ORIGINAL

OPEN MEETING

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MEMORANDUM

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Arizona Corporation Commission
DOCKETED
DEC 28 2007
DOCKETED BY

TO: THE COMMISSION

FROM: Utilities Division

DATE: December 28, 2007

RE: IN THE MATTER OF THE APPLICATION OF PAETEC HOLDING CORP., MCLEODUSA INCORPORATED AND MCLEODUSA TELECOMMUNICATIONS SERVICES, INC. FOR APPROVAL TO TRANSFER INDIRECT CONTROL OF MCLEODUSA TELECOMMUNICATIONS SERVICES, INC. AND FOR MCLEODUSA TELECOMMUNICATIONS SERVICES, INC. TO PARTICIPATE IN CERTAIN DEBT FINANCING ARRANGEMENTS. (DOCKET NO. T-03267A-07-0554)

Introduction

On September 27, 2007, PAETEC Holding Corp. ("PAETEC") and McLeodUSA Incorporated ("McLeodUSA Parent") filed an Application requesting expedited approval under A.R.S. § 40-285 and A.A.C. R14-2-803 and R14-2-804.B.1, to the extent necessary, as well as any other applicable statues or rules, for the transfer of indirect control of McLeodUSA Telecommunications Services, Inc. ("McLeodUSA") from McLeodUSA Parent to PAETEC and for McLeodUSA to participate in PAETEC's debt financing arrangements. Additionally, the Applicants requested approval to issue guarantee and to pledge or encumber assets.

The transfer of control will result from PAETEC's proposed acquisition of McLeodUSA Parent through the merger of McLeodUSA Parent with a newly formed subsidiary of PAETEC ("PS Acquisition Corp.). Following the merger, McLeodUSA Incorporated will be the surviving entity. No transfer of certificate, assets, or customers will occur as a result of the transfer of control or McLeodUSA's participation in the debt financing. McLeodUSA will continue to provide service to its Arizona customers under its existing certificate with no change in the rates, terms, or conditions of service as currently provided.

Description of the Parties

McLeodUSA Parent and PAETEC in their Application and through data responses represent the following:

McLeodUSA is a corporation organized under the laws of Iowa with a principal place of business located at One Martha's Way, Hiawatha, Iowa 52233. McLeodUSA currently provides telecommunications services in 48 States. McLeodUSA offers local service in the following 25 States:

Arizona	Indiana	Michigan	Nebraska	Oklahoma	Utah
Arkansas	Iowa	Minnesota	New Mexico	Oregon	Washington
Colorado	Kansas	Missouri	North Dakota	South Dakota	Wisconsin
Idaho	Louisiana	Montana	Ohio	Texas	Wyoming
Illinois					

In Arizona, McLeodUSA is authorized to provide resold and facilities-based local exchange and exchange access telecommunications services pursuant to Decision No. 62627, granted June 9, 2000. McLeodUSA is also authorized to provide resold interexchange telecommunications services pursuant to Decision No. 61001, granted July 16, 1998.

McLeodUSA is a wholly-owned subsidiary of McLeodUSA Holdings, Inc, which is a wholly-owned subsidiary of McLeodUSA Parent. McLeodUSA currently provides service to approximately 3,142 business and residential customers in the State of Arizona. McLeodUSA and the other Arizona affiliates[1] of McLeodUSA Parent employ approximately 18 people in Arizona.

McLeodUSA Parent is a privately-held Iowa company headquartered in Cedar Rapids, Iowa. Through its operating subsidiaries, McLeodUSA Parent currently owns and operates a high-capacity fiber network that spans 20 Midwest, Southwest, Northwest, and Rocky Mountain States. The fiber network contains approximately 13,000 intercity route miles and approximately 4,000 metro route miles. McLeodUSA Parent provides telecommunications services primarily to small and medium-sized enterprise and multi-location commercial customers.

PAETEC is a publicly traded corporation under the laws of Delaware with a principal place of business located at One PAETEC Plaza, 600 Willowbrook Office Park, Fairport, New York 14450. Through its operating subsidiaries, PAETEC currently provides telecommunications services to more than 45,000 medium and large business customers in major metropolitan areas in 24 states. Collectively, the 12 wholly-owned subsidiaries operate in 48 States and the District of Columbia. PAETEC is currently certified to provide local service in the following 35 States listed below, plus the District of Columbia:

Alabama	Georgia	Maryland	Nevada	Ohio	Texas
California	Illinois	Massachusetts	New Hampshire	Oregon	Utah
Colorado	Indiana	Michigan	New Jersey	Pennsylvania	Vermont
Connecticut	Kansas	Minnesota	New Mexico	Rhode Island	Virginia
Delaware	Kentucky	Mississippi	New York	South Carolina	Wisconsin
Florida	Louisiana	Missouri	North Carolina	Tennessee	

[1] The additional Arizona affiliates of McLeodUSA Parent include: McLeodUSA Information Services, Inc., McLeodUSA Network Services, Inc., and McLeodUSA Purchasing, LLC.

In Arizona, PAETEC's two subsidiaries, PAETEC Communications, Inc. ("PCI") and US LEC Communications, Inc. ("US LEC"), are authorized to provide resold intrastate interexchange telecommunications services. PCI is authorized to provide service pursuant to Decision No. 62458 granted, April 14, 2000, and US LEC is authorized to provide service by Decision No. 66740, granted January 20, 2004.

PAETEC intends to voluntarily surrender the US LEC Certificate of Convenience and Necessity ("CC&N") and has filed a separate Application for Commission approval under Docket No. T-04194A-07-0624.

As of October 31, 2007, PAETEC and its Arizona affiliates are serving 282 customers in the State of Arizona. This number primarily represents business customers but does include some residential customers. PAETEC currently has no Arizona employees.

PAETEC currently serves major Metropolitan Statistical Areas ("MSA") in 24 States and employs approximately 2,300 people. PAETEC is headquartered in Rochester, New York, with major operations centers in Charlotte, North Carolina; Mt. Laurel, New Jersey; and Irvine, California. PAETEC has been operating as a competitive communications provider for nearly a decade and presently has more than 2.65 million access line equivalents in service as of June 30, 2007.

Description of Proposed Transactions

McLeodUSA Parent and PAETEC in their Application represent the following:

1. PAETEC and McLeodUSA Parent entered into an Agreement and Plan of Merger dated September 17, 2007.

2. The Agreement provides for a business combination, or merger, of PAETEC and McLeodUSA Parent by which PAETEC will acquire McLeodUSA Parent in an all-stock merger and McLeodUSA Parent will be merged into a wholly-owned subsidiary of PAETEC.

3. The PAETEC entity into which McLeodUSA Parent will be merged is a newly formed entity named PS Acquisition Corp., which was created for the specific purpose of this transaction.

4. McLeodUSA will be the surviving entity of the merger and will be an indirect, wholly-owned subsidiary of PAETEC.

5. Although the transaction will result in a change in the ownership and control of McLeodUSA, no transfer of certificate, assets, or customers will occur as a result of the transfer of control or McLeodUSA's participation in the debt financing.

6. McLeodUSA will continue to provide service to its Arizona customers pursuant to its existing certificate and customers will continue to receive service under the same rates, terms, and conditions of service. The transfer of control and McLeodUSA's participation in the debt financing will be transparent to the customers of McLeodUSA.

7. PAETEC will acquire McLeodUSA Parent in an all-stock merger for approximately $557 million. The merger price consists of approximately $492 million in PAETEC common stock and approximately $65 million in net debt assumption.

8. Current McLeodUSA Parent shareholders will receive 1.30 shares of PAETEC common stock for every share of McLeodUSA Parent common stock that they own.

9. PAETEC will continue to be headquartered in Fairport, New York, and will maintain McLeodUSA Parent's operations in Cedar Rapids, Iowa, and other regional centers, including Tulsa, Oklahoma. After closing of the transaction, PAETEC's current board of directors will add one director to be designated by certain principal stockholders of McLeodUSA Parent.

10. Under the proposed transaction, McLeodUSA will guarantee the obligations of PAETEC, as borrower, under the senior secured credit facilities aggregate principal amount of $550 million and grant a security interest in all of its assets to secure all amounts owing under the credit facilities. PAETEC has a $498 million term loan facility[2] and a $50 million revolving credit facility with final maturity dates of February 28, 2013 and February 28, 2012, respectively. Any proceeds under the revolving credit facility will be used for working capital, capital expenditures, and other general corporate purposes. Under the terms of the Credit Agreement, each direct and indirect, current and future subsidiary of PAETEC is required to provide an unconditional guarantee of all amounts owing under the credit facilities and to grant a security interest in all of its assets to secure all amounts owing under the credit facilities.

11. McLeodUSA will also guarantee the obligations of PAETEC under the $300 million aggregate principal amount of PAETEC's 9.5% Senior Notes due in 2015.[3] Subject to receipt of required governmental approvals, each of PAETEC's current and future wholly-owned subsidiaries is required to guarantee the Notes on a senior unsecured basis. There is no obligation for any subsidiary to guarantee the Notes until after such subsidiary obtains such required governmental approvals.

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[2] Under the term loan facility, borrowings were used to refinance substantially all of the senior secured indebtedness of PAETEC Corp. (the predecessor of PAETEC) and to repurchase all outstanding shares of the US LEC Corp. preferred stock in connection with the closing of the merger of PAETEC Corp. and US LEC Corp., in addition to paying the fees and expenses incurred in connection with the refinancing and stock repurchase.

[3] The net proceeds of the notes offering, along with cash on hand was used to repay $300 million principal amount of term loans outstanding under the credit facilities. As a result of the partial term loan repayment, the current credit facilities consist of the $498 million term loan and the $50 million revolving credit facility.

12. In addition, McLeodUSA intends to incur, guarantee and/or secure additional borrowings up to a total of $500 million of additional indebtedness in the form of incremental term loans and additional notes, which are permitted under the credit agreement governing the credit facilities and under the indenture that governs the terms of the Notes. Any such increased borrowings may be used for capital expenditures, and general corporate and working capital purposes.

13. The requested encumbrance of McLeodUSA's assets and related guaranty will replace McLeodUSA's existing encumbrance and guaranty approved by the Commission on February 20, 2007 in Decision No. 69346.

14. McLeodUSA's existing $600,000 performance bond, which was obtained as a requirement of Decision No. 64657, will continue to remain in place.

The Applicants Request

McLeodUSA Parent, and PAETEC in their Application request that the Commission approve the following:

a. The transfer of indirect control of McLeodUSA resulting from the proposed merger pursuant to A.A.C. R14-2-803; and

b. McLeodUSA's participation in the debt financing arrangements pursuant to A.R.S. 40-285 and A.A.C. R14-2-804.

The Applicants also request expedited consideration and approval of this Application without hearing no later than January 1, 2008.

Staff's Analysis and Conclusions

The Affiliated Interests Rules

The Public Utility Holding Companies and Affiliated Interests Rules apply to all Class A – investor-owned utilities, defined as telecommunications carriers that have Arizona jurisdictional annual revenues of more than $1 million. In the 2006 Annual Report filed with the Commission, McLeodUSA generated more than $1 million of Arizona jurisdictional revenue. The proposed merger of PAETEC and McLeodUSA Parent will create an entity that is considered a Class A investor-owned utility. As a result, the Application is subject to A.A.C. R14-2-801 through 805 of the Public Utility Holding Companies and Affiliated Interests Rules.

In its Application and in response to additional requests by Staff, the Applicants provided the following information as required by A.A.C. R14-2-803 (A):

1. The names and business addresses of the proposed officers and directors of the holding company;

   Information concerning PAETEC's directors and officers has been provided as an attachment to the Application. Both PAETEC's and McLeodUSA's business addresses have also been provided in the Application.

2. The business purposes for establishing or reorganizing the holding company;

   The proposed merger will offer business customers an alternative to legacy carriers through the combined footprint of the Applicants, along with a comprehensive suite of business services, and an extensive switching and fiber network. In addition, the merger should position PAETEC to realize substantial cost savings and achieve synergies to enhance their service offerings and provide more advanced telecommunications services to a broader customer base. The combined managerial and operational expertise of both PAETEC and McLeodUSA Parent will strengthen the competitive position of both companies whereby benefiting Arizona consumers and the telecommunications marketplace within the State of Arizona.

3. The proposed method of financing the holding company and the resultant capital structure;

   As described in the Application, PAETEC is a publicly traded company with an established capital structure and significant financial resources. The methods it uses for financing will not change as a result of this transaction. A newly created subsidiary of PAETEC will merge with McLeodUSA Parent, with McLeodUSA surviving. PAETEC will issue additional equity in the company in connection with this transaction, but this will not materially impact how the company is financed.

4. The resultant effect on the capital structure of the public utility;

   The Applicants have indicated that as a result of the merger, PAETEC will become the new parent of McLeodUSA. The capital structure of the Arizona operating subsidiaries of both PAETEC and McLeodUSA Parent will be unaffected by the merger.

5. An organization chart of the holding company that identifies all affiliates and their relationships within the holding company;

   The Applicants have provided both pre-merger and post-merger organization charts as an attachment to the Application.

6. The proposed method for allocating federal and state income taxes to the subsidiaries of the holding company;

The Applicants have stated that Federal and State income tax allocations among PAETEC and its subsidiaries are consistent with the provisions of Treasury Regulation Sections 1.1552-1(a). PAETEC's approach to allocating tax liability will not change materially as a result of this transaction.

7. The anticipated changes in the utility's cost of service and the cost of capital attributable to the reorganizations;

   The merger is not expected to have any adverse impact on the cost of services provided by McLeodUSA and the PAETEC operating subsidiary. The merger should improve all of the operating subsidiaries' access to capital at favorable rates through their common parent, PAETEC.

8. A description of diversification plans of affiliates of the holding company; and

   The Applicants have no current plans for diversification or business activities unrelated to operations of the current subsidiaries.

9. Copies of all relevant documents and filings with the United States Securities and Exchange Commission and other federal or state agencies.

   The Applicants have made various filings for State and Federal approvals as required to consummate PAETEC's acquisition of McLeodUSA Parent. Copies of the documents have been provided to Staff in electronic format. Documents included filings made with the U.S. Securities and Exchange Commission, Federal Communications Commission, and many States, such as California, Colorado, Georgia, Mississippi, New York, Pennsylvania, Tennessee, Texas, Delaware, Indiana, Louisiana, Minnesota, Ohio, West Virginia, and the District of Columbia.

10. The contemplated annual and cumulative investment in each affiliate for the next five years, in dollars and as a percentage of projected net utility plant, and an explanation of the reasons supporting the level of investment and the reasons this level will not increase the risks of investment in the public utility.

    PAETEC has indicated that its primary business is providing medium-sized and large business and enterprise organizations in large metropolitan areas with a package of integrated communications services, including local and long distance voice, data, and Internet services. PAETEC's services are currently provided by 12 wholly-owned subsidiaries which, collectively, operate in 48 States and the District of Columbia. To date, PAETEC has not contemplated the annual and cumulative investment in each of these affiliates for the next five years and, therefore, cannot provide the figures requested. However, PAETEC was able to provide confidential two year high level projected capital expenditures for the post-merger combined entity.

11. An explanation of the manner in which the utility can assure that adequate capital will be available for the construction of necessary new utility plant and for improvements in existing utility plant at no greater cost than if the utility or its affiliate did not organize or reorganize a public utility holding company.

    The Applicants represent that the Arizona operating subsidiaries of PAETEC and McLeodUSA Parent will be able to attract capital on terms no less favorable than prior to the merger. Adequate, and probably increased, capital will be available for growth and development in Arizona.

The Parties have stated in its Application that McLeodUSA's Arizona customers will continue to receive service under the same rates, terms, and conditions of service as currently provided. The proposed merger is not expected to impair the financial status of the Arizona operating subsidiaries of PAETEC or McLeodUSA Parent; neither preventing them from attracting capital at fair and reasonable terms, or impairing the ability to provide safe, reasonable, and adequate service. Based on the information provided, Staff believes the Parties have complied with the requirements of A.A.C. R14-2-803(C) and 804(C).

McLeodUSA requests authorization to pledge its Arizona assets as security for the debt issuance. 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 McLeodUSA's assets should not impair the availability of service to customers since McLeodUSA 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, Staff finds that any authorization for encumbrances should provide customer protection for prepayments and deposits.

The Public Interest

McLeodUSA is in compliance with Decision No. 69346 in which the Commission approved an encumbrance of McLeodUSA's assets and a guaranty for certain financing arrangements of its parent.

On February 20, 2007, in Decision No. 69346, the Commission approved McLeodUSA's pledge of its Arizona assets as security and for McLeodUSA to act as a co-guarantor for Senior Second Secured Notes issued by McLeodUSA Parent, and to participate in certain other financing arrangements. This proposed transaction will affect Decision No. 69346 since McLeodUSA will participate in the replacement of the 2006/2007 debt, used to issue the Senior Second Secured Notes, with a new financing arrangement, however, McLeodUSA's assets will again be encumbered as security for the loans necessary to refinance the existing debt and purchase in this proposed Application.

As of November 1, 2007, the combined PAETEC and McLeodUSA companies' Arizona workforce consisted of approximately 18 employees. PAETEC has indicated that it does not foresee any Arizona workforce reductions or Arizona plant or facility closings from McLeodUSA, PAETEC, or any of its Arizona affiliates should this Application be approved by the Commission.

The proposed acquisition will allow PAETEC to add network assets including 17,000 fiber-route miles and increase its total number of switches to 116. The combined company will benefit business customers by allowing it to offer a comprehensive suite of business services, and an extensive switching and fiber network. The transaction is also expected to strengthen the ability of the operating subsidiaries, including McLeodUSA and PCI, by allowing them to enhance their service offerings to Arizona consumers and provide more advanced telecommunications to a broader customer base. The combined managerial and operational expertise of both PAETEC and McLeodUSA Parent will also benefit the operating subsidiaries.

In its Application, the Parties have indicated that through the complementary strengths, product sets, and geographic footprints of the two companies, PAETEC should realize substantial cost savings and achieve $30 million in cumulative cost synergies during the first and second years following closing of the transaction. PAETEC provided additional information indicating that the majority of synergy savings will be realized through the elimination of duplicative spending on network facilities. PAETEC expects to streamline its network through additional volume discounts on long distance and local wholesale services, consolidation of signaling networks, and consolidation of duplicative switching and collocation centers. Due to increased volume commitments through mergers and acquisitions, PAETEC anticipates lower per unit costs from its wholesale vendors, such as Qwest, Global Crossing, and AT&T, who build their networks that support toll free services which PAETEC offers to its business customers. The lower per unit costs will allow PAETEC to more competitively price the service to its retail customer base, including its customers in Arizona.

The Applicants have indicated that McLeodUSA has invested $40.52 million in telecommunications equipment in Arizona, primarily consisting of one Class 5 switch, one soft switch, 28 collocations, and a limited amount of intercity fiber. PAETEC, currently, has no physical presence in Arizona and, therefore, the value of its investment in Arizona is zero. PAETEC provided Staff with confidential high level projected capital expenditures for 2008 and 2009 for the post-merger combined entity.

In Decision No. 69346, the Commission approved McLeodUSA's request for authorization to issue guarantees and pledge its Arizona assets as security for certain financing arrangements of its parent McLeodUSA Parent. In a private offering on September 28, 2006, McLeodUSA Parent issued approximately $120 million in 10½ percent Senior Secured Notes due in 2011. As part of the financing arrangement, McLeodUSA Parent agreed to exchange the Senior Secured Notes for substantially identical notes, registered under the Federal Securities Laws, within 180 days. Subject to certain conditions, McLeodUSA Parent and its subsidiaries were allowed to incur additional debt and grant additional liens on their assets, including incurring new debt up to $26 million in aggregate principal amount.

McLeodUSA now seeks the authorization to guarantee the obligations of PAETEC, as borrower, under Senior Secured Credit Facilities of $550 million aggregate principal amount; grant a security interest in all of its assets to secure all amounts owing under the Credit Facilities; guarantee the obligations of PAETEC under the $300 million aggregate principal amount of PAETEC's 9.5% Senior Notes due 2015; and incur, guarantee, and/or secure additional borrowings of up to $500 million of additional indebtedness in the form of incremental term loans and additional notes. This new encumbrance of McLeodUSA's assets and related guaranty will replace McLeodUSA's existing encumbrance and guaranty approved by the Commission in Decision No. 69346.

The Applicants have indicated that McLeodUSA's existing $600,000 performance bond, which was obtained as a requirement of Decision No. 64657, granted March 25, 2002, will continue to remain in place. McLeodUSA currently holds deposits from Arizona customers totaling $7,346.86. No customer deposits are being held in Arizona by any other affiliates of McLeodUSA Parent. PAETEC and its affiliates are not holding any deposits from Arizona customers. PAETEC has indicated that it is of the understanding that McLeodUSA's $600,000 performance bond, currently in place, cannot be used in the encumbrance of assets.

In the Application, PAETEC will acquire McLeodUSA Parent in an all-stock merger for approximately $557 million. The merger price consists of approximately $492 million in PAETEC common stock and approximately $65 million in net debt assumption. Current McLeodUSA Parent shareholders will receive 1.30 shares of PAETEC common stock for every share of McLeodUSA Parent common stock that they own.[4] As indicated previously, the proposed transaction will have no impact on the rates, terms and conditions of service currently provided to customers of McLeodUSA. As supported by the information previously provided, Staff believes that the proposed transaction will not impair the financial status of the Arizona operating subsidiaries of PAETEC or McLeodUSA Parent; nor prevent the Applicants' ability to attract capital at fair and reasonable terms and to provide safe, reasonable, and adequate service.

Pursuant to A.A.C. R14-2-805, McLeodUSA is up to date with filing its 2006 annual diversification activities and plans. PAETEC and its Arizona affiliates combined Arizona annual operating revenues do not exceed $1 million; therefore PAETEC is not subject to A.C.C. R14-2-805. The Compliance Division has stated that there are no delinquencies for PAETEC and McLeodUSA. Staff has verified that the 2006 annual reports of McLeodUSA and PAETEC and its Arizona subsidiaries are on file with the Commission and up to date. On December 4, 2007, the Corporations Division reports that McLeodUSA and the other 3 Arizona affiliates of McLeodUSA Parent are in good standing. In addition, the 2 Arizona subsidiaries of PAETEC are also in good standing.

Both PAETEC and McLeodUSA have indicated that there are no outstanding or unresolved consumer complaints pending with this Commission. Staff's search of the Consumer

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[4] It is noted in the Application, that approximately 40 million shares of PAETEC common stock will be issued to shareholders of currently outstanding McLeodUSA Parent stock. PAETEC has approximately 102.1 million shares of common stock currently outstanding. McLeodUSA Parent's employee stock options, of which 2.7 million are outstanding, will be converted into options to purchase PAETEC shares, to the extent not exercised before closing.

Services database for the past 3 years through December 4, 2007 for McLeodUSA, indicates a total of 20 complaints, 6 inquiries, and 1 opinion, and that all complaints have been resolved and closed. During that same time period, no complaints, inquiries, or opinions have been filed on the other McLeod Parent Arizona affiliates or PAETEC Arizona subsidiaries.

On December 12, 2007, the Applicants submitted an Affidavit of Publication confirming publication of a legal notice relative to the proposed transaction in *The Arizona Republic* on December 10, 2007. The Applicants have also provided Staff with a draft of a direct mailing that will be provided to the McLeodUSA customers following a decision in this matter. Staff has reviewed the proposed customer notice and concludes that it is consistent with Commission requirements.

Staff is not aware of any concerns or objections filed by any entity or individual. Staff reviewed the Application and supplemental filings, and considered all responses to Staff's data requests.

Staff's Recommendations

Staff recommends that the Application of PAETEC and McLeodUSA Parent for a transfer of control of McLeodUSA to PAETEC, resulting from the proposed merger, be approved pursuant to A.A.C. R14-2-803.

Staff recommends that the Application of PAETEC and McLeodUSA Parent for McLeodUSA's participation in debt financing arrangements be approved pursuant to A.R.S. 40-285 and A.A.C. R14-2-804.

Staff also recommends that the Application be approved without a hearing because Staff believes this transaction does not:

a. impair the financial status of the Applicants;
b. prevent the Applicants' ability to attract capital at fair and reasonable terms;
c. prevent the Applicants' ability to provide safe, reasonable and adequate service;
d. adversely affect customers.

Staff further recommends that approval be conditioned on the following:

a. That PAETEC provides notice to the Commission within 30 days following the acquisition close proposed in this transaction.

b. That for one year following acquisition close or until PAETEC and McLeodUSA Parent informs the Commission by filing an affidavit with Docket Control that acquisition-related activities are completed, whichever occurs last, PAETEC and McLeodUSA Parent provide written notification to the Director of the Utilities Division and to the individual members of the Commission, at least 60 days in advance, of any planned acquisition-related Arizona workforce layoffs; any planned acquisition-related Arizona plant closings; and any planned acquisition-related Arizona facility closings.

c. That PAETEC and McLeodUSA Parent provide the Compliance Section with updates by April 15, 2008 and April 15, 2009 on the status of plans to increase employees and investment in Arizona.

d. That PAETEC and McLeodUSA Parent provide the Compliance Section with updates by April 15, 2008 and April 15, 2009 of any changes in the status of debt financing plans.

e. That PAETEC, McLeodUSA Parent, and McLeodUSA be limited from pledging any customer deposits, advances, or prepayments currently held by McLeodUSA or which may be held by McLeodUSA and/or PAETEC in the future, as debt security.

f. That PAETEC shall file, as an annual compliance item in this docket, a notarized attestation from an Officer of the Company stating whether all Arizona customer deposits, advances, and prepayments are excluded from encumbrance, or whether they are secured by a performance bond or irrevocable sight draft Letter of Credit which is not included in the pledged collateral.

g. That PAETEC notifies the McLeodUSA customers of the proposed acquisition and financing through a direct mailing to the McLeodUSA customers. Verification of the notice should be filed with Docket Control within 90 days of a decision in this matter.

Ernest G. Johnson
Director
Utilities Division

EGJ:PJG:tdp\MAS

ORIGINATOR: Pamela J. Genung

BEFORE THE ARIZONA CORPORATION COMMISSION

MIKE GLEASON
Chairman
WILLIAM A. MUNDELL
Commissioner
JEFF HATCH-MILLER
Commissioner
KRISTIN K. MAYES
Commissioner
GARY PIERCE
Commissioner

IN THE MATTER OF THE APPLICATION OF PAETEC HOLDING CORP., MCLEODUSA INCORPORATED AND MCLEODUSA TELECOMMUNICATIONS SERVICES, INC. FOR APPROVAL TO TRANSFER INDIRECT CONTROL OF MCLEODUSA TELECOMMUNICATIONS SERVICES, INC. AND FOR MCLEODUSA TELECOMMUNICATIONS SERVICES, INC. TO PARTICIPATE IN CERTAIN DEBT FINANCING ARRANGEMENTS	DOCKET NO. T-03267A-07-0554 DECISION NO. ___________ ORDER

Open Meeting
January 15 and 16, 2008
Phoenix, Arizona

BY THE COMMISSION:

FINDINGS OF FACT

INTRODUCTION

On September 27, 2007, PAETEC Holding Corp. ("PAETEC") and McLeodUSA Incorporated ("McLeodUSA Parent") filed an Application requesting expedited approval under A.R.S. § 40-285 and A.A.C. R14-2-803 and R14-2-804.B.1, to the extent necessary, as well as any other applicable statues or rules, for the transfer of indirect control of McLeodUSA Telecommunications Services, Inc. ("McLeodUSA") from McLeodUSA Parent to PAETEC and for McLeodUSA to participate in PAETEC's debt financing arrangements. Additionally, the Applicants requested approval to issue guarantee and to pledge or encumber assets.

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THE PARTIES

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1. McLeodUSA is a corporation organized under the laws of Iowa with a principal place of business located at One Martha's Way, Hiawatha, Iowa 52233. McLeodUSA currently provides telecommunications services in 48 States. McLeodUSA offers local service in the following 25 States:

Arizona	Indiana	Michigan	Nebraska	Oklahoma	Utah
Arkansas	Iowa	Minnesota	New Mexico	Oregon	Washington
Colorado	Kansas	Missouri	North Dakota	South Dakota	Wisconsin
Idaho	Louisiana	Montana	Ohio	Texas	Wyoming
Illinois					

2. In Arizona, McLeodUSA is authorized to provide resold and facilities-based local exchange and exchange access telecommunications services pursuant to Decision No. 62627, granted June 9, 2000. McLeodUSA is also authorized to provide resold interexchange telecommunications services pursuant to Decision No. 61001, granted July 16, 1998.

3. McLeodUSA is a wholly-owned subsidiary of McLeodUSA Holdings, Inc, which is a wholly-owned subsidiary of McLeodUSA Parent. McLeodUSA currently provides service to approximately 3,142 business and residential customers in the State of Arizona. McLeodUSA and the other Arizona affiliates[1] of McLeodUSA Parent employ approximately 18 people in Arizona.

4. McLeodUSA Parent is a privately-held Iowa company headquartered in Cedar Rapids, Iowa. Through its operating subsidiaries, McLeodUSA Parent currently owns and operates a high-capacity fiber network that spans 20 Midwest, Southwest, Northwest, and Rocky

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Mountain States. The fiber network contains approximately 13,000 intercity route miles and approximately 4,000 metro route miles. McLeodUSA Parent provides telecommunications services primarily to small and medium-sized enterprise and multi-location commercial customers.

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Colorado	Indiana	Michigan	New Jersey	Pennsylvania	Vermont
Connecticut	Kansas	Minnesota	New Mexico	Rhode Island	Virginia
Delaware	Kentucky	Mississippi	New York	South Carolina	Wisconsin
Florida	Louisiana	Missouri	North Carolina	Tennessee	

6. In Arizona, PAETEC's two subsidiaries, PAETEC Communications, Inc. ("PCI") and US LEC Communications, Inc. ("US LEC"), are authorized to provide resold intrastate interexchange telecommunications services. PCI is authorized to provide service pursuant to Decision No. 62458 granted, April 14, 2000, and US LEC is authorized to provide service by Decision No. 66740, granted January 20, 2004.

7. PAETEC intends to voluntarily surrender the US LEC Certificate of Convenience and Necessity ("CC&N") and has filed a separate Application for Commission approval under Docket No. T-04194A-07-0624.

8. As of October 31, 2007, PAETEC and its Arizona affiliates are serving 282 customers in the State of Arizona. This number primarily represents business customers but does include some residential customers. PAETEC currently has no Arizona employees.

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9. PAETEC currently serves major Metropolitan Statistical Areas ("MSA") in 24 States and employs approximately 2,300 people. PAETEC is headquartered in Rochester, New York, with major operations centers in Charlotte, North Carolina; Mt. Laurel, New Jersey; and Irvine, California. PAETEC has been operating as a competitive communications provider for nearly a decade and presently has more than 2.65 million access line equivalents in service as of June 30, 2007.

THE TRANSACTION

McLeodUSA Parent and PAETEC in their Application represent the following:

10. PAETEC and McLeodUSA Parent entered into an Agreement and Plan of Merger dated September 17, 2007.

11. The Agreement provides for a business combination, or merger, of PAETEC and McLeodUSA Parent by which PAETEC will acquire McLeodUSA Parent in an all-stock merger and McLeodUSA Parent will be merged into a wholly-owned subsidiary of PAETEC.

12. The PAETEC entity into which McLeodUSA Parent will be merged is a newly formed entity named PS Acquisition Corp., which was created for the specific purpose of this transaction.

13. McLeodUSA will be the surviving entity of the merger and will be an indirect, wholly-owned subsidiary of PAETEC.

14. Although the transaction will result in a change in the ownership and control of McLeodUSA, no transfer of certificate, assets, or customers will occur as a result of the transfer of control or McLeodUSA's participation in the debt financing.

15. McLeodUSA will continue to provide service to its Arizona customers pursuant to its existing certificate and customers will continue to receive service under the same rates, terms, and conditions of service. The transfer of control and McLeodUSA's participation in the debt financing will be transparent to the customers of McLeodUSA.

16. PAETEC will acquire McLeodUSA Parent in an all-stock merger for approximately $557 million. The merger price consists of approximately $492 million in PAETEC common stock and approximately $65 million in net debt assumption.

17. Current McLeodUSA Parent shareholders will receive 1.30 shares of PAETEC common stock for every share of McLeodUSA Parent common stock that they own.

18. PAETEC will continue to be headquartered in Fairport, New York, and will maintain McLeodUSA Parent's operations in Cedar Rapids, Iowa, and other regional centers, including Tulsa, Oklahoma. After closing of the transaction, PAETEC's current board of directors will add one director to be designated by certain principal stockholders of McLeodUSA Parent.

19. Under the proposed transaction, McLeodUSA will guarantee the obligations of PAETEC, as borrower, under the senior secured credit facilities aggregate principal amount of $550 million and grant a security interest in all of its assets to secure all amounts owing under the credit facilities. PAETEC has a $498 million term loan facility[2] and a $50 million revolving credit facility with final maturity dates of February 28, 2013 and February 28, 2012, respectively. Any proceeds under the revolving credit facility will be used for working capital, capital expenditures, and other general corporate purposes. Under the terms of the Credit Agreement, each direct and indirect, current and future subsidiary of PAETEC is required to provide an unconditional guarantee of all amounts owing under the credit facilities and to grant a security interest in all of its assets to secure all amounts owing under the credit facilities.

20. McLeodUSA will also guarantee the obligations of PAETEC under the $300 million aggregate principal amount of PAETEC's 9.5% Senior Notes due in 2015.[3] Subject to receipt of required governmental approvals, each of PAETEC's current and future wholly-owned subsidiaries is required to guarantee the Notes on a senior unsecured basis. There is no obligation for any subsidiary to guarantee the Notes until after such subsidiary obtains such required governmental approvals.

21. In addition, McLeodUSA intends to incur, guarantee and/or secure additional borrowings up to a total of $500 million of additional indebtedness in the form of incremental term

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[2] Under the term loan facility, borrowings were used to refinance substantially all of the senior secured indebtedness of PAETEC Corp. (the predecessor of PAETEC) and to repurchase all outstanding shares of the US LEC Corp. preferred stock in connection with the closing of the merger of PAETEC Corp. and US LEC Corp., in addition to paying the fees and expenses incurred in connection with the refinancing and stock repurchase.

[3] The net proceeds of the notes offering, along with cash on hand was used to repay $300 million principal amount of term loans outstanding under the credit facilities. As a result of the partial term loan repayment, the current credit facilities consist of the $498 million term loan and the $50 million revolving credit facility.

loans and additional notes, which are permitted under the credit agreement governing the credit facilities and under the indenture that governs the terms of the Notes. Any such increased borrowings may be used for capital expenditures, and general corporate and working capital purposes.

22. The requested encumbrance of McLeodUSA's assets and related guaranty will replace McLeodUSA's existing encumbrance and guaranty approved by the Commission on February 20, 2007 in Decision No. 69346.

23. McLeodUSA's existing $600,000 performance bond, which was obtained as a requirement of Decision No. 64657, will continue to remain in place.

THE APPLICANTS REQUEST

McLeodUSA Parent, and PAETEC in their Application request that the Commission approve the following:

a. The transfer of indirect control of McLeodUSA resulting from the proposed merger pursuant to A.A.C. R14-2-803; and

b. McLeodUSA's participation in the debt financing arrangements pursuant to A.R.S. 40-285 and A.A.C. R14-2-804.

The Applicants also request expedited consideration and approval of this Application without hearing no later than January 1, 2008.

STAFF'S ANALYSIS

The Affiliated Interests Rules

24. The Public Utility Holding Companies and Affiliated Interests Rules apply to all Class A – investor-owned utilities, defined as telecommunications carriers that have Arizona jurisdictional annual revenues of more than $1 million. In the 2006 Annual Report filed with the Commission, McLeodUSA generated more than $1 million of Arizona jurisdictional revenue. The proposed merger of PAETEC and McLeodUSA Parent will create an entity that is considered a Class A investor-owned utility. As a result, the Application is subject to A.A.C. R14-2-801 through 805 of the Public Utility Holding Companies and Affiliated Interests Rules.

25. In its Application and in response to additional requests by Staff, the Applicants provided the following information as required by A.A.C. R14-2-803 (A):

a. The names and business addresses of the proposed officers and directors of the holding company;

Information concerning PAETEC's directors and officers has been provided as an attachment to the Application. Both PAETEC's and McLeodUSA's business addresses have also been provided in the Application.

b. The business purposes for establishing or reorganizing the holding company;

The proposed merger will offer business customers an alternative to legacy carriers through the combined footprint of the Applicants, along with a comprehensive suite of business services, and an extensive switching and fiber network. In addition, the merger should position PAETEC to realize substantial cost savings and achieve synergies to enhance their service offerings and provide more advanced telecommunications services to a broader customer base. The combined managerial and operational expertise of both PAETEC and McLeodUSA Parent will strengthen the competitive position of both companies whereby benefiting Arizona consumers and the telecommunications marketplace within the State of Arizona.

c. The proposed method of financing the holding company and the resultant capital structure;

As described in the Application, PAETEC is a publicly traded company with an established capital structure and significant financial resources. The methods it uses for financing will not change as a result of this transaction. A newly created subsidiary of PAETEC will merge with McLeodUSA Parent, with McLeodUSA surviving. PAETEC will issue additional equity in the company in connection with this transaction, but this will not materially impact how the company is financed.

d. The resultant effect on the capital structure of the public utility;

The Applicants have indicated that as a result of the merger, PAETEC will become the new parent of McLeodUSA. The capital structure of the

Arizona operating subsidiaries of both PAETEC and McLeodUSA Parent will be unaffected by the merger.

e. An organization chart of the holding company that identifies all affiliates and their relationships within the holding company;

The Applicants have provided both pre-merger and post-merger organization charts as an attachment to the Application.

f. The proposed method for allocating federal and state income taxes to the subsidiaries of the holding company;

The Applicants have stated that Federal and State income tax allocations among PAETEC and its subsidiaries are consistent with the provisions of Treasury Regulation Sections 1.1552-1(a). PAETEC's approach to allocating tax liability will not change materially as a result of this transaction.

g. The anticipated changes in the utility's cost of service and the cost of capital attributable to the reorganizations;

The merger is not expected to have any adverse impact on the cost of services provided by McLeodUSA and the PAETEC operating subsidiary. The merger should improve all of the operating subsidiaries' access to capital at favorable rates through their common parent, PAETEC.

h. A description of diversification plans of affiliates of the holding company; and

The Applicants have no current plans for diversification or business activities unrelated to operations of the current subsidiaries.

i. Copies of all relevant documents and filings with the United States Securities and Exchange Commission and other federal or state agencies.

The Applicants have made various filings for State and Federal approvals as required to consummate PAETEC's acquisition of McLeodUSA Parent. Copies of the documents have been provided to Staff in electronic format. Documents included filings made with the U.S. Securities and Exchange

Commission, Federal Communications Commission, and many States, such as California, Colorado, Georgia, Mississippi, New York, Pennsylvania, Tennessee, Texas, Delaware, Indiana, Louisiana, Minnesota, Ohio, West Virginia, and the District of Columbia.

j. The contemplated annual and cumulative investment in each affiliate for the next five years, in dollars and as a percentage of projected net utility plant, and an explanation of the reasons supporting the level of investment and the reasons this level will not increase the risks of investment in the public utility.

PAETEC has indicated that its primary business is providing medium-sized and large business and enterprise organizations in large metropolitan areas with a package of integrated communications services, including local and long distance voice, data, and Internet services. PAETEC's services are currently provided by 12 wholly-owned subsidiaries which, collectively, operate in 48 States and the District of Columbia. To date, PAETEC has not contemplated the annual and cumulative investment in each of these affiliates for the next five years and, therefore, cannot provide the figures requested. However, PAETEC was able to provide confidential two year high level projected capital expenditures for the post-merger combined entity.

k. An explanation of the manner in which the utility can assure that adequate capital will be available for the construction of necessary new utility plant and for improvements in existing utility plant at no greater cost than if the utility or its affiliate did not organize or reorganize a public utility holding company.

The Applicants represent that the Arizona operating subsidiaries of PAETEC and McLeodUSA Parent will be able to attract capital on terms no less favorable than prior to the merger. Adequate, and probably increased, capital will be available for growth and development in Arizona.

26. The Parties have stated in its Application that McLeodUSA's Arizona customers will continue to receive service under the same rates, terms, and conditions of service as currently provided. The proposed merger is not expected to impair the financial status of the Arizona operating subsidiaries of PAETEC or McLeodUSA Parent; neither preventing them from attracting capital at fair and reasonable terms, or impairing the ability to provide safe, reasonable, and adequate service. Based on the information provided, Staff believes the Parties have complied with the requirements of A.A.C. R14-2-803(C) and 804(C).

27. McLeodUSA requests authorization to pledge its Arizona assets as security for the debt issuance. 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 McLeodUSA's assets should not impair the availability of service to customers since McLeodUSA 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, Staff finds that any authorization for encumbrances should provide customer protection for prepayments and deposits.

THE PUBLIC INTEREST

28. McLeodUSA is in compliance with Decision No. 69346 in which the Commission approved an encumbrance of McLeodUSA's assets and a guaranty for certain financing arrangements of its parent.

29. On February 20, 2007, in Decision No. 69346, the Commission approved McLeodUSA's pledge of its Arizona assets as security and for McLeodUSA to act as a co-guarantor for Senior Second Secured Notes issued by McLeodUSA Parent, and to participate in certain other financing arrangements. This proposed transaction will affect Decision No. 69346 since McLeodUSA will participate in the replacement of the 2006/2007 debt, used to issue the Senior Second Secured Notes, with a new financing arrangement, however, McLeodUSA's assets

will again be encumbered as security for the loans necessary to refinance the existing debt and purchase in this proposed Application.

30. As of November 1, 2007, the combined PAETEC and McLeodUSA companies' Arizona workforce consisted of approximately 18 employees. PAETEC has indicated that it does not foresee any Arizona workforce reductions or Arizona plant or facility closings from McLeodUSA, PAETEC, or any of its Arizona affiliates should this Application be approved by the Commission.

31. The proposed acquisition will allow PAETEC to add network assets including 17,000 fiber-route miles and increase its total number of switches to 116. The combined company will benefit business customers by allowing it to offer a comprehensive suite of business services, and an extensive switching and fiber network. The transaction is also expected to strengthen the ability of the operating subsidiaries, including McLeodUSA and PCI, by allowing them to enhance their service offerings to Arizona consumers and provide more advanced telecommunications to a broader customer base. The combined managerial and operational expertise of both PAETEC and McLeodUSA Parent will also benefit the operating subsidiaries.

32. In its Application, the Parties have indicated that through the complementary strengths, product sets, and geographic footprints of the two companies, PAETEC should realize substantial cost savings and achieve $30 million in cumulative cost synergies during the first and second years following closing of the transaction. PAETEC provided additional information indicating that the majority of synergy savings will be realized through the elimination of duplicative spending on network facilities. PAETEC expects to streamline its network through additional volume discounts on long distance and local wholesale services, consolidation of signaling networks, and consolidation of duplicative switching and collocation centers. Due to increased volume commitments through mergers and acquisitions, PAETEC anticipates lower per unit costs from its wholesale vendors, such as Qwest, Global Crossing, and AT&T, who build their networks that support toll free services which PAETEC offers to its business customers. The lower per unit costs will allow PAETEC to more competitively price the service to its retail customer base, including its customers in Arizona.

33. The Applicants have indicated that McLeodUSA has invested $40.52 million in telecommunications equipment in Arizona, primarily consisting of one Class 5 switch, one soft switch, 28 collocations, and a limited amount of intercity fiber. PAETEC, currently, has no physical presence in Arizona and, therefore, the value of its investment in Arizona is zero. PAETEC provided Staff with confidential high level projected capital expenditures for 2008 and 2009 for the post-merger combined entity.

34. In Decision No. 69346, the Commission approved McLeodUSA's request for authorization to issue guarantees and pledge its Arizona assets as security for certain financing arrangements of its parent McLeodUSA Parent. In a private offering on September 28, 2006, McLeodUSA Parent issued approximately $120 million in 10½ percent Senior Secured Notes due in 2011. As part of the financing arrangement, McLeodUSA Parent agreed to exchange the Senior Secured Notes for substantially identical notes, registered under the Federal Securities Laws, within 180 days. Subject to certain conditions, McLeodUSA Parent and its subsidiaries were allowed to incur additional debt and grant additional liens on their assets, including incurring new debt up to $26 million in aggregate principal amount.

35. McLeodUSA now seeks the authorization to guarantee the obligations of PAETEC, as borrower, under Senior Secured Credit Facilities of $550 million aggregate principal amount; grant a security interest in all of its assets to secure all amounts owing under the Credit Facilities; guarantee the obligations of PAETEC under the $300 million aggregate principal amount of PAETEC's 9.5% Senior Notes due 2015; and incur, guarantee, and/or secure additional borrowings of up to $500 million of additional indebtedness in the form of incremental term loans and additional notes. This new encumbrance of McLeodUSA's assets and related guaranty will replace McLeodUSA's existing encumbrance and guaranty approved by the Commission in Decision No. 69346.

36. The Applicants have indicated that McLeodUSA's existing $600,000 performance bond, which was obtained as a requirement of Decision No. 64657, granted March 25, 2002, will continue to remain in place. McLeodUSA currently holds deposits from Arizona customers totaling $7,346.86. No customer deposits are being held in Arizona by any other affiliates of

McLeodUSA Parent. PAETEC and its affiliates are not holding any deposits from Arizona customers. PAETEC has indicated that it is of the understanding that McLeodUSA's $600,000 performance bond, currently in place, cannot be used in the encumbrance of assets.

37. In the Application, PAETEC will acquire McLeodUSA Parent in an all-stock merger for approximately $557 million. The merger price consists of approximately $492 million in PAETEC common stock and approximately $65 million in net debt assumption. Current McLeodUSA Parent shareholders will receive 1.30 shares of PAETEC common stock for every share of McLeodUSA Parent common stock that they own.[4] As indicated previously, the proposed transaction will have no impact on the rates, terms and conditions of service currently provided to customers of McLeodUSA. As supported by the information previously provided, Staff believes that the proposed transaction will not impair the financial status of the Arizona operating subsidiaries of PAETEC or McLeodUSA Parent; nor prevent the Applicants' ability to attract capital at fair and reasonable terms and to provide safe, reasonable, and adequate service.

38. Pursuant to A.A.C. R14-2-805, McLeodUSA is up to date with filing its 2006 annual diversification activities and plans. PAETEC and its Arizona affiliates combined Arizona annual operating revenues do not exceed $1 million; therefore PAETEC is not subject to A.C.C. R14-2-805. The Compliance Division has stated that there are no delinquencies for PAETEC and McLeodUSA. Staff has verified that the 2006 annual reports of McLeodUSA and PAETEC and its Arizona subsidiaries are on file with the Commission and up to date. On December 4, 2007, the Corporations Division reports that McLeodUSA and the other 3 Arizona affiliates of McLeodUSA Parent are in good standing. In addition, the 2 Arizona subsidiaries of PAETEC are also in good standing.

39. Both PAETEC and McLeodUSA have indicated that there are no outstanding or unresolved consumer complaints pending with this Commission. Staff's search of the Consumer Services database for the past 3 years through December 4, 2007 for McLeodUSA, indicates a

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[4] It is noted in the Application, that approximately 40 million shares of PAETEC common stock will be issued to shareholders of currently outstanding McLeodUSA Parent stock. PAETEC has approximately 102.1 million shares of common stock currently outstanding. McLeodUSA Parent's employee stock options, of which 2.7 million are outstanding, will be converted into options to purchase PAETEC shares, to the extent not exercised before closing.

total of 20 complaints, 6 inquiries, and 1 opinion, and that all complaints have been resolved and closed. During that same time period, no complaints, inquiries, or opinions have been filed on the other McLeod Parent Arizona affiliates or PAETEC Arizona subsidiaries.

40. On December 12, 2007, the Applicants submitted an Affidavit of Publication confirming publication of a legal notice relative to the proposed transaction in *The Arizona Republic* on December 10, 2007. The Applicants have also provided Staff with a draft of a direct mailing that will be provided to the McLeodUSA customers following a decision in this matter. Staff has reviewed the proposed customer notice and concludes that it is consistent with Commission requirements.

41. Staff is not aware of any concerns or objections filed by any entity or individual. Staff reviewed the Application and supplemental filings, and considered all responses to Staff's data requests.

STAFF'S RECOMMENDATIONS

42. Staff recommends that the Application of PAETEC and McLeodUSA Parent for a transfer of control of McLeodUSA to PAETEC, resulting from the proposed merger, be approved pursuant to A.A.C. R14-2-803.

43. Staff recommends that the Application of PAETEC and McLeodUSA Parent for McLeodUSA's participation in debt financing arrangements be approved pursuant to A.R.S. 40-285 and A.A.C. R14-2-804.

44. Staff also recommends that the Application be approved without a hearing because Staff believes this transaction does not:

a. impair the financial status of the Applicants;

b. prevent the Applicants' ability to attract capital at fair and reasonable terms;

c. prevent the Applicants' ability to provide safe, reasonable and adequate service;

d. adversely affect customers.

45. Staff further recommends that approval be conditioned on the following:

a. That PAETEC provides notice to the Commission within 30 days following the acquisition close proposed in this transaction.

b. That for one year following acquisition close or until PAETEC and McLeodUSA Parent informs the Commission by filing an affidavit with Docket Control that acquisition-related activities are completed, whichever occurs last, PAETEC and McLeodUSA Parent provide written notification to the Director of the Utilities Division and to the individual members of the Commission, at least 60 days in advance, of any planned acquisition-related Arizona workforce layoffs; any planned acquisition-related Arizona plant closings; and any planned acquisition-related Arizona facility closings.

c. That McLeodUSA Parent and PAETEC provide the Compliance Section with updates by April 15, 2008 and April 15, 2009 on the status of plans to increase employees and investment in Arizona.

d. That McLeodUSA Parent and PAETEC provide the Compliance Section with updates by April 15, 2008 and April 15, 2009 of any changes in the status of debt financing plans.

e. That PAETEC be limited from pledging any customer deposits, advances, or prepayments currently held by McLeodUSA or which may be held by McLeodUSA and/or PAETEC in the future, as debt security.

f. That PAETEC shall file, as an annual compliance item in this docket, a notarized attestation from an Officer stating whether all Arizona customer deposits, advances, and prepayments are excluded from encumbrance, or whether they are secured by a performance bond or irrevocable sight draft Letter of Credit which is not included in the pledged collateral.

g. That PAETEC notifies the McLeodUSA customers of the acquisition through a direct mailing to the McLeodUSA customers. Verification of the notice should be filed with Docket Control within 90 days of a decision in this matter.

CONCLUSIONS OF LAW

1. PAETEC, McLeodUSA Parent, and McLeodUSA are public service corporations within the meaning of Article XV of the Arizona Constitution.

2. The Commission has jurisdiction over McLeodUSA and the subject matter in this filing.

3. The Commission, having reviewed the filing and Staff's Memorandum dated December 19, 2007, concludes that it is in the public interest to grant the Application of PAETEC Holding Corp. and McLeodUSA Incorporated pursuant to the Public Utility Holding Companies and Affiliated Interests Rules, A.A.C. R14-2-801 et seq., in connection with a proposed transaction whereby PAETEC will acquire control of McLeodUSA and to approve the transaction under A.A.C. R14-2-803 and A.A.C. R14-2-804 and A.R.S. § 40-285.

ORDER

IT IS THEREFORE ORDERED that the Application of PAETEC Holding Corp. and McLeodUSA Incorporated for approval under the Public Utility Holding Companies and Affiliated Interests Rules, A.A.C. R14-2-801 et seq., in connection with a proposed transaction whereby PAETEC will acquire control of McLeodUSA and for approval under A.A.C. R14-2-803 and A.A.C. R14-2-804 and A.R.S. § 40-285 and hereby is approved.

IT IS FURTHER ORDERED that the request for authority for McLeodUSA's participation in debt financing arrangements proposed in this transaction under A.R.S. 40-285 and A.A.C. R14-2-804 is approved.

IT IS FURTHER ORDERED that PAETEC provide notice to the Commission within 30 days following the acquisition close proposed in this transaction.

IT IS FURTHER ORDERED that for one year following the acquisition close or until PAETEC and McLeodUSA Parent inform the Commission by filing an affidavit with Docket Control that acquisition-related activities are completed, whichever occurs last, PAETEC and McLeodUSA Parent provide written notification to the Director of the Utilities Division and to the individual members of the Commission, at least 60 days in advance, of any planned acquisition-related Arizona workforce layoffs; any planned acquisition-related Arizona plant closings; and any planned acquisition-related Arizona facility closings.

IT IS FURTHER ORDERED that PAETEC and McLeodUSA Parent provide the Compliance Section with updates by April 15, 2008 and April 15, 2009 on the status of plans to increase employees and investment in Arizona.

. . .

IT IS FURTHER ORDERED that PAETEC and McLeodUSA Parent provide the Compliance Section with updates by April 15, 2008 and April 15, 2009 of any changes in the status of debt financing plans.

IT IS FURTHER ORDERED that PAETEC, McLeodUSA Parent, and McLeodUSA be limited from pledging any customer deposits, advances, or prepayments currently held by McLeodUSA or which may be held by McLeodUSA and/or PAETEC in the future, as debt security.

IT IS FURTHER ORDERED that PAETEC shall file, as an annual compliance item in this docket, a notarized attestation from an Officer of the Company stating whether all Arizona customer deposits, advances, and prepayments are excluded from encumbrance, or whether they are secured by a performance bond or irrevocable sight draft Letter of Credit which is not included in the pledged collateral.

IT IS FURTHER ORDERED that PAETEC completes the recommended notice to the McLeodUSA customers of the proposed acquisition and financing through a direct mailing to the McLeodUSA customers.

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IT IS FURTHER ORDERED that PAETEC file verification that the notice has been completed with Docket Control within 90 days of a decision in this matter.

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

BY THE ORDER OF THE ARIZONA CORPORATION COMMISSION

CHAIRMAN	COMMISSIONER

COMMISSIONER	COMMISSIONER	COMMISSIONER

IN WITNESS WHEREOF, I BRIAN C. McNEIL, Executive Director of the Arizona Corporation Commission, have hereunto, set my hand and caused the official seal of this Commission to be affixed at the Capitol, in the City of Phoenix, this _______day of __________________, 2008.

____
BRIAN C. McNEIL
Executive Director

DISSENT: ___________________________

DISSENT: ___________________________

EGJ:PJG:tdp/MAS

SERVICE LIST FOR: PAETEC Holding Corp., McLeodUSA Inc., and McLeodUSA Telecommunications, Services, Inc.
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