluded from the pledged assets. Staff further

recommends that the Applicants file the original performance bond with the Business Office and the appropriate copies in Docket Control as a compliance item, within 60 days of the effective date of the decision in this proceeding.

Staff further recommends authorizing the Applicants to engage in any transactions and to execute or cause to be executed any documents so as to effectuate the authorizations requested with the application.

THE ARIZONA REPUBLIC

Public Notice of Filing of Approval to Encumber Assets in Connection with Application for Approval of New Financing Filed by Time Warner Telecom of Arizona LLC, Xspedius Management Co., Switched Services, LLC and Xspedius Management Co. Docket Nos: T-03943A-06-0691; T-04112A-06-0691; T-04113A-06-0691

Time Warner Telecom of Arizona LLC, Xspedius Management Co., Switched Services, LLC and Xspedius Management Co. (collectively "Applicants") filed an application with the Arizona Corporation Commission ("Commission") on October 26, 2006, asking for authorization to provide their guarantee, serve as borrowers or co-borrowers, or to otherwise provide security in connection with a \$600 million senior secured bank term loan and a \$100 million secured bank revolving credit facility entered into by Applicants' parent company, Time Warner Telecom Holdings, a subsidiary of Time Warner Telecom 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 Applicants' legal counsel, Osborn Maledon PA, 2929 North Central, Suite 2100, Phoenix, AZ 85012. 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 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@azcc.gov. Requests should be made as early as possible to arrange the accommodation. Published: December 8, 2006

STATE OF ARIZONA }
COUNTY OF MARICOPA } SS.

Karen Way, being first duly sworn, upon oath deposes and says: That she is a legal advertising representative 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, and that the copy hereto attached is a true copy of the advertisement published in the said paper on the dates as indicated.

The Arizona Republic

December 8, 2006

Karen Way

Sworn to before me this
8TH day of
December A.D. 2006



Marilyn Greenwood
Notary Public