BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of VERIZON COMMUNICATIONS INC., and FRONTIER COMMUNICATIONS CORPORATION Joint Application for an Order Declining to Assert Jurisdiction, or, in the Alternative, to Approve the Indirect Transfer of Control of VERIZON NORTHWEST INC.	)))))))))))	Docket No. UT-090842

TESTIMONY IN SUPPORT OF SETTLEMENT AGREEMENT

BY

FRONTIER COMMUNICATIONS CORPORATION,
VERIZON COMMUNICATIONS INC.

I. <u>Introduction</u>

Q. Who is sponsoring this testimony?

A. This testimony is jointly sponsored by: Frontier Communications Corporation ("Frontier") and Verizon Communications Inc. ("Verizon") (Frontier and Verizon, collectively, the "Applicants").

Q. Please state your names.

A. Our names are Daniel McCarthy (Frontier) and Timothy McCallion (Verizon). Our qualifications are set forth in our pre-filed direct testimonies.

Q. What is the purpose of your testimony?

A. Our joint testimony describes and supports all provisions of the settlement agreement entered into by the Applicants with the Staff of the Washington Utilities and Transportation Commission ("Staff") executed on December 17, 2009, and filed concurrently with this testimony ("Settlement" or "Agreement"). The parties to the Agreement are referred to herein as the "Parties." The Applicants provide this testimony in support of the Settlement, provide an overview of the principal aspects of the Settlement, as well as explain why the Settlement is consistent with the public interest and the interests of the Applicants. The Applicants join with the Staff and request that the Commission issue an order approving the Settlement and providing the approvals requested in the application.

Q. Have all parties joined in the Settlement?

A. No. But the Applicants have entered into a number of settlements agreements with competitive local exchange carriers ("CLECs") that have been filed with the Commission, along with supporting testimony. Those settlements resolve wholesale issues associated with the transaction. Thus, the Commission has before it four separate settlements for consideration: (1) the Settlement; (2) the Joint CLEC Settlement; (3) the Comcast Settlement; and (4) the Level 3 Settlement.

II. Background

Q. Please briefly describe the history of this proceeding.

A. On May 29, 2009, Verizon and Frontier filed an application seeking Commission approval for the indirect transfer of control of Verizon Northwest Inc. ("Verizon Northwest") from Verizon to Frontier as described in the application. The Applicants requested that the Commission decline to assert jurisdiction or, in the alternative, to approve the transaction under Chapter 80.12 RCW and any other applicable law or rule the Commission deems necessary to effect the transaction.

On July 6, 2009, Verizon and Frontier filed direct testimony in support of their application, and Frontier submitted supplemental direct testimony on August 3, 2009. On November 3, 2009, Staff and other parties filed responsive testimony. Finally, on November 19, 2009, Verizon and Frontier filed their rebuttal testimony. Collectively, the Parties have filed thousands of pages of testimony and exhibits, and exchanged volumes of discovery (with Applicants having responded to more than 1,000 discovery requests). The Parties met a number of times throughout the process, including technical conferences to discuss Staff's questions and issues of interest regarding the transaction, and settlement discussions intensified in recent weeks. All of these discussions resulted in the Settlement that is now before the Commission.

Q. Please summarize the Settlement.

A. The Settlement includes an attachment that enumerates 35 agreed-upon conditions, some of which have additional sub-conditions. The conditions are grouped into categories that assure the Commission that key customer-facing and service-related protections are implemented.

- Financial Conditions (Conditions 1-12), which include commitments for Frontier to provide detailed and extensive reports to the Commission on finances, synergy savings, transactions with Verizon, and a multi-year strategic plan for central office switches in Washington to ensure service standards are met; to file for an alternative form of regulation ("AFOR") plan in the next five years; to avoid recovering separation, branding and transition (as well as increases in management) costs from Washington ratepayers; to certify affiliate transactions; and to ensure that Washington assets will not be encumbered.
- DSL/Broadband Deployment (Conditions 13-18), which include specific commitments by Frontier, in terms of investment levels and timing, regarding enhanced broadband deployment in Washington.
- Retail Service Quality (Conditions 19-22), which include Frontier's commitments to increase customer credits provided under the existing Verizon Service Performance Guarantee program.

- Retail Services Rates (Conditions 23-26), which include Frontier's commitments to cap certain retail rates for at least three years, to continue to provide certain bundled grandfathered services offered by Verizon, and to provide certain rights to consumers to change carriers without change-related charges for a period of time following the transaction.
- Operating Support Systems (Conditions 27-31), which include commitments by Frontier and Verizon regarding replication and transition of retail operating systems, specific sharing of information with Staff regarding the software and systems transitions, an agreement by Verizon to employ a third-party reviewer of the results associated with systems replication and performance, and commitments by Frontier regarding any subsequent transition to other operating systems in the future.
- WTAP (Conditions 32-35), which include commitments by Frontier to provide credits to Washington Telephone Assistance Program ("WTAP")-qualified customers if WTAP discounts are not processed correctly, to provide detailed reports to the Commission on WTAP processing, and to institute a three-way calling verification process with the Department of Social and Health Services ("DSHS").

Q. How is the rest of your testimony organized?

A. Section III elaborates on each of the conditions in the Settlement, Section IV summarizes why the Settlement is in the public interest as well as in the interests of the Applicants, and Section V contains our conclusion.

III. Conditions

A. Financial Conditions (1-12).

Q. Are there provisions in the Settlement that address Staff's concerns with Frontier's financial ability post-close?

A. Yes. The Settlement includes a number of financial conditions and commitments that are responsive to concerns expressed in the testimony of Staff witness William H. Weinman (Exh. WHW-1T). Frontier (or "Company") is an experienced and financially capable telecommunications provider and is well-positioned to manage and operate Verizon Northwest's Washington operations. Frontier's rebuttal testimony provided additional detailed financial information regarding Frontier's greatly improved leverage ratio (DW-1T at 14-21), cash flows (DW-1T at 36-43) and access to capital (DW-1T at 43-48) post-transaction. Frontier's testimony showed that the Company is a financially sound incumbent local exchange carrier ("ILEC") and that Frontier is among a limited number of carriers that have the financial resources combined with the strategic intention to invest capital and provide excellent service in Washington. In terms of its financial profile and expected operating performance, Frontier will be one of the financially strongest ILECs in the country after the consummation of this transaction. In fact, the pro forma company is expected to have better credit metrics than does Qwest. Cash flow in the combined Frontier/Verizon properties is expected to provide ample funding for operating expenses, capital expenditures, service of debt, and payment of dividends to equity-holders. The information included in Frontier's testimony provided the Staff with additional data that it needed to conclude that the transaction was in the public interest, and the commitments in the Settlement ensure that detailed reports of information will continue to be provided to the Commission post-close.

Q. What types of financial-related information will be required to be provided to the Commission under the Settlement?

A. Under Condition 1, Frontier is required to provide quarterly reports to the Commission regarding company balances of intercompany receivables and payables, as well as dividend information. Frontier will provide that information for five years or until Frontier's debt is rated as investment grade. Frontier also committed to notify the Commission Staff of its post-transaction consolidated Net Debt/EBITDA and price per share used to determine transaction shares and the calculation of share price within 30 days after the close of the transaction (Condition 6).

Under Condition 3, Frontier will provide detailed synergy savings reports for each six-month period for four years after the close of the transaction (or until all synergies from the transaction have been realized). For five years, Frontier also will provide an annual summary of transaction with Verizon and its affiliates that are related to transition services or other services associated with the transaction (Condition 7).

And Frontier has committed to developing and filing with the Commission reports with a multi-year strategic plan on expected remaining life of all host and remote central office switches and a proposed replacement plan for such switches (Condition 12). The report, which will be filed annually until Frontier has obtained an AFOR, will include planned expenditures for such a replacement plan.

Q. Did Frontier agree to financial conditions designed to ensure that Washington ratepayers are not harmed by the transaction?

A. Yes. In the Settlement, Frontier agreed to file an AFOR plan within five years of the close of the transaction, and when it does so, it will use a cost-of-capital based upon "investment grade" debt and equity (Condition 2). This addresses Staff's stated concerns about Frontier's debt rating potentially having an adverse impact on rates (*see* WHW-1T at 8-12, 22-23) in the face of an industry (telecommunications) in transition. In addition, Moody's Investors Service and Fitch Ratings indicated at the time of the transaction announcement that Frontier's credit rating would be placed on "watch" for positive upgrade. And Condition 2 ensures that ratepayers receive the benefit of such an improvement, as Frontier's cost-of-capital in a future AFOR will be treated as investment grade.

Frontier also has agreed not to seek to recover from Washington ratepayers any separation, branding and transition costs (Condition 4), and will hold retail and wholesale customers harmless for increases in overall managements costs that result from the transaction (Condition 11). These conditions ensure that Frontier shareholders (including former Verizon shareholders), not Washington ratepayers and wholesale customers, pay for the transactions costs associated with the transaction and guarantee customers will not bear any burden related to any such costs (*see* WHW 1T at 12-13).

Frontier also agreed to not encumber the assets of Frontier Northwest, which means that Frontier agrees not to even *request* Commission approval to use the Frontier Northwest assets to secure debt for a period of three years (Condition 5). Frontier agreed to continue to report Washington operations to the Commission consistent with the

Washington specific data that is currently being reported by Verizon (Condition 10) and to comply with all applicable affiliated interest requirements and provide supporting information to Staff upon request (Condition 8). Finally, the Applicants agreed to notify the Commission of any material change to the transaction terms and conditions and to submit a supplemental application if the substantive transaction conditions and terms affecting Commission regulated services in Washington are impacted (Condition 9).

With these conditions, the Commission can be assured that Washington ratepayers will not be harmed by the proposed transaction and that the Commission will have detailed information to monitor and identify any potential financial issues that could potentially impact ratepayers.

B. DSL/Broadband Deployment (Conditions 13-18).

Q. Please describe the broadband commitments in the Settlement.

A. Frontier has made a significant and measurable commitment to expand broadband availability in Washington. Unserved and underserved areas of Verizon service territory will quickly receive expanded broadband services under the Settlement. In the Settlement, Frontier has made a series of robust, wide-ranging and wire-center specific broadband deployment commitments in Washington (Condition 15). Frontier Northwest will deploy broadband service in not less than 95% of the current Verizon Northwest Washington wire centers within two years of closing. In the aggregate, Frontier has further agreed to make broadband services available to approximately 89% of the households in the current Verizon Northwest service territory in Washington by December 31, 2014. Condition 15 also spells out specific milestones for currently unserved, under-served and all other wire centers. For example, Frontier must make DSL available to 50% of the households in wire centers where DSL is currently not available by 2011 and to 85% of households in those wire centers by the end of 2014.

Frontier also will submit an initial plan and annual reports that details how these commitments will be and are being met, and will consult with the Staff regarding the geographic scope of the broadband deployment (including the specific wire centers that will be included) (Condition 17). In order to address any unforeseen technical impediments to broadband deployment, a concern raised by Staff (*see* WHW-1T at 14-15), Frontier commits to immediately identify such impediments to the Commission in a detailed report and to propose an alternative broadband deployment plan to provide a similar level of public benefit (Condition 14). This will allow the Commission an opportunity to ensure that the stated broadband deployment benefits will be delivered to Washington.

Condition 16 also has minimum download speed commitments: it requires that Frontier must make broadband access service available at a download speed of 1.5 Mbps or higher and an upload speed of 381 kbps or higher to no less than 75% of the households in its service area by 2011. By the end of 2014, Frontier must make available retail broadband service with a download speed of 3 Mbps to at least 80% of the households in its service territory.

In testimony, Staff raised concerns about whether, in the post-transaction period, Frontier would have the financial capacity to fulfill its plan of expanding broadband investment in Washington. Condition 13 includes a specific commitment by Frontier to expend approximately $40 million on broadband deployment in Washington by

December 2014. Indeed, the condition requires Frontier to specifically deposit $40 million in a bank account, escrow account or other account as approved by the Commission to fulfill its broadband commitments in Washington. Frontier will be able to draw down on the $40 million fund only as it shows to the Commission's satisfaction that each broadband project in Washington is completed. This dedicated funding and the Commission's control of its disbursement, demonstrates a real commitment to broadband deployment in Washington and addresses any concern by Staff of Frontier's ability to devote financial resources to broadband deployment in Washington (*see* WHW-1T at 8). Frontier's broadband commitments under the Settlement provide the Commission with certainty that Frontier will in fact commit sufficient capital to maintain and enhance its Washington network, and that dedicated funds have been allocated (to a certain extent placed under Commission authority in the case of the account from which the Commission approve withdrawals), to better ensure that this investment occurs.

C. <u>Retail Service Quality (Conditions 19-22)</u>.

Q. Does the Settlement contain any conditions imposing customer credits based on retail service quality performance?

A. Yes. Frontier is committed to ensuring that customer service will not be disrupted or adversely impacted as a result of the transaction. In response to concerns expressed in the testimony of Staff witness Russell (*see* Exh. KMR-1T), Frontier has committed to both augmenting Verizon's existing "Service Performance Guarantee" ("SPG") program with additional credits, as well as the creation of a new retail service quality program with self-executing penalties if Frontier fails to meet the delineated standards. Under

Condition 19, Frontier will increase the missed commitment credit for residential customers from $25 to $35, and verbally notify customers of this credit offering at the time of the customer's order. It also will offer the customer alternative services for failure to deliver basic service on time, and provide a flat-rate credit of $5 for out-of-service conditions greater than two days. These enhanced requirements provide additional assurance that Frontier will provide, at a minimum, the same level of service Verizon provides today and that customers will receive even greater credits when Frontier fails to meet the service commitment.

Frontier also has agreed to a retail service quality plan that involves customer credits in the event that any of six metrics are not met. This is a significant commitment by Frontier to guarantee its performance, particularly because Verizon does not have any sort of similar plan at this time. Under the plan, Frontier could pay customer credits of up to $100K per metric per year, with an escalation clause that could double the maximum level of such credits if Frontier fails to meet the metrics for two years and could triple the maximum level of credits if Frontier fails to meet the metrics for three years. Frontier also will submit a plan to the Commission that addresses the steps to be taken to address any missed metric, if that were to occur (Condition 21).

D. Retail Services Rates (Conditions 23-26).

Q. Does the Settlement protect retail customer rates?

A. Yes. Frontier is committed to maintaining the terms, conditions and rates maintained in Verizon Northwest tariffs upon closing. As a result, existing customers will continue to receive the same regulated services at the same rates. In addition, Frontier has agreed in the Settlement to a number of retail rate conditions in response to concerns expressed in the testimony of Staff witness Roth (*see* Exhibit JYR-1HCT). For example, Frontier agreed to cap rates for Retail Flat and Measured Rate Residential Services at current levels for a minimum of three years (Condition 23). Thus, under the Settlement, retail customers will enjoy a rate freeze for these services for a full three years after the transaction closing.

Frontier also committed to provide "grandfathered" services currently provided by Verizon Northwest for at least six months or until Frontier obtains Commission approval to offer similar services, whichever is later (Condition 24). These services are not currently open to new customers, and Frontier will continue to make these services available to existing subscribers. Frontier also agreed to continue to provide bundled services offered by Verizon Northwest for a minimum of twelve months following close of the transaction (Condition 26).

Also consistent with a condition proposed by Ms. Roth, Frontier has agreed that, for 90 days after the close of the transaction, it will waive presubscribed interexchange carrier ("PIC") charges for current customers who wish to change to another carrier (Condition 25).

Q. Will the revenue imputation associated with Verizon's spin-off of its directories business continue to apply post-transaction?

A. Yes, and that is memorialized in Condition 22. This condition was added to address the concerns of the Staff to ensure that retail customers will continue to obtain the rate benefits associated with the settlement of Docket UT-061777 (*see* Exh. KMR-1T).

E. Operations Support Systems (Conditions 27-31).

Q. What are the conditions in the Settlement to protect Washington customers in the transition of operational support systems ("OSS") from Verizon to Frontier?

A. Under the terms of the Merger Agreement, Verizon will transfer and Frontier will continue to utilize the same operational support systems and processes utilized by Verizon to serve customers in Washington. Verizon will replicate its support systems and utilize those replicated systems to provide service in Washington for at least 60 days prior to closing of the proposed transaction. Verizon has agreed as part of the Settlement to provide Staff with additional access to the pre-production and production systems replication processes and the right to review systems testing results. In addition, Verizon is obligated to pay for the retention of an independent third-party "reviewer" of retail results regarding the performance of its replicated OSS prior to and subsequent to putting the replicated systems into production. Conditions 27-28 address Staff's stated concern about being able to validate assurances by Verizon and Frontier that this transaction will have better results than previous Verizon divestitures (*see* WHW-1T at 15). These conditions further ensure that the systems being transferred to Frontier are functioning both *before* and *after* the systems go into production mode. Here is a summary:

Before Verizon puts the replicated systems into production mode, it will share with Staff the "Program Test Strategy" Plan to be used to review the replicated systems, and the results of pre-production tests on the customer-affecting systems that serve retail customers (Condition 27). These tests must show that the systems are working and that if there were any "full service denials" associated with the systems, they have been resolved. Also, a third party reviewer must validate that the test results are accurate. And the Settlement sets forth a process by which the Staff will help select the third party reviewer that will be retained and paid for by Verizon.

As for performance during production mode, Verizon will share with Staff the results for four key, specific retail measures: installation commitments met; customer network troubles per 100 access lines; repairs cleared within 48 hours; and billing error complaints (Condition 28). On these key measures, Verizon must show that by the end of the production mode, there has been no material degradation from benchmark quality of service data from 12 months prior to production mode on the replicated systems. And here, too, a third party reviewer must validate that the results are accurate.

As further assurance that the systems are working properly prior to close, the Settlement provides that the closing will not occur unless and until Frontier validates and confirms that the replicated systems are fully operational. Also, Verizon must complete the testing and issue a report to the Commission validating that the OSS are operational at least five days prior to close. Thus, Conditions 27-28 ensure that the systems being transferred to Frontier are functioning both *before* and *after* the systems go into production mode, and it calls for an independent third party to review the relevant test results. The continued use of the Verizon systems will result in the same quality and no disruption of service for customers in Washington.

With respect to competitive local exchange carriers (“CLECs”), Frontier will also continue to utilize the same Verizon systems and processes, and Frontier will honor all of the Verizon interconnection agreements and arrangements in place following closing.

Frontier also will seek input from CLECs on any proposed changes in functionality or e-bonding (Condition 30).

Condition 29 applies after close, and is designed in response to concerns that Staff witness Williamson expressed in testimony regarding what he referred to as the "second cut-over" (Exh. RTW-1HCT at 20-23). Under this condition, if Frontier plans to transition from the Verizon replicated systems during the three years after closing, it will prepare and submit a detailed OSS integration plan to Staff. The plan will detail any problems that occurred in other systems integrations and explain what is being done to avoid similar problems in Washington. Frontier will provide this plan at least 180 days prior to implementing any such system transition.

F. WTAP (Conditions 32-35).

In response to concerns raised by Staff witness Stillwell regarding WTAP processing (*see* Exh. SLS-1T), Frontier committed to provide a one-time $75 credit to any WTAP-qualified customer for which a WTAP discount, credit or waiver is not processed within the first bill cycle of application (Condition 32). This credit does not exist today, and Frontier committed to apply it for three years. Frontier also committed to provided detailed monthly reports to the Commission on its processing of WTAP applications (Condition 33). Moreover, Frontier will institute a system for WTAP processing that has long been advocated by the Staff: a three-way call between Frontier, the customer and the DSHS to verify WTAP eligibility (Condition 35). Verizon does not utilize this process now, so this commitment will constitute a benefit arising from the transaction.

IV. Interest of the Parties and the Public Interest

Q. What is Frontier's view of the Settlement?

A. The Settlement is in Frontier's interest because it has been able to reach agreement with several Parties on a set of conditions that not only protect customers and competitors from perceived risks, but also will allow Frontier to operate the current Verizon Northwest properties in Washington in an efficient and reasonable manner. Frontier also believes the Settlement to be in the public interest because the concerns of the settling parties have been adequately addressed. As Frontier explained in its previous testimony, broadband deployment is an important component of Frontier's business plan and will mitigate access line losses. Furthermore, with Frontier's financial and service deployment commitments to expanding broadband in Washington, consumers will receive benefits they would not otherwise receive if the transaction were not approved. With the support from Staff, the intervening CLECs and Comcast for the approval of this transaction, Frontier urges the Commission to find that this transaction warrants approval without further conditions.

Q. Have the Applicants addressed interconnection and wholesale concerns raised by Staff and the other intervenors?

A. Yes. As noted above, the Applicants have entered into settlement agreements with all of the CLECs that have intervened in this proceeding. The Commission has before it three separate settlements with CLECs: (1) the Joint CLEC Settlement; (2) the Comcast Settlement and (3) the Level 3 Settlement. The terms of these settlements address the concerns raised by Staff and the intervenors and will benefit not just Comcast, the Joint CLECs and Level 3. Because these settlements involve certain prospective interconnection obligations governed by Section 251 of the Act, those substantive interconnection terms in the settlements will be incorporated into interconnection agreement amendments filed with the Commission and will be governed by the non-discrimination protections of the Act (including Section 252(i)). In other words, other carriers in Washington will be able to receive the same benefits through amendments to their interconnection agreements and therefore the Staff's concerns on interconnection and wholesale issues have been addressed.

Q. What is Verizon's view of the Settlement?

A. The Settlement is in Verizon's interest because it avoids continued litigation with the Staff on terms that Verizon is willing to accept to address concerns and issues raised by the Staff. Verizon believes that it was important to work through the negotiated solution set forth in the Settlement to address the Staff's stated concerns and to provide commitments to allow the Staff to recommend Commission approval of the transaction. As demonstrated above and in the testimony of the Staff in support of the Settlement, the Agreement addresses the concerns raised in Staff's testimony. The Settlement also is in the public interest, as it provides specific commitments made by the Applicants designed to ensure that the transaction will not cause harm, the relevant standard for Commission review, and ensures significant broadband deployment in unserved and under-served areas that would not occur absent this transaction.

V. Conclusion

Q. Please summarize your testimony.

A. For the reasons discussed above, the Settlement is in the public interest and in the interests of the Parties. Accordingly, the Applicants respectfully recommend that the Commission adopt the Settlement in its entirety and approve the transaction.

Q. Does this conclude the Parties' testimony in support of the Settlement?

A. Yes.