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ORIGINAL

MEMORANDUM

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TO: Docket Control

FROM: Ernest G. Johnson
Director
Utilities Division

EA for EGJ

DATE: April 13, 2007

RE: STAFF REPORT FOR THE JOINT APPLICATION OF LEVEL 3 COMMUNICATIONS, LLC; BROADWING COMMUNICATIONS, LLC; AND WITEL COMMUNICATIONS, LLC FOR A PARTIAL WAIVER OF THE PUBLIC UTILITY HOLDING COMPANIES AND AFFILIATED INTERESTS RULES (A.A.C. R14-2-801 ET SEQ.), AND APPROVAL OF ENCUMBRANCE OF ASSETS. (DOCKET NOS. T-03654A-07-0101, T-03708A-07-0101, T-03779A-07-0101 AND T-04176A-07-0101)

Attached is the Staff Report for the application of Level 3 Communications, LLC, Broadwing Communications, LLC; and WilTel Communications, LLC for a partial waiver of the Public Utility Holding Companies and Affiliated Interests Rules and Approval of Encumbrance of Assets. Staff recommends conditional approval.

EGJ:AII:red

Originator: Alexander Ibhide Igwe

Attachment: Original and sixteen copies

Arizona Corporation Commission
DOCKETED
APR 13 2007

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Docket No. T-03654A-07-0101, et al.

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**STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION**

**LEVEL 3 COMMUNICATIONS, LLC, BROADWING
COMMUNICATIONS, LLC; AND WITEL COMMUNICATIONS, LLC
DOCKET NO. T-03654A-07-0101, T-03708A-07-0101,
T-03779A-07-0101 AND T-04176A-07-0101**

**APPLICATION FOR A PARTIAL WAIVER OF THE PUBLIC UTILITY HOLDING
COMPANIES AND AFFILIATED INTERESTS RULES AND APPROVAL OF
ENCUMBRANCE OF ASSETS**

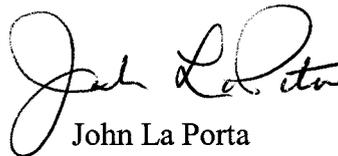
APRIL 13, 2007

STAFF ACKNOWLEDGMENT

The Staff Report for Level 3 Communications, LLC, Broadwing Communications, LLC, and WilTel Communications, LLC (Docket Nos. T-03654A-07-0101, T-03708A-07-0101, T-03779A-07-0101 and T-04176A-07-0101) was the responsibility of the Staff member listed below. Alexander Ihade Igwe was responsible for the financial review and analysis of this application. John La Porta researched the Consumer Service issues in this proceeding.



Alexander Ihade Igwe
Executive Consultant III



John La Porta
Public Utilities Consumer Analyst 1

EXECUTIVE SUMMARY
LEVEL 3 COMMUNICATIONS, LLC, ET AL
DOCKET NOS. T-03654A-07-0101 ET AL

On February 16, 2007, Level 3 Communications, LLC, ("Level 3 LLC"); Broadwing Communications, LLC ("Broadwing"); and WilTel Communications, LLC ("WilTel"), (collectively, the "Applicants") filed a joint application with the Arizona Corporation Commission ("Commission") for a limited waiver of the Public Utility Holding Companies and Affiliated Interests rules or authorization to issue guarantees and pledge their Arizona assets as security for certain financing arrangements. The proposed financing arrangements will be comprised of two transactions. The first transaction relates to issuance of \$1 billion notes to qualified institutional buyers, by Level 3 Financing, Inc., the immediate parent of Level 3 LLC. Proceeds of the proposed notes will be utilized to refinance existing indebtedness. The notes shall consist of 8.75% fixed interest rate notes with a maturity date of 2017 and variable rate interest notes with maturity dates in 2015. The second transaction will consist of Level 3 financing entering into a \$1.4 billion Credit Agreement with maturity in 2014. The Applicants and WilTel Local Networks, LLC (another subsidiary of Level 3, LLC) also seek Commission authorization to pledge their Arizona assets and issue guarantees for the proposed Credit Agreement. The Guarantor Applicants indicate that Arizona customer deposits and prepayments will be excluded from the proposed encumbrance.

The Applicants contend that the proposed financing transactions are in the public interest because the arrangements promote competition by giving Applicants access to greater financial resources at favorable terms. Also, the proposed financing arrangements will decrease the expenses incurred on the existing debt and enhance Applicants' ability to provide competitive telecommunication services to existing and new customers in Arizona. Further the Applicants contend that the proposed financing will not result in any change in management or the day to day operations; nor will it adversely impact Applicants' current or future operations in Arizona.

Staff finds that Applicants' request for a limited waiver from the Rules may not fully protect Arizona ratepayers. Further, Staff finds that the Applicants' request for authorization to issue guarantees and pledge Arizona assets as security for the notes should not impair the availability of service to consumers since the Applicants provide competitive services that are available from alternate providers. Staff agrees with the Applicants that the proposed transactions should not 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 for the proposed financing arrangements, subject to the condition that all Arizona customer deposits and prepayments, if any, be secured by a bond or an irrevocable sight draft letter of credit which is excluded from the encumbered assets.

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AFFIDAVIT OF PUBLICATION

Introduction

On February 16, 2007, Level 3 Communications, LLC (“Level 3 LLC”); Broadwing Communications, LLC (“Broadwing”); and WilTel Communications, LLC (“WilTel”), (Collectively, the “Applicants”) filed a joint application with the Arizona Corporation Commission (“Commission”) requesting a partial waiver of the Public Utility Holding Companies and Affiliated Interests Rules (“Rules”), in connection certain debt financing arrangements or in the alternative, Commission authorization to issue guarantees and to the extent necessary, encumber their assets to secure the proposed debt. Also, WilTel Local Network, LLC (“WilTel LN”) seeks Commission approval to encumber its assets as part of the proposed Credit Agreement discussed below. On March 9, 2007, the Applicants submitted a supplemental filing indicating that the amount of the proposed Credit Agreement has increased from \$1 billion to \$1.4 billion.

Public Notice

On March 28, 2007, the Applicants filed an affidavit of publication indicating that notice of the financing application was published in the *Arizona Republic* on March 20, 2007. A copy of the notice is attached.

Background

Level 3 LLC is a Delaware limited liability company certificated by the Commission to provide facilities-based and resale local exchange, toll and access services pursuant to Decision No. 61737 dated June 4, 1999. Level 3 LLC is a wholly owned subsidiary of Level 3 Financing, Inc. (“Issuer”), which in turn is wholly owned by Level 3 Communications, Inc. (“Parent”).

Broadwing is a subsidiary of Level 3 LLC, certificated to provide telecommunication services in all fifty states, including the District of Columbia. Also, Broadwing is authorized to provide local exchange telecommunication services in 19 states and the District of Columbia. Broadwing reports that the Federal Communication Commission through Section 214 authorizes it to provide interstate and international telecommunications services. In Arizona, Broadwing was certificated by the Commission in Decision No. 66105, dated July 25, 2003, to provide resold and facilities-based intrastate telecommunication services.

WilTel is also a subsidiary of Level 3 LLC. It is the parent of WilTel-Comm, which in turn is the parent of WilTel-LN. WilTel is certificated to provide resold and facilities-based competitive local exchange and inter-exchange services pursuant to Decision No. 62025 dated November 2, 1999. The Commission authorized WilTel-LN to provide competitive resold and facilities-based local exchange, exchange access, and intrastate dedicated access telecommunication services in Decision No. 62727, dated June 30, 2000.

The Applicants state that based on their operational revenues, they are Class “A” utilities, and thus, subject to the Public Utility Companies and Affiliated Interests Rules (“Rules”). The

Rules seek to (a) prevent commingling of utility and non-utility funds; (b) prohibit cross-subsidization on non-utility activities by utility ratepayers; (c) prevent negative impact on non-utility activities on a utility's financial credit; and (d) ensure that the utility and its affiliates provide the Commission with the information necessary to "carry out its regulatory responsibilities".¹ The Applicants assert that the proposed transactions will not directly or indirectly result in or cause an increase in the Applicants' maximum rates on file with the Commission for competitive services. Further, the Applicants argue that the Commission concluded in Decision No. 64737 that compliance with A. A. C. R14-2-803, R14-2-804(A), (B), and (C), and R14-2-805 is necessary if a financing transaction "could directly or indirectly result in or cause an increase in its maximum rate on file with the Commission for any competitive services". The Applicants contend that because they provide highly competitive services that are readily available from alternate providers, their proposals will not impact their maximum rates on file with the Commission for competitive services. Also, the Applicants argue that the proposed financing arrangements will not impact their ability to continue to provide services, nor alter the rates, terms and condition of their services. Finally, the Applicants argue that it would be unreasonably costly and burdensome to comply with the Rules for the proposed financing arrangements.

The Transaction

The Applicants seek Commission authorization to participate in two financing arrangements. In the first transaction, Level 3 Financing, Inc. will issue \$1 billion in new notes that are exempt from registration under the U. S. Federal securities laws. This transaction requires the Applicants to issue their guarantees for the notes, in an aggregate principal amount up to \$1 billion. The proposed notes will be subsequently exchanged for substantially identical notes subject to registration under the U. S. Federal securities laws. The Applicants claim that proceeds of the notes will be used to refinance existing indebtedness. The proposed financing will comprised of 8.75 percent fixed interest rate notes with a maturity date of 2017 and variable rate interest notes with maturity dates in 2015. The Applicants seek Commission authorization to issue guarantees regarding the proposed notes.

The second transaction will consist of a proposed 1.4 billion Credit Agreement with maturity in 2014. The Applicants and WilTel-LN seek Commission authorization to pledge their Arizona assets and issue guarantees for the proposed Credit Agreement. The Applicants propose to exclude Arizona customer deposits and prepayments from encumbrance.

The Applicants state that the proposed financing arrangements serve the public interest because the above transactions will promote competition by availing Applicants with access to greater financial resources at favorable terms. Also, the proposed financing arrangements will decrease the expenses incurred on the existing debt and enhance Applicants' ability to provide competitive telecommunication services in Arizona.

¹ Decision No. 56618

Financial Analysis

Staff recommends denial of the Applicant's request for a limited waiver of the Rules. Staff's analysis indicates that a limited waiver of the Rules does not sufficiently mitigate potential harm to ratepayers in Arizona. Staff finds that public interest is better served by conditionally authorizing the Applicants to issue guarantees, and to the extent necessary, to encumber their Arizona assets as security for the proposed debt financing. A.R.S. §40-285 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 it provides 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.

Consumer Services Issues

The Corporations Division of the Arizona Corporation Commission reports that the Guarantor Applicants were individually in good standing.

Staff's search of the Consumer Services database indicates that the Guarantor Applicants had zero complaints, inquiries and opinions from January 1, 2003 to February 26, 2007.

Staff Conclusions and Recommendations

Staff concludes that the Applicants' proposed financing arrangements are in the public interest. Staff agrees with the Applicant that the above proposal will not further impair their collective financial status, or hinder their collective ability to attract capital at fair and reasonable terms, or inhibit their ability to provide safe, reasonable and adequate service. Staff finds that because the Applicants provide competitive services, the risks to Arizona customers are significantly mitigated by the availability of similar services from alternate providers at competitive rates. However, Staff is concerned that Arizona customers may still have exposure to losses to the extent they have prepaid for service or made deposits.

Staff recommends that the Commission authorize the Applicants to issue guarantees and pledge their Arizona assets as security for: (a) \$1 billion in new notes, comprised of 8.75 percent fixed interest rate notes with a maturity date of 2017 and variable rate interest notes with maturity dates in 2015, and (b) \$1.4 billion Credit Agreement with maturity in 2014. Staff further recommends that the Commission authorize WiTel-LN to participate in the proposed Credit Agreement.

Staff further recommends that all Arizona customer deposits and prepayments, if any, be secured by a bond or an irrevocable sight draft letter of credit, which is excluded from Applicants' pledged assets.

Staff recommends that if the Applicants exercise the option of procuring a performance bond or an irrevocable sight draft letter of credit to protect Arizona customer deposits and prepayments, that they file proof of the performance bond in Docket Control, 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 LEVEL 3 COMMUNICATIONS, LLC, WITEL COMMUNICATIONS, LLC, WITEL LOCAL NETWORK, LLC AND BROADWING COMMUNICATIONS, LLC for APPROVAL of WAIVER of PUBLIC UTILITY HOLDING COMPANIES and AFFILIATED INTEREST RULES and ENCUMBRANCE OF ASSETS.

Docket Nos. T-03654A-07-0101, T-03708A-07-0101, T-03779A-07-0101, T-04176A-07-0101

Level 3 Communications, LLC ("Level 3 LLC"), Broadwing Communications, LLC, and Witel Communications, LLC (collectively, the "Guarantor Applicants"), filed an application with the Arizona Corporation Commission ("Commission") on February 16, 2007, requesting a limited waiver of the Commission's Public Utility Holding Companies and Affiliated Interests Rules, A.A.C. R14-2-801 to R14-2-806 in connection with two separate financing arrangements and approval of the encumbrance of the Guarantor Applicants' assets. Witel Local Network, LLC ("Witel-LN") also requests approval to encumber its Arizona assets pursuant to A.R.S. § 40-285 as part of the second transaction. In the first transaction, Level 3 Financing, Inc., the immediate corporate parent of Level 3 LLC, plans to issue approximately \$1 billion in notes to qualified institutional buyers to refinance existing notes, and the Guarantor Applicants will act as guarantors with respect to the note issuance. In the second transaction, Level 3 Financing, Inc. will enter into a Credit Agreement for up to \$1.4 billion. The Guarantor Applicants will act as guarantors of that agreement, and the Guarantor Applicants and Witel-LN will pledge their Arizona assets as part of the agreement.

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 Level 3 LLC'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.

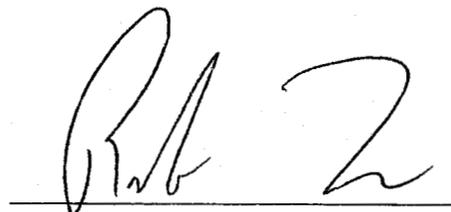
Published: March 20, 2007

STATE OF ARIZONA }
COUNTY OF MARICOPA } SS.

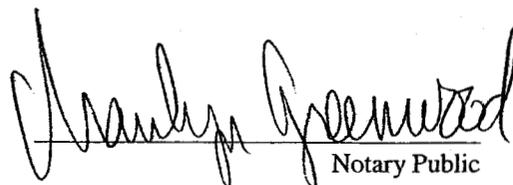
Robert Lane, being first duly sworn, upon oath deposes and says: That he is a legal advertising representative of the Arizona Business Gazette, a newspaper of general circulation in the county of Maricopa, State of Arizona, published at Phoenix, Arizona, by Phoenix Newspapers Inc., which also publishes 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

March 20, 2007



Sworn to before me this
20TH day of
March A.D. 2007


Notary Public