

State of Florida



Public Service Commission

CAPITAL CIRCLE OFFICE CENTER • 2540 SHUMARD OAK BOULEVARD
TALLAHASSEE, FLORIDA 32399-0850

-M-E-M-O-R-A-N-D-U-M-

DATE: November 18, 2008

TO: Office of Commission Clerk (Cole)

FROM: Division of Regulatory Compliance (Curry, Kennedy)
Division of Economic Regulation (Buys, Maurey)
Office of the General Counsel (Morrow, McKay)

RE: Docket No. 080529-TP – Joint application for approval of indirect transfer of control of telecommunications facilities by Smart City Finance LLC and Hargray-Smart City Acquisition Co., LLC.

AGENDA: 12/02/08 – Regular Agenda – Proposed Agency Action – Interested Persons May Participate

COMMISSIONERS ASSIGNED: All Commissioners

PREHEARING OFFICER: Edgar

CRITICAL DATES: None

SPECIAL INSTRUCTIONS: None

FILE NAME AND LOCATION: S:\PSC\RCP\WP\080529.RCM.DOC

Case Background

On July 11, 2008, Smart City Finance LLC and Hargray-Smart City Acquisition Co., LLC (Hargray) executed a Purchase Agreement whereby Hargray will purchase Smart City Finance LLC's ownership interest in Smart City Telecommunications LLC d/b/a Smart City Telecom (Smart City Telecom) and will become its new parent.

On August 8, 2008, Smart City Finance LLC and Hargray, along with Smart City Telecom (together, the Applicants), submitted a joint application requesting approval by the Florida Public Service Commission (Commission) for the indirect transfer of control of Smart

City Telecom from Smart City Finance LLC to Hargray. In addition, the Applicants request that the Commission find that the carrier selection requirements of Rule 25-4.118, Florida Administrative Code, Local, Local Toll, or Toll Provider Selection, to be inapplicable.

Although not mentioned by the Applicants in their filing, Smart City Telecom is designated as an eligible telecommunications carrier (ETC). Staff believes that the Commission need not address Smart City Telecom's designation as an ETC in this proceeding. Smart City Telecom will continue as the telecommunications services provider after the transfer is consummated, and retain its designation as an ETC. Thus no action is required.

Smart City Telecom is currently a wholly-owned subsidiary of Smart City Finance LLC and is authorized by the Commission pursuant to Incumbent Local Exchange Telecommunications Company (ILEC) Certificate No. 1971 to provide local exchange telecommunications services, and pursuant to Pay Telephone Service Company (PATS) Certificate No. 7664 to provide pay telephone services. Pursuant to Section 364.33, Florida Statutes, Certificate of Necessity Prerequisite to Construction, Operation, or Control of Telecommunications Facilities, Commission approval is required for the transfer of control of Smart City Telecom's ILEC and PATS facilities from Smart City Finance LLC to Hargray.

Pursuant to the Proposed Agency Action Order No. PSC-00-2230-PAA-TP, issued by the Commission on November 22, 2000, Smart City Telecom acquired the assets, including the ILEC Certificate No. 1971, of Vista-United Telecommunications. Order No. PSC-00-2230-PAA-TP was made final and effective by the issuance of Consummating Order No. PSC-00-2415-CO-TP by the Commission on December 18, 2000. Since that time, Smart City Telecom has been providing local exchange, interexchange, and high-speed data services to residential and business customers in Celebration, Lake Buena Vista, Little Lake Bryan, Bay Lake, and Walt Disney World. The Commission has received a total of five customer complaints against Smart City Telecom, the last of which was received on January 8, 2003. Smart City Telecom appears to have consistently complied with the Commission's rules and orders, including timely payment of its Regulatory Assessment Fees.

Smart City Telecom is also registered as an Intrastate Interexchange Telecommunications Company (IXC) and holds IXC Registration No. TJ471. The Applicants are not seeking the Commission's approval for the indirect transfer of control of Smart City Telecom's IXC facilities. Pursuant to Sections 364.02(14)(g) and 364.011(1), Florida Statutes, IXCs are exempt from the requirements of Section 364.33, Florida Statutes. In addition, Smart City Finance LLC is the parent of Smart City Solutions, LLC d/b/a Smart City Communications, which holds Competitive Local Exchange Telecommunications Company (CLEC) Certificate No. 8030. Like IXCs, CLECs are exempt from the requirements of Section 364.33, Florida Statutes, pursuant to Section 364.337(2), Florida Statutes.

Hargray is a Delaware limited liability company formed for the purpose of acquiring Smart City Telecom and other properties under the control of Smart City Finance LLC. Hargray is a wholly-owned subsidiary of Hargray-Smart City Holdings LLC, which through a second tier

subsidiary Hargray Communications Group, Inc.¹, provides telecommunications services in South Carolina and Georgia. The company's operations include traditional telephone carrier services as well as cable television, wireless telephone, and Internet services. Hargray Communications Group, Inc. currently serves approximately 84,274 access lines, 33,108 data subscribers, 27,801 video subscribers, and 7,271 wireless subscribers in South Carolina and Georgia. Upon closing of a corporate restructuring, Hargray-Smart City Holdings LLC will be wholly-owned by Quadrangle Capital Partners II LP, Quadrangle Capital Partners II-A LP and Quadrangle Select Partners II LP (collectively, Quadrangle).

Quadrangle is a private equity fund managed by affiliates in the New York-based investment firm, Quadrangle Group LLC. Quadrangle invests in media and communications companies through separate private and public investment vehicles. Since 2000, Quadrangle has completed over 20 investments in the communications industry, including investment in rural local exchange carriers, competitive local exchange carriers, cable operators and wireless providers. One example of Quadrangle's investments is NuVox Communications, Inc., holder of CLEC Certificate No. 5638 and IXC Registration No. TJ975 in Florida.

The Commission is vested with jurisdiction over this matter pursuant to Sections 364.01, 364.33, 364.335 and 364.603, Florida Statutes. Accordingly, staff believes the following recommendations are appropriate.

¹ Hargray Communications Group, Inc. is a subsidiary of Hargray Holdings, LLC.

Discussion of Issues

Issue 1: Should the Commission approve the joint application for approval of the indirect transfer of control of Smart City Telecommunications LLC d/b/a Smart City Telecom, holder of ILEC Certificate No. 1971 and PATS Certificate No. 7664, from Smart City Finance LLC to Hargray-Smart City Acquisition Co., LLC, and acknowledge that a waiver of Rule 25-4.118, Florida Administrative Code, is not required?

Recommendation: Yes, the Commission should approve the application for approval of the indirect transfer of control of Smart City Telecommunications LLC d/b/a Smart City Telecom, holder of ILEC Certificate No. 1971 and PATS Certificate No. 7664, from Smart City Finance LLC to Hargray-Smart City Acquisition Co., LLC, and should acknowledge that a waiver of Rule 25-4.118, Florida Administrative Code is not required. **(Curry, Kennedy, Buys, Maurey, Morrow, McKay)**

Staff Analysis:

I. Jurisdiction

A. Section 364.33, Florida Statutes

The Commission has authority under Section 364.33, Florida Statutes, to approve an application for transfer of control. Staff notes that this provision does not provide specific standards which the Commission may follow in making its decision to approve a transfer of control. However, staff believes that Section 364.01, Florida Statutes, implies a public interest standard that the Commission should follow when deciding whether to approve or deny transfers of control, among other transactions.

The legislative intent in Section 364.01, Florida Statutes, is clear: the Commission is to exercise its jurisdiction in order to protect “the public health, safety, and welfare” as it relates to basic local telecommunications services. Based on the intent of the Florida Legislature, the Commission should base its decisions on whether to grant applications for transfer of control if it satisfies the public interest. In developing its recommendation, staff reviewed the management, technical, and financial capability of the acquiring entity.

B. Waiver of Rule 25-4.118, Florida Administrative Code

Pursuant to Rule 25-4.118(1), Florida Administrative Code, a customer’s carrier cannot be changed without the customer’s authorization. Rule 25-4.118(2), Florida Administrative Code, provides that a carrier shall submit a change request only if one of the following has occurred:

- (a) The provider has a letter of agency (LOA) . . . from the customer requesting the change;
- (b) The provider has received a customer-initiated call for service . . . ;

(c) A firm that is independent and unaffiliated with the provider . . . has verified the customer's requested change

The Applicants request that the Commission find that the carrier selection requirements of Rule 25-4.118, Florida Administrative Code, Local, Local Toll, or Toll Provider Selection, to be inapplicable. The requirements of Rule 25-4.118, Florida Administrative Code, apply when there is a change in the provider of a customer's telecommunications services.

In this instance, Smart City Telecom is the company that is currently registered with the Secretary of State, and is the Commission-certificated entity that currently provides regulated telecommunications services to Florida customers. Whether the Commission approves or denies the Applicants' request for transfer of control of Smart City Telecom, Florida customers will not be subject to a change of their telecommunications services provider. Because the provider will not change, a waiver of Rule 25-4.118, Florida Administrative Code, is not required.

C. FCC Activity – WC Docket No. 08-170²

Staff has monitored the status of the Applicants' Domestic Section 214 Application filed with the FCC on August 11, 2008. The FCC established a streamlined pleading cycle, announced in DA 08-2063, released on September 9, 2008. On October 14, 2008, the DOJ, National Security Division, requested that the FCC defer action on WC Docket No. 08-170.

Staff contacted the Applicants, as well as the FCC, to obtain an explanation for the deferral. According to the FCC, the DOJ was reviewing the federal application because one of the eight managing members of Quadrangle is an Irish national and holder of a U.S. green card. In a teleconference on October 30, 2008, a DOJ representative informed staff that all applications in which foreign nationals are identified as managing members or owners require the DOJ's review. At the time of the teleconference, the DOJ had not completed its review.

In a November 3, 2008 letter to the FCC, the DOJ officially withdrew its request that the FCC defer action in WC Docket No. 08-170 and acknowledged that it has no objection to the application. On November 12, 2008, the FCC issued DA 08-2480 granting authorization for the transfer of control of Smart City Telecommunications LLC and Smart City Solutions, LLC from Smart City Finance LLC to Hargray-Smart City Acquisition Co., LLC.

II. Staff's Assessment

A. Management Capability

Smart City Telecom is now a wholly-owned subsidiary of Smart City Finance LLC and is authorized by the Commission to provide local exchange telecommunications services and pay telephone services. If the Commission approves the Applicant's request for indirect transfer of

² Domestic Section 214 Application filed for the transfer of control of Smart City Telecommunications LLC and Smart City Solutions, LLC from Smart City Finance LLC to Hargray-Smart City Acquisition Co., LLC.

control, Smart City Telecom will not change or become a new entity. Smart City Telecom will become a subsidiary of Hargray.

Smart City Telecom will continue operating in Florida and will be led by the same management team that currently supports the day-to-day management of the telecommunications operations. Oversight will be provided by Hargray's executive management team. Each member of the executive management team demonstrates varying levels of prior experience in the management and operations of telecommunications companies, including wireline and wireless. Based on these factors, the Applicants claim that Smart City Telecom will have the same management capabilities to provide service as it had under the control of Smart City Finance LLC.

The Applicants have stated that because the transaction only effects a change in the identity of Smart City Telecom's parent, the transaction will be seamless and invisible to Florida customers. The indirect transfer of control will have no effect on the rates, terms, or conditions of service provided by Smart City Telecom. The Applicants claim that acting through its existing management, Smart City Telecom will continue to provide the same services to its customers in Florida, pursuant to the same tariffs, as it currently provides. No Florida assets will be transferred from Smart City Telecom, and Smart City Telecom will continue to own and operate its Florida telecommunications facilities.

On September 30, 2008, Florida's staff participated in a conference call with staff of the South Carolina Public Service Commission seeking information on Hargray Communications Group, Inc.'s performance in South Carolina. The feedback received by staff was that Hargray Communications Group, Inc. was very responsive to requests from the South Carolina Public Service Commission, consumer complaints were very few in number with no memory of any recent complaints, and that the company made timely payments into the state's Universal Service Fund. Staff notes that Hargray Communications Group, Inc. was acquired by Quadrangle in June 2007 and based on feedback provided by the staff of the South Carolina Public Service Commission, there has been no negative impact on Hargray Communications Group, Inc.'s quality of service it provides to business and residential customers in its service territory.

On October 28, 2008, the Applicants submitted a letter to the Commission that they received from Walt Disney World Co. (Disney). The letter, signed by Mr. John McGowan, Executive Counsel, represents Disney's approval of the transfer of control of telecommunications facilities by Smart City Finance LLC and Hargray-Smart City Acquisition Co., LLC. Staff notes that sales of telecommunications services by Smart City Telecom to Disney, and its affiliates and subsidiaries operating at the WALT DISNEY WORLD® Resort, collectively represent the bulk of Smart City Telecom's revenue stream.

B. Technical Capability

The Applicants have stated that no assets will be transferred from Smart City Telecom and that Smart City Telecom will continue to own and operate its Florida telecommunications facilities. The current technical staff will be retained and will continue to provide operation and maintenance support of the facilities. The same networks that currently serve Florida customers will continue to serve them after the transfer of control has been completed. Smart City

Telecom's past performance with respect to the Commission's service standards indicates that the quality of service provided in Florida is acceptable. Customer complaints are few, with the last complaint received by the Commission on January 8, 2003.

The Applicants argue that the proposed transaction will provide Hargray Communications Group, Inc. and Smart City Telecom access to each other's network capabilities, technical strengths, and complementary services, which together are expected to strengthen their ability to expand their offerings and provide more advanced telecommunications services to a broader customer base. The Applicants also provide that the proposed acquisition will enable Smart City Telecom to offer innovative products and to further strengthen both companies' marketplace positions to the benefit of consumers. The Applicants state that the transaction will be conducted in a manner that will be virtually transparent to the customers of Smart City Telecom.

C. Financial Capability

The Applicants state that Hargray has the requisite financial capability to fully support its operations subsequent to the transfer of control. Hargray, Smart City Finance LLC, and Hargray Holdings LLC (Hargray Holdings) are privately held corporations. Their financial statements are not filed with the Securities and Exchange Commission or generally available for public inspection. The Applicants submitted financial information in response to staff's data requests. Portions of the information are filed under a claim of confidentiality.

Staff believes Hargray will have a non-investment grade bond rating, i.e., no higher than BB+. Standard & Poor's Ratings Service assigned Hargray Holdings a corporate bond rating of B. Moody's Investor Service (Moody's) assigned Hargray Communications Group, Inc., a corporate bond rating of B2. Moody's reported that the acquisition of Smart City does not impact Hargray Communications Group Inc.'s bond ratings at this time.

The Applicants state that Hargray Holdings' non-investment grade debt rating is consistent with the ratings of other communications companies such as Fairpoint Communications, Inc, NuVox Communications, Paetec Holdings Corp., and Qwest. Staff found this statement to be accurate. The Applicants explain that the past success of Hargray Holdings demonstrates the reasonableness of its debt structure. According to the Applicants, the debt structure of Hargray will be more conservative (less debt compared to equity) than the debt structure of Hargray Holdings.

Hargray has received a debt commitment letter from CoBank, ACB, Royal Bank of Canada and General Electric Capital Corporation (Lenders) pursuant to which the Lenders have agreed to provide Hargray with credit facilities in the form of a senior secured term loan (Term Loan) and a senior secured revolving loan (Revolver). The proceeds from the Term Loan will be used to finance the acquisition. The proceeds from the Revolver will be used for working capital, capital expenditures, and for other general corporate purposes.

Hargray claims that it will have substantial free cash flow to invest in its operations or accelerate its debt payments. Hargray estimates that it will have 33 percent of its EBITDA

(Earnings Before Interest, Taxes, Depreciation and Amortization) to pay its interest expense, 30 percent of its EBITDA for capital expenditures, and 19 percent of its EBITDA remaining for further investment or acceleration of debt payments. Hargray states that the impact of its debt structure on its free cash flows is comparable to that of other telecommunications companies. Staff concurs that Hargray's free cash flow, expressed as a percentage of EBITDA, appears to be comparable to other telecommunications companies.

The Applicants provided staff with information that they believe shows Hargray will have the necessary cash flow to fund its operations, fund capital expenditures, and meet its debt service. Given the Applicants' representations regarding sufficient cash flow and commitments for debt financing from major banks, staff believes Hargray has the necessary financial capability to support its operations.

III. Conclusion

Based upon staff's analysis of the management, technical, and financial capabilities of the acquiring company, staff believes that the transfer of control of Smart City Telecom from Smart City Finance LLC to Hargray would be in the public interest.

Therefore, staff recommends that the Commission should approve the joint application for approval of the indirect transfer of control of Smart City Telecommunications LLC d/b/a Smart City Telecom, holder of ILEC Certificate No. 1971 and PATS Certificate No. 7664, from Smart City Finance LLC to Hargray-Smart City Acquisition Co., LLC, and acknowledge that a waiver of Rule 25-4.118, Florida Administrative Code, is not required.

Docket No. 080529-TP
Date: November 18, 2008

Issue 2: Should this docket be closed?

Recommendation: The Order issued from this recommendation will become final and effective upon issuance of a Consummating Order, unless a person whose substantial interests are affected by the Commission's decision files a protest that identifies with specificity the issues in dispute, in the form provided by Rule 28-106.201, Florida Administrative Code, within 21 days of the issuance of the Proposed Agency Action Order. If the Commission's Order is not protested, this docket should be closed administratively upon notification by the Applicants that this transfer of control either has or has not been consummated. **(Morrow, McKay)**

Staff Analysis: At the conclusion of the protest period, if no protest is filed, this docket should be closed administratively upon notification by the Applicants that the transfer of control either has or has not been consummated.