EXHIBIT LIST
DOCKET TITLE: *Verizon/Frontier Transfer*
DOCKET NUMBER: UT-090842
DATE: December 15 - 18, 2009

WITNESS: FRONTIER: BILLY JACK GREGG				
STAFF CROSS-EXAMINATION EXHIBITS				
				Testimony of Michael Fletcher before the West Virginia Commission
				Frontier Response to Staff Data Request No. 129
				Frontier Response to Staff Data Request No. 131 CONFIDENTIAL
				Frontier Response to Staff Data Request No. 132
				Frontier Response to Staff Data Request No. 133 (including 5 attachments)
				Frontier Response to Staff Data Request No. 134
				Illinois rule on service guarantee
				Graph titled "Initial Trouble Reports per 100 Access Lines (taking out 18% out-of-service attributable to HSI)
				Graph titled "Out-of-Service TRs per 100 Access Lines @ 82%"

Case Number 09-0871-T-PC
Frontier Communications Corporation,
Citizens Telecommunications Company of West Virginia,
dba Frontier Communications of West Virginia,
Verizon West Virginia Inc., et al.

Direct Testimony
Michael L. Fletcher
Utilities Division

On Behalf of the Staff of
The Public Service Commission of West Virginia

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November 16, 2009

201 Brooks Street, P. O. Box 812, Charleston, WV 25323

DIRECT TESTIMONY OF MICHAEL L. FLETCHER

Q. **PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND POSITION WITH PRESENT EMPLOYER.**

A. My name is Michael L. Fletcher. My business address is 201 Brooks Street, P.O. Box 812, Charleston, West Virginia 25323. I am currently Deputy Director, Carrier and Consumer Operations, with the Public Service Commission's Utilities Division.

Q. **MR. FLETCHER, WOULD YOU PLEASE DESCRIBE YOUR QUALIFICATIONS AND BACKGROUND FOR THIS POSITION?**

A. I received a Bachelor's Degree with High Distinction from the University of Virginia in 1972. My undergraduate major was economics. Subsequently, I attended graduate school at the University of Virginia where I completed all of the requirements for a doctorate in economics except the dissertation. After completing the required course work, I was hired as a faculty member to teach undergraduate economics courses at the University of Virginia. I taught Principles of Economics, Intermediate Microeconomic Theory, Industrial Organization and Public Finance.

I was employed by the Public Service Commission in July 1982. I have testified in a wide variety of cases involving, for example, conservation alternatives, electric utility deficient capacity, lead-lag studies, numerous rulemaking proceedings, and various other electric, natural gas, telecommunications, and motor carrier proceedings before this Commission.

Q. WHAT IS THE PURPOSE OF THIS PROCEEDING?

A. This case is the joint application of Frontier Communications Corporation (Frontier) and Verizon West Virginia Inc. (Verizon-WV) and certain affiliates for approval of the transfer of Verizon's local exchange and long distance business in West Virginia to companies to be owned and controlled by Frontier Communications Corporation. These joint applicants seek necessary approval from this Commission pursuant to *West Virginia Code* §24-2-12. Pursuant to *West Virginia Code* §24-2-12, the Commission may grant its consent for this proposed transaction upon a showing that (1) the terms and conditions thereof are reasonable, (2) that neither party to the proposed transaction is given an undue advantage over the other, and (3) the terms and conditions of the proposed transaction do not adversely effect the public in West Virginia.

Q. IS IT POSSIBLE TO SUMMARIZE THE PROPOSED TRANSACTION BRIEFLY?

A. The proposed transaction is thoroughly detailed in the Petitioners' original filing in this case. However, MLF Exhibit No. 1 is a page from a Frontier document[1] which simplifies a summary in a schematic representation. MLF Exhibit No. 1, page 2, is from

[1] Extract from Frontier filed response on September 21, 2009, to Staff Question No. 21 from Staff's *First Set of Interrogatories, Data Requests Or Requests For Information Directed To Citizens Telecommunications Company of West Virginia dba Frontier Communications of West Virginia* (hereafter *Staff First Request to Frontier-WV*).

the same document showing the massive proposed changes in access lines resulting from this proposed transaction.

Q. WHAT IS THE FORMAT OF STAFF'S DIRECT TESTIMONY IN THIS CASE?

A. My direct testimony will address Staff's concerns about this proposed transaction involving the Petitioner's assertions about broadband expansion effects, Frontier Communications' "innovative service programs", comparative quality of service issues, and whether the proposed transaction potentially harms current Verizon-WV customers. Mr. Steve Wilson will file separate direct testimony explaining Staff's concerns regarding various financial aspects of the proposed transaction.

Q. WHAT REASONS ARE PROVIDED BY FRONTIER COMMUNICATIONS THAT THIS COMMISSION SHOULD APPROVE THE PROPOSED TRANSACTION?

A. Frontier Communications asserts there are five reasons for this Commission to conclude that the proposed transaction benefits Verizon, Frontier, current Verizon-WV customers and West Virginia[2]:

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[2] Direct Panel Testimony by Daniel McCarthy and J. Michael Swatts, filed on July 10, 2009 (hereafter Frontier Direct Panel Testimony).

- "First, Frontier plans to increase broadband availability in West Virginia."[3]
- "Second, Frontier will extend its innovative customer service programs to the newly acquired areas, thus encompassing almost all of West Virginia."[4]
- "Third, Frontier will focus on West Virginia as a key strategic state."[5]
- "Fourth, the transaction will transform Frontier, strengthening its balance sheet through a substantial decrease in its ratio of debt to EBITDA, a 25% reduction in its shareholder dividend and a reduced dividend payout ratio."[6]
- "Fifth, the transaction will not harm customers."[7]

Q. WHAT POSSIBLE RISKS ASSOCIATED WITH THIS PROPOSED TRANSACTION ARE CITED BY FRONTIER COMMUNICATIONS?

A. A word search of Frontier' Direct Panel Testimony filed on July 10, 2009, reveals that the word "risk" does not appear a single time. A similar word search of the initial Joint Petition filed on May 29, 2009, reveals that "risk" appears once in Exhibit 2.1. "Agreement and Plan of Merger" on page 58 and that single occasion is in reference to "Risk Factors" in filed Securities and Exchange Commission (SEC) documents.

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3 Frontier Direct Panel Testimony, p.7, line 7.

4 Frontier Direct Panel Testimony, p.7, lines 15-16.

5 Frontier Direct Panel Testimony, p.8, line 2.

6 Frontier Direct Panel Testimony, p.8, lines 15-17.

7 Frontier Direct Panel Testimony, p.9, line 2.

Q. WHAT "RISK FACTORS" ARE INDICATED IN THE REFERENCED SEC DOCUMENTS?

A. On September 14, 2009, Frontier Communications filed Amendment No. 2 to its Form S-4 Registration Statement with the SEC. The "Risk Factors" disclosed by Frontier Communications in that document include the following major points[8]:

Risks Relating to the Spin-Off and the Merger

- The calculation of the merger consideration will not be adjusted in the event the value of the Spinco business or assets declines before the merger is completed. As a result, at the time Frontier stockholders vote on the merger, they will not know the value of the Spinco business or assets which will be acquired in the merger. The value of the Spinco business and assets may have an effect on the value of Frontier common stock following completion of the merger.

- Frontier's effort to combine Frontier's business and the Spinco business may not be successful.

- The combined company may not realize the growth opportunities and cost synergies that are anticipated from the merger.

- After the close of the transaction, sales of Frontier common stock may negatively affect its market price.

- If the assets contributed to Spinco by Verizon are insufficient to operate the Spinco business, it could adversely affect the combined company's business, financial condition and results of operations.

- The combined company's business, financial condition and results of operations may be adversely affected following the merger if it is not able

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[8] Included bullet points are extracted directly from listed "Risk Factors" as filed with the Securities and Exchange Commission on September 14, 2009, Amendment No. 2 to Form S-4 Registration Statement, Registration No. 333-160789, pages 24-36.

to obtain consents to assign certain Verizon contracts to Spinco.

- Regulatory agencies may delay approval of the spin-off and the merger, fail to approve them, or approve them in a manner that may diminish the anticipated benefits of the merger.
- The merger agreement contains provisions that may discourage other companies from trying to acquire Frontier.
- Failure to complete the merger could adversely affect the market price of Frontier common stock as well as Frontier's business, financial condition and results of operations.
- If the spin-off does not qualify as a tax-free spin-off under Section 355 of the Internal Revenue Code, referred to as the Code, including as a result of subsequent acquisitions of stock of Verizon or Frontier, then Verizon or Verizon stockholders may be required to pay substantial U.S. federal income taxes, and Frontier may be obligated to indemnify Verizon for such taxes imposed on Verizon.
- If the merger does not qualify as a tax-free reorganization under Section 368 of the Code, Frontier and the stockholders of Verizon may be required to pay substantial U.S. federal income taxes.
- Frontier will be unable to take certain actions after the merger because such actions could jeopardize the tax-free status of the spin-off or the merger, and such restrictions could be significant.
- Investors holding shares of Frontier common stock immediately prior to the merger will, in the aggregate, have a significantly reduced ownership and voting interest after the merger and will exercise less influence over management.
- The pendency of the merger could adversely affect the business and operations of Frontier and the Spinco business.

Risks Related to the Combined Company's Business Following the Merger

- The combined company will likely face further reductions in access lines, switched access minutes of use, long distance revenues and federal and state subsidy revenues, which could adversely affect it.
- The combined company will face intense competition, which could adversely affect it.
- Some of the combined company's future competitors will have superior

resources, which may place the combined company at a cost and price disadvantage.

- The combined company may be unable to grow its revenues and cash flows despite the initiatives Frontier has implemented and intends to continue after the merger.
- Weak economic conditions may decrease demand for the combined company's services.
- Disruption in the combined company's networks and infrastructure may cause the combined company to lose customers and incur additional expenses.
- The combined company's business will be sensitive to the creditworthiness of its wholesale customers.
- A significant portion of the combined company's workforce will be represented by labor unions and will therefore be subject to collective bargaining agreements, and if the combined company is unable to enter into new agreements or renew existing agreements before they expire, the combined company workers subject to collective bargaining agreements could engage in strikes or other labor actions that could materially disrupt the combined company's ability to provide services to its customers.
- The combined company may complete a significant strategic transaction that may not achieve intended results or could increase the number of its outstanding shares or amount of outstanding debt or result in a change of control.

Risks Related to Liquidity, Financial Resources and Capitalization

- If the recent severe contraction in the global financial markets and current economic conditions continue into 2010, this economic scenario may have an impact on the combined company's business and financial condition.
- Substantial debt and debt service obligations may adversely affect the combined company.
- The combined company will require substantial capital to upgrade and enhance its operations.

Risks Related to Regulation

- Changes in federal or state regulations may reduce the access charge revenues the combined company will receive.

- The combined company will be reliant on support funds provided under federal and state laws.
- The combined company and its industry will likely remain highly regulated, and the combined company will likely incur substantial compliance costs that could constrain its ability to compete in its target markets.

Risks Related to Technology

- In the future, as competition intensifies within the combined company's markets, the combined company may be unable to meet the technological needs or expectations of its customers, and may lose customers as a result.

Frontier Communications' discussion of each of the foregoing "Risk Factors" should be an important consideration by this Commission in reaching its decision. For ease of the reader an extract of the full text of these "Risk Factors" is shown in MLF Exhibit No.2. The difficulty for all of the parties to this proceeding and the Commission is in assigning a probability factor to the realization of the foregoing asserted benefits and thirty (30) "Risk Factors" of the proposed transaction. It is reasonable to assume that more than one of the cited risks will occur. Which ones will negatively affect Frontier Communications and in turn negatively affect its customers including those who are currently Verizon-WV customers?

Q. WHAT ARE THE BENEFITS AND RISKS OF THE PROPOSED TRANSACTION TO VERIZON?

A. The Direct Panel Testimony of Verizon[9] states "Verizon has decided to focus on its nationwide wireless operations, and on its wireline operations in states that have primarily high density markets." Thus, approval of the proposed transaction by this Commission and other required regulatory agencies furthers Verizon's decided "focus" by being allowed to officially eliminate troublesome wireline operations in low density markets.

The only risk I have been able to define for Verizon is the risk that this proposed transaction will not receive the necessary approvals or otherwise reach an unsuccessful conclusion. The agreement appears to virtually insulate Verizon from any other major risk that Verizon anticipated arising from the transaction. For example, as shown in the foregoing Frontier list of "Risk Factors" :

- "If the spin-off does not qualify as a tax-free spin-off under Section 355 of the Internal Revenue Code, referred to as the Code, including as a result of subsequent acquisitions of stock of Verizon or Frontier, then Verizon or Verizon stockholders may be required to pay substantial U.S. federal income taxes, and <u>Frontier may be obligated to indemnify Verizon for such taxes imposed on Verizon</u>." [10]

Another example[11] is that under "Certain Circumstances" causing termination of the proposed agreement the sum of $80 million would be payable by Frontier

[9] Direct Panel Testimony of Stephen E. Smith and Kathy L. Buckley on Behalf of Verizon, filed on July 10, 2009, page 6, lines 15-16.

[10] See my foregoing testimony, page 6, lines 11-16. Emphasis added.

[11] See Agreement and Plan of Merger, Section 9.3. "Amounts Payable in Certain Circumstances"

Communications to Verizon.

Further, the Agreement and Plan of Merger "definitions" provide that :

- "1.167 "Spinco Closing Equity Value" means the amount equal to the sum of (A) $5.247 billion plus (B) the Required Payment Amount, if any."

- "1.144 "Required Payment Amount" means the aggregate amount, if any, of all amounts required to be paid, refunded, deferred, escrowed, or foregone pursuant to an order, settlement agreement or otherwise (including in the form of any contribution or transfer of Assets or assumption or retention of Liabilities, measured at fair market value and assuming the maximum amount of any contingent amount is paid or foregone and the full amount of any deferred, contingent or escrowed amount is not received) by Verizon or its Subsidiaries, other than post-Closing obligations of Spinco or any Spinco Subsidiary, as a condition to obtaining any consent of any Governmental Authority in the Territory required to consummate the Distribution or the Merger or to complying with any order approving the Distribution and the Merger."

Thus, should this or any regulatory agency require Verizon to pay any amount as a condition of regulatory approval, that amount becomes part of the "Spinco Closing Equity Value" payable by Frontier Communications.

Apparently the only risk faced by Verizon is that one or more regulatory agencies, including this Commission, may deny the petition. The numerous risks cited by Frontier Communications and the lack of risks for Verizon raises the question of whether this proposed transaction fails the statutory requirement that "that neither party to the proposed transaction is given an undue advantage over the other".

Q. DOES STAFF AGREE WITH THE PETITIONER'S EMPHASIS ON THIS PROPOSED TRANSACTION'S EFFECT ON BROADBAND AVAILABILITY IN WEST VIRGINIA AS A MAJOR REASON THIS COMMISSION SHOULD APPROVE THE TRANSACTION?

A. Approximately one-fourth of Frontier's Direct Panel Testimony is devoted to asserted increases in broadband availability as a major reason this Commission should approve the proposed transaction. The Direct Testimony of Mr. Gregg states:

> "Q. WHAT WILL BE THE BEST MEASURE OF FRONTIER'S FUTURE PERFORMANCE IN WEST VIRGINIA?
>
> A. In a word: broadband. Frontier has made it clear that its future success as a company depends on broadband." [12]

Staff disagrees that the Commission's determination of its decision in this case should be unduly influenced by such assertions concerning prospects for broadband availability in West Virginia.

As this Commission is fully aware from Case No. 08-0761-T-GI and from the number of informal and formal customer complaints filed, the current major issue involving the Verizon-WV service area is not broadband availability, but is the quality of service for plain, ordinary wireline service. There are assertions in both Frontier's Direct Panel Testimony and that of Mr. Gregg that the expansion of broadband availability will

[12] Direct Testimony of Billy Jack Gregg, Billy Jack Gregg Universal Consulting, filed on behalf of Frontier Communications Corporation, (hereafter Direct Testimony of Billy Jack Gregg), page 10, lines 13-16.

lead to an improvement in the quality of basic service for current Verizon-WV wireline customers. Contrary to these assertions, Verizon-WV, in Case No. 08-0761-T-GI, identified twenty-nine wire centers in its service territory as those most in need of rehabilitation efforts. All of these twenty-nine targets are urban or municipal in nature and there is no reason to believe that any of these twenty-nine targets lack some form of broadband availability through Verizon, cable companies, wireless and/or CLECs. It does not follow that Frontier's promise to expand broadband availability is either a necessary or sufficient solution to solve these deficiencies in wireline quality of service.

Mr. Gregg states that Verizon-WV currently provides broadband access to "only 60% of its customers"[13] and goes on to state that Frontier currently makes such access available to "94% of its residential customers"[14]. The Frontier Direct Panel Testimony states that Frontier has provided broadband availability to "approximately 92% of the households in its service area" but that "only about 60% of the <u>homes</u> in Verizon's West Virginia service area have <u>access to Verizon's broadband service</u>."[15] While the testimony is generally careful to distinguish such comparisons on the basis of "customers served" or "households served" by each utility, these comparisons can easily become misconstrued in an "apples and oranges" fashion to read that 92% of households in Frontier's service area have broadband access, but that only 60% of households in

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[13] Direct Testimony of Billy Jack Gregg, page 14, lines 16-17.

[14] Direct Testimony of Billy Jack Gregg, page 15, line 1.

[15] Frontier Direct Panel Testimony, p. 27, lines 20-23, Emphasis added.

Verizon-WV's service area have broadband access. For example, a spokesperson for Frontier was quoted in the *Charleston Daily Mail*[16] stating exactly that:

> "Secondly, 40 percent of the households in Verizon's footprint in the state do not even have access to broadband."

Mr. Gregg's response to Staff's inquiry about what percentage of households within Verizon's service territory have access to broadband, other than through satellite, was "unknown".[17] What is known with certainty is that "households" in the Verizon-WV footprint do not have to rely solely on broadband access from Verizon-WV and do not do so. Broadband access in Verizon-WV's footprint is also provided by cable companies, CLECs, wireless carriers, and satellite broadband providers. Mr. Gregg restricts his discussion to "land-based" sources of broadband access exclusive of options available from satellite broadband providers. He states "Satellite broadband service is typically higher in cost and slower in speed than land-based broadband service."[18] It follows then that the purpose of the proposed transaction is to provide, in no specifically defined way, lower cost and faster speed broadband access.

What is not known with any certainty is how many households in Verizon-WV's

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[16] *Charleston Daily Mail* on November 5, 2009, page 5A.

[17] Filed response on October 7, 2009, to Staff Question No. 4(B), Staff's *Second Set of Interrogatories, Data Requests Or Requests For Information Directed To Citizens Telecommunications Company of West Virginia dba Frontier Communications of West Virginia* (hereafter *Staff Second Request to Frontier-WV*). The response to Staff Question 4(C) concerning Verizon-WV business customer access to broadband from other than Verizon-WV, was also "Unknown".

[18] Direct Testimony of Billy Jack Gregg, page 15, footnote 12.

footprint have broadband access or for that matter how many households in West Virginia have such access from various sources. This is of course why West Virginia recently received a $1.4 million federal grant to actually map broadband access in West Virginia. Further, exactly what level of broadband "cost" and "speed" should this Commission consider as being in the "public interest" in its decision to approve or deny the sale of utility service?

Mr. Gregg states "Approximately 43% of Frontier West Virginia's residential customers subscribe to broadband, while only about 25% of Verizon's customers actually subscribe."[19] The comparison of the percentage of customers subscribing to broadband from Frontier-WV and Verizon-WV is very misleading. Obviously, Verizon customers without access to broadband can not subscribe. Mr. Gregg's response to Staff's information request shows that as of December 31, 2008, the percentage of broadband subscribers for Frontier-WV and Verizon-WV for whom broadband is actually available is virtually identical.[20]

Q. IS IT STAFF'S OPINION THAT EXPANDING BROADBAND AVAILABILITY IN WEST VIRGINIA IS NOT A WORTHWHILE GOAL?

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[19] Direct Testimony of Billy Jack Gregg, page 16, lines 20-21.

[20] Attachment to Response to Question 6, *Staff Second Request to Frontier-WV*.

A. No. The point is that the "need" for the scale of such expansion is currently unknown.[21] Further, given the current estimate that 80% of West Virginia households have broadband access[22] and even if expanding access to 100% was a reasonable economic goal, the data for <u>both</u> Verizon-WV and Frontier-WV implies that a 20% increase in broadband access would lead to about a 9% increase in actual subscriptions. Mr. Gregg's response to Staff questions about what he considered a "reasonable target percentage for broadband access" was that "Based on Frontier investments to date, it appears that a broadband availability of 85% to 90% of households over a number of years would be reasonable."[23] Thus, given current subscriber demand, a 5% (80% to 85%) to 10% (80% to 90%) increase in access implies an estimated increase in actual subscriptions to broadband from 2% to 4%. Staff simply does not believe that the Commission's decision in this case should give much weight to unsubstantiated assertions involving expansion of access to a non-utility product for which about 43% subscription demand currently exists and at a maximum may increase subscribership by 9% by households, not businesses.

Staff recommends that the Commission reject broadband access as a major

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[21] Both the Frontier Direct Panel Testimony and that of Mr. Gregg cite Frontier's $55.2 million application for broadband deployment grant assistance from the *American Recovery and Reinvestment Act.* The State of West Virginia has also applied for a $126.3 million grant. Additional grant applications specific to West Virginia total about $181 million. Since the grants winning approval are not known at this time, these applications represent yet another significant unknown concerning the possible impact of this proposed transaction on broadband expansion in West Virginia.

[22] *From the Governor's Desk: A weekly column by Gov. Joe Manchin*, "West Virginia Leading the Way in Rural Broadband", April 11, 2008.

[23] Responses to Question 5 (C) and 5(E), *Staff Second Request to Frontier-WV.*

consideration in a decision to approve the proposed transaction. Clearly the statutory mandate of this Commission is to insure that West Virginia customers are provided with quality utility service, i.e., wireline service, at reasonable rates, and Staff believes that this proposed transaction is neither necessary nor sufficient to achieve that goal.

Q. WHAT ARE YOUR CONCERNS REGARDING FRONTIER'S "INNOVATIVE CUSTOMER SERVICE PROGRAMS"?

A. Frontier's business model is focused on selling its prospective customers primarily non-telecommunication services such as Internet access, "Frontier Secure Connections", "Frontier Portal", "Frontier's Piece of Mind service", video access (presently via satellite TV), and "upselling" those customers various bundles of non-telecommunication services. Indicative of Frontier's business model is the following exchange between Jason Armstrong, an analyst with Goldman Sachs; Don Shassian, Frontier Communications' Chief Financial Officer; and Maggie Wilderotter, Frontier Communications' Chairman and Chief Executive Officer:

> **"Jason Armstrong - Goldman Sachs**
>
> Okay. That's great. Maybe, second, totally unrelated question. You guys have done a good job offsetting the access line declines through creative upselling of existing customers. You talked this quarter about peace of mind and you talked yesterday about the Yahoo! front page. Can you help us think through the margin profile of this type of customer relative to your base? And is this something we should be thinking about, higher ARPU but lower margins as we think about longer term modeling of this company?

Don Shassian

Jason, I don't think -- I think we've got revenue upside, the margins on these are still very, very healthy. The wireless data, the peace of mind. These are all nice supplemental incremental revenues that our customers can see buying the products from us. They look at us at being a reliable and independent and being expert on these things. So there is very, very handsome margins.

Most of this is -- we are not looking at any significant reseller operations here which would result in significantly decreased margins. So, right now things we are looking at are still quite handsome on the margin side.

Maggie Wilderotter

Yes, a good example. On the Yahoo! partnership which is a revenue share to us, we basically provide the right-of-way into the customer home through the portal, Jason. And Yahoo! pays us money. So it is all margin, if you look at it from that perspective.

In addition, on the wireless data side, Don has mentioned this in the past, it is about a 70% margin for us on that type of a business. Peace of mind has very strong margins. So we are not just creative in terms of trying to address the customer need, but I think we can do it and add value and customers are willing to pay for that and it keeps us in the margin range that has been our target. That is really part of the discipline in terms of how we look at the business."[24]

As previously cited[25], Mr. Gregg states "Approximately 43% of Frontier West Virginia's residential customers subscribe to broadband, while only about 25% of Verizon's customers actually subscribe." Mr. Gregg[26] and the Frontier Direct Panel

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[24] Frontier Communications Corporation, Q2 2008 Earnings Call Transcript, quoted with permission of Seeking Alpha and can be accessed in its entirety at www.SeekingAlpha.com

[25] Direct Testimony of Billy Jack Gregg, page 16, lines 20-21.

[26] Direct Testimony of Billy Jack Gregg, page 17.

Testimony[27] describe factors thought to account for this disparity in broadband subscribership. Such factors include the additional services that Frontier makes available to broadband subscribers, that Frontier will dispatch a technician to install new broadband service, and that from time to time Frontier offers free computers if the new subscriber will sign up for a two-year broadband commitment. The cited disparity presumably gives Frontier opportunities to use its "innovative customer service programs" to increase customer demand for broadband.

Also as previously cited[28], Mr. Gregg's response to Staff's information request shows that as of December 31, 2008, the percentage of broadband subscribers for Frontier-WV and Verizon-WV for whom broadband is actually available is virtually identical. Since there is no disparity in this percentage, the cited explanatory factors do not provide much explanation, nor are there opportunities for increased subscribership, foregone by Verizon, awaiting the arrival of Frontier's "innovative customer service programs". The most likely explanation for the lack of disparity in demand for broadband with access is similar demographics, similar customer perceptions regarding a need for broadband, and various enticements provided by both Verizon-WV and Frontier-WV.

Staff is very concerned because although this Commission allows for the billing of such "innovative" services through Frontier's telephone bill, the Commission has

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27 Frontier Direct Panel Testimony, pages 13-15.

28 Attachment to Response to Question 6, *Staff Second Request to Frontier-WV*.

repeatedly stated that it has no jurisdiction over the rates, quality of service, and/or terms and conditions for non-telecommunication services. The end result is that the regulatory ability to effectively resolve utility customer billing disputes and quality of service complaints involving such bundled regulated and non-regulated services is significantly reduced.

In Case No. 06-0092-T-C, Staff explained its opposition to bundled pricing of regulated utility service with non-regulated, non-telecommunication services. As explained there much of the economic literature regards bundling of services as a form of price discrimination intended to increase revenues. Further, such bundling of services can be anti-competitive in that such bundles generally include long term contracts and early termination fees that would not be allowed by this Commission for stand alone regulated utility services. Complex bundling of services can create barriers to entry by requiring prospective service providers to enter the market at a larger scale and cost than would otherwise be required. Finally, such bundling of services reduces customer information and the ability to chose among competing bundles with different components.

Mr. Gregg states that since 2006 Frontier-WV has offered a free computer if the new subscriber will sign up for a two-year broadband commitment and has provided approximately 11,000 customers in West Virginia with free computers.[29] This 11,000 number is significantly more than Frontier reported in response to Staff about the number

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[29] Direct Testimony of Billy Jack Gregg, page 17, lines 17-18.

of customers who received a free computer or laptop from 2006 to 2009.[30] Of the Frontier-WV residential customers subscribing to broadband as of December 31, 2008, only about 11% received free computers or laptops in 2006 or 2007. Moreover, for those customers given free computers in 2006 and for whom their two or three year commitment has expired only somewhat more than half[31] remain a Frontier-WV broadband customer.

In conclusion, Frontier Communications' "innovative customer service programs" and free computers may be effective in increasing the subscribership to Frontier broadband services beyond what it would be without such programs, but the cited lack of disparity in subscribership between Verizon-WV and Frontier-WV is not factually present. The focus of Frontier Communications' business model is to extract revenues from West Virginia customers who Mr. Gregg has characterized as "high median age, low average education level, low average income level"[32] in partial explanation for low levels of broadband subscribership.[33]

[30] See "confidential" response to Staff's Question 8(E)(2) and 8(E)(3), *Staff First Request to Frontier-WV.*

[31] See "confidential" response to Staff's Question 8(D), *Staff First Request to Frontier-WV.*

[32] Direct Testimony of Billy Jack Gregg, page 17, lines 17-18.

[33] Direct Testimony of Billy Jack Gregg, page 12, lines 16-17 and page 13, lines 1-2.

Q. WHAT HAS YOUR INVESTIGATION REVEALED CONCERNING THE COMPARATIVE QUALITY OF SERVICE HISTORICAL DATA FOR FRONTIER AND VERIZON?

A. For purposes of comparison I have reviewed the quality of service data reported by Frontier and Verizon to the Federal Communications Commission (FCC) for the years 1999 through 2008. This data is available at the FCC through the FCC's ARMIS[34] Report 43-05.

The actual data for various quality of service metrics is shown in MLF Exhibit No. 3. This exhibit shows data for:[35]

- Citizens Telecommunications of West Virginia
- Citizens Mountain State of West Virginia
- a simple arithmetic average for Citizens' West Virginia operations shown as Citizens-WV
- the aggregate for all Citizens Communications operations
- Verizon-WV
- the aggregate for all Verizon Communications operations.

[34] ARMIS stands for Automated Reporting Management Information System and such reports are available at *www.fcc.gov/wcb/***armis**

[35] Citizens Communications changed its name to Frontier Communications in May 2008 but the historical ARMIS report data for West Virginia and "in aggregate" is still reported under the Citizens name. The names are left unchanged in this section of my testimony because the names correspond to the 10 year historical data shown in MLF Exhibit No. 3 which in turn were taken from the ARMIS data corresponding to the Citizens entities.

Both West Virginia and aggregate metrics are shown because while the West Virginia companies are more familiar to Staff and the Commission the metrics for the aggregate companies may be more indicative of what current Verizon-WV customers may expect from Frontier Communications.

Q. PLEASE SUMMARIZE WHAT THESE FCC REPORTS SHOW?

Total Trouble Reports per Month per 100 Lines (10 year averages)
(Includes Initial and Repeat Trouble Reports)

	Citizens-WV	Verizon-WV	Citizens	Verizon
Residential service	4.2	2.8	3.1	2.1
Business service	1.7	0.8	1.7	0.9

- The conclusion that Verizon-WV has, on average, **fewer** *Total Trouble Reports per 100 Lines* for residence service than Citizens-WV is statistically significant[36] at 1%.
- The conclusion that Verizon (in aggregate) has, on average, **fewer** *Total Trouble Reports per 100 Lines* for residential service than Citizens (in aggregate), is statistically significant at 1%.
- The conclusion that Verizon-WV has, on average, **fewer** *Total Trouble Reports per 100 Lines* for business service than Citizens-WV is statistically significant at

[36] Rather than rely on the observation that one average was numerically greater than the other I used a difference in averages statistical test where the null hypothesis was that the averages were equal. Significant at 1% means there is 1 chance in 100 that the averages are equal.

1%.

- The conclusion that Verizon has, on average, **fewer** *Total Trouble Reports per 100 Lines* for business service than Citizens is statistically significant at 1%.

Average Installation Interval in Days (10 year averages)

	Citizens-WV	Verizon-WV	Citizens	Verizon
Residential service	4.1	1.0	4.6	1.2
Business service	5.3	2.2	6.1	2.1

- The conclusion that Verizon-WV has, on average, a **lower** *Average Installation Interval in Days* for residential service than Citizens-WV is statistically significant at 1%.
- The conclusion that Verizon has, on average, a **lower** *Average Installation Interval in Days* for residential service than Citizens is statistically significant at 1%.
- The conclusion that Verizon-WV has, on average, a **lower** *Average Installation Interval in Days* for business service than Citizens-WV is statistically significant at 1%.
- The conclusion that Verizon has, on average, a **lower** *Average Installation Interval in Days* for business service than Citizens is statistically significant at 1%.
- It is noted that the *Average Installation Interval in Days* for both Citizens-WV and Citizens generally increased from 2005 to 2008.

Percent Local Installation Commitments Met (10 year averages)

	Citizens-WV	Verizon-WV	Citizens	Verizon
Residential service	91.26	98.12	95.76	98.48
Business service	88.70	96.36	95.09	97.10

- The conclusion that Verizon-WV has, on average, a **greater** *Percent Local Installation Commitments Met* for residential service than Citizens-WV is statistically significant at 1%.
- The conclusion that Verizon has, on average, a **greater** *Percent Local Installation Commitments Met* for residential service than Citizens is statistically significant at 1%.
- The conclusion that Verizon-WV has, on average, a **greater** *Percent Local Installation Commitments Met* for business service than Citizens-WV is statistically significant at 1%.
- The conclusion that Verizon has, on average, a **greater** *Percent Local Installation Commitments Met* for business service than Citizens is statistically significant at 1%.

Out of Service Repair Intervals in Hours (10 year averages)
(Includes Initial Out of Service and Repeat Out of Service Intervals)

	Citizens-WV	Verizon-WV	Citizens	Verizon
Residential service	17.4	34.1	18.6	29.1
Business service	15.2	14.8	18.2	17.4

- The conclusion that Verizon-WV has, on average, a **greater** *Out of Service Repair Intervals in Hours* for residential service than Citizens-WV is statistically significant at 1%.
- The conclusion that Verizon has, on average, has a **greater** *Out of Service Repair Intervals* in Hours for residential service than Citizens is statistically significant at 1%.
- The difference in 10-year averages for Verizon-WV and Citizens-WV for *Out of Service Repair Intervals in Hours* for business service is **not** statistically significant.
- The difference in 10-year averages for Verizon and Citizens for *Out of Service Repair Intervals in Hours* for business service is **not** statistically significant.
- The Verizon-WV *Out of Service Repair Intervals in Hours* for residential service markedly increased from 2005 (30) through 2008 (72.4), but there was much less of an increase for Verizon during the same period.
- Even though Citizens-WV and Citizens reported, on average, much lower *Out of Service Repair Intervals in Hours* for residence service than Verizon-WV, the data show a disturbing increase for Citizens-WV from 2006 through 2008.

Repeat Out of Service Trouble Reports as a Percentage of Initial Out of Service Trouble Reports (10 year averages)

	Citizens-WV	Verizon-WV	Citizens	Verizon
Residential service	17.47	19.14	13.49	18.10
Business service	22.49	14.49	16.02	16.73

- The conclusion that Verizon-WV has, on average, a **greater** *Repeat Out of Service Trouble Reports as a Percentage of Initial Out of Service Trouble Reports* for residential service than Citizens-WV is **not** statistically significant at 1%, but **is** at a 5% level.
- The conclusion that Verizon has, on average, a **greater** *Repeat Out of Service Trouble Reports as a Percentage of Initial Out of Service Trouble Reports* for residential service than Citizens is statistically significant at 1%.
- The conclusion that Verizon-WV has, on average, has a **greater** *Repeat Out of Service Trouble Reports as a Percentage of Initial Out of Service Trouble Reports* for business service than Citizens-WV is statistically significant at 1%.
- The difference in 10-year averages for Verizon and Citizens for *Repeat Out of Service Trouble Reports as a Percentage of Initial Out of Service Trouble Reports* for business service is **not** statistically significant.

Q. WHAT ARE YOU ABLE TO CONCLUDE FROM THE FOREGOING REVIEW OF THE FCC ARMIS QUALITY OF SERVICE DATA?

A. Verizon-WV and Verizon performed better, on average, than did Citizens-WV and Citizens, respectively, <u>for both residential and business service</u> in the following:

- *Total Trouble Reports per Month per 100 Lines*
- *Average Installation Interval in Days*
- *Percent Local Installation Commitments Met*.

Citizens-WV and Citizens performed better, on average, than did Verizon-WV and Verizon, respectively, <u>for residential service</u> in the following:

- *Out of Service Repair Intervals in Hours*
- *Repeat Out of Service Trouble Reports as a Percentage of Initial Out of Service Trouble Reports.*

There was no statistically significant difference for *Out of Service Repair Intervals in Hours* for business service.

The comparison yields mixed results concerning the West Virginia specific and aggregate ten (10) year history of providing different levels of quality of service. The increased *Out of Service Repair Intervals in Hours* by Verizon-WV for residential service is a major concern of ongoing Case No. 08-0761-T-GI. While Citizens-WV historically has outperformed Verizon-WV in this category, the data shows a disturbing increasing trend in *Hours* for Citizens-WV after 2005.

I conclude, based on this historical analysis, that if the proposed transaction were approved, the quality of service for current Verizon-WV wireline customers could actually decrease in significant categories. Further, assuming the successful resolution of Case No. 08-0761-T-GI, approval of the proposed transaction is not necessary for this purpose.

Q. DO YOUR CONCLUSIONS LEAD YOU TO AGREE THAT APPROVAL OF THE PROPOSED TRANSACTION WILL NOT HARM CURRENT VERIZON-WV CUSTOMERS?

A. Absolutely not.

The Petition and Direct Testimony filed by the Petitioners in this case are full of assertion and promises, but no measurable commitments. Neither the Petition nor the Frontier Direct Testimony even mention the numerous "Risk Factors" faced by Frontier Communications. Some of those cited "Risk Factors", such as the state of the economy and changes in technology, apply to both Verizon and Frontier Communications. However, a significant number flow from and because of this proposed transaction. These latter risks are not only borne by Frontier Communications, but also by its prospective new West Virginia customers.

As more fully detailed in the direct testimony of Staff witness Wilson, Staff's review of the historical financial policies of Frontier Communications causes grave concern about Frontier's practice of paying dividends in excess of net income. At least in part, the result is a continual drain on Frontier's retained earnings that is not sustainable over time. Finally, part of this proposed transaction involves a huge financing cost associated with the $3.3 billion dollar payment by Frontier to Verizon and that financing cost is neither known nor measurable.

The emphasis given to broadband access expansion contains no commitment on when such expansion would occur. It doesn't address the fundamental fact that major areas of Verizon-WV targeted by Verizon-WV as most in need of enhanced repair efforts don't lack broadband access, but lack reliable wireline service.

Finding "innovative service programs" with large margins is critical to Frontier Communications' business model. Expanding the exposure of West Virginia customers to such "programs" is, in Staff's view, potentially harmful given the prevalence of long term contracts and an inability of this Commission to offer consumer protection for service bundles mainly composed of non-regulated non-telecommunication services. The comparison of performance concerning quality of service measures as reported to the FCC indicates that the areas of superior performance by Frontier are precisely those areas already being addressed in the open and ongoing Case No. 08-0761-T-GI. In other areas of service quality the data shows that Frontier provides historically inferior performance relative to Verizon which would harm customers.

Finally, given the financial concerns cited by Staff Witness Wilson and the probability that one or more of the critical "Risk Factors" cited by Frontier will materialize, the likely result is pressure to allow an increase in utility rates. Mr. Gregg's statement that "At least in the short term, rates for each company will be maintained where they are."[37] In reference to "the immediate impact on retail customers following the transaction", Frontier's Direct Panel Testimony is less vague in defining "short term", by only promising that " Frontier has no specific plans to make any changes to the services in West Virginia <u>at closing</u>."[38] Neither assertion reduces Staff's concern about the negative customer impact of this proposed transaction on both rates and services.

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[37] Direct Testimony of Billy Jack Gregg, page 22, lines 9-10.

[38] Frontier Direct Panel Testimony, page 34, lines 22-23.

Q. DO YOU HAVE ANY ADDITIONAL CONCERNS ABOUT THE PROPOSED TRANSACTION?

The Frontier's Direct Panel Testimony (p38) states that the company is aware of Case No. 08-0761-T-GI and would continue with the settlement agreement or the Verizon-WV Retail Service Quality Plan. However, Frontier cautions that "Frontier may have different strategies and approaches to fulfilling the Plan and maintaining compliance...".[39] The Verizon-WV Retail Service Quality Plan (RSQP) contains a specific time line for key events to occur as part of the plan and many of those key events are to occur after the projected closing of this proposed transaction in April 2010. Frontier's comment about "different strategies and approaches" raises significant questions about the effective transition of the RSQP and whether such transition would delay improvement in wireline service.

Staff is concerned about the apparent lack of knowledge and concern by Frontier of the condition of Verizon-WV facilities and therefore the market value of the assets Frontier intends to acquire. Frontier entered into an agreement with Verizon in what seems to have been a very short time predicated on new revenue sources, but absent any due diligence for the value of the facilities that would be acquired. Obviously if Frontier has severely underestimated the cost of improving the quality of wireline service in West Virginia and potentially other states, the asserted $500 million in cost savings become

[39] Frontier Direct Panel Testimony, page 38, lines 19-21.

even more nebulous, and the added risk of continued wireline service problems is borne by Verizon-WV customers.

Q. WHAT ARE STAFF'S RECOMMENDATIONS?

A. Staff recommends that the Petitioners proposed transaction be denied by the Commission on the grounds that it fails the *WV Code* §24-2-12 requirement "the terms and conditions of the proposed transaction do not adversely effect the public in West Virginia".

If the Commission nevertheless finds sufficient reason to approve the proposed transaction, Staff recommends that such approval occur under the following conditions:

- Frontier should be required to abide by a definitive time line for the expansion of broadband access to current Verizon-WV customers without such access, especially for density cells 3 and 4.
- Frontier should not be allowed to market its "innovative service programs" with either contract terms exceeding one year or exorbitant termination fees.
- Promotional offerings by Frontier, such as free computers, must explain the comparative costs to the customer before purchase between, for example, the purchase price of a comparable computer and the sum of the payments for required bundled services over the term commitment of the promotional offering.
- Frontier must provide specifics of how it would comply with the Verizon-WV Retail Service Quality Plan including a commitment for expenditures on materials, facilities, and manpower.

- Frontier should not be permitted to increase rates for any service currently offered by Verizon-WV for a period of five years following the transfer of Verizon-WV to Frontier.
- Frontier and Verizon should be required to remove from the agreement any provision that requires Frontier to essentially pay for any monetary conditions imposed on Verizon as a condition of approval of the proposed transaction by this Commission or any other regulatory body.
- As a condition of this Commission's approval Verizon should be required to contribute the sum of $300 million for improvements in the Verizon-WV quality of service.[40] The contributed sum would be placed in an appropriate escrow account to be used by Frontier for such improvements and with prior consent for withdrawal of funds by this Commission.

Q. DOES THIS CONCLUDE YOUR TESTIMONY IN THIS PROCEEDING?

A. Yes.

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[40] As detailed in Staff Witness Wilson's separate Direct Testimony on page 3, the Verizon-WV average construction expenditure from 1993 through 2003 was $121.6 million and the average construction expenditure from 2004 through 2008 was $63.1 million. Therefore, an estimate in lieu of the failure of Frontier being able to provide Staff with its own estimate of what would be required to rehabilitate the Verizon-WV wireline facilities is ($121.6 million - $63.1 million)*5 years = $292.5 million. This is an estimate of what Verizon-WV would have spent in construction expenditures from 2004 through 2008 at the prior 10 year historical average for construction expenditures.

Docket UT-090842
UTC Staff Data Request Nos. 127-139 to Verizon and Frontier
December 3, 2009

UTC STAFF DATA REQUEST NO. 129:

Regarding Mr. Gregg's assertion that Frontier's ARMIS data does not allow for a fair comparison to Verizon's ARMIS data:

a. In regards to the service quality data that Verizon submits to ARMIS, does Verizon include more than the minimum information required, i.e., unregulated activities or "customer chosen appointments"?

b. Is it possible to remove the data that skew Frontier's service quality in order to make a fair comparison between the two companies? If not, are there any service quality data available to compare Frontier's service quality performance with that of the Verizon companies included in the present transaction?

Response:

Applicants assert Objection Nos. 3, 7, 9 and 10. Subject to and without waiver of the objections, Applicants respond as follows:

a. Yes. To the best of Mr. Gregg's knowledge, Verizon includes customer chosen appointments, but not unregulated activities.
b. No. Frontier does not have the data necessary to restate ARMIS results.

Prepared By: Cassandra Guinness
Date: December 3, 2009
Witness: To be determined

Docket UT-090842
UTC Staff Data Request Nos. 127-139 to Verizon and Frontier
December 3, 2009

UTC STAFF DATA REQUEST NO. 132:

Please provide a copy of the incentive regulation agreement Frontier has with the New York PSC identified in Mr. Gregg's testimony on page 17, line 1. In regards to that incentive regulation agreement that began in 2001:

a. What is the total annual dollar figure at risk by way of customer rebates Frontier would have to pay if all of the service quality metrics fell below the benchmarks?
b. What other sanctions would Frontier face?
c. What are the specific service quality metrics that must be met?

Response:

Applicants assert Objection Nos. 3, 7, 9, 10 and 12. Subject to and without waiver of the objections, Applicants respond as follows:

a. Please see attached document: "WA Staff Set 13 FRO132 OMP Modifications.pdf. This document defines the modifications to the Open Market Plan that Frontier Telephone of Rochester had with the New York PSC (Case 93 – C –0103 and Case 93-C-0033).The total dollars at risk under the Open Market Plan for failure to meet service quality objectives was $9 million.
b. Frontier Telephone of Rochester faces no "sanctions". Under the incentive regulation plan (that is no longer effective), Frontier could have been prohibited from passing a dividend to the parent company.
c. Please see the attached file: WA Staff Set 13 FRO132 Service Metrics 58 Pts.pdf for a description of the service quality metrics and objectives.

Prepared By: Cassandra Guinness
Date: December 3, 2009
Witness: To be determined

WA Staff Set 13 FRO132 OMP Modifications.pdf

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

Petition of Rochester Telephone Corporation for Approval of Proposed Restructuring Plan — Case 93-C-0103

Petition of Rochester Telephone Corporation for Approval of a New Multi-Year Rate Stability Agreement — Case 93-C-0033

Hon. Rafael Epstein

JOINT PROPOSAL FOR OPEN MARKET PLAN CONTINUATION AND MODIFICATION

NON-PROPRIETARY VERSION

Jointly submitted for Commission consideration on January 20, 2000

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STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

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	Hon. Rafael Epstein

JOINT PROPOSAL FOR OPEN MARKET PLAN CONTINUATION AND MODIFICATION

PREAMBLE

Frontier Telephone of Rochester, Inc. ("FTR") is committed to full competition for all customers (including carriers/CLECs) in the FTR service territory. FTR is committed to maintaining and improving service quality for all consumers. FTR is also connnitted to providing the maximum amount of benefits to consumers, and to developing and making available current, new, and emerging technologies in FTR's service territory marketplace.

CONTINUATION OF THE OPEN MARKET PLAN

All parties, including, but not limited to, Frontier Telephone of Rochester, Inc. ("FTR"), Department of Public Service Staff ("staff'), the New York State Consumer Protection Board ("CPB"), Choice One Communications of New York, Inc. ("Choice One"), Time Warner Telecom of New York, Inc. ("Time Warner"), and the Public Utility Law Project ("PULP"), propose the following as a Joint Proposal for Open Market Plan continuation and modification in order to settle the current phases of Cases 93-C-0033 and 93-C-0103. This Joint Proposal shall constitute a recommendation to the New York State Public Service Commission ("Commission") to continue the Open Market Plan ("OMP"), including all approved modifications and amendments thereto. The parties recommend that this Joint Proposal be approved and made effective as an amendment to the current OMP as soon as possible. The parties recommend that the Commission, based on this Joint Proposal, maintain all other aspects of the OMP unless specifically and expressly modified by this Joint Proposal or by the Commission.

DEFINITIONS

For purposes of this Joint Proposal, the following terms shall have the following meanings:

1. "Joint Proposal" is the agreement for settlement proposed to the Commission for its consideration and adoption pursuant to section 3.9 of title 16 of the New York Code of Rules and Regulations.

2. "Approval date" is defined as the actual calendar date when the Commission issues an Order or an Opinion and Order to approve, modify or terminate the Open Market Plan.

3. "Approval period" is defined as thirty (30) calendar days from the Approval date of the Joint Proposal, as defined above.

4. "Best efforts" shall mean efforts reasonably taken in good faith and with due care under the circumstances with the specific intention of bringing about the desired result.

5. "Soft dial tone" means the ability to place emergency assistance calls using the digits 9-1-1 on disconnected lines in the situations defined herein. All other calling capability on an access line with Soft dial tone will not be permitted.

6. "TELRIC" means Total Element Long Run Incremental Cost which is a term coined by the Federal Communications Commission ("FCC") for its adaptation of the TSLRIC ("Total Service Long Run Incremental Cost") costing standard to the costing of network elements and other items. TELRIC is a cost-based pricing methodology based on forward-looking economic costs.

7. "CLEC" means competitive local exchange carrier or competitive carrier or new entrant carrier.

8. "ADSL" means asymmetric digital subscriber line, which is a high-speed, wireline transmission technology generally being used to provide high-speed data connections to the Internet.

9. "DSLAM" means digital subscriber line access multiplexer, which is a technology used to concentrate traffic in ADSL arrangements in a central office or a remote location.

10. "Total Service Resale" means the sale by FTR of local telephone service, at wholesale rates, to CLECs for the offering of service at retail rates.