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 1

 BEFORE THE WASHINGTON STATE

 2 UTILITIES AND TRANSPORTATION COMMISSION

 In the Matter of the Joint )

 3 Application of ) DOCKET NO. UT-090842

 )

 4 VERIZON COMMUNICATIONS INC. ) Volume V

 AND FRONTIER COMMUNICATIONS ) Pages 367 to 582

 5 CORPORATION. )

 )

 6 For an Order Declining to )

 Assert Jurisdiction Over, or, )

 7 in the Alternative, Approving )

 the Indirect Transfer of )

 8 Control of Verizon Northwest )

 Inc. )

 9 \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_)

10 A hearing in the above matter was held on

11 February 3, 2010, from 9:30 a.m to 5:05 p.m., at 1300

12 South Evergreen Park Drive Southwest, Room 206, Olympia,

13 Washington, before Administrative Law Judge PATRICIA

14 CLARK and CHAIRMAN JEFFREY D. GOLTZ and Commissioner

15 PATRICK J. OSHIE and Commissioner PHILIP B. JONES.

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25 Court Reporter

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 7 TM-24HC 480

 8 TM-25HC 480

 9 F. WAYNE LAFFERTY

10 FWL-3 W/D

11 FWL-4 W/D

12 FWL-5 W/D

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 1 P R O C E E D I N G S

 2 JUDGE CLARK: Good morning, it's

 3 approximately 9:30 a.m., February 3rd, 2010. This is

 4 the time and the place set for continuation of the

 5 hearing in Docket UT-090842. The record should reflect

 6 that Commissioner Philip Jones, Commissioner Patrick

 7 Oshie, and Chairman Jeffrey Goltz are present for this

 8 morning's hearing.

 9 When we recessed yesterday afternoon, we had

10 a panel who's already seated for continuation of any

11 cross-examination and then redirect. I just want to

12 advise everyone that I am not turning on the conference

13 bridge this morning because we have tested it and there

14 are already people placed on hold, which of course

15 conveys the lovely music into the hearing room. We will

16 make special accommodation for Public Counsel's witness,

17 Ms. Alexander, to call in on a separate line at the time

18 for her to testify.

19 When we recessed yesterday afternoon, we were

20 anticipating an oral requisition request response, so,

21 Mr. Thompson, if you could update us on that, that would

22 be helpful.

23 MR. THOMPSON: Yes, Your Honor, I was going

24 to ask Mr. Weinman on redirect about this because I'm

25 thinking it might be the best way to clarify it.

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 1 JUDGE CLARK: That sounds excellent, and so

 2 we will not have the response, we'll await your

 3 redirect.

 4 Ms. Shifley, have you concluded your

 5 cross-examination of this panel?

 6 MS. SHIFLEY: Yes, I have, Your Honor, thank

 7 you.

 8 JUDGE CLARK: And the Commissioners, do you

 9 have any additional questions for this panel?

10 CHAIRMAN GOLTZ: Can I ask Mr. Weinman one

11 more question?

12 JUDGE CLARK: Of course.

13

14 Whereupon,

15 DANIEL MCCARTHY, TIMOTHY J. MCCALLION, WILLIAM H.

16 WEINMAN, AND ROBERT T. WILLIAMSON,

17 having been previously duly sworn, were called as

18 witnesses herein and were examined and testified as

19 follows:

20

21 E X A M I N A T I O N

22 BY CHAIRMAN GOLTZ:

23 Q. Mr. Weinman, yesterday I inquired of the

24 company witnesses about the condition in the settlement

25 agreement whereby if there were extra regulatory

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 1 conditions placed on the approval of the transaction

 2 through a stock transfer mechanism, the burden of that

 3 would fall on Frontier; do you recall that?

 4 A. (Weinman) Yes.

 5 Q. My question is, and you may not know the

 6 answer to this, and that's fine if you don't, but in

 7 Staff's consideration of suggesting conditions on this

 8 transaction or on approval of this transaction, did that

 9 provision limit you in any way? That is to say, if that

10 provision had not been in the settlement agreement,

11 might Staff have suggested some additional conditions?

12 The reason I say that is there's been some concern I

13 gather about sort of the financial viability of Frontier

14 in this as the successor here, and basically my question

15 placed another way is would that concern and the

16 knowledge that any new conditions which the financial

17 consequences would be born by Frontier influence your

18 view, your decision making?

19 A. (Weinman) Well, it certainly was a factor,

20 but I believe that at least from my recollection of the

21 process as we went through it, our biggest concern was

22 having a third party verify the IT systems. And since

23 Verizon -- that cost won't be passed along to Frontier,

24 and other than that my answer is no. There was nothing

25 else that I'm aware of that came up in discussions

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 1 within our team that caused us to say we might like this

 2 but the contract prohibits that.

 3 CHAIRMAN GOLTZ: Okay, thank you.

 4 JUDGE CLARK: All right, thank you.

 5 I'm going to turn first to Mr. Romano to see

 6 if you have any redirect for your witness.

 7 MR. ROMANO: Yes, thank you, Your Honor.

 8

 9 R E D I R E C T E X A M I N A T I O N

10 BY MR. ROMANO:

11 Q. Mr. McCallion, do you have any reaction to

12 the discussion yesterday about Frontier being better

13 suited to serve Washington than Verizon?

14 A. (McCallion) Well, Frontier is an excellent

15 company. They've been in the business many years,

16 they've had a number of acquisitions, and we think

17 they're just an excellent operator of telephone lines.

18 However, I don't want that to diminish from the fact

19 that Verizon has provided very good service to its

20 customers, as the Commission can see from the service

21 results that we report to the Commission. We've

22 continued to invest in our network over the years in

23 addition to, for example, in making a very significant

24 investment in fiber to the premise. And the numbers are

25 confidential, but it's in the hundreds of millions of

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 1 dollars of investment that we've done just for FiOS for

 2 our customers. In addition to that, we've maintained

 3 our core network on a very good basis as the service

 4 quality results show.

 5 Q. There was also a question about the relative

 6 size of the Washington territory with respect to Verizon

 7 and Frontier. Were you able to look into what the

 8 relative percentages were?

 9 A. (McCallion) Yes, I looked at those numbers,

10 and as we sit here today Washington switched access

11 lines compared to Verizon total switched access lines

12 are about 1.5%. I performed a similar calculation for

13 what that percentage would be in the new Frontier, and I

14 came up with 8.2%.

15 Q. There was also a discussion about the role of

16 the third party reviewer. Do you have any response to

17 the discussion about whether the third party reviewer

18 will validate the results during production, which is

19 the Paragraph 28 in the Staff settlement?

20 A. (McCallion) Well, the answer is yes, but let

21 me give you some context. You know, throughout the

22 process Verizon's had a very significant interest in the

23 replication process going smoothly and the systems

24 functioning as they're designed to function, because

25 we're going to be using those replicated systems for a

0377

 1 minimum of 60 days to provide service to our customers.

 2 In addition to that, Frontier has very much the same and

 3 even a greater interest in the success of the

 4 replication of the systems. They're going to have the

 5 opportunity to validate that the systems are working

 6 properly, and then they're going to be running the

 7 business using those systems. So we felt there was a

 8 very strong interest on the part of both companies.

 9 The Staff, however, wanted additional

10 assurances beyond the Verizon and the Frontier

11 assurances that they would be very diligent in ensuring

12 the systems are working properly, so that led to not

13 only Paragraph 27 in the settlement agreement but also

14 to Paragraph 28 in the settlement agreement. And as

15 Mr. Weinman has testified, they were very interested in

16 having the third party reviewer. In addition to that,

17 they wanted some measures that they could look at as a

18 qualitative measure to ensure not only were we saying it

19 was working fine, that the third party reviewer was

20 validating the results, but that they could see an

21 impact on customers, and hence we came up with the four

22 standards that are in Paragraph 28.

23 MR. ROMANO: Thank you, Your Honor, that's

24 all the redirect I have.

25 JUDGE CLARK: Mr. Saville.

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 1 MR. SAVILLE: Thank you, Your Honor.

 2 Good morning, Commissioners.

 3

 4 R E D I R E C T E X A M I N A T I O N

 5 BY MR. SAVILLE:

 6 Q. Mr. McCarthy, yesterday Ms. Shifley asked

 7 some questions with respect to Frontier preparing a

 8 budget for the Washington operations that are currently

 9 controlled by Verizon. Do you recall those questions?

10 A. (McCarthy) Yes, I do.

11 Q. And can you explain to the Commissioners

12 where Frontier is in the process of developing the

13 budget for the state of Washington?

14 A. (McCarthy) Certainly. When we talk about

15 putting a budget together, it's a far more detailed

16 exercise than just saying this is the amount of money

17 that we're going to spend in a period. It means

18 building by line item by project all the different

19 things that we'll be putting into a budget in any single

20 year. So when we responded that we don't have that

21 built, it's because we simply don't own the property at

22 this point, and that exercise would happen in the fixed

23 assets and the operational support systems of the

24 acquired property in Washington.

25 What I can tell the Commission is that at

0379

 1 this point our view is that in the first stub year

 2 assuming that we close mid year this year would be about

 3 a $30 Million CapX plan. It would also be about $55

 4 Million to $60 Million in the next 2 years. You already

 5 have heard that we think it's about $40 Million for the

 6 broadband, so that would be on top of those CapX

 7 figures. And then obviously we would be finishing our

 8 FiOS commitment.

 9 Q. Thank you.

10 During Ms. Shifley's questions yesterday

11 there was also reference to the fact that as a part of

12 this transaction Frontier will be financing debt for

13 part of the transaction and that the terms and covenants

14 associated with that financing have not been identified.

15 Can you again explain where Frontier is in the process

16 as far as the financing?

17 A. (McCarthy) Certainly. First of all, I would

18 just like to say Mr. Whitehouse, our Senior Vice

19 President and Treasurer, is here to give detailed

20 testimony and answer any specific questions you have on

21 that, but from a general perspective, we've said

22 publicly that we are looking to go into the market and

23 raise the debt really in the first, end of the first

24 quarter, early second quarter. There's a very specific

25 window that the information from the SEC perspective

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 1 would be fresh from both organizations that would allow

 2 us to do that. And so we feel very good about being in

 3 the market in that time frame. We think looking at an

 4 indication of a recent offering that we just did in

 5 conjunction with a debt tender gives you a very good

 6 feel for what the interest rates potentially would be

 7 and the covenants would be. And we're at 8 3/8 as far

 8 as the interest rate, effective interest rate, and the

 9 covenants were virtually the same or identical to our

10 current covenants, which are not very restrictive at all

11 with only a simple leverage ratio covenant. At this

12 point we think that there's very strong demand, as

13 Mr. Whitehouse will give you a lot more information on

14 as he's on the stand, and we don't anticipate there

15 being any problem going to market for that debt.

16 Q. Ms. Shifley also asked a series of questions

17 regarding the analysis and projections Frontier's put

18 together with respect to post closing and assumptions

19 based on no synergies being recognized by Frontier as a

20 result of this transaction. Can you comment on the

21 assumption that Frontier will not achieve any synergies

22 as a result of this transaction?

23 A. (McCarthy) Yes. We believe that's very

24 unlikely at this point. We did plan on achieving those

25 synergies over a three year period, but obviously we

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 1 expect to achieve some synergies immediately upon close

 2 associated with the elimination of any allocated

 3 overhead costs from Verizon. So immediately we would

 4 achieve those synergies, and then as we move forward

 5 with the integration we would achieve the rest of the

 6 synergies, and we're still very confident in the $500

 7 Million.

 8 Q. And if Frontier was unable to achieve the

 9 synergies that are projected, does that cause you as the

10 Chief Operating Officer any concerns about Frontier's

11 future viability?

12 A. (McCarthy) No, it doesn't. Obviously

13 Mr. Whitehouse is here to answer detailed questions on

14 the financial model as well as our pro formas going

15 forward, but from my perspective as the Chief Operating

16 Officer, it does not. I think it still delevers us

17 significantly from where we are today and provisions us

18 with a ratio and our dividend to be comparable to some

19 of the stronger players in the ILEC industry today.

20 Q. Mr. McCarthy, there were several questions

21 both by Ms. Shifley and then the Commissioners regarding

22 the specific settlement agreement that Frontier and

23 Verizon have entered into with Staff. Do you have that

24 document in front of you?

25 A. (McCarthy) I do.

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 1 Q. Okay. I want to ask you about some of the

 2 specific conditions included in that settlement just as

 3 follow up. condition 29, if you could turn to that.

 4 There were questions about Frontier's plan to transition

 5 from the Verizon replicated OSS systems that are coming

 6 over as part of this transaction to Frontier's own

 7 systems. Can you discuss what the status of Frontier's

 8 plans are with respect to ultimately transitioning the

 9 Frontier systems?

10 A. (McCarthy) Certainly. When we've

11 represented that there's no plans at this point to

12 change, there really are no plans to change off the OSS.

13 I think that it does offer an opportunity for us to

14 achieve some additional synergies, but at this point

15 we're going to take control of those systems and operate

16 those systems for the minimum time frames that we have

17 agreed to, and we may determine that those systems are

18 actually the systems we would like to retain and use in

19 these properties for the long run. There is

20 opportunities in our commercial arrangement with Verizon

21 for us to reduce the software maintenance fees in

22 different ways, and we may explore that, but at some

23 point in time we would expect to move to our own fully

24 functioning OSS system, one that we're currently cutting

25 all of West Virginia over to, and we're not anticipating

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 1 any problems. We've actually over the last four or five

 2 years migrated all of our billing systems where we used

 3 to have three or four different billing systems for

 4 different components of the company onto a single

 5 platform. We've invested heavily in making sure that

 6 it's scalable and provides the functionality that would

 7 be necessary. And at some point in time we would look

 8 to do that, but at this point we're going to take the

 9 systems as they are, and we're going to operate them and

10 evaluate whether or not it's the right solution for the

11 long run.

12 Q. In terms of condition 29, if and when

13 Frontier makes that decision to migrate over to its own

14 systems, Frontier is committed to working with the Staff

15 as far as the implementation of that conversion?

16 A. (McCarthy) Absolutely.

17 Q. If I could get you to look at condition 18.

18 Yesterday Ms. Shifley identified some pricing and some

19 speeds associated with stand-alone DSL service that is

20 currently being provided by Verizon and Frontier. Do

21 you recall that?

22 A. (McCarthy) Yes.

23 Q. And you understand that this condition 18,

24 Frontier is making the commitment to continue to offer

25 stand-alone DSL for a minimum of 12 months?

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 1 A. (McCarthy) Correct.

 2 Q. And can you comment on Frontier's plans as

 3 far as discontinuing stand-alone DSL at the expiration

 4 of this 12 month period?

 5 A. (McCarthy) Frontier has no plans to

 6 discontinue stand-alone DSL. We have found in our

 7 markets today that it's a product that customers do

 8 want, certain segments of the customer base. And I

 9 would just point out that in our legacy markets, we sell

10 really 2 what I would categorize as flavors of

11 stand-alone DSL. One is a max DSL which could be

12 whatever the max speed is available on the market. That

13 could be in certain areas 1 1/2 megabits. It could be

14 up to 9 or 10 megabits or 12 megabits depending upon the

15 market that you're in. We also do offer a light

16 version, but the light product that was referenced

17 yesterday was a product that we created purely because

18 consumers were looking for a scaled down low end version

19 of high speed. It's not purely a stand-alone product.

20 We offer it for any customers who want it in a bundle as

21 well. The feedback that I've gotten from customers

22 around that product is it's someone who's generally

23 looking for basic Internet access, maybe to check

24 E-mails and do basic web surfing, and we found that

25 there was a pretty good demand for that product in our

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 1 area.

 2 Q. Mr. McCarthy, if I could get you to turn to

 3 condition 26. In this condition Frontier has agreed to

 4 continue to offer and provide bundled services offered

 5 by Verizon Northwest for 12 months following the close

 6 of the transaction. Can you comment on whether Frontier

 7 has any plans to discontinue these bundled service

 8 offerings by Verizon Northwest after the expiration of

 9 the 12 month period?

10 A. (McCarthy) We have no plans to discontinue

11 the bundles whatsoever. We may introduce new products,

12 new features, new bundles, but we would not be looking

13 to eliminate the current bundles.

14 Q. Yesterday I believe it was Commissioner Oshie

15 that had some questions about condition number 13 and

16 specifically the mechanics associated with the

17 establishment of the $40 Million in an account or an

18 escrow fund. Do you recall those questions?

19 A. (McCarthy) I do.

20 Q. Could you I guess explain from your

21 perspective what Frontier envisions as far as the

22 process and how the establishment of this $40 Million

23 fund would be set up?

24 A. (McCarthy) Certainly. Frontier really had

25 wanted to be open to whichever way the Commission

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 1 thought was the correct way to set up that $40 Million

 2 funds, but from our side we had thought of the escrow as

 3 probably the single cleanest mechanism. And when we

 4 looked at the escrow, I think your points were exactly

 5 on point, and that was that it would be set up as an

 6 irrevocable escrow account where we would set up the

 7 instructions with a third party escrow agent to only

 8 allow the disbursement back to Frontier based upon a

 9 written instruction from the Commission that it was

10 satisfied that we had met the requirements of the

11 broadband buildout for that period.

12 Q. And under the terms of this condition,

13 Frontier would absorb all the costs associated with

14 establishing that account or paying an escrow agent to

15 monitor the funds?

16 A. (McCarthy) Yes, we would absolutely do that,

17 and we anticipate that we would set that escrow account

18 up out of cash on hand at closing.

19 Q. Mr. McCarthy, if I could get you to turn to

20 condition 19, which is under the heading retail service

21 quality. I apologize, the next condition, condition 20.

22 Are you there?

23 A. (McCarthy) Yes, I am.

24 Q. There was some discussion and questions

25 yesterday by Commissioners regarding the service quality

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 1 credits that are contemplated in this condition 20. Do

 2 you recall those questions?

 3 A. (McCarthy) I do.

 4 Q. And can you explain your understanding as far

 5 as the potential service quality credits that Frontier

 6 would be exposed to under this condition 20 if it failed

 7 to meet particular conditions one time or over a series

 8 of multiple periods?

 9 A. (McCarthy) Certainly. My understanding is

10 it was certainly absolutely correct that it was $600,000

11 in that first year. But as you look at the second year

12 and the third year, there's an acceleration and the

13 incentive for us to ensure that we're in compliance. So

14 the second year penalty would be $1.2 Million, and the

15 third year penalty would be $1.8 Million potentially, so

16 in total at risk of $3.6 Million.

17 Q. So in other words if Frontier failed to

18 achieve compliance with the standards that are

19 identified in condition 20 and those problems persisted

20 over the three year term that Frontier first operated

21 these properties, would it in that final year be subject

22 to a penalty of or customer credits of $1.8 Million?

23 A. (McCarthy) Correct.

24 Q. Okay. And so the 3.6 you were referencing

25 would be $600,000 the first year potentially, $1.2

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 1 Million the second year, and then $1.8 Million the third

 2 year, so in aggregate it would be $3.6 Million over the

 3 three year term?

 4 A. (McCarthy) Correct.

 5 Q. And can you comment on this service quality

 6 plan and, you know, whether or not Frontier has any

 7 concerns about being able to maintain high quality

 8 service after this transaction closes?

 9 A. (McCarthy) We don't have any concerns.

10 We've looked at Washington has been one of the best

11 performers of the properties that we've seen in the

12 Verizon portfolio, and we're confident that we'll be

13 able to meet those metrics.

14 Q. Condition 17, Mr. McCarthy, if I could get

15 you to look at that. This condition 17 indicates that

16 Frontier Northwest will submit an initial plan for

17 broadband deployment and consult with the Commission

18 Staff regarding the specifics of that deployment plan;

19 is that correct?

20 A. (McCarthy) That is correct.

21 Q. And as this is drafted, it only contemplates

22 that Frontier would consult with the Commission Staff.

23 Does Frontier have any concerns about also providing

24 this plan and consulting with Public Counsel with

25 respect to Frontier's plans to deploy broadband?

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 1 A. (McCarthy) We have absolutely no problem

 2 consulting with Public Counsel. We have agreed to do

 3 that in other states, and we would be happy to welcome

 4 their input in the right places for us to move forward

 5 as quickly as possible on broadband.

 6 Q. And, Mr. McCarthy, this is my last question,

 7 Mr. McCallion did touch on this, but I just would like

 8 you to confirm it in response to Chairman Goltz's

 9 question yesterday. Chairman Goltz had asked us to

10 identify from Frontier's perspective Washington's size

11 relative to Frontier on a total basis, have you

12 completed that analysis?

13 A. (McCarthy) Yes. It would be as

14 Mr. McCallion represented, 8.2%.

15 MR. SAVILLE: Thank you, I have no further

16 questions.

17 JUDGE CLARK: Thank you.

18 Mr. Thompson.

19 MR. THOMPSON: Thank you.

20

21 R E D I R E C T E X A M I N A T I O N

22 BY MR. THOMPSON:

23 Q. Mr. Weinman, Ms. Shifley yesterday asked you

24 if Staff had done any analysis of Frontier's pro forma

25 results of operations if it were to experience line loss

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 1 at various levels going forward into the future, and you

 2 indicated that Staff had done some analysis, and then

 3 that resulted in a records requisition. Would you like

 4 to amend your answer to that question?

 5 A. (Weinman) Yes, I would. I think yesterday I

 6 used the phrase done on the back of an envelope. We

 7 looked at the data that we were going to provide to

 8 Public Counsel, and it had a significant error in the

 9 logic. We put new stuff together at the last minute

10 trying to get ready for cross. And so I guess because

11 of the error, I would change my answer to no, we really

12 haven't done any calculation with reliable data on line

13 loss.

14 Q. Ms. Shifley also asked you about Frontier's

15 double B bond rating and whether a company with a double

16 B bond rating has a greater risk of default than a

17 company with an investment grade rating. What's your

18 opinion about the probability of default by Frontier if

19 the transaction is consummated?

20 A. (Weinman) I think the probability of that

21 happening is low. If you look at the telephone industry

22 in general, there are only three companies, AT&T,

23 Verizon, and CenturyLink, that have investment grade

24 bonds. The transaction substantially improves

25 Frontier's balance sheet in terms of debt and equity.

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 1 Two rating agencies, Moody's and Fitch, have put them on

 2 watch for upgrades, and so it appears that -- extremely

 3 low. Staff has put in the provision in the AFOR that

 4 when we're looking at results of operations, the cost of

 5 capital, cost of debt, will be considered investment

 6 grade. So the customers really shouldn't see any effect

 7 in the short term while we go through that first period

 8 of results of operations and cost of money with

 9 Frontier.

10 Q. Another question that Ms. Shifley asked you

11 about was whether the various bill credits provided for

12 in condition 20 of the service quality program were,

13 well, there was a discussion about whether those were

14 sufficient to give the company an incentive to meet

15 service quality standards, and Mr. McCarthy actually

16 just addressed the amount that's at stake there, but is

17 there -- are there also existing Commission rules that

18 would apply as well?

19 A. (Weinman) Yes, the Commission does have

20 service quality rules, and I agree with Mr. McCarthy

21 with the escalating the total amount. Those to my

22 knowledge weren't around when Qwest got in trouble, but

23 -- and also the Department of Defense has kind of beat

24 this up. If there will be an issue with any billing,

25 then Frontier has agreed to go forward and resolve the

0392

 1 issue and budget for whatever need to make the system

 2 fix or whatever is my understanding.

 3 Q. Similarly Commissioner Oshie I believe asked

 4 you what was the difference between when Qwest was put

 5 under its service quality program and Frontier in this

 6 case. Do you have anything you would like to add to

 7 your answer on that?

 8 A. (Weinman) Yes, I would. At the time Qwest

 9 was suffering from poor quality of service, we did not

10 have service quality rules. And by -- in comparison,

11 Verizon's service quality has been very good, very low

12 trouble indexes, and there's no reason to believe that

13 Frontier won't continue on with maintaining that type of

14 performance. There has been some issues with the FCC

15 ARMIS data of high trouble reports, and I think Billy --

16 witness Mr. Gregg has addressed that for Frontier. The

17 other thing that we did early on in this process is we

18 contacted other commissions on Frontier's service

19 quality, specifically Minnesota, Oregon, New York,

20 Missouri, and Wisconsin, and the staff people that we

21 talked to gave good -- a good report that Frontier does

22 have good quality of service and that they haven't had

23 any quality of service issues in those states.

24 Q. Chairman Goltz asked you about the -- asked

25 some questions about the magnitude of the Yellow Pages

0393

 1 imputation, is that explained anywhere in Staff

 2 testimony?

 3 A. (Weinman) Yes, Ms. Russell on page 29 shows

 4 that the or testifies that the annual imputation of

 5 Yellow Pages revenues would be about $37.5 Million.

 6 That equates to about $6 per customer.

 7 Q. Per month, correct?

 8 A. (Weinman) Correct.

 9 Q. The $37.5 Million is an annual figure?

10 A. (Weinman) Yes.

11 Q. Chairman Goltz asked you a question to get

12 into sort of the theoretical question of whether risk

13 equals harm under the Commission's no harm standard.

14 Would you like to, I think you said that risk does equal

15 harm, do you want to explain your answer further?

16 A. (Weinman) Yeah, I believe I misspoke. That

17 was towards the end of the day. Risk is -- needs to be

18 assessed in terms of probabilities. And so if it's --

19 if there's a high probability that the risk will occur,

20 then we should consider that as harm. The risk needs to

21 be analyzed and -- with evidence and not just speculated

22 in terms of the issue. One thing that the risk can be

23 there regardless of the entity that is providing the

24 service. In other words, probably the simplest example

25 for me is one of the risks listed in Frontier's S-4 is

0394

 1 labor contracts. Well, those labor contracts really

 2 aren't a risk for Verizon, so it's an example where

 3 Frontier discloses it, but it doesn't necessarily shift

 4 -- it is really only the one that suffers that portion

 5 of the risk. So some of the risks identified are common

 6 to both companies.

 7 MR. THOMPSON: Thank you very much, that's

 8 all I have for redirect.

 9 JUDGE CLARK: Thank you.

10 MS. SHIFLEY: Your Honor, based on some of

11 the testimony that we just heard, I may want to require

12 recross, could I have a moment off the record?

13 JUDGE CLARK: Well, I am a little bit

14 concerned about the pace of the hearing, and we're way

15 behind schedule, and I do understand that Public Counsel

16 is going to be given the opportunity for oral rebuttal.

17 Are these matters that you can handle on oral rebuttal

18 rather than having recross, reexamination by

19 Commissioners, and reredirect?

20 MS. SHIFLEY: I believe that our recross

21 questions would be very brief and just go to one or two

22 matters.

23 JUDGE CLARK: Very brief?

24 MS. SHIFLEY: Yes, I believe so.

25 JUDGE CLARK: All right, I'll allow it.

0395

 1 MS. SHIFLEY: Thank you. I just need one

 2 moment.

 3 JUDGE CLARK: Ms. Shifley.

 4 MS. SHIFLEY: Thank you, Your Honor.

 5

 6 R E C R O S S - E X A M I N A T I O N

 7 BY MS. SHIFLEY:

 8 Q. Mr. McCarthy, you were just asked some

 9 questions regarding capital spending in Washington and

10 the fact that Frontier has no capital budget, and you

11 gave some dollar amounts for capital spending. In all

12 the responses to our data requests prior to today,

13 Frontier has said that it has no capital budget for

14 Washington and hasn't provided any numbers, and today

15 you did just provide some multimillion dollar CapX

16 spending estimates on the record. Could you please

17 clarify what those numbers were that you stated?

18 A. (McCarthy) Certainly. And I think we have

19 been consistent all along that we do not have the budget

20 developed, and I think I explained that. Are you asking

21 me just to restate what those numbers are?

22 Q. Yes, please.

23 A. (McCarthy) I said that in the first year,

24 assuming that we would close at the end of June that it

25 would be approximately $30 Million and that in the next

0396

 1 two years it would be $55 Million to $60 Million and

 2 that there would be $40 Million above that that's

 3 involved with the broadband commitment that we've made

 4 to the Commission as well as completion of the FiOS

 5 buildout.

 6 Q. Mr. McCarthy, what data support do you have

 7 for these numbers?

 8 A. (McCarthy) I'm not sure I understand your

 9 question.

10 Q. Do you have any data support showing that

11 this is an appropriate level of funding or backing up

12 these numbers or showing how you calculated these

13 numbers?

14 A. (McCarthy) Certainly. We have been very

15 forthright throughout all of our presentations to the

16 public as well as to the Commission saying that during

17 the first several years we were going to increase

18 capital spending to approximately 12% of revenue as a

19 way of working on the plant that we are taking over, and

20 then the $40 Million is detailed in our broadband model.

21 Q. So the numbers that you just stated, the $30

22 Million, $55 Million and $60 Million, are just based on

23 a 12% calculation from your expected revenues?

24 A. (McCarthy) Yes, and we would use that to

25 develop the detailed budgets that we would use to

0397

 1 operate the properties.

 2 Q. So those weren't developed on a Washington

 3 specific basis, the numbers that you just stated on the

 4 record?

 5 A. (McCarthy) That would be 12% of the expected

 6 revenues in Washington.

 7 MS. SHIFLEY: Thank you, that's all.

 8 JUDGE CLARK: All right.

 9 Redirect?

10 MR. SAVILLE: No, Your Honor.

11 JUDGE CLARK: All right, thank you.

12 Any further questions for this panel?

13 Commissioner Jones.

14

15 E X A M I N A T I O N

16 BY COMMISSIONER JONES:

17 Q. Just a quick, quick clarifying question.

18 Mr. McCallion, 27(b), is the Verizon paying for the

19 third party reviewer?

20 A. (McCallion) Yes, that's part of the cost of

21 replicating the system, so we are paying for that.

22 Q. And what is your budget estimate of that

23 obligation on Verizon?

24 A. (McCallion) We are now discussing with Staff

25 which firm to select, but it's in the, to give you a

0398

 1 general idea, it's above half a million dollars and

 2 could be upwards closer to $1 Million.

 3 Q. Okay.

 4 A. (McCallion) But we haven't selected in

 5 consultation with the Staff the actual firm that's going

 6 to do that.

 7 Q. And is that the -- is that the only monetary

 8 commitment that you have on closing other than the

 9 delivery of -- I mean the OSS on April 1st, the delivery

10 and the testing of the OSS, but is that the primary

11 monetary commitment you have on closing to pay for

12 something?

13 A. (McCallion) Well, the monetary commitment

14 that we have is all of the costs associated with setting

15 up what we refer to as SpinCo as a separate entity. So

16 it would be any real estate costs that might be

17 associated with that, rearrangements of the network that

18 are associated with that, and also the costs of

19 replicating the systems. I know that the numbers are

20 confidential, but it's a very high number in the

21 hundreds of millions of dollars.

22 COMMISSIONER JONES: Thank you.

23 JUDGE CLARK: Anything further?

24 Commissioner Oshie.

25 COMMISSIONER OSHIE: Thank you.

0399

 1 E X A M I N A T I O N

 2 BY COMMISSIONER OSHIE:

 3 Q. I just have a question for Mr. McCarthy, and,

 4 you know, I'm -- in your redirect you talked about, you

 5 know, synergies and used an explanation of what those --

 6 you believe the synergies may be, and you made the

 7 comment that at least -- and I don't recall whether you

 8 said that the real -- most of the synergies received --

 9 and that's what I don't remember quite, the adjective

10 here defined, would be from eliminating the overhead,

11 Verizon's overhead from the -- in the takeover. Is that

12 my understanding, is that what you said?

13 A. (McCarthy) I'm not sure what the transcript

14 would show, Commissioner, but what I was trying to

15 illustrate was that initially at close there is a

16 certain allocation that is from Verizon for their

17 corporate structure, whether it's real estate to operate

18 all the different divisions around the United States,

19 around the world for that matter, and that allocation

20 would be eliminated day one. So that would be a synergy

21 we would see, and we're pretty confident that that will

22 happen immediately at close.

23 Q. Yes, and that's how I really took it. And I

24 guess my question then is, isn't, you know, won't

25 Frontier's allocation to overhead be, you know, isn't

0400

 1 that going to be calculated in its place? In other

 2 words, isn't there going to be a cost that is similar?

 3 I mean I know it won't be exact, but you're just

 4 replacing Verizon's overhead with Verizon's overhead,

 5 now is that -- I mean is that the synergy you're talking

 6 about?

 7 A. (McCarthy) Well, first of all, this is just

 8 one of the synergies, and I was using that as an example

 9 of day one.

10 Q. No, I understand.

11 A. (McCarthy) But I would say that our overhead

12 levels would be potentially significantly less than

13 Verizon's.

14 Q. Significantly means what? I mean by -- on a

15 percentage basis are you expecting it to be 25% less or

16 -- I mean can you make a calculation, at least a rough

17 calculation?

18 A. (McCarthy) I don't have that figure here

19 with me, I apologize. But when you think about Frontier

20 and you would see -- and I'm certainly not trying to be

21 evasive. We move all of our operations as close to the

22 customer as possible. We have very few people that are

23 in our corporate headquarters for instance. So when you

24 look at our headquarters in Stanford, Connecticut, it's

25 only about 200 people that are actually there compared

0401

 1 to potentially an allocation from the Verizon

 2 headquarters and everything that they have in running a

 3 very, very large corporation today. So I think it's

 4 safe to say that we would see some synergies from that

 5 as we close the transaction.

 6 COMMISSIONER OSHIE: All right, and so you

 7 used the term significant, but you don't know what -- I

 8 mean I guess I'm -- and you'll see some synergies from

 9 that, okay, all right, thank you.

10 JUDGE CLARK: Anything further?

11 Thank you for your testimony, Mr. McCarthy,

12 Mr. McCallion, Mr. Weinman, and Mr. Williamson.

13 We're going to take a moment off record to

14 allow Public Counsel to call their witnesses in oral

15 rebuttal. As everyone will recall, there was a very

16 brief period between the time when the Commission

17 rescheduled the hearing and when this -- when the

18 hearing was originally set. There was insufficient time

19 for the parties to prefile rebuttal testimony regarding

20 the settlements, so oral rebuttal and oral surrebuttal

21 will be strictly limited to the settlement agreements.

22 We're off record.

23 (Recess taken.)

24 JUDGE CLARK: The record should reflect that

25 during the recess we were able to successfully engage a

0402

 1 call with Public Counsel, I believe Public Counsel's

 2 first witness, so I'm going to call on you, Ms. Shifley,

 3 and ask you to call your witness, please.

 4 MS. SHIFLEY: Thank you, Your Honor.

 5 Good morning, Ms. Alexander, would you please

 6 state your name, title, --

 7 JUDGE CLARK: Oh, no, no, no. All right, so

 8 your next witness is Barbara Alexander.

 9 MS. SHIFLEY: Yes, I now call Ms. Barb

10 Alexander.

11 JUDGE CLARK: Thank you, and I'll administer

12 the oath.

13 Ms. Alexander, if you could raise your right

14 hand, please.

15 (Witness BARBARA R. ALEXANDER was sworn.)

16 JUDGE CLARK: Thank you.

17 Ms. Shifley.

18 MS. SHIFLEY: Thank you, Your Honor.

19

20 Whereupon,

21 BARBARA R. ALEXANDER,

22 having been first duly sworn, was called as a witness

23 herein and was examined and testified as follows:

24

25

0403

 1 D I R E C T E X A M I N A T I O N

 2 BY MS. SHIFLEY:

 3 Q. Good morning, Ms. Alexander, would you please

 4 state your name, title, and business address for the

 5 record.

 6 A. Yes, my name is Barbara Alexander,

 7 A-L-E-X-A-N-D-E-R. I use the title of Consumer Affairs

 8 Consultant. My business address is 83 Wedgewood Drive,

 9 Winthrop, Maine 04364.

10 Q. Thank you. Ms. Alexander, have you

11 previously filed any testimony or exhibits in this

12 proceeding?

13 A. Yes, I did file testimony on behalf of the

14 Public Counsel.

15 Q. And on whose behalf are you testifying today?

16 A. The Public Counsel.

17 Q. Could you please briefly summarize the

18 purpose of your testimony?

19 A. My testimony today is in response to two

20 stipulations that have been filed that are pending

21 before the Commission. The first is between the Joint

22 Applicants and the Department of Defense and Federal

23 Agencies. The second is the stipulation between the

24 Staff and the Joint Applicants.

25 Q. Okay. I'll just begin by asking you whether

0404

 1 you've had a chance to review the recently filed

 2 settlement between the Joint Applicants and the

 3 Department of Defense?

 4 A. Yes.

 5 Q. Would you please identify any concerns that

 6 you have with the settlement?

 7 A. Yes, I will. The provisions of this

 8 settlement add some minor improvements to the previously

 9 filed stipulation between the Staff and the Joint

10 Applicants. I certainly approve of the notion of

11 quarterly service quality reports, and I certainly

12 understand why a remedial plan might be an appropriate

13 response if there is any indication of failure to meet

14 the standards that are set forth in the previous

15 stipulation that I mentioned between the Staff and the

16 Joint Applicants. However, I do not view these

17 advantages as significant, nor do I believe that they

18 improve what I consider to be significant defects in the

19 stipulation between the Staff and the Joint Applicants.

20 The notion that submitting a plan is a sufficient

21 response to incent the company to actually comply with

22 service quality standards is not in my opinion

23 sufficient. Frontier under this provision would

24 basically have sole control over the development of the

25 plan, the development of its budget to achieve the plan,

0405

 1 the time period during which the plan will be operative,

 2 and how it will in fact ensure compliance in the future.

 3 (Discussion off the record.)

 4 A. Taking up where I left off that you just

 5 indicated, and sole control over the procedures or steps

 6 that it will recommend to achieve the purpose of the

 7 plan. In my opinion, this approach is not a

 8 particularly useful incentive to the company. If

 9 there's an objection to the plan for example, that would

10 have to be handled either informally or formally by the

11 Commission, and by the time any kind of proceeding is

12 completed with regard to the nature of the plan, the

13 sufficiency of the plan, another quarter or more will

14 have passed. Second, under this provision if the

15 remedial plan does not achieve its purpose, the only

16 result is another plan. I do not feel that these

17 provisions are over all likely to provide any

18 significant benefit to the underlying settlement, which

19 in a moment I will describe as deficient in a number of

20 ways.

21 BY MS. SHIFLEY:

22 Q. Thank you, Ms. Alexander.

23 I would now like to ask you a few questions

24 regarding the proposed settlement reached between Staff

25 and the Joint Applicants. First, Staff witness

0406

 1 Mr. Weinman stated in his testimony in support of the

 2 settlement that the retail service quality provisions of

 3 the settlement provide assurance that the local exchange

 4 company's basic service quality metrics will not

 5 deteriorate following the transaction. Is Mr. Weinman's

 6 statement correct in your opinion?

 7 A. No, I'm afraid it is not correct. The main

 8 reason why it is not correct is that the settlement does

 9 not prevent deterioration in performance where that

10 performance by Verizon is already better than the

11 minimum standards in the Commission's regulations. As a

12 result, Frontier's performance could be less than

13 currently delivered by Verizon without any impact on its

14 earnings or financial standing. In my opinion, allowing

15 deterioration of service below what is currently being

16 provided by Verizon to its customers in Washington is a

17 harm to Washington's customers.

18 Q. Ms. Alexander, would you please turn to

19 condition 19 on page 5 of the proposed settlement. Are

20 you there?

21 A. Yes.

22 Q. This condition states that Frontier Northwest

23 will adhere to Verizon's SPG program, Service

24 Performance Guaranty program, with some augmentations.

25 What is your assessment of this condition?

0407

 1 A. I certainly appreciate the fact that this

 2 provision will make sure that Frontier will comply with

 3 a currently tariffed item in Verizon's tariffs approved

 4 by this Commission. But frankly, I do not view that in

 5 and of itself as any significant benefit, because as I

 6 understood it Frontier had already indicated it would

 7 comply with those tariffs. So the only advantages here

 8 would fall to the notion of increasing the dollar

 9 amounts for the types of customer specific failures that

10 are addressed by the tariff and offering a new dollar

11 amount credit for a new kind of failure that is not

12 otherwise required. So my comments would be directed to

13 those two things.

14 The dollar amounts involved here are very

15 small. While the exact dollar amounts are alleged to be

16 confidential so I will not reveal the exact dollar

17 amounts, they are reflected in the Staff's response to

18 the Public Counsel's Data Request 25, and it shows that

19 the dollar amounts that would have been in effect with

20 the higher dollars, the $25 to $35, if that had been in

21 effect more recently, the financial impact on the

22 company is minuscule in my opinion. The flat rate

23 dollar amount, $5, if someone suffers an out of service

24 condition greater than 2 days is also quite small in

25 terms of the actual impact on the customer and the

0408

 1 overall impact on the company. The Commission's

 2 regulations already require customers to be -- already

 3 requires that trouble reports be repaired within 48

 4 hours. In many other states the dollar amount is keyed

 5 to the length of the outage, and that is not handled

 6 properly in this stipulation in my opinion since a

 7 customer who's off for 4 days gets $5 and a customer

 8 who's off for 2 days and 20 minutes gets $5.

 9 But it's important to understand that I don't

10 object to the notion of customer credits for individual

11 customer failures. I think it's an appropriate adjunct

12 to a well-rounded service quality plan, but my point

13 here is that the dollar amounts in question are unlikely

14 to have any significant incentive on Frontier to prevent

15 any increase in the incidences that are covered by this

16 credit mechanism. In other words, the companies can pay

17 to have poor service quality under this approach in a

18 significantly increased level without suffering any

19 financial consequences.

20 Q. Thank you.

21 Turning now to the proposed condition number

22 20, which appears on page 6 of the proposed settlement,

23 are you there?

24 A. Yes.

25 Q. This condition creates six new service

0409

 1 quality metrics in place for three years and with self

 2 executing credits or penalties. What is your

 3 recommendation regarding the first and second metrics?

 4 A. Well, let me say first that this provision

 5 overall is an attempt to try to establish a service

 6 quality index of the kind that I recommended and that

 7 the Staff recommended in our direct testimony, and I

 8 appreciate the effort to do that. I think the idea of

 9 doing that is in fact appropriate, but my concerns with

10 this overall approach are the standards that are being

11 established here and the dollar amounts that are

12 attached to the failure to meet the standards. So going

13 to the six standards, the first two I certainly endorse,

14 and I think it's important to have a standard similar to

15 the one that is being proposed here. I don't object to

16 those proposed performance standards.

17 Q. Ms. Alexander, what is your recommendation

18 regarding the remaining metrics in the proposed

19 condition 20?

20 A. The four standards remaining here are already

21 in place. They are the minimum performance standards

22 that are in effect in Washington. Obviously Frontier

23 must comply with those standards. But they are, as I

24 pointed out in my testimony, I believe they are

25 insufficient because in some of these areas Verizon

0410

 1 provides a higher level of performance, a better level

 2 of performance than the minimum standards. I believe

 3 that more -- a higher level should be locked in to

 4 prevent harm to customers as a result of the new owner

 5 of this telephone system being approved. I would also

 6 point out that the company promised in its application

 7 that it would improve performance of service quality,

 8 and I take that as an enforceable matter that the

 9 Commission should also take into account when

10 establishing the proper performance standards. So this

11 I think is one of the two fatal defects in this

12 provision, that is it would allow deterioration in

13 actual performance. And I would point to the call

14 center performance in 2009 by Verizon and the trouble

15 report rate by Verizon, both of which are better than

16 the minimum standards today.

17 Q. Ms. Alexander, do you have any concerns about

18 how long these service quality provisions in condition

19 19 and 20 will remain in effect under the proposed

20 settlement?

21 A. Before I turn to that, and I apologize, I

22 actually didn't finish my prior discussion of the second

23 fatal defect in this provision. The first was the

24 standards themselves, but the second and perhaps more

25 importantly than even the first is the lack of adequate

0411

 1 financial incentives attached to meeting these

 2 standards. The total dollar amount involved here in the

 3 first year even if all six metrics are not met is a

 4 maximum of $600,000, which is to be blunt a drop in the

 5 bucket. If they miss all these standards for two out of

 6 three years, the total is $1.2 Million. If they miss

 7 them all for three years, the total is $1.8 Million.

 8 These are minor amounts when considering Frontier's

 9 acquisition of Verizon's revenues and services in

10 Washington. I had proposed in my direct testimony $9.5

11 Million maximum penalty incentive in the form of credits

12 that would go to all customers for systemic service

13 quality performance degradation. The Staff had proposed

14 $5 Million. So the gulf between what even the Staff

15 recommended and what is reflected in the stipulation is

16 in my opinion enormous and indefensible. I do not

17 believe these dollar amounts will have any significant

18 impact on the company or its shareholders in obtaining

19 -- in setting out the proper incentives to prevent

20 deterioration.

21 So next question had to do with the length of

22 time that these conditions are in effect; is that

23 correct?

24 Q. Yes, that's correct. I asked you if you had

25 any concerns about how long the provisions in 19 and 20

0412

 1 will be in effect under the settlement?

 2 A. Yes. For reasons that are not explained in

 3 the settlement itself, condition 19 concerning the

 4 customer credits, individual customer credits, Frontier

 5 has the right to move to eliminate these, this feature

 6 after 24 months. It is not clear to me and I would

 7 object to the notion of giving Frontier the ability to

 8 eliminate the additional dollars that it has agreed to

 9 here after 2 years. There are no criteria in the

10 settlement that would govern that decision.

11 Second and just as important is that the

12 standards and the penalties in condition 20 are only in

13 effect for 3 years. There is no criteria -- there is no

14 basis for explaining why after 3 years we would not care

15 about this. And the reason why I think it's very

16 important to extend this provision is that we do not

17 know when Frontier will take these replicated systems

18 and move all of the data into its own legacy systems

19 that it uses in all the other states in which it

20 operates. They refused in this proceeding to tell us

21 when they might do that. It is that transfer which in

22 my opinion carries risks that need to be addressed in

23 the Commission's order.

24 Q. Thank you.

25 Would you now please turn to condition 28 on

0413

 1 page 8 of the proposed settlement, which concerns

 2 replication of Verizon's operations support systems.

 3 A. Yes.

 4 Q. Would you please describe any concerns you

 5 may have with the retail service quality criteria set

 6 forth in this condition?

 7 A. Yes. I am very concerned with this

 8 provision, although I agree with what I believe the

 9 intent was, which is to try to create a mechanism to

10 ensure that at the point at which Frontier is going to

11 start using the replicated systems and the transaction

12 is "closed" that there is some basis for determining

13 whether in fact the use of the replicated systems is

14 delivering just as high of service quality and customer

15 service performance as they were the day before the

16 replicated systems were put into effect. So certainly I

17 understand the intent, and I certainly agree with trying

18 to create a mechanism to address that issue.

19 But the conflict is the lack of specificity

20 and the lack of detail about how this oversight will

21 work is of concern to me and I suggest should be to the

22 Commission. The notion that you will be given data

23 about 60 days worth of performance on 4 metrics only and

24 have a 5 day period within which to make a determination

25 that something called material degradation has or has

0414

 1 not occurred is questionable to me. The 5 days is

 2 probably too short. The amount of data you're getting

 3 is too small a group.

 4 The notion that material degradation can be

 5 defined -- is not defined in this settlement is of

 6 significant concern. I think there's the potential for

 7 disputes, for lack of clear direction, and there is

 8 nothing here that describes what the Staff would do in

 9 this very short time period if it had concerns or

10 questions and how it would proceed and what rights they

11 would have to get things fixed or halt the transfer or

12 whatever. So all of those things are of concern and

13 legitimately call into question the value of what is

14 laid out here.

15 Finally, I think it's very important to note

16 the term billing error is not defined. In my 20 year

17 experience with service quality supervision of telephone

18 utilities, it has been extraordinarily difficult to get

19 any basis for capturing something called a billing error

20 out of the telephone utility database, and I will just

21 say that that term is going to be very difficult to nail

22 down. Was the bill produced on time, did the bill

23 contain all the services that the customer ordered, does

24 the bill contain the correct amount for the services

25 that the customer ordered, does the bill contain all the

0415

 1 proper disclosures, and it's my experience that

 2 customers may not recognize errors for more, you know,

 3 it may take more than one billing cycle for those type

 4 of errors to be obvious.

 5 Q. Thank you, Ms. Alexander.

 6 And just in conclusion could you please

 7 describe what your overall assessment and recommendation

 8 regarding the service quality conditions in the proposed

 9 settlement is?

10 A. My overall assessment is that the settlement

11 does not properly respond to the very real needs to

12 identify the risks and create a self-enforcement

13 mechanism to address the risks of service quality

14 deterioration in a transaction of this type.

15 MS. SHIFLEY: Thank you, Ms. Alexander, I

16 have no further questions.

17 JUDGE CLARK: Thank you, Ms. Shifley.

18 We're going to turn now to cross-examination,

19 and is Verizon inquiring first or Frontier?

20 MR. SAVILLE: Your Honor, for Frontier we do

21 not have any cross-examination.

22 JUDGE CLARK: All right.

23 Verizon.

24 MR. ROMANO: Same for Verizon.

25 JUDGE CLARK: Is your microphone on,

0416

 1 Mr. Romano?

 2 MR. ROMANO: Verizon does not have any cross

 3 either.

 4 JUDGE CLARK: Mr. Thompson.

 5 MR. THOMPSON: No cross for Staff.

 6 JUDGE CLARK: All right.

 7 Let's see if there is any Commissioner

 8 inquiry for you, Ms. Alexander.

 9 Commissioner Jones.

10

11 E X A M I N A T I O N

12 BY COMMISSIONER JONES:

13 Q. Just a clarifying question, Ms. Alexander, on

14 that last point on the definition of billing error in

15 merger commitment number 28, is that defined in the

16 ARMIS data that you used for the other indicia like out

17 of service repairs, and I think the ARMIS database is

18 43-08, correct?

19 A. The ARMIS database does not capture billing

20 errors as I understand it, sir.

21 Q. So how would the Commission Staff verify

22 billing errors, which data?

23 A. That is exactly my concern. I do not know

24 how they would require Frontier to report it, how to

25 track it, and what they would do with it, because there

0417

 1 is no historical information against which you would

 2 compare the 60 days of data on this that they're going

 3 to get.

 4 Q. I am looking through your testimony now,

 5 BRA-1CT, and I'm trying to find any recommendation that

 6 you have in writing on this particular point. Do you

 7 have a recommendation for the --

 8 JUDGE CLARK: If I may interrupt,

 9 Commissioner Jones, this is just Ms. Alexander's oral

10 rebuttal on the settlement, and my understanding is that

11 Public Counsel will be calling her at a later date to

12 offer testimony regarding her prefiled.

13 COMMISSIONER JONES: I see, I'll withdraw

14 that question.

15 JUDGE CLARK: Sorry for the interruption.

16 COMMISSIONER JONES: I'm done.

17 JUDGE CLARK: Commissioner Oshie, do you have

18 any inquiry for Ms. Alexander regarding the settlement,

19 her position regarding the settlement?

20 COMMISSIONER OSHIE: Now I'm not sure if I

21 should ask her during when she -- because really she

22 made a statement in her response to Ms. Shifley, and it

23 was just a clarification, but it really does -- it's

24 germane to her testimony, so I can hold it, it's not

25 that big a deal.

0418

 1 JUDGE CLARK: All right, thank you,

 2 Commissioner Oshie, and I apologize for creating more

 3 confusion rather than eliminating some.

 4 Chairman Goltz.

 5 CHAIRMAN GOLTZ: Yeah, I have one question

 6 about the settlement, I believe it is anyway.

 7

 8 E X A M I N A T I O N

 9 BY CHAIRMAN GOLTZ:

10 Q. And that's, Ms. Alexander, have you been

11 either involved or tracking the resolutions in other

12 states with regard to these issues between various

13 commissions and Frontier and Verizon?

14 A. I do not have an up-to-date database on that.

15 I have looked at a couple decisions that have been

16 reached that Public Counsel has passed along to me in

17 the context of this case, and I particularly took a look

18 at the Illinois situation. I know that it is not yet

19 approved by the commission, but I read Mr. McCarthy's

20 testimony and his agreements on service quality in

21 Illinois, and that one I guess I know more about than

22 the others.

23 Q. Well, let me ask you just with what you know,

24 are the, and maybe just the Illinois decision if that's

25 what we're talking about, is the -- are the -- have you

0419

 1 had a chance to review the service quality provisions in

 2 that decision?

 3 A. I've looked at the service quality issues

 4 that are pending there.

 5 Q. Okay.

 6 A. And I've looked at what Mr. McCarthy has

 7 pledged to comply with in Illinois, yes.

 8 Q. Okay. Then my question is in that provision,

 9 if we were to look at that, would we find a list of

10 agreements on service quality that would be more

11 stringent than what are in the Paragraphs 19 and 20 of

12 this stipulation?

13 A. That would be -- in Illinois it is just

14 different, and there are some things about the Illinois

15 decision that are better, and I use that word

16 quote/unquote, than this stipulation. First of all, in

17 Illinois the staff and the company have agreed that the

18 company will comply with actual more recent performance

19 that is better than the existing minimum Illinois

20 service quality standards. As far as the dollar amounts

21 are concerned, the approach in Illinois is to prohibit

22 the company in Illinois from paying dividends to its

23 parent if there are service quality failures. I do not

24 know the value of that compared to the dollar amounts in

25 this provision, but my impression is that those dollars

0420

 1 would be greater than the dollar amounts involved in

 2 this stipulation.

 3 CHAIRMAN GOLTZ: Thank you, that's all I

 4 have.

 5 JUDGE CLARK: Thank you, Ms. Alexander. Just

 6 a moment, Ms. Shifley, do you have any redirect for this

 7 witness?

 8 MS. SHIFLEY: No, I do not, Your Honor.

 9 JUDGE CLARK: Thank you for your testimony,

10 Ms. Alexander. This line is going to remain open, and

11 you're going to be the only caller on it, so you're

12 welcome to listen in to the remaining oral rebuttal and

13 surrebuttal. Again, don't place your phone on hold or

14 we will have music in the hearing room and I'll have to

15 disconnect this line as well.

16 THE WITNESS: I certainly understand that

17 problem.

18 Did you announce earlier any plans for the

19 next stage of this proceeding?

20 JUDGE CLARK: No, I did not. We are,

21 however, significantly behind schedule. I had

22 anticipated that we would be much further along than

23 oral rebuttal by this time if we are going to finish on

24 Thursday, which is highly unlikely at this juncture.

25 All right, Ms. Shifley, would you like to

0421

 1 call your next witness in oral rebuttal.

 2 MS. SHIFLEY: Yes, Your Honor, I would like

 3 to now call Mr. Stephen Hill.

 4 JUDGE CLARK: Thank you.

 5 Raise your right hand, please.

 6 (Witness STEPHEN G. HILL was sworn.)

 7 JUDGE CLARK: Thank you, please be seated.

 8 Ms. Shifley.

 9 MS. SHIFLEY: Thank you, Your Honor.

10

11 Whereupon,

12 STEPHEN G. HILL,

13 having been first duly sworn, was called as a witness

14 herein and was examined and testified as follows:

15

16 D I R E C T E X A M I N A T I O N

17 BY MS. SHIFLEY:

18 Q. Good morning, Mr. Hill.

19 A. Good morning.

20 Q. Could you please state your name, title, and

21 business address for the record.

22 A. My name is Stephen G. Hill, I'm Principal of

23 Hill Associates, a consulting firm that addresses

24 financial issues in regulatory proceedings. My address

25 is P.O. Box 587, Hurricane, West Virginia, the

0422

 1 telecommunications consulting capital of the Eastern

 2 U.S.

 3 Q. Mr. Hill, have you previously filed any

 4 testimony or exhibits in this proceeding?

 5 A. Yes, I filed direct testimony on November the

 6 3rd I believe that addressed financial aspects of this

 7 transaction, and I recommended that the Commission

 8 reject this deal.

 9 Q. On whose behalf are you testifying today?

10 A. Public Counsel.

11 Q. Could you please briefly summarize the

12 purpose of your testimony today?

13 A. Yes. My testimony today at this time is

14 going to address the financial conditions out of the

15 settlement conditions 1 through 12 as well as the

16 Staff's rationale for deciding to settle. I believe

17 that's important to discuss. My conclusion is that

18 those conditions 1 through 12 do not actually protect

19 the financial health of the company and that I continue

20 to recommend that the Commission reject both the

21 settlement and the transaction.

22 Q. Thank you.

23 Commission Staff states in its testimony

24 supporting the settlement that the Joint Applicants have

25 provided necessary assurance regarding the financial

0423

 1 risks in this transaction in their rebuttal testimony.

 2 Do you agree with Staff that Verizon and Frontier

 3 respond effectively to all the financial concerns raised

 4 previously in this proceeding?

 5 A. No, I very, very strongly disagree with

 6 Staff. I was quite surprised to see that that was

 7 Mr. Weinman's testimony. There is significant factual

 8 evidence drawn from both the company's publicly

 9 available documents filed with the SEC as well as

10 documents that were highly confidential that were

11 presented to the board of directors which will

12 contradict Mr. Weinman's statement that the company's

13 rebuttal answered all his financial questions.

14 Frontier is not a financially strong company.

15 It's a financially weak company. Its earnings have

16 declined year by year from 80 cents per share in 2006 to

17 40 cents a share 2009 while they continue to pay $1 in

18 dividends. That caused their equity ratio to drop from

19 24 to 8. There's no rebuttal on that issue. The

20 company's rate of access line loss has increased from 4%

21 in '04 to '06 to 5.1% in 07/09. The company has no

22 comment about that. This is a company that had income

23 from continuing operations decline 20% in 2 years. They

24 put their people on mandatory furlough last year. No

25 comment about that in rebuttal. All they say in

0424

 1 rebuttal is we're a Fortune 1,000 company, and we hope

 2 that we have a triple B bond rating one day. That's the

 3 rebuttal. In my view that doesn't answer those

 4 questions.

 5 There were questions raised about Verizon's

 6 carveout of SpinCo that are not answered. Verizon's

 7 response was frankly to get upset that I would say that

 8 Verizon was trying to maximize their sale price. Of

 9 course, any company, anybody that's selling a house or a

10 car or anything is going to try to get the top dollar

11 for that sale. And if you can within reasonable bounds

12 affect the allocation process in your favor, you will do

13 so. And if you're a corporate president and you don't

14 do that to maximize your profits, then I think you ought

15 to be canned. So it's quite obvious to me that Verizon

16 has an incentive to maximize that sale price and have

17 done so, and the only response by Verizon is frankly to

18 say that I am impugning their integrity by saying that

19 they might allocate that SpinCo property some other way.

20 There's no effective rebuttal on that, and that's an

21 important issue. That allocation determines what the

22 earnings before interest, taxes, depreciation,

23 amortization, EBITDA, is going to be for 2010. That's a

24 launching pad for all the projections. It determines

25 what the debt is going to be in 2010. And that ratio

0425

 1 debt to EBITDA is a big selling point. Well, the debt

 2 is, if you examine the balance sheet, it's a negotiated

 3 element, it's not allocated, and that description of the

 4 debt comes from Mr. Whitehouse in one of his data

 5 responses. So the company hasn't responded to that in

 6 the rebuttal.

 7 Similarly, they haven't responded to the fact

 8 that their financial projections are overoptimistic.

 9 There are very, very bold assumptions in their financial

10 projections. A 30% reduction in the rate of line loss

11 for SpinCo, a 50% increase in revenue per line for

12 SpinCo. Well, that seems like a very happy scenario.

13 And when questioned about this, questioned whether or

14 not those data had been tested to see if there was a

15 point at which they would become problematic, the

16 company consistently said no, we have done no stress

17 tests. And the only rebuttal that was offered by

18 Frontier was Mr. McCarthy's rebuttal that I made some

19 sort of miscalculation in this data. I made no

20 calculations in these data. These data were taken

21 directly from the board presentations on May the 12th,

22 the day before the transaction was approved. So, you

23 know, I don't know the rationale for Mr. McCarthy's

24 characterization of my testimony, but these are numbers

25 that were taken directly from the board presentations

0426

 1 that I presented to you, which I believe are seriously

 2 optimistic and that there could be financial problems if

 3 those optimistic projections are not met. The problem

 4 is there's no way to test that. The company hasn't done

 5 it. In the financial model they provided, you're unable

 6 to make those tests. So the Staff's decision to settle

 7 because of the company's rebuttal testimony was ill

 8 informed in my view.

 9 Q. Staff also indicates in its testimony

10 supporting the settlement that its previous concerns

11 regarding the S-4 risk factors have been resolved.

12 Specifically Mr. Weinman states that the SEC requires

13 full disclosure of all risks attendant a merger

14 transaction, inferring that those risks need not be

15 seriously addressed. What is your response to this?

16 A. Well, both Mr. Weinman and I in our testimony

17 originally were concerned about the risk factors. The

18 rebuttal, company's rebuttal, said basically everybody

19 has to publish risk factors, and they're unlikely to

20 occur. There was no, as I saw it, any serious analysis

21 of any primary risk factor that was listed in Frontier's

22 S-4 as rebuttal. Basically the rebuttal was these are

23 not a problem, they're just something we're required to

24 say. And they used the example of AT&T's S-4, and they

25 I believe quoted some of AT&T's S-4. Certainly true the

0427

 1 companies that are going to merge have to file S-4's,

 2 and the SEC requires them to disclose to their investors

 3 what some probable risks are. And for a financially

 4 sound company like AT&T, those risks are probably small.

 5 But for a company, a smaller company that's financially

 6 weaker than the company it's acquiring which is three

 7 times the size, those financial risks that are

 8 enumerated can become realized. They are certainly

 9 real. I mean one of the risks that Frontier talks about

10 is the risk, the construction risk they face. Verizon

11 is underinvested, and therefore there is serious

12 construction risk that they have to meet. I mean that's

13 certainly not untrue. They've confirmed that time and

14 time again here in testimony. So you can't say that

15 this is a -- risks are to be ignored. They certainly

16 aren't to be ignored. And some companies that report

17 risk don't realize them. Some companies that report

18 risk, for example FairPoint also had an S-4 with risks

19 listed, it ultimately realized those risks, and that can

20 be very bad for rate payers if those risks are

21 ultimately realized.

22 Q. Thank you.

23 There was some discussion of capital budget

24 for Washington, and part of that discussion did tie with

25 the commitment for expenditures tied to broadband that

0428

 1 are in the settlement. Do you have any comments about

 2 the discussion of the capital budget for Washington?

 3 A. A couple of things in Mr. McCarthy's mention

 4 today of money they might spend in Washington. It sort

 5 of encapsulates the presentation that I see here is that

 6 it's a lot of what we think we can do, what we might do,

 7 here are some numbers about what we might do, but

 8 they're not -- there's not really any definite plans

 9 underneath those numbers. For example, he talked about

10 $60 Million in the second year, some number like that,

11 and said, no, there's not a capital budget, there's not

12 an actual plan to spend any money here, that's just a

13 number 12% of what we think the revenues are going to

14 be. That's an assumption on an assumption.

15 And I would also note that in the May 1st

16 board of directors meeting, Frontier lowered its

17 estimate of capital spending from 12% on the dollar to

18 10%, so I frankly don't know why Mr. McCarthy was using

19 the 12% number.

20 But he wants to come before you at the 11th

21 hour and say, oh, yeah, we're going to spend money here.

22 They don't have plans, they don't have any plans in

23 place to spend money. They're going to spend money. I

24 mean they'll have to spend money to order to upgrade the

25 infrastructure that they're acquiring, but there's no

0429

 1 definite plan. So for me his comment today about the

 2 capital budget sort of encapsulates the problems I'm

 3 having with this whole presentation. There's not a lot

 4 of factual support. They seem like very nice people,

 5 the story is compelling, we want to work here, Verizon

 6 doesn't, that's all compelling, but I haven't seen

 7 enough factual evidence to convince me that these

 8 financial problems that I've raised have been answered.

 9 Q. In your direct testimony you propose a number

10 of conditions you believe are necessary to protect

11 Washington customers, and your testimony speaks for

12 itself, but have circumstances changed or evidence been

13 presented in rebuttal or in the settlement to make those

14 conditions less necessary?

15 A. I don't believe so. The conditions that are

16 set out in the settlement agreement, the 12 conditions,

17 are I believe insufficient to protect rate payers from

18 financial consequences. And if you would like me to, I

19 can go through those 12 conditions.

20 Q. Certainly.

21 A. I'm turning now to the settlement agreement,

22 attachment 1, financial conditions, and I'll go through

23 them at a relatively high level. We've already talked

24 about some of them. For example, condition number 1, I

25 see this as a reporting function. The condition is to

0430

 1 monitor the cash flows between Frontier Northwest and

 2 Frontier. It's not a bad idea, I don't think it's a bad

 3 idea, but I don't think it offers any protection,

 4 financial protection, to the rate payers. I mean there

 5 are no limits. What's a good ratio, should 90% go to

 6 the parent and 10% to the local or 10 and 90 or, you

 7 know, vice versa? There are no limits. There's no

 8 trigger for action. If the amount going upstairs gets

 9 to be X times their construction budget, is that a

10 problem? Where do we begin to be concerned about that?

11 And there -- and also there are no consequences, so we

12 just -- we're just watching the fish swim by and we're

13 not trying to catch anything.

14 The second one is a requirement to file an

15 AFOR. Well, this is not really an onerous condition for

16 a regulated utility. I mean it's in my view I've always

17 thought of AFOR as regulation light basically. I mean

18 and what utility wouldn't want to be less regulated? So

19 this is kind of like asking Brer Rabbit if he wants to

20 go to the brier patch, of course he does. So I don't

21 see that that has really much of anything to do with

22 protecting the company's finances. I would just note if

23 this becomes part of the deal I would hope that the

24 Commission would require a full bore rate case before

25 you get started on any kind of AFOR process down the

0431

 1 road. I mean you got to have a decent starting point.

 2 So if you do this, I think you should think about that.

 3 Reporting synergy savings, also a good idea.

 4 I don't know that it does anything to protect the

 5 company financially or the rate payers from financial

 6 harm. There's no sharing, there's no consequences

 7 again, and there's no trigger for any kind of regulatory

 8 action. Also I find the language to be vague. 3(a)

 9 introspective activity, what is that? 3(c) impacts on

10 Washington operations, what are those, what are they

11 talking about, monetary? We just don't know, so I think

12 that's a little bit vague.

13 Number 4 seems to me to restate a company

14 commitment they made already, and I would think that

15 would be standard regulatory practice to not allow

16 transaction related costs to be filtered down to rate

17 payers, so I don't think that's much of a commitment.

18 Number 5, as we discussed with Mr. Weinman

19 yesterday, Frontier may not encumber the assets of

20 Frontier Northwest. Utilities don't, telephone

21 utilities don't issue mortgage debt. It's different

22 than an energy utility. The property doesn't last that

23 long, so it's not -- it's not really mortgageable, and

24 it's mostly debentures which are not tied to any assets.

25 So this is what's really being encumbered is the income

0432

 1 stream that's generated by what rate payers pay to the

 2 company. So number 5 I don't think makes an impact.

 3 Moving on to number 6, which asks the company

 4 to file what its actual debt to EBITDA ratio is after

 5 the transaction, I think this simply underscores the

 6 fact that we don't know what it is now. And, you know,

 7 what if it's not 4, what if it's 8, what do we do? Is

 8 there anything we can do? It's not listed in here.

 9 Number 7 seems to be a reporting function. I

10 don't have any problem with reporting functions. I mean

11 this is affiliated interest, and the Commission already

12 has affiliated interest requirements, seems to fall

13 under that. Doesn't seem much of a give away once again

14 for Frontier, something they would have to comply with

15 anyway already.

16 Number 9, applicants inform the Commission of

17 any changes before the transaction actually occurs.

18 This is good common sense, there's nothing wrong with

19 it. What do you do? What if something, you know, oh,

20 oops, the interest rate's 12%, it's not the 8 1/2%, what

21 do you do? Do you say, okay, we decline, we change our

22 minds? I mean once again there's no response to this.

23 You're really looking at the numbers. They send you a

24 piece of paper and say something changed, our debt cost

25 us 12%, and then what do you do?

0433

 1 Number 10, Frontier Northwest must maintain

 2 books to ensure it will continue to report Washington

 3 operations to the Commission, this is simply Frontier is

 4 required to do what Verizon is now doing, nothing beyond

 5 that. We found out yesterday from Mr. McCarthy and

 6 McCallion that Verizon Northwest is a corporation. As

 7 such, it should have, and does they said on the record,

 8 has income statements, balance sheets, and cash flow

 9 statements. Those should be part of this reporting.

10 They should report their financial statements. This is

11 not required in here, but if you're going to do this,

12 that's a minimum. It should be done.

13 And that reminds me of one thing I want to go

14 back to. Number 11 is a reporting requirement, the same

15 as number 4, I'm going to save discussion on number 12.

16 I want to go back to number 1. Forgot to say

17 that in the Commission's discussion with Mr. Weinman

18 yesterday about, well, how do you sequester these funds

19 in the state when you're talking about a national

20 company and all this other stuff, and Mr. Weinman's

21 direct testimony you recall said very clearly that you

22 can't ring fence this company, and I completely agree

23 with that, because it's a -- the Washington operations

24 are a division of Verizon/Frontier Northwest. They're

25 not a separate stand-alone company. Seems to me, and I

0434

 1 just thought of this yesterday, it seems to me that as

 2 part of this transaction if you want to approve it, you

 3 could require them to incorporate in Washington. You

 4 could go down to the Secretary of State's office and,

 5 you know, a couple thousand bucks they got a company.

 6 They would have to allocate capital and allocate, you

 7 know, personnel and all this other stuff, but they could

 8 incorporate. They could become Frontier Washington, and

 9 then you can ring fence. Then with a actual legal

10 entity, then you have more control over the cash flows

11 in and out of the company. And I'm, you know, I'm sorry

12 to drop this on the company at the last minute, but

13 frankly it just occurred to me the other day, yesterday.

14 So that's something to consider.

15 I'm sorry to jump around, going back over to

16 number 12, this is -- I think this is a very good idea.

17 Basically you're tracking -- you want the company to

18 present what is effectively a capital budget for -- it

19 doesn't give a time period, but it says effective

20 remaining life of the host and remote central switches

21 and stuff like that. If you're looking for a

22 replacement plan, what you're looking for basically is

23 the capital budget. You want to know what they intend

24 to spend to get to where they say they're going to get

25 to. This is a good idea. And then they have to report

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 1 how they're progressing, and you can combine that with

 2 the knowledge of where the money's going to determine if

 3 they're actually putting the rubber to the road, if

 4 they're actually getting to where they say they want to

 5 be at a certain time. So I think once again it's a

 6 tracking reporting function that may help the Commission

 7 in managing this whole thing. I don't think it really

 8 offers any financial safety measures, but I don't think

 9 it's a bad idea.

10 Q. Thank you, Mr. Hill.

11 And the conditions in the proposed

12 settlement, are any of those similar to what you

13 proposed?

14 A. Obliquely. We proposed that the company

15 limit its dividends to what its earnings are, and there

16 are some difficulties with that we discussed earlier.

17 But that is not a requirement here, although I think

18 there is an idea in these 12 factors with financial

19 conditions that wants to see that Frontier does what it

20 says it's going to do. I'm a little -- this requirement

21 that they limit their dividends is a little more heavy

22 handed, but basically it goes after the same thing,

23 trying to retain money in this local operation so we can

24 have some local input to the capital needs. That's the

25 idea, which is kind of the same as the 12 conditions,

0436

 1 but it's a different way to get about it.

 2 The other thing that's very different is I

 3 recommend that Verizon be required to kick in $70

 4 Million into this deal, and in order to do that, that

 5 $70 Million payment would have to be declared to be not

 6 a required payment amount, quote/unquote, which is

 7 defined in the merger as a regulatory clawback that

 8 Frontier ultimately would have to pay for. See, I don't

 9 want Frontier to pay for that, I want Verizon to kick

10 that money in. And then I also would like, similar to

11 the condition number 12, like the Commission to monitor

12 the capital expenditures.

13 I'll say one more thing and then I'm done

14 with this, but there's a lot of monitoring going on

15 here, and I don't know if you have anybody on your Staff

16 who is underworked, I doubt it, but that seems to come

17 up in all of these merger cases. The Commission winds

18 up doing an immense amount of monitoring, and I would

19 guess that over the years as personnel changes, that

20 gets less and less acute. So maybe we could think about

21 having the companies fund someone to monitor their

22 actions rather than putting that burden on the

23 Commission.

24 Q. Mr. Hill, in sum, what is your recommendation

25 to this Commission as to the proposed settlement?

0437

 1 A. I recommend the Commission reject the

 2 settlement. I think there are too many unanswered

 3 questions with regard to the financial issues in this

 4 transaction for the Commission to accept a settlement.

 5 I think these 12 conditions don't actually protect rate

 6 payers from financial consequences, and the company

 7 hasn't answered enough questions about its conditions

 8 and its forecasts for me to have confidence that it's

 9 not going to be a problem ultimately.

10 MS. SHIFLEY: Thank you, I have no further

11 questions at this time, Your Honor.

12 JUDGE CLARK: Thank you.

13 Who will be inquiring on behalf of Verizon?

14 MR. RUGGIERO: Good morning, Your Honor, this

15 is Joe Ruggiero.

16 JUDGE CLARK: We'll take a moment off record.

17 (Discussion off the record.)

18 JUDGE CLARK: All right, Mr. Ruggiero.

19

20 C R O S S - E X A M I N A T I O N

21 BY MR. RUGGIERO:

22 Q. Good morning.

23 A. Still morning.

24 Q. You testified a few moments ago that one

25 failing of the settlement agreement was that it did not

0438

 1 adopt your requirement that Verizon be required to kick

 2 in $70 Million; do you recall that?

 3 A. I don't believe I said that was a failing of

 4 the settlement agreement. I think it was a difference

 5 between what I recommended and the settlement agreement.

 6 Q. All right. Could we take a look at your

 7 direct testimony, it's Exhibit SGH-1HCT.

 8 JUDGE CLARK: Mr. Ruggiero, I just want to

 9 remind you that we are going to have the opportunity to

10 examine Mr. Hill later on that direct testimony and that

11 we really kind of focus on his opposition to the

12 settlement agreement at this time.

13 MR. RUGGIERO: Your Honor, I completely

14 understand.

15 JUDGE CLARK: All right.

16 MR. RUGGIERO: It's a difficult line for us

17 because he raised the notion of the settlement, the $70

18 Million as part of the settlement agreement.

19 JUDGE CLARK: I understand, and so I'm going

20 to watch carefully how you phrase your inquiry.

21 MR. RUGGIERO: I think you are going to find

22 that I will be done in less than 5 minutes.

23 BY MR. RUGGIERO:

24 Q. Can you please turn to your direct testimony

25 at page 24, Mr. Hill. It's Exhibit SGH-1HCT.

0439

 1 MS. SHIFLEY: Your Honor, could I just object

 2 to this again. As you just stated, the

 3 cross-examination here should focus on Mr. Hill's

 4 analysis of the settlement agreement, and this question

 5 seems to be going to his direct testimony.

 6 JUDGE CLARK: Mr. Ruggiero.

 7 MR. RUGGIERO: Your Honor, his oral rebuttal

 8 testimony to the settlement was that he disagreed with

 9 the settlement because it did not adopt his proposed

10 condition that Verizon, quote, be required to kick in

11 $70 Million. Now I want to cross him on that comment,

12 but an important part of that cross is to look back at

13 his testimony where he first said it.

14 JUDGE CLARK: And I understand that, and I'm

15 trying very hard not to frustrate the purpose of your

16 cross-examination, but I really believe that this

17 inquiry would be better suited to contesting perhaps

18 Mr. Hill's position in direct when he testifies at a

19 later time.

20 MR. RUGGIERO: I think that will be fine,

21 Your Honor, I will take your recommendation on that.

22 JUDGE CLARK: Thank you.

23 MR. RUGGIERO: Verizon has no questions for

24 Mr. Hill at this time.

25 JUDGE CLARK: Thank you.

0440

 1 Mr. Saville.

 2 MR. SAVILLE: Your Honor, nothing from

 3 Frontier.

 4 JUDGE CLARK: Mr. Thompson.

 5 MR. THOMPSON: No cross from Staff.

 6 JUDGE CLARK: Is there any inquiry from

 7 Commissioner Jones?

 8 COMMISSIONER JONES: Just a couple points.

 9

10 E X A M I N A T I O N

11 BY COMMISSIONER JONES:

12 Q. You talked about the overly optimistic

13 financial projections that the company presented to the

14 board. I'm a little confused about the financial

15 projections that you used in your analysis.

16 COMMISSIONER JONES: And maybe this is better

17 left for direct, Judge, okay.

18 JUDGE CLARK: I think so, and I think that

19 this is somewhat confusing, but at this juncture we're

20 just trying to make sure that Public Counsel's due

21 process rights to contest the terms and conditions of

22 the settlement are not infringed, and they will have the

23 opportunity to put on their direct case at a later time.

24 BY COMMISSIONER JONES:

25 Q. Just one clarifying question then. When you

0441

 1 talk about the financial projections of the company, are

 2 you also referring to the company's use of its financial

 3 advisors, Citibank and Evercore, because they supposedly

 4 developed or helped vet both evaluation recommendations?

 5 A. They vetted them, but I don't think that they

 6 developed the model. My understanding is that

 7 Mr. McCarthy's group developed the model, and the

 8 financial advisors took those projections and made a

 9 determination that it was fair for the stockholders and

10 my -- okay, I'm not going to answer that first question

11 you asked.

12 Q. Please don't.

13 And did you hear my inquiry on merger

14 commitment number 1 yesterday of Mr. Weinman?

15 A. I did, yes, sir.

16 Q. Because that to me is the heart or one of the

17 key points of the settlement agreement, so I think to

18 rephrase to use your words, you think it's a good idea

19 but not sufficient?

20 A. Yes, that's my position.

21 COMMISSIONER JONES: Okay, thank you.

22 JUDGE CLARK: Commissioner Oshie has no

23 questions.

24 Chairman Goltz.

25 CHAIRMAN GOLTZ: I think it would be more

0442

 1 efficient for me to wait until after I hear the

 2 company's cross, because it all relates to the direct

 3 testimony.

 4 JUDGE CLARK: All right, thank you, Chairman.

 5 Is there redirect?

 6 MS. SHIFLEY: Not at this time, Your Honor.

 7 JUDGE CLARK: Thank you for your testimony at

 8 this time, Mr. Hill, and we do understand we'll see you

 9 again.

10 THE WITNESS: I hope so.

11 JUDGE CLARK: We will.

12 Ms. Shifley, do you have additional witnesses

13 on oral rebuttal?

14 MS. SHIFLEY: Yes, Your Honor. At this time

15 I would like to call Dr. Trevor Roycroft.

16 JUDGE CLARK: Thank you.

17 (Witness TREVOR R. ROYCROFT was sworn.)

18 JUDGE CLARK: Thank you, please be seated.

19 Ms. Shifley.

20 MS. SHIFLEY: Thank you, Your Honor.

21

22 Whereupon,

23 TREVOR R. ROYCROFT,

24 having been first duly sworn, was called as a witness

25 herein and was examined and testified as follows:

0443

 1 D I R E C T E X A M I N A T I O N

 2 BY MS. SHIFLEY:

 3 Q. Good morning, Mr. Roycroft.

 4 A. Good morning.

 5 Q. Could you please state your name and business

 6 address for the record.

 7 A. My name is Trevor R. Roycroft. My business

 8 address is 51 Sea Meadow Lane, Brewster, Massachusetts

 9 02631.

10 Q. Dr. Roycroft, what is your current position?

11 A. I operate Roycroft Consulting, which is a

12 firm that provides economic and policy analysis in the

13 public utility and telecommunications information

14 technology industries.

15 Q. And on whose behalf are you testifying today?

16 A. I'm testifying on behalf of the Public

17 Counsel Section of the Washington State Attorney

18 General.

19 Q. And have you previously filed any testimony

20 in this proceeding?

21 A. Yes, I filed direct testimony previously.

22 Q. Dr. Roycroft, do you believe that the

23 settlement agreement has reasonably addressed the harms

24 that were raised in the responsive cases?

25 A. No, I don't. Staff and Public Counsel

0444

 1 identified numerous harms associated with the proposed

 2 transaction, and we've already heard from Mr. Hill and

 3 Ms. Alexander regarding the harms associated with the

 4 financial risks and the risks associated with service

 5 quality. I'll be addressing other harms including harms

 6 associated with the failure of Verizon to perform

 7 adequate due diligence, I'm sorry, Frontier to perform

 8 adequate due diligence in Washington and across the

 9 Verizon separate telephone operation service areas, and

10 I will be referring to those separate telephone

11 operations service areas as the VSTO service areas. In

12 addition, Staff and Public Counsel identified risks

13 associated with multiple cutovers associated with the

14 transaction as well as the transition to replicated

15 systems which could lead to operational problems. Risks

16 and harms are identified associated with increasing

17 rates that Frontier is likely to charge. Frontier's

18 focus on upselling customers is another risk, risks for

19 Verizon customers that are currently on term contracts

20 with Verizon that will be transitioned to Frontier as

21 well as separate risks associated with Frontier's use of

22 contracts with its customers. One of the main purported

23 benefits of the settlement agreement is associated with

24 DSL, and it's very important to understand the

25 settlement's addressing of DSL related issues in the

0445

 1 broadband deployment. In direct case both Public

 2 Counsel and Staff identified risks associated with

 3 Frontier's focus on the deployment of first generation

 4 DSL technology, higher prices that Frontier charges for

 5 DSL services, and Frontier's limitations placed on DSL

 6 usage. In its rebuttal case, Joint Applicants dismissed

 7 these concerns and --

 8 JUDGE CLARK: Dr. Roycroft, I really hate to

 9 interrupt you, but at this time I really want you to not

10 focus on what was raised in the testimony that you

11 sponsored in response to the other case but rather to

12 the settlement agreements themselves and your position

13 regarding the conditions in the settlement agreement and

14 your overall recommendation to the Commission on that

15 issue.

16 THE WITNESS: Thank you.

17 A. In summary, the proposed settlement doesn't

18 address the harms that were identified by Staff and

19 Public Counsel, and I'm going to be focusing primarily

20 on the broadband pricing and marketing and operation

21 support system conditions.

22 BY MS. SHIFLEY:

23 Q. Thank you.

24 In looking at the structure of the settlement

25 proposal, do you believe that it is adequate in light of

0446

 1 the previously identified concerns regarding the fact

 2 that Verizon can walk away from this deal?

 3 A. No. The settlement does not address any

 4 potential Verizon contribution or warranty associated

 5 with the properties that Frontier will be acquiring from

 6 Verizon, and this does not remedy the risks associated

 7 with that fact. If outside plant is in need of

 8 remediation, those risks fall onto Frontier and

 9 Frontier's rate payers. This fact of Verizon not being

10 involved with the process or providing any warranty does

11 not have -- can have an impact on Frontier's financial

12 viability, may negatively impact service quality, and

13 could hinder or make difficult to complete the broadband

14 commitments that are identified in the settlement. So

15 the risks that are shifted to Frontier are not remedied

16 by the settlement agreement.

17 Q. Dr. Roycroft, you previously mentioned the

18 broadband commitment in the settlement, do you believe

19 that the settlement agreement has adequately addressed

20 broadband deployment?

21 A. No, I don't, and I think this is a very

22 important component of the Commission's understanding of

23 the settlement agreement from the standpoint that the

24 major benefit area identified in the settlement

25 agreement is broadband deployment, and this is held up

0447

 1 as an example of how any harms associated with the

 2 transaction will be offset. The specifics within the

 3 settlement agreement on broadband are important to

 4 understand, but I think it's also important that the

 5 Commission keep in mind the bigger picture with regard

 6 to broadband. Issues of broadband that are going to be

 7 of concern and affect Washington consumers include the

 8 coverage of the broadband that ultimately results after

 9 Frontier takes over Verizon's Washington operations, the

10 types of technologies that Frontier will deploy, the

11 quality of the broadband, the prices that the broadband

12 is sold at, and any limitations that Frontier places on

13 that broadband usage.

14 I think it's notable when evaluating this

15 transaction that Washington stands out among the VSTO

16 properties with regard to what Verizon has done.

17 Verizon has made substantial capital investments in

18 Washington to deploy fiber to the home, and that fiber

19 to the home investment has certainly provided benefits

20 to Washington consumers. Verizon has deployed more

21 fiber in Washington state than Frontier has across its

22 entire legacy operating territory, and that has resulted

23 in benefits, and I think what the Commission should

24 recognize is that that vision of a business model that

25 Verizon has brought is going to go away if Frontier

0448

 1 takes over Verizon's operations in this state, and those

 2 potential consumer benefits of expanded fiber are at

 3 risk.

 4 Frontier's business model with regard to

 5 broadband is focused on first generation DSL technology,

 6 and DSL technology can be enhanced to what is often

 7 referred to as a second generation where you put fiber

 8 out farther into the neighborhood, shorten the copper

 9 loop lengths, and provide higher speeds. That's what

10 AT&T is doing, and that's what Qwest is doing with

11 regard to its broadband. Frontier is not pursuing that

12 model. It's pursuing an old fashioned DSL deployment

13 using existing plant corrected for the deficiencies that

14 the provision of waste service injected with regard to

15 inhibiting potential broadband deployments. In addition

16 to focusing on this first generation DSL, Frontier's

17 business model sells DSL at higher prices than Verizon

18 does, and in addition Frontier sells DSL with usage

19 restrictions that Verizon does not impose. So this

20 shift in vision with regard to broadband is one that I

21 think it's important for the Commission to understand

22 and to consider when they evaluate the alleged benefits

23 that the broadband commitment contained within the

24 settlement agreement brings.

25 Q. Thank you.

0449

 1 Dr. Roycroft, do you believe that the

 2 structure of the settlement agreement with regard to the

 3 $40 Million escrow account is reasonable?

 4 A. No. There are several problems with the $40

 5 Million escrow account. The first problem was that this

 6 $40 Million escrow account was determined or arrived at

 7 within the context of the settlement agreement without

 8 the benefit of understanding the overall capital

 9 spending plan here in Washington. And we've heard a

10 little bit about some insight that Frontier is now

11 willing to share regarding that capital spending this

12 morning, but when the settlement was negotiated, that

13 information, even that information, that very limited

14 information, was not available.

15 The problem with regard to DSL deployment

16 within the context of this $40 Million escrow account

17 and the recovery of funds by Frontier from that escrow

18 account relates -- is going to arise due to the shared

19 nature of DSL deployment. When DSL is deployed, it's

20 using facilities that are shared with voice services.

21 The settlement agreement does not determine or define

22 how it is that remediation for example that may be

23 necessary to bring broadband to a certain area, which

24 also favorably impacts voice services, whether that is

25 something that is permissible or will there be some need

0450

 1 to divide out the appropriate dedicated moneys for

 2 broadband.

 3 To give you an idea of how difficult it is to

 4 think about the $40 Million in the context of what it

 5 actually means, it's useful to consider what Frontier

 6 has told the West Virginia Public Service Commission

 7 which adds to more information and helps to give that

 8 commission some understanding of what their commitment

 9 means in that state. In West Virginia, which has a

10 slightly larger number of access lines than Washington,

11 about 50,000 more access lines than Washington, Frontier

12 has stated that it will expend over a 3 year period $48

13 Million on broadband. However, they also told the

14 commission specific numbers with regard to capital

15 expenditures that they plan during that same 3 year

16 period. They told the Commission that they plan on

17 investing over that 3 year period $201 Million in their

18 network at the same time that they're investing the $48

19 Million in broadband.

20 MR. SAVILLE: Your Honor, I would object that

21 this is beyond the scope of the settlement that is

22 before the Commission at this point in time.

23 JUDGE CLARK: Response, Ms. Shifley.

24 MS. SHIFLEY: Your Honor, I believe that what

25 Dr. Roycroft is trying to do is to point out what his

0451

 1 assessment is regarding the deficiency of the $40

 2 Million escrow, and so it does directly relate to this

 3 part of the proposed settlement.

 4 JUDGE CLARK: Dr. Roycroft, is your testimony

 5 in this regard a comparison of condition 13 in

 6 Washington with other conditions or testimony presented

 7 on this case in West Virginia?

 8 THE WITNESS: I'm sorry, testimony on this

 9 case presented in West Virginia?

10 JUDGE CLARK: Yes.

11 THE WITNESS: No, it's a comparison with what

12 is being described in this settlement agreement and

13 helping the Commission understand why the $40 Million is

14 a number that is essentially suspended without context

15 and very difficult to interpret.

16 JUDGE CLARK: So I think the answer to my

17 question is just yes, that you are comparing condition

18 13 in the Washington settlement with what has happened

19 in another jurisdiction regarding this particular issue?

20 THE WITNESS: Yes.

21 JUDGE CLARK: Thank you.

22 I'm going to overrule the objection and allow

23 it.

24 Do you remember where you were?

25 THE WITNESS: Yes, I do.

0452

 1 A. As I was indicating, as I was stating,

 2 Frontier has told the West Virginia commission that it

 3 will expend during that same 3 year period $201 Million,

 4 and even more specifically Frontier in West Virginia in

 5 the first year of that 3 year period contained within

 6 that $201 Million has committed to expend $12 Million to

 7 remediate service quality problems and improve outside

 8 plant. So this sort of information then allows the West

 9 Virginia commission to gain a better understanding of

10 what that $48 Million might actually mean. The

11 settlement agreement as it's written lacks that context.

12 It also lacks clear definitions as to what is a

13 qualified broadband expense, and the shared nature of

14 broadband and voice services opens up the possibility

15 that these broadband dollars, these alleged broadband

16 dollars may go to fund other types of investments that

17 are shared with voice or just necessary to remediate

18 problems with outside plant.

19 A second problem with the $40 Million and the

20 settlement itself is that the broadband commitment does

21 not address Federal broadband stimulus funding. There

22 is an opportunity for Frontier to apply for broadband

23 stimulus funds that could be used in Washington, and I

24 certainly hope that Frontier does pursue that

25 opportunity. However, within the context of the

0453

 1 settlement agreement, it's not -- it appears that

 2 Frontier could gain broadband stimulus funds, pay for

 3 the project with those funds, and then recoup moneys

 4 from this $40 Million fund. There's nothing to prevent

 5 within the four corners of the settlement agreement the

 6 $40 Million necessarily having to come from Frontier.

 7 So as a result by not focusing, not even mentioning the

 8 Federal broadband stimulus program, the settlement

 9 agreement misses an opportunity to push broadband to a

10 higher level within the state.

11 A third problem with the $40 Million stimulus

12 fund, the $40 Million broadband fund as it's written

13 within the settlement agreement, is that it specifically

14 rules out any dollars going to expand fiber deployments.

15 And I understand that there's a need to segregate moneys

16 to complete the FiOS buildout, and the settlement

17 agreement appropriately eliminates those dollars from

18 the $40 Million fund, but the opportunity for Frontier

19 to leverage its broadband fiber platform in Washington

20 to satisfy the terms of the settlement agreement is

21 excluded. The settlement specifically says that we --

22 that the moneys can not be used to deploy fiber to the

23 home, and that seems to be an unreasonable limitation

24 with regard to the level of technology that this $40

25 Million can support.

0454

 1 Finally on this issue, $40 Million, the

 2 settlement agreement talks about quantifying synergies,

 3 and the only place that I see any potential to even link

 4 the settlement agreement with synergy sharing in any

 5 sort of immediate sense is with this $40 Million

 6 broadband commitment. And it is notable that this $40

 7 Million commitment over a 5 year period, the broadband

 8 obligation is not to be completed until the end of 2014,

 9 which is just about 5 years down the road, is not very

10 much synergy sharing. We've heard from the company's

11 witnesses today that they're expecting 500 in run rate

12 synergies. Run rate synergies meaning that once these

13 synergies are arrived at, they will occur year after

14 year. They ramp up over a period of a 3 year term.

15 It's reasonable I believe based on my analysis to

16 associate $41 Million per year of synergies with

17 Washington state. In analysis that I conducted, it

18 seems ramping up those synergies over a 3 year period

19 would indicate that there should be reasonably $89

20 Million of synergies available in Washington state, and

21 if we add in the fourth year to 2014 that value would go

22 up to $130 Million. Sharing those synergies through

23 broadband deployment is a win-win in this situation.

24 Frontier gets the opportunity to have broadband more

25 widely deployed, Washington consumers get the economic

0455

 1 development benefits of broadband. Allowing 30% of the

 2 reasonably associated synergies to stay in Washington

 3 and the rest to go elsewhere, either to Frontier's

 4 shareholders or to other jurisdictions, is not a

 5 reasonable outcome, and the settlement agreement does

 6 not provide for a reasonable sharing mechanism.

 7 In summary on this point, the settlement's

 8 broadband provisions with regard to this $40 Million

 9 commitment are not a reasonable approach to the

10 broadband issue.

11 BY MS. SHIFLEY:

12 Q. Thank you.

13 And you were just talking about the -- you

14 were just discussing the subset of the broadband issue

15 dealing with the escrow account. Could you discuss the

16 deficiencies of the broadband deployment conditions in a

17 little bit more detail if you have any points on other

18 deficiencies?

19 A. Yes. With regard to the specific broadband

20 commitments, how much broadband will be deployed in this

21 -- as a result of the terms of the settlement, there are

22 several problems. The first is that there's an

23 unacceptably long timeline. We're looking at a horizon

24 of December 31st, 2014, for which Frontier may use to

25 satisfy these commitments. That's 5 years from now.

0456

 1 It's also important to note that during that 5 year

 2 period it will be a relatively small movement in the

 3 amount of broadband that will be deployed in the state

 4 of Washington.

 5 Q. Dr. Roycroft, just one thing, just a reminder

 6 that there is some confidential information in the

 7 settlement agreement, so if your testimony just doesn't

 8 mention any of the specific confidential information in

 9 the settlement, thank you.

10 A. I think we'll be okay.

11 As I was saying, Washington state already has

12 among the VSTO service areas the highest level of

13 broadband deployment among the 14 states, and the

14 movement that we're going to see over this extended

15 period of time is relatively small. To put it into

16 context, what we're getting a commitment for, 89%

17 average of households in Frontier's Washington service

18 area, is something that's already been achieved by

19 Century Tel and very close to what Qwest has achieved.

20 We don't even get the 92% that Frontier has presented to

21 this Commission on numerous occasions as being the

22 broadband vision of Frontier with regard to getting

23 coverage out to a large number of customers.

24 Furthermore, by the end of 2014, the settlement leaves 5

25 wire centers potentially unserved, and I see absolutely

0457

 1 no reason why at the end of 2014 within Frontier's

 2 service area, given the amount of synergies that they're

 3 expecting, that there should be unserved wire centers in

 4 Washington state in their service area.

 5 Second, the third issue that I wanted to

 6 mention with regard to the structure of the broadband

 7 commitment was that the DSL technology that is described

 8 in the settlement agreement sets an extremely low hurdle

 9 for Frontier. The technology is essentially already

10 outdated, and by the time that we hit the benchmark year

11 of 2014, this technology deployment is going to be

12 antiquated. The settlement specifies that 75% of

13 households should have 1.5 megabit downstream, 381

14 kilobits upstream by the end of 2011 and then by the end

15 of 2014 that 80% of households should have 3 megabits

16 per second downstream. No mention of upstream speeds,

17 and that too is a weakness from the standpoint that

18 upstream speeds are increasingly important from the

19 standpoint of consumers' abilities to upload information

20 or work at home.

21 For example, in California 2 years ago the

22 commission there approved a advanced services subsidy

23 fund, and to gain subsidy dollars from that fund, the

24 applications had to have 3 megabits per second

25 downstream, 1 megabits per second upstream, with the

0458

 1 rationale of the commission being that that was the

 2 minimum that they saw of being effective for working

 3 from home. So we don't even get that level of

 4 commitment with regard to Frontier's obligation in the

 5 settlement agreement.

 6 And furthermore, the target that is

 7 identified here doesn't even bother to leverage the fact

 8 that Frontier is capable of deploying higher speeds and

 9 already is. We set a very low hurdle here, 3 megabits

10 per second by the end of 2014, when we're told by

11 Mr. Gregg that 3 megabits per second is their standard

12 deployment today and that they are deploying higher

13 speeds in some areas. In fact, just last week before

14 the FCC Frontier filed an ex parte communication that

15 specifies that 5 megabits per second can be achieved by

16 Frontier 41% of current Frontier locations. So rather

17 than building in a higher hurdle for Frontier, the

18 settlement agreement essentially provides a very weak

19 set of broadband standards with regard to the types of

20 technologies associated with the deployment.

21 Q. Thank you, Dr. Roycroft.

22 Moving now a little bit beyond what we were

23 just discussing, Staff witness Mr. Weinman stated that

24 in the CenturyTel/Embarq merger, the FCC required a 100%

25 broadband deployment. Does this fact offset the

0459

 1 deficiencies in the settlement agreement's broadband

 2 provisions?

 3 A. No, I don't believe that it does. At this

 4 time what the FCC may do is uncertain, and it certainly

 5 isn't reasonable for this Commission to be presented

 6 with the hope that the FCC will do something better as a

 7 remedy to the very weak broadband provisions of the

 8 settlement agreement.

 9 Q. Do you have anything further on that point?

10 A. No.

11 Q. Does the settlement agreement address

12 Frontier's DSL pricing strategies?

13 A. I don't believe that it goes far enough on

14 DSL pricing. The settlement identifies a specific cap

15 with regard to stand-alone DSL for 12 months. It also

16 identifies apparently some pricing restrictions for 12

17 months associated with DSL that may be in a bundle.

18 Both my analysis and Staff analysis indicate that

19 Frontier's DSL rates are substantially higher than

20 Verizon's, and it's likely that those DSL rates will be

21 introduced in Washington after those caps expire. The

22 settlement fails to adequately address DSL pricing.

23 Q. In your direct testimony, you identify

24 Frontier practices with regard to broadband service that

25 identify an upper limit on the amount of data that may

0460

 1 be transmitted over a Frontier broadband connection.

 2 Does the settlement agreement address this issue?

 3 A. No, it does not, and I think this is once

 4 again an important aspect of understanding the change in

 5 vision between Verizon and Frontier with regard to how

 6 they operate their business. Frontier has an acceptable

 7 use policy for broadband which states that Frontier may

 8 suspend, terminate, or apply additional charges to the

 9 service if usage exceeds a reasonable amount of usage

10 and then goes on to define a reasonable amount of usage

11 as defined as 5 gigabytes combined upload and download

12 consumption during the course of a 30 day billing

13 period. So what this means is that if comparing it to

14 Verizon, Verizon essentially says our service is all you

15 can eat. You pay us our $19.99 a month for the specific

16 speed of service, and you can download as much as you

17 want.

18 JUDGE CLARK: Dr. Roycroft, I really hate to

19 interrupt you again, but I really think it's important

20 at this juncture, as difficult as it is, to try to stay

21 kind of focused only on the parameters of the settlement

22 agreement, and recognize that you will be coming back to

23 testify regarding some of these other distinctions.

24 THE WITNESS: I'm not sure if I can proceed.

25 JUDGE CLARK: Ms. Shifley, maybe you can

0461

 1 help.

 2 MS. SHIFLEY: Yes.

 3 BY MS. SHIFLEY:

 4 Q. Dr. Roycroft, just to clarify your last,

 5 would you like to just answer very briefly whether or

 6 not the settlement agreement addresses the issue of

 7 limitations on data that can be transmitted?

 8 A. No, it does not.

 9 Q. I would like to now move to some questions

10 about non-broadband services. Again previously

11 potential harms to Washington rate payers were

12 identified regarding Frontier's pricing strategies for

13 retail telephone services. Do the retail service rates

14 provisions in the settlement agreement, which are

15 conditions 23 through 26, adequately address these

16 potential harms?

17 A. No, I don't believe that they do. The

18 settlement agreement's provisions with regard to retail

19 pricing with regard to the residential basic service cap

20 seems to be a reasonable provision. Other services, and

21 other services are consumed by large numbers of Verizon

22 Washington consumers, do not have similar protection.

23 The settlement agreement fails to offer adequate

24 protection, and this represents another shortfall of the

25 settlement agreement.

0462

 1 Q. Thank you.

 2 In your direct testimony, again you discuss

 3 the need for a fresh look policy for Verizon's customers

 4 who are locked into a term contract at the time of the

 5 merger's closing. Does the settlement agreement address

 6 this issue?

 7 A. It only addresses that issue in part. It

 8 appropriately identifies the pick change provision which

 9 allows consumers to reevaluate their choice of long

10 distance providers without penalty. However, the

11 settlement agreement does not address the fact that some

12 Verizon customers are currently locked into term

13 contracts for non-long distance services, and these

14 customers, some of them, may have a choice of service

15 provider. The settlement agreement essentially does not

16 allow those consumers to make that choice without

17 penalty and rather forces them into a relationship with

18 a carrier that they did not choose.

19 Q. Dr. Roycroft, I would like to turn now to the

20 issues relating to the proposed replication and

21 integration of Verizon's operating systems. In your

22 direct testimony you discuss risks associated with

23 Frontier's use of replicated Verizon systems. Staff's

24 direct testimony expressed similar concerns. Does the

25 settlement agreement reasonably address the risks

0463

 1 associated with the system cutover?

 2 A. No, I don't believe that it does. Focusing

 3 on the provisions contained in Paragraph 27 of the

 4 attachment to the settlement agreement, this provision

 5 of the settlement agreement focuses on what will happen

 6 with regard to the preproduction testing, and I think

 7 it's important to evaluate how close a look or how

 8 detailed a look at the preproduction environment this

 9 provision of the settlement results in. The

10 preproduction period is one that will lead to the -- it

11 precedes the 60 day period when there will be production

12 mode of operation of the replicated systems. The

13 preproduction testing limits the evaluation, appears to

14 limit the evaluation of the third party reviewer to

15 whether there are any severity level 1 failures, which

16 are defined as full service denials. So Subparagraph A

17 of Paragraph 27 seems to define a very limited role for

18 this third party reviewer. It doesn't allow the third

19 party reviewer or doesn't specify that the third party

20 reviewer will provide a full evaluation of the

21 preproduction operations, but rather whether there have

22 been any severity level 1 failures and whether those

23 have been resolved. For example, there are also

24 severity level 2 failures which are associated with a

25 software problem for which a work around has been

0464

 1 developed. That sort of information could lend some

 2 insight into how robust the replicated systems are and

 3 what sort of level of work arounds are existing within

 4 those systems. So the look or the level of detail

 5 associated with the preproduction mode as reviewed by

 6 the third party reviewer seems to be overly narrow and

 7 perhaps not allowing for a full evaluation of the

 8 preproduction environment.

 9 Very briefly, Ms. Alexander discussed the

10 Paragraph 28, I just wanted to add to her discussion

11 that the benchmarking process with regard to these 4

12 service quality metrics appears to be somewhat biased in

13 my opinion from the standpoint that it specifies that

14 the comparison is in the previous 12 months of data with

15 previous 12 months of operating data, and Staff witness

16 Russell indicates that in 2 of these metrics that

17 Verizon's performance has been declining over time. So

18 by focusing on the last 12 months, it seems to be

19 lowering the bar with regard to the performance.

20 Finally, I would note and just reiterate that

21 the settlement, these provisions of the settlement

22 agreement don't appear to give the Staff sufficient

23 authority to delay the closing or otherwise order

24 remediation to problems that may result from these

25 reports.

0465

 1 Q. Thank you, Dr. Roycroft.

 2 I just have three more questions and I

 3 believe that we should be able to get through these

 4 pretty quickly here since we're coming up on the lunch

 5 hour.

 6 In your direct testimony you also discussed

 7 risks associated with future cutovers of Frontier's

 8 customers from the replicated systems to Frontier's

 9 legacy system. Does the settlement agreement adequately

10 address this concern?

11 A. No, I don't believe that it does. These

12 cutovers, we don't know when these cutovers are going to

13 occur, and the provision within the settlement in

14 Paragraph 29 sunsets after three years. Frontier has

15 told the Commission that it's in no rush to cut over

16 these systems, and as a result it would appear that this

17 three year sunset could leave important information out

18 of the Commission's hands when these cutovers eventually

19 do occur.

20 Q. One last point, Dr. Roycroft, the settlement

21 agreement requires Frontier to petition for an AFOR, an

22 alternative form of regulation, within 5 years. Do you

23 believe that this is a benefit for customers?

24 A. No, I don't, and I'll just add to Mr. Hill's

25 discussion of the AFOR provision that there's no reason

0466

 1 for an AFOR to be attached to this settlement agreement.

 2 AFORs can be risky propositions for customers, and

 3 whether or not there would be any benefit for consumers

 4 from an AFOR it's difficult to say, but certainly I've

 5 seen AFORs that have resulted in harms to consumers.

 6 Furthermore, given the timing of the AFOR, I'm not quite

 7 sure how the synergies would be appropriately accounted

 8 for within the window of opportunity. Assuming that

 9 they stayed out for three years associated with the

10 residential rate freeze and then had to come in before

11 the five year deadline, whether or not those synergies

12 will be properly reflected in operations in developing a

13 test year analysis is difficult to say.

14 Q. I know that we've covered a lot this morning,

15 and thank you, Dr. Roycroft, but could you just state in

16 conclusion your recommendation with regard to the

17 proposed settlement agreement between the Joint

18 Applicants and Staff?

19 A. I don't believe that the settlement agreement

20 offers an adequate solution to the problem presented by

21 Frontier's application. It certainly doesn't overcome

22 the deficiencies of the transaction. There are still

23 harms that will arise, and the benefits identified in

24 the settlement agreement do not rise to a level to

25 offset or overcome those harms. I believe that the

0467

 1 Commission should reject the settlement agreement, and I

 2 also still believe that the Commission should reject the

 3 transaction. Thank you.

 4 MS. SHIFLEY: No further questions at this

 5 time, Your Honor.

 6 JUDGE CLARK: Thank you.

 7 The Commissioners have decided, there's a lot

 8 of carryover in Dr. Roycroft's testimony between the

 9 settlement agreement and his prefiled testimony, so the

10 Commissioners are going to reserve their examination of

11 Dr. Roycroft until he presents his testimony later in

12 this hearing.

13 Hint, hint, do you have any inquiry,

14 Mr. Ruggiero?

15 MR. RUGGIERO: I think Verizon will do the

16 same.

17 JUDGE CLARK: Mr. Saville.

18 MR. SAVILLE: Not at this time, Your Honor.

19 JUDGE CLARK: Mr. Thompson.

20 MR. THOMPSON: No cross.

21 JUDGE CLARK: All right, I'm assuming there's

22 no redirect then since there's no cross.

23 MS. SHIFLEY: That's correct, Your Honor.

24 JUDGE CLARK: All right, thank you,

25 Dr. Roycroft, and I do apologize, I'm not trying to cut

0468

 1 you off, I'm just trying to make sure that we have

 2 clarity in our record.

 3 THE WITNESS: Thank you.

 4 JUDGE CLARK: All right, we are going to be

 5 at lunch recess until approximately 1:15. Ms. Shifley,

 6 I understand that that concludes the presentation of

 7 oral rebuttal.

 8 MS. SHIFLEY: Yes, it does, Your Honor.

 9 JUDGE CLARK: And so I want counsel to think

10 seriously about the need for oral surrebuttal over the

11 lunch hour, and I'll see you at 1:15, 1:30, I'm sorry, I

12 apologize, 1:30.

13 Was there some procedural matter you needed

14 me to address before then, Mr. Romano?

15 MR. ROMANO: Yes, Your Honor, just to

16 clarify, in terms of us determining what we would offer

17 up in surrebuttal, we would need some extended time to

18 figure that out given that we just heard the oral

19 rebuttal for the first time, so can we have an extended

20 break to prepare that?

21 JUDGE CLARK: Longer than an hour and a half?

22 MR. ROMANO: Two hours approximately.

23 JUDGE CLARK: That's fine as long as you

24 really need the two hours to make that kind of

25 determination based on what we've heard this morning.

0469

 1 MR. ROMANO: Yes, Your Honor, we need to

 2 prepare the surrebuttal given that we've just heard

 3 this.

 4 JUDGE CLARK: All right, then we're going to

 5 be at a lunch recess until 2:00 p.m.

 6 (Luncheon recess taken at 12:05 p.m.)

 7

 8 A F T E R N O O N S E S S I O N

 9 (2:00 p.m.)

10 JUDGE CLARK: When we recessed for lunch, we

11 were ready to commence with oral surrebuttal, turning to

12 you first, Mr. Romano.

13 MR. ROMANO: Thank you, Your Honor, Verizon

14 would like to call to the stand Steve Smith and Tim

15 McCallion.

16 JUDGE CLARK: All right, thank you.

17 Mr. McCallion, I will just remind you that

18 you remain under oath.

19 And, Mr. Smith, if you would please rise.

20 (Witness STEPHEN EDWARD SMITH was sworn.)

21 JUDGE CLARK: Thank you, please be seated.

22 Mr. Romano.

23 MR. ROMANO: Thank you, Your Honor.

24

25

0470

 1 Whereupon,

 2 STEPHEN EDWARD SMITH and TIMOTHY J. MCCALLION,

 3 having been first duly sworn, were called as witnesses

 4 herein and were examined and testified as follows:

 5

 6 D I R E C T E X A M I N A T I O N

 7 BY MR. ROMANO:

 8 Q. Mr. McCallion, were you in the room during

 9 the previous oral rebuttal testimony session?

10 A. (McCallion) Yes, I was.

11 Q. So did you hear Mr. Hill argue that the

12 settlement agreement with the Staff was insufficient

13 because it did not address what he claimed to be

14 Verizon's underinvestment in the state?

15 A. (McCallion) Yes.

16 Q. How do you respond to that?

17 A. (McCallion) Well, Mr. Hill was simply

18 incorrect when he states that Verizon's underinvested in

19 its plant. As I testified to earlier and as the Staff

20 witness testified to, our network trouble reports per

21 hundred lines have been low, and that's certainly a good

22 indicator of good service quality in your plant. In

23 addition to that, Dr. Roycroft testified about Verizon's

24 investment in fiber to the premise, which has been a

25 very significant investment, so there's just no basis

0471

 1 for Mr. Hill's assertions.

 2 Q. Thank you, Mr. McCallion.

 3 MR. ROMANO: I would like to pass out what

 4 will be a first surrebuttal exhibit.

 5 MR. RUGGIERO: Your Honor, may I approach?

 6 MR. ROMANO: And just to add, this is a

 7 highly confidential document, so to the extent we can in

 8 our conversation, let's just avoid discussing specific

 9 numbers.

10 I will wait until everyone has a chance to

11 look at the document.

12 BY MR. ROMANO:

13 Q. Do you have that in front of you?

14 JUDGE CLARK: Just one minute, please, I need

15 to make sure that we're getting the right number for

16 marking this for identification purposes, and I believe

17 the next number would be TM-24HC.

18 And you can go ahead now, Mr. Romano, I'm

19 sorry.

20 MR. ROMANO: Thank you.

21 BY MR. ROMANO:

22 Q. Mr. McCallion, do you have in front of you

23 what's been marked as TM-24HC?

24 A. (McCallion) Yes, I do.

25 Q. And what does this document show?

0472

 1 A. (McCallion) Well, what this document shows

 2 is that Verizon's capital expenditures per access line

 3 did not decline in the recent period from 2006 to 2009.

 4 In fact, when you include the FiOS investment, a very

 5 important investment that we made, it shows an upward

 6 trend in investment per access line. And if you exclude

 7 the FiOS investment, it basically shows a flat level of

 8 investment per access line, not a declining level of

 9 investment per access line. So Verizon has continued to

10 invest in its network here in Washington.

11 MR. ROMANO: Your Honor, next I would like to

12 have marked another surrebuttal exhibit which will be

13 marked as TM-25HC, which is also highly confidential, so

14 to the extent, Mr. McCallion, you can avoid referring to

15 figures, that would be appreciated.

16 BY MR. ROMANO:

17 Q. Mr. McCallion, can you please explain what

18 this document that's now marked as Exhibit TM-25HC

19 shows?

20 A. (McCallion) Yes, this exhibit has two charts

21 on it. The chart on the left shows the CapX plus the

22 maintenance expense per access line. The chart on the

23 right also shows the CapX plus maintenance expense per

24 access lines. On the left side we actually break down

25 the capital expenditures and the plants separately, and

0473

 1 in the chart on the right we've added them together.

 2 Q. Thank you.

 3 Mr. Smith, were you here this morning when

 4 Mr. Hill explained at length why he believed that the

 5 settlement agreement was insufficient because it did

 6 nothing to address what he perceived to be as an

 7 incorrect transaction value?

 8 A. (Smith) Yes.

 9 Q. And what is your --

10 MS. SHIFLEY: Your Honor, could I object, I'm

11 sorry, I believe that Mr. Romano has mischaracterized

12 Mr. Hill's testimony. I don't believe that Mr. Hill

13 used the term that Mr. Romano just stated.

14 JUDGE CLARK: Mr. Romano, response?

15 MR. ROMANO: I can rephrase, Your Honor.

16 JUDGE CLARK: Thank you.

17 BY MR. ROMANO:

18 Q. Mr. Smith, do you recall Mr. Hill explaining

19 at length Verizon's reaction to his testimony with

20 regard to the way the transaction was valued?

21 A. (Smith) Yes.

22 Q. And what is your reaction to that testimony?

23 A. (Smith) I believe he based his argument on

24 his assertion that the way in which the financials were

25 prepared by Verizon were not correct or misused

0474

 1 allocations or as he said managers would go to the edge

 2 to create a set of numbers that made the property look

 3 better.

 4 MS. SHIFLEY: Your Honor, again I would just

 5 object to the witness's response. I don't believe that

 6 Mr. Hill ever used -- ever stated what he is now

 7 claiming Mr. Hill stated.

 8 JUDGE CLARK: Ms. Shifley, I'm going to

 9 overrule the objection, and I think that these

10 particular topics rather than being objections to

11 Mr. Smith's testimony or Mr. McCallion's might better be

12 questions you pose in cross-examination of these

13 witnesses.

14 MS. SHIFLEY: Thank you, Your Honor.

15 BY MR. ROMANO:

16 Q. Please go ahead, Mr. Smith.

17 A. (Smith) And for the record, Verizon would

18 like to strongly disagree. In fact, in his testimony

19 this morning Mr. Hill used the phrase very, very

20 strongly on another point. I think you can add three or

21 four more verys in front of how I feel about what he

22 stated here. I think that captures I think our

23 position. His statement is inflammatory, and worse yet

24 it's made without a single shred of evidence either

25 presented today or previously.

0475

 1 Mr. Hill understands that Verizon's a

 2 publicly traded company and that as such that imposes on

 3 it a set of external controls as to how it runs its

 4 operations including how it keeps its books. Verizon is

 5 also a heavily regulated business. These regulators

 6 also impose the same controls, and those controls make

 7 it necessary for us to keep a strong set of internal

 8 controls. Verizon's executive management team makes

 9 quarterly and annual assertions as to the accuracy of

10 its controls in accordance with Sarbanes-Oxley, and

11 those controls extend to the preparation of Verizon's

12 financial statements. Verizon's financial statements

13 are prepared in accordance with GAAP and benchmarked

14 against the best practices in the industry.

15 His concern appears to arise around

16 allocations, and just to level set on allocations, the

17 revenues of the business are not allocated. 60% of the

18 costs of the business directly arise in the operations

19 that are being conveyed. It is true that 40% of the

20 costs are allocated, but the allocation rules that we

21 follow were established by the FCC and by the states

22 where we do business, and we implement those rules based

23 on time studies and other procedures that are prescribed

24 by those agencies.

25 Further, the practices that we follow are

0476

 1 reviewed annually by our auditors. Verizon prepared the

 2 VSTO financials using the very same accounting policies

 3 and practices that it employs in the preparation of

 4 Verizon's consolidated statements as well as separate

 5 operating telephone company statements such as Verizon

 6 Northwest, Verizon North, Verizon California, Verizon

 7 West Virginia. The VSTO financials were audited by E&Y,

 8 and those audited financials contain a full set of

 9 footnotes that explain how the financials were prepared.

10 Those audited results were further reviewed by the

11 national office of E&Y because the audited financials

12 were included in Frontier's S-4 filing.

13 If all of this were not enough, Verizon made

14 -- is contractually bound to provide Frontier with

15 financial statements that are consistent with the way in

16 which we keep our books. We made representations and

17 warranties to Frontier that we would do so. In the

18 event that we don't, they have the right not to close

19 the transaction.

20 At the end of his statement he said, you

21 know, the Verizon manager ought to be canned if he

22 doesn't -- if he didn't do -- stretch the edge or

23 whatever you would like me to clarify later. You know,

24 Verizon's an ethical company. A Verizon manager would

25 be canned if he did the very thing that Mr. Hill

0477

 1 described.

 2 Q. Okay, turning to another subject, Mr. Hill

 3 also criticized the Staff settlement agreement as not

 4 requiring Verizon to have some sort of continuing

 5 interest post close. How do you respond to that

 6 criticism?

 7 A. (Smith) I think that that is unwarranted.

 8 As the record and witnesses have attested to, Staff and

 9 others, Verizon has been a good service provider, it has

10 invested in the state, and it has found in Frontier an

11 excellent provider for service going forward. In fact,

12 given the strategic direction that Verizon intends to

13 go, it will be a much better provider for the state of

14 Washington and its rate payers. Further, from a

15 business matter, it makes no sense for Verizon to have a

16 continuing interest in a business that it no longer

17 operates.

18 MR. ROMERO: Thank you.

19 That's it for the surrebuttal panel for

20 Verizon, Your Honor.

21 JUDGE CLARK: All right, thank you.

22 And I'm not going to allow any friendly cross

23 so I'm not even calling on Frontier or Staff.

24 Ms. Shifley.

25 MS. SHIFLEY: Your Honor, may I just have one

0478

 1 minute, please?

 2 JUDGE CLARK: Yes.

 3 MS. SHIFLEY: We have no cross-examination at

 4 this time.

 5 JUDGE CLARK: All right.

 6 Do any commissioners have inquiry of this

 7 surrebuttal panel?

 8 Commissioner Jones is shaking his head no.

 9 Commissioner Oshie.

10 COMMISSIONER OSHIE: No.

11 JUDGE CLARK: Chairman Goltz.

12

13 E X A M I N A T I O N

14 BY CHAIRMAN GOLTZ:

15 Q. Just so I understand on the Exhibits 24 and

16 25, TM-24 and 25HC, on 24HC on the, let's see, there's

17 -- on the left-hand column there's three categories, I'm

18 talking about the first one, and I'm sure this isn't

19 confidential, I'm sorry, I'm talking about the second

20 one, which is capital. That's not -- the headings

21 aren't confidential, are they?

22 A. (McCallion) No, they aren't.

23 Q. Okay. So the capital in thousands, and then

24 there's a non-FiOS amount, does that have a

25 corresponding line on TM-25HC?

0479

 1 A. (McCallion) I'm sorry, could you repeat the

 2 question.

 3 Q. 24HC on the category called capital, there's

 4 a number 2, and there's a total FiOS and a non-FiOS, and

 5 I want to know if there's a corresponding non-FiOS

 6 capital amount on TM-25HC or a corresponding -- I'm

 7 sorry, I'm very confused, let me start over.

 8 On 24HC the total under capital and has

 9 yearly amounts, is there -- why is that different or is

10 it the same as the second line on 25HC?

11 MR. ROMANO: Mr. Chairman, I could try to

12 help.

13 CHAIRMAN GOLTZ: That would be fine.

14 MR. ROMANO: I won't reveal any numbers, but

15 just if you look at --

16 CHAIRMAN GOLTZ: Oh, I see, okay.

17 MR. ROMANO: If you look at the -- if you

18 line up the correct year --

19 CHAIRMAN GOLTZ: I see it, okay. I thought I

20 found inconsistency but I didn't, never mind. I'm done.

21 JUDGE CLARK: All right, is there redirect?

22 MR. ROMANO: No, Your Honor.

23 JUDGE CLARK: Would you like to move the

24 admission of TM-24HC and TM-25HC?

25 MR. ROMANO: Yes, Your Honor.

0480

 1 JUDGE CLARK: Is there any objection to their

 2 receipt?

 3 MS. SHIFLEY: No, Your Honor.

 4 JUDGE CLARK: All right, hearing none,

 5 TM-24HC and TM-25HC are received.

 6 Thank you for your testimony, Mr. Smith,

 7 Mr. McCallion.

 8 And does that conclude the presentation of

 9 Verizon's oral surrebuttal?

10 MR. ROMANO: Yes, Your Honor.

11 JUDGE CLARK: All right, and I'm going to

12 turn next to Frontier.

13 MR. BEST: Your Honor, Chuck Best again for

14 Frontier, we would call Daniel McCarthy, David

15 Whitehouse, and Billy Jack Gregg, and we'll do them as a

16 panel if that's okay with Your Honors.

17 JUDGE CLARK: I think it would be most

18 expeditious to do it that way.

19 MR. BEST: And I will be handling Mr. Gregg,

20 and Mr. Saville will be handling the other two

21 witnesses.

22 JUDGE CLARK: Mr. McCarthy, I'm just going to

23 remind you that you remain under oath.

24 And the other two witnesses, if you would

25 rise, please, and raise your right hand.

0481

 1 (Witnesses DAVID R. WHITEHOUSE and BILLY JACK

 2 GREGG were sworn.)

 3 JUDGE CLARK: Thank you, please be seated.

 4 Mr. Best.

 5 MR. BEST: Thank you, Your Honor. Would you

 6 like me to have the witnesses introduce themselves now

 7 or do it as they testify?

 8 JUDGE CLARK: It would be nice to have the

 9 panel introduced now, thank you.

10

11 Whereupon,

12 DANIEL MCCARTHY, DAVID R. WHITEHOUSE and

13 BILLY JACK GREGG,

14 having been first duly sworn, were called as witnesses

15 herein and were examined and testified as follows:

16

17 D I R E C T E X A M I N A T I O N

18 BY MR. BEST:

19 Q. Mr. Gregg, could you state your full name and

20 spell your last.

21 A. (Gregg) Billy Jack Gregg, G-R-E-G-G.

22 Q. And, Mr. Gregg, what do you do for a living?

23 A. (Gregg) I'm a utility consultant.

24 Q. Okay. Are you representing Frontier in this

25 matter?

0482

 1 A. (Gregg) Yes.

 2 Q. And, Mr. Whitehouse, could you state your

 3 full name and spell your last.

 4 A. (Whitehouse) David Whitehouse, last name

 5 spelled W-H-I-T-E-H-O-U-S-E.

 6 Q. Mr. Whitehouse, what do you do for a living?

 7 A. (Whitehouse) I'm the Senior Vice President

 8 and Treasurer of Frontier Communications.

 9 Q. And, Mr. McCarthy finally, he has been

10 introduced before, but --

11 JUDGE CLARK: We're okay with Mr. McCarthy.

12 MR. BEST: Thank you.

13 JUDGE CLARK: We're well acquainted, thank

14 you.

15 BY MR. BEST:

16 Q. Beginning with Mr. Gregg, Mr. Gregg, you're a

17 consultant for Frontier in this case; is that right?

18 A. (Gregg) That's correct.

19 Q. And in fact you helped Frontier with service

20 quality issues as part of this transaction across the

21 states it was doing them in?

22 A. (Gregg) Yes, in multiple states.

23 Q. And are you familiar with what's gone on in

24 those other states with respect to service quality and

25 conditions and things like that?

0483

 1 A. (Gregg) Yes, and also the agreements that

 2 have been reached in many other states.

 3 Q. Could you -- a question came up I know

 4 earlier I think from Chairman Goltz about the conditions

 5 in other states that was asked really of Ms. Alexander,

 6 can you give some perspective about what's gone on in

 7 the various states and how the Washington settlement

 8 with Staff in particular and also to some degree with

 9 the DOD relate to the other settlements in the other

10 states?

11 A. (Gregg) Yeah. Although I recognize that

12 each state has a different system and a different

13 context for service quality enforcement, the agreement

14 reached in Washington is more comprehensive than the

15 agreements reached in other states in many ways.

16 Ms. Alexander mentioned the agreement in Illinois as an

17 example of what she considered to be a better agreement.

18 In Illinois the agreement reached by Frontier specified

19 seven separate metrics, and there was a potential

20 sanction of a restriction on dividends if those service

21 quality metrics were not met. However, that sanction

22 only applied if a majority of those seven metrics, four

23 out of seven, were not met in any annual period. In

24 comparison, in Washington there are six separate service

25 quality metrics, each of which has potential customer

0484

 1 credits of $100,000 associated with them. In addition,

 2 five of those six metrics have the credits calculated

 3 monthly, not on an annual basis. On top of that, there

 4 is a 40% increase in the existing service performance

 5 guaranty plan that exists for Verizon that has been

 6 agreed to by Frontier.

 7 And finally, there is a new credit that has

 8 been agreed to by Frontier for out of service conditions

 9 greater than two days. Ms. Alexander characterized the

10 $5 credit associated with those outages as

11 insubstantial. I disagree. $5 amounts to approximately

12 30% of the basic monthly charge for premium service in

13 Washington. Thus I believe that the service quality

14 agreement and metrics contained in the settlement in

15 Washington are entirely appropriate, and especially so

16 because we are dealing not with a remedial plan, as you

17 heard Mr. Weinman state, but with a prophylactic plan.

18 This plan is meant to prevent a deterioration

19 from the current high level of service quality in

20 Washington. As a result, it is entirely appropriate to

21 have a series of escalating customer credits based on

22 Frontier's demonstrated performance. However, I fully

23 believe that those escalations will not occur, because

24 based on Frontier's actual track record in the states

25 where it now operates, we have every indication that

0485

 1 these credits will not be necessary.

 2 As you heard Mr. Weinman also state, state

 3 commissions in other states where Frontier currently

 4 operates have a good opinion of Frontier. My experience

 5 has been the same. Frontier is not currently under any

 6 current service quality investigations in any state, and

 7 it does not currently pay penalties for service quality

 8 violations in any state. In summary, I believe that the

 9 settlement on service quality issues contained in the

10 Washington settlement is entirely reasonable and

11 appropriate for the state of Washington.

12 Q. Thank you.

13 And one last question, Mr. Gregg, when

14 looking at a settlement, do you think it's fair to

15 single out specific pieces of a settlement and say,

16 gosh, that's not good enough, or do you think you need

17 to look at the settlement in total?

18 MS. SHIFLEY: Your Honor, could I just object

19 to this question, I believe that it does go beyond the

20 scope of what Ms. Alexander testified to.

21 JUDGE CLARK: Do you want to respond,

22 Mr. Best?

23 MR. BEST: I believe that Public Counsel

24 spent a fair amount of time going through each

25 measurement and saying this isn't good enough, this

0486

 1 isn't good enough, and I guess the only point I'm trying

 2 to get the witness to comment on is whether that's

 3 really fair. Because if you do that throughout the

 4 entire settlement, then it builds on itself, and you end

 5 up with something completely different. I guess that's

 6 the point we're trying to make.

 7 JUDGE CLARK: The objection is overruled.

 8 A. (Gregg) My experience has been that most

 9 settlements are a series of give and take procedures by

10 both sides. No side gets everything that it wants.

11 Settlements by their very nature are compromises.

12 MR. BEST: Thank you, that's all I have.

13 JUDGE CLARK: All right.

14 Mr. Saville.

15 MR. SAVILLE: Thank you, Your Honor,

16 Commissioners.

17

18 D I R E C T E X A M I N A T I O N

19 BY MR. SAVILLE:

20 Q. Mr. Whitehouse, just a couple of questions

21 for you. You were here this morning when Mr. Hill

22 testified?

23 A. (Whitehouse) Yes, I was.

24 Q. And do you recall his statement when he

25 described Frontier as it exists today as not a

0487

 1 financially strong company?

 2 A. (Whitehouse) Yes, I believe he referred to

 3 it as a weak company, to which I would highly disagree.

 4 You know, when I think about the merits of a strong or a

 5 weak company, I would pick three key things I would

 6 focus on in this discussion at the moment. One is the

 7 free cash flow generating capabilities of the entity,

 8 the rating of the entity, and their access to capital,

 9 and I'll touch on each of those briefly.

10 Frontier's a company that generates

11 approximately $500 Million a year of free cash flow.

12 And by free cash flow we're talking about the cash flow

13 that is left over after the company has paid all its

14 bills, paid its CapX, paid its interest expense, paid

15 its taxes, and in fact it is what is left over. And

16 indeed we do present to our board of directors a very,

17 in my opinion, high class problem where at the end of

18 the year we say, we have this extra cash flow, how would

19 you like us to allocate it. It is their decision. And

20 I believe the witness earlier today implied that paying

21 dividends was at odds with, you know, capital

22 expenditures, and that in fact is not how the board

23 thinks about it. They're not at odds with each other.

24 They fully understand that you need to invest in the

25 company to continue generating the cash to pay the

0488

 1 dividends. And it is that process by which they declare

 2 the dividend. It's only after they're comfortable that

 3 the company has the appropriate level of investment and

 4 that the capital structure and our credit metrics are

 5 where we would like them to be before we consider

 6 dividends or share repurchases or other forms of

 7 investment.

 8 I think the next topic is rating. I think

 9 Mr. Hill implied because we were a double B rated

10 company that that was a weak rating, and I think I

11 should clarify that point as well. You know, credit

12 ratings are -- run a full spectrum from triple A being

13 the strongest to I believe D being the weakest, a

14 company that is in default. Somewhere along the way

15 there was a line drawn, and everything above triple B or

16 higher was rated investment grade, and everything below

17 triple B was not investment grade. We happen to be a

18 double B rated company. And just as a triple B company

19 is not the same as a triple A, a double B rated company

20 is not the same as a B+ rated company. You can't

21 generalize that all non-investment grade companies are,

22 you know, junk credits. In fact, Moody's would tell you

23 that 73% of the companies they rate are non-investment

24 grade, so that if you use that standard that you have to

25 be investment grade to be a strong company, that would

0489

 1 imply 73% of the companies operating that are rated are

 2 weak, and I don't think that's reasonable or fair.

 3 And finally, a company's strength is

 4 certainly tied to access to capital, because certainly

 5 the market speaks in that regard. If you're able to

 6 access capital and raise capital from a third party,

 7 that's a very good proxy for your financial strength.

 8 And I will simply point out that in this year alone

 9 Frontier has entered the market twice raising over $1.2

10 Billion worth of capital. Our last transaction we only

11 sought to raise $400 Million and ended up with $1.7

12 Billion worth of demand. And I will point out that the

13 rate on that debt of 8.375% was 200 basis points cheaper

14 than the offering we did before we announced this

15 transaction, so I would argue that the market clearly

16 sees the benefits of the deleveraging of this

17 transaction and accordingly has afforded a -- accepted a

18 lower rate on our capital.

19 Q. Mr. Whitehouse, Mr. Hill also testified, made

20 some statements that Frontier in putting together

21 projections on the post transaction company was overly

22 optimistic in terms of its projections. Can you comment

23 on that?

24 A. (Whitehouse) Yeah, I believe his -- I

25 believe his word was bold, and I would again strongly

0490

 1 disagree to that. I think the model that was created

 2 and was shared with Public Counsel encompasses over 100

 3 years worth of collective experience of folks that are

 4 operating managers and experienced acquirers with

 5 assumptions that in my view were conservative. In fact,

 6 the company adjusted its long range view in light of the

 7 challenging economic surroundings that we saw in the

 8 early part of this year to establish a lower jumping off

 9 point for the basis by which we projected forward. We

10 didn't simply bootstrap some numbers on some old

11 projections that were stale. This was real live data

12 that was used to formulate the model. You know, all of

13 these assumptions were presented in the board of

14 directors materials that have been furnished to all the

15 parties involved here. And, in fact, you know, the

16 access line losses that we've seen in 2009, which was

17 also referenced this morning, have been improving versus

18 2008. So even though we did, you know, take a

19 conservative view, I think those assumptions are proving

20 to be valid and appropriate in light of the way the

21 performance of the company has ultimately played out.

22 Q. Condition Number 5 in the settlement

23 agreement indicates that Frontier Northwest will not

24 encumber the assets, and there was testimony by Mr. Hill

25 this morning indicating that that was not really a

0491

 1 meaningful condition as a part of this settlement

 2 agreement. Can you address Mr. Hill's comment?

 3 A. (Whitehouse) Yes. I'm not sure where he was

 4 coming from on that other than to say that I know that

 5 creditors would love to have a direct mortgage or pledge

 6 of the assets of the ILEC. It was the primary form of

 7 security, and it could easily be used to secure a lower

 8 rate for this financing, and we have chosen to not offer

 9 that up and to instead issue unsecured debt as it

10 relates to this transaction, which is a clear benefit to

11 the state by not having any potential encumbrances on

12 those assets. And in doing so, you could certainly

13 offer up a security like that and lower the rate, but

14 we've chosen not to encumber ourselves and take away any

15 financial flexibility just in return for a cheaper rate.

16 Q. Thank you.

17 Mr. Hill also commented on the risk factors

18 that Frontier has incorporated into its S-4 filing and

19 suggested that Frontier hasn't adequately considered or

20 addressed those risk factors as part of this

21 transaction. Can you respond to his comment?

22 A. (Whitehouse) Yes, I would like to respond to

23 that. I think it was covered by some other witnesses,

24 but as many have said in their written testimony, the

25 SEC requires a full disclosure of all potential risks

0492

 1 and does not allow issuers to detail any potential

 2 mitigants to those. It's meant to protect issuers from

 3 potential litigation in the event an investor claims

 4 that they weren't provided with all the potential risks.

 5 And you certainly have to weight them and look at the

 6 probability of them occurring. And I would argue that

 7 in the preparation of the model, again drawing upon the

 8 decades and decades of collective experience of all the

 9 parties involved, that to the extent risk was believed

10 to have some quantifiable risk, it would have been

11 factored into that model when taken as a whole. But it

12 is virtually impossible to assess risk by risk by risk

13 what the impact of those are and then aggregate those

14 into a meaningful number. My argument is that to the

15 extent that a risk is appropriate to incorporate into

16 the model, it is indeed there.

17 Q. Thank you.

18 Just a couple more quick questions.

19 Mr. Whitehouse, Mr. Hill commented this morning that

20 Frontier management has stated that we hope to be

21 investment grade after this transaction and somehow

22 characterized that as it was just wishful thinking on

23 the part of Frontier management. Can you respond to

24 that?

25 A. (Whitehouse) Yeah, it is anything but that.

0493

 1 In fact, the management of Frontier has stated publicly

 2 their commitment to delever this entity, and that is not

 3 a commitment that we make lightly. When you make such

 4 commitments to the market, trust me, they write them

 5 down, and they hold you to those. And we have committed

 6 to a leveraged target of less than 2 1/2 times net debt

 7 to earnings before taxes and depreciation and

 8 amortization. That is a very common benchmark metric to

 9 utilize to give some indication of where you would need

10 to be to petition for an investment grade rating.

11 And I think it's also worth noting how the

12 process of getting an upgrade works in today's

13 environment. As many in the room may know, the rating

14 agencies took some lumps over the last couple years for

15 perhaps, you know, not being conservative enough in how

16 they rated companies, and as a result the agencies are

17 very much in a -- of the view now that, you know, you

18 got to prove it to me first. So to expect an agency to

19 provide an upgrade to a triple B rating before the

20 transaction is even closed is not realistic, nor would

21 we have ever asked them to do so. In fact, what we

22 would expect to happen is the transaction will close, we

23 will show in the course of several quarters of showing

24 the entity is operating in a reasonably smooth fashion

25 and the synergies that we've offered up are being

0494

 1 realized and the metrics are where they need to be, we

 2 would make a case for an upgrade. But we understand

 3 that does take some time and we need to prove that to

 4 them.

 5 But I think it should be certainly noted that

 6 our rating has a positive outlook from two of the three

 7 agencies, which what that means is the agency is viewing

 8 the likely trend of the rating and when looking at this

 9 transaction clearly designated that the metrics indicate

10 an upgrade is certainly more warranted than any other

11 action as it relates to the credit. The one entity that

12 did not, Standard & Poor's, my understanding in speaking

13 to them is simply a different protocol that they

14 undertake when they assign outlooks. They, as I

15 mentioned earlier, would wait until the transaction

16 closed before they came out with any refresh on the

17 outlook of the stock, of the credit, excuse me.

18 Q. Last question, Mr. Whitehouse, Mr. Hill

19 indicated that with a settlement agreement there were

20 still significant risks as far as Frontier's financial

21 health if this transaction is approved. Do you agree

22 that this settlement with the conditions that are

23 included in the settlement provides further assurance,

24 adequate assurance to the Commission of the ongoing

25 financial wellbeing of Frontier?

0495

 1 A. (Whitehouse) Yes, I do.

 2 Q. Thank you.

 3 Mr. McCarthy, a couple of questions for you.

 4 You were here this morning when Mr. Hill testified?

 5 A. (McCarthy) I was.

 6 Q. As well as Ms. Alexander?

 7 A. (McCarthy) I was.

 8 Q. And Mr. Roycroft?

 9 A. (McCarthy) I was.

10 Q. Mr. Hill indicated that as part of the

11 projections that Frontier has included in its analysis,

12 financial analysis, it hasn't sufficiently factored in

13 access line losses that either Verizon or Frontier are

14 experiencing. Can you address that?

15 A. (McCarthy) Certainly. I would -- what I

16 would say to that is first of all the access line rates

17 that Mr. Hill had talked about from Frontier escalating

18 still would put us at that rate at some of the best line

19 losses in the industry. Our assumptions in the model

20 that were used really had essentially status quo losses

21 in the early years of ownership and then declining to I

22 believe 7.9% loss, which is still higher than where we

23 are today. And really from our perspective, the key to

24 stemming line losses is, one, investing in broadband,

25 two, having our local engagement philosophy rolled out

0496

 1 throughout the service territories, and really, three,

 2 focusing the entire organization on that customer

 3 centric approach towards going to market. And when you

 4 look at those three combined, we've had a recipe for

 5 success that has yielded line losses despite having

 6 competitive overlap of over 73% in our area of line

 7 losses down in the 6% range in the most recently

 8 challenging economic environment. So I really don't

 9 think that our assumptions were overly aggressive in

10 that regard.

11 Q. Mr. McCarthy, Ms. Alexander in commenting on

12 the service quality aspects of the settlement agreement

13 and specifically the credits that would be paid if

14 Frontier failed to meet the various service quality

15 metrics, she described the $600,000 of credits that

16 Frontier would be subject to during the first year as a

17 drop in the bucket, and can you respond to that?

18 A. (McCarthy) Yes. I would say from Frontier's

19 perspective as the Chief Operating Officer, any kind of

20 service penalty is too much. Certainly $600,000 would

21 absolutely not only get my attention, but it would get

22 our CEO's attention, and more than likely I would be

23 explaining to the board of directors why I was paying a

24 $600,000 penalty in Washington. So the concept that

25 that would not get our attention is just not true.

0497

 1 And then I would just say that aside from the

 2 agreements that we've put forward, the way that we

 3 compete in the market is really to compete effectively

 4 on customer service. And not maintaining a quality

 5 customer service and a quality product doesn't help us

 6 to compete, so we have certainly the incentive to

 7 maintain high quality service above and beyond the

 8 settlement that's on the table.

 9 Q. Thank you.

10 Mr. Roycroft testified that with Verizon

11 transferring service territory in Washington to

12 Frontier, Verizon's FiOS vision is going away in

13 Washington. Do you agree with that?

14 A. (McCarthy) No, I don't. As part of the

15 transaction, we are acquiring all the assets associated

16 with FiOS. We've made commitments in fact, as you might

17 have seen in some of the press, we've actually -- we've

18 gotten approval from all 41 of the local franchising

19 authorities that were necessary to transfer the assets,

20 and we fully plan on meeting all the commitments around

21 that. So Mr. Roycroft's quote of the vision of FiOS

22 disappearing is just not true. It will be here, it will

23 be a benefit in Washington post close, and we plan on

24 operating the system just as Verizon does today.

25 Q. Mr. Roycroft also commented on Frontier's DSL

0498

 1 service and described DSL generally as an inadequate

 2 technology. Do you agree with that?

 3 A. (McCarthy) I don't. From our perspective

 4 and I think most of the telephone companies in America,

 5 DSL technology still remains the workhorse of how

 6 broadband is delivered to households over copper lines.

 7 In fact, we work very closely with all the equipment

 8 manufacturers to make sure that their upgrade pads on

 9 equipment are aligned with what our needs are. We are

10 constantly upgrading transport technology as well as the

11 electronics to get the most that we can in

12 deliverability throughout the footprint. In fact, we

13 spend time all the time on that. The implication or the

14 opinion put forth that this is first generation

15 technology is just not true. There are new developments

16 that happen all the time including bonding, different

17 methods of delivering transport to the different DSLAM's

18 that really offer the opportunity to continue to upgrade

19 the ability to deliver high quality service throughout

20 the footprint. And we use different types of techniques

21 depending upon the densities and different tactics to go

22 after home penetrations with as little as 20 to 50 homes

23 in the area. And that's just something that I think in

24 the Verizon model they have not really focused on, and

25 it's one of the benefits that we bring to this

0499

 1 transaction.

 2 Q. Mr. Roycroft was also critical of the part of

 3 the settlement agreement in terms of Frontier's

 4 commitment on broadband speeds that would be made

 5 available in the state of Washington. Can you address

 6 that concern raised by Mr. Roycroft?

 7 A. (McCarthy) Well, first off I would say that

 8 I spend quite a bit of time every year throughout the

 9 year looking at how to stay competitive in markets

10 across the country from a speed perspective, so we now

11 that we've gotten to 92% of the markets, the households

12 in our markets, we're constantly looking at ways to

13 increase speed, increase throughput, in all of those

14 markets. The commitment in Washington really follows

15 the same kind of evolution that we've used in our legacy

16 markets, and that is we want to get to the most reach

17 that we can as quickly as possible. Obviously if we can

18 do that and generate higher speeds for customers, we

19 would do that. However, these were minimum commitments

20 that we think that we can attain during that time frame.

21 Along the way there will be customers that get higher

22 speeds, it's just the way the technology actually works,

23 so it's really driven by loop length in many cases. But

24 I think that the commitments that we've made here in

25 Washington are actually as large or larger than any

0500

 1 other state that we've done any kind of settlement with

 2 as part of this transaction.

 3 Q. Mr. Roycroft also was critical of Frontier

 4 imposing some type of usage limitation on customers of

 5 broadband services. Could you respond to his criticism?

 6 A. (McCarthy) Yes. I understand Mr. Roycroft's

 7 point that 5 gigabit is in our acceptable use policy

 8 today. It was put in place several years ago as we

 9 responded to some abusive behavior in our network. I

10 have not, since I've been on the road for the last

11 probably four months, I have not been intimately

12 involved in revising the acceptable use policy, but my

13 understanding is that a new acceptable use policy will

14 be promulgated prior to the close of this transaction

15 that would actually have the 5 gigabit cap removed.

16 Q. Mr. Roycroft also highlighted the $40 Million

17 broadband commitment that's included in the settlement

18 agreement and somehow suggested that that $40 Million

19 was not sufficient or Frontier had not really conducted

20 the appropriate analysis to determine that $40 Million

21 was the appropriate number to achieve what's identified

22 in the settlement. Can you respond to that?

23 A. (McCarthy) Certainly. The $40 Million

24 figure was derived from using a broadband model that

25 took into account the starting point as being the

0501

 1 latitude and longitude of every network element that

 2 exists in Washington, for that matter across the

 3 country. We then looked at the wire centers, we looked

 4 at the equipment that was there, we looked at the

 5 transport to and from that network element, we looked at

 6 the densities around it from a customer perspective, and

 7 we developed a model that was based in our own

 8 experience in serving similar density customers around

 9 the country, and that is really the basis for the $40

10 Million. We've actually subsequent to signing the deal,

11 we've verified it again, had independent work done to

12 verify our model, and we're very comfortable that the

13 $40 Million is appropriate for the commitments we're

14 making.

15 Q. Mr. Roycroft also suggested that the

16 settlement agreement was inadequate because it didn't

17 specifically require Frontier to apply for Federal

18 stimulus funding and that there was the potential that

19 if the company did apply for Federal stimulus funding,

20 we would use that funding to offset the $40 Million

21 commitment that is included in the settlement. Can you

22 respond to that?

23 A. (McCarthy) Certainly. I would say two

24 points. First, we did apply for some stimulus funding

25 in the first round. We applied for approximately a $70

0502

 1 Million draw in West Virginia. We did it very

 2 specifically because we were the second largest

 3 incumbent in West Virginia, and we were also certified

 4 as a CLEC there, so we were able to move forward with

 5 that application. Unfortunately we were not successful

 6 with the application. We just were notified about that.

 7 We did not apply in other areas, especially in areas

 8 that we would be acquiring in this transaction, because

 9 we did not have a certificate, and we were not the

10 incumbent in those areas, especially when you were

11 looking at the final 5% to 7% as being the candidate

12 target segment for potential stimulus funding. Having

13 said that, the rules that were promulgated, as I

14 understand it, changes to them two to three weeks ago,

15 and the application deadline it's my understanding is

16 3/15, so I don't think that we'll make the next

17 application deadline for the stimulus. But if we did

18 for some reason and we were successful, I would assure

19 the Commission that the stimulus funds would be used for

20 that final 5% to 7% that are not economic. It would not

21 displace the $40 Million that we've committed to to get

22 to the 89%.

23 Q. Mr. McCarthy, last question, you heard the

24 testimony of Mr. Hill, Ms. Alexander, and Mr. Roycroft,

25 all critical of various aspects or components of the

0503

 1 settlement agreement that Frontier has entered into with

 2 the Commission Staff. Do you feel that their criticisms

 3 are appropriate, and can you comment on the overall

 4 settlement document that we've entered into with the

 5 Staff?

 6 A. (McCarthy) I would just echo I think

 7 Mr. Gregg's comments on that in that I've been involved

 8 certainly with our team and the Verizon team in

 9 negotiating settlements in many of the states, and it is

10 a give and take, and the settlement should be taken in

11 the total context of the 35 plus conditions that are

12 incorporated here. And I think that taking each one and

13 trying to bootstrap up even higher doesn't take into

14 account the entire bargain that was put together with

15 Staff.

16 MR. SAVILLE: Thank you.

17 JUDGE CLARK: Thank you.

18 Again, no friendly cross, so Ms. Shifley.

19 MS. SHIFLEY: Yes, Your Honor, I just have a

20 few questions.

21

22 C R O S S - E X A M I N A T I O N

23 BY MS. SHIFLEY:

24 Q. I would like to start with a couple questions

25 for Mr. Whitehouse. Mr. Whitehouse, is it true that

0504

 1 Verizon currently has a higher rating than Frontier

 2 does, bond rating?

 3 A. (Whitehouse) Yes, it does.

 4 Q. Okay. And you mentioned that a lot of

 5 companies that Moody's rates are below investment grade;

 6 is that correct?

 7 A. (Whitehouse) That is correct.

 8 Q. How many utilities are non-investment grade?

 9 A. (Whitehouse) I don't have that data.

10 Q. And I just want to ask you a couple

11 questions, you stated that you made the or the financial

12 model was made available to Public Counsel?

13 A. (Whitehouse) Yes, it was.

14 Q. So I just wanted to ask you a couple

15 questions about that financial model that you had

16 provided to us. I believe that some of the specific

17 figures in the model are highly confidential, so I won't

18 address those in particular, I just will ask some

19 questions about some of the various parameters of the

20 model, but please caution me if I'm approaching

21 something that might be highly confidential. You and

22 your management team at Frontier created this model and

23 provided it to the advisors; is that correct?

24 A. (Whitehouse) I think it's better described

25 that our advisors were involved in this process from day

0505

 1 one and played an integral role in the development of

 2 that model.

 3 Q. But it was created by Frontier; is that

 4 correct?

 5 A. (Whitehouse) The key assumptions were

 6 created by Frontier; that is correct.

 7 Q. And in the financial model that you provided

 8 to Public Counsel, there were only five parameters that

 9 could be changed; is that correct?

10 MR. SAVILLE: Your Honor, I'm going to

11 object, I think this goes beyond the scope of what was

12 testified to in the live rebuttal. I think these

13 questions could appropriately be addressed to

14 Mr. Whitehouse when he's available for cross-examination

15 as part of the underlying case.

16 JUDGE CLARK: Ms. Shifley, response.

17 MS. SHIFLEY: I'm only addressing these right

18 now because Mr. Whitehouse made some statements about

19 the model as a support for why the model provided Public

20 Counsel with adequate information, and this just goes to

21 the quality of the model and the completeness and

22 utility of it.

23 JUDGE CLARK: The objection is overruled.

24 A. (Whitehouse) The model was furnished as well

25 as all the assumptions that went into that model as

0506

 1 well. I think it's fair to say that it's an extremely

 2 complex model with thousands of cells. It's virtually

 3 impossible to design a model that is so user friendly

 4 that any third party stepping into the transaction

 5 without the full benefit of the development of all its

 6 assumptions can simply type in a number and have it flow

 7 perfectly through the model. It was never developed for

 8 the intention of third party consultants or witnesses to

 9 use. It was developed for management and the

10 appropriate team involved in that transaction to utilize

11 as a tool in evaluating the transaction, and thus it is

12 the -- that is why the model is constructed the way that

13 it is.

14 BY MS. SHIFLEY:

15 Q. So you just said that there were thousands of

16 cells, and of those, five of the parameters could

17 actually be changed; is that correct?

18 A. (Whitehouse) I believe in the version you

19 have that at some point the model is locked down and

20 there's no need to add additional functionality for

21 running iterations.

22 Q. So there's a version that is actually more

23 functioning or more highly sophisticated than the one

24 that you provided to Public Counsel; is that correct?

25 A. (Whitehouse) No, I'm not saying that. I'm

0507

 1 saying that the model is what it is. That is the model

 2 that we provided to every state and to everyone who's

 3 requested it. But there is no model that would allow

 4 you that ability to run iterations. Certainly

 5 management with its detailed knowledge of the model

 6 could provide such sensitivities, but it would not be --

 7 it would not be -- the model would not be designed such

 8 that any third party could just come in and do that. It

 9 would require some retooling of that model to do so.

10 Q. And that higher functionality would be

11 something that Frontier management could do?

12 A. (Whitehouse) They certainly have the

13 capability, yes. Same way they have the capability to

14 build the model. If we had to rebuild it, it could be

15 done, but that is the only model that is available at

16 this time.

17 Q. And available to all parties including

18 Frontier management?

19 A. (Whitehouse) Yes.

20 Q. And the model does not allow revenues for the

21 VSTO SpinCo areas or for legacy Frontier operations to

22 be changed; is that correct?

23 A. (Whitehouse) That's correct.

24 Q. So that means that no party could actually

25 run the model with different assumptions for projected

0508

 1 revenues?

 2 A. (Whitehouse) Yeah, I believe that's fair.

 3 But again, as I stated, the model was not designed -- it

 4 was designed to be a tool for management, not a tool for

 5 other third parties not directly involved in the

 6 transaction. And we certainly can provide, as we have,

 7 you know, hundreds of data requests to provide

 8 additional information to give parties better insight as

 9 to the assumptions that were included in that model.

10 Q. So management didn't run a financial model

11 that used any other revenue projections than the single

12 assumption that it made?

13 A. (Whitehouse) I believe there have been some

14 subsequent requests from other states to do such

15 analysis, and but the model that is -- was provided was

16 the model that management decided upon to be the base

17 case, the expected outcome of the transaction, and thus

18 it is the official version.

19 Q. So Frontier's management didn't run any

20 financial model with different revenue projections?

21 MR. SAVILLE: Objection, it was asked and

22 answered.

23 JUDGE CLARK: Response, Ms. Shifley.

24 MS. SHIFLEY: I believe what I'm looking for

25 is a yes or no answer from the witness, and I just

0509

 1 haven't got that, so I wanted to make sure the record

 2 was clear.

 3 A. (Whitehouse) I don't believe it's a yes or

 4 no. I'm not sure I would be able to answer that yes or

 5 no. I think what --

 6 JUDGE CLARK: Mr. Whitehouse, you need to not

 7 do anything until I rule, okay.

 8 THE WITNESS: Sorry.

 9 JUDGE CLARK: I think the question has

10 actually been asked and answered. I think this is now

11 the third time.

12 MS. SHIFLEY: Thank you, Your Honor.

13 BY MS. SHIFLEY:

14 Q. And it also was not possible in the model

15 that you provided or that Frontier management used to

16 change the rate of line loss for the VSTO SpinCo or

17 legacy Frontier territories; is that correct?

18 A. (Whitehouse) That is correct.

19 Q. So for example if the model that you provided

20 to Public Counsel, if Public Counsel or the Commission

21 wanted to make some different assumptions about the rate

22 of line loss for VSTO SpinCo than Frontier made, we or

23 the Commission would not be able to do so with the

24 financial model that you provided; is that correct?

25 MR. SAVILLE: I'm going to object, that

0510

 1 misstates his prior testimony. I think he's indicated

 2 that the model assumptions are able to be varied upon a

 3 request by a party.

 4 JUDGE CLARK: Response, Ms. Shifley.

 5 MS. SHIFLEY: I'm asking -- I would just like

 6 to understand how the model itself functions that we

 7 were provided and allowed to do analysis on, and I'm

 8 just trying to clarify that we were unable to actually

 9 test the model with different assumptions.

10 JUDGE CLARK: All right, then you need to

11 rephrase the question, and the objection is overruled

12 with the restatement.

13 BY MS. SHIFLEY:

14 Q. The model that you provided to Public

15 Counsel, did it allow Public Counsel to enter different

16 rates of line loss for either VSTO or for the legacy

17 Frontier territories?

18 A. (Whitehouse) No, it did not.

19 Q. Could the parameters for SpinCo, VSTO, or

20 legacy Frontier be changed for operating expenses?

21 A. (Whitehouse) No, I believe -- no, they could

22 not.

23 Q. What about capital expenditures?

24 A. (Whitehouse) Again I believe my answer is

25 going to be back to where I started was that the model

0511

 1 took into account the input from all management involved

 2 in the development of the model. For quality control

 3 purposes, it's not prudent to have a model that is just

 4 floating around with everyone putting different

 5 assumptions and inputs into it. It controls -- it is a

 6 better control to have a model that at some point you

 7 set a base line, and that becomes the expected outcome

 8 that management uses as one of the many tools including

 9 all the various qualitative assessments that are going

10 to be taken into account by management and the board as

11 to whether to move forward with that transaction or not.

12 Sorry, but we did not have it as a goal at the time to

13 have a user friendly model that anyone could just step

14 into and make changes at will. It's a far too complex

15 transaction to create a model that has that type of

16 functionality.

17 Q. So the model that Frontier management used is

18 different than the model that you provided to parties

19 and regulators?

20 MR. SAVILLE: Objection, asked and answered.

21 JUDGE CLARK: I'm going to sustain the

22 objection even without hearing.

23 MS. SHIFLEY: Just a moment.

24 BY MS. SHIFLEY:

25 Q. Mr. Whitehouse, I think I just have a couple

0512

 1 more questions. You made some comments regarding a

 2 showing of access line losses in 2009. Can you provide

 3 any support for the data?

 4 A. (Whitehouse) I certainly can. We've

 5 reported them every quarter for both Frontier and for

 6 the VSTO operations as to what the line losses have been

 7 on an annual basis.

 8 Q. Are they in your quarterly reports,

 9 Mr. Whitehouse?

10 A. (Whitehouse) They absolutely are.

11 Q. And one more question. Standard & Poor's

12 reported that after the merger was announced they might

13 upgrade or downgrade Frontier based on how the

14 transaction proceeds; is that correct?

15 A. (Whitehouse) As I explained, the direct

16 conversations that I had with Standard & Poor's implied

17 to me that they indeed would like to see more

18 information about the transaction, because it is their

19 protocol to wait until the transaction closes and they

20 have all the facts before they make an official view on

21 the outlook or the ultimate rating of the company. That

22 wasn't anything that's specific to Frontier, I was told

23 that is the way they view all outlooks. It has to be

24 something that is pending inside of a 12 month period.

25 Since this transaction was not slated to close inside of

0513

 1 12 months, it chose not to address the outlook.

 2 Q. So is that yes or no to my previous question?

 3 Could you just clarify whether or not I was correct?

 4 A. (Whitehouse) I do not have their write-up in

 5 front of me, so I would not -- I do not recall the exact

 6 verbiage they used in their publication.

 7 MS. SHIFLEY: Thank you.

 8 One moment, Your Honor.

 9 No further questions at this time, Your

10 Honor.

11 JUDGE CLARK: Great, thank you, Ms. Shifley.

12 Is there any Commissioner inquiry?

13 Commissioner Jones.

14

15 E X A M I N A T I O N

16 BY COMMISSIONER JONES:

17 Q. This is a question for Billy Jack Gregg.

18 Would you just state on the record who the leading

19 telecommunication analyst is in West Virginia? This is

20 really important to me.

21 A. (Gregg) I would say he's located somewhere

22 in greater Putnam County, but exactly where would be

23 hard to tell.

24 COMMISSIONER JONES: No further questions.

25 JUDGE CLARK: Commissioner Oshie, do you have

0514

 1 any inquiry?

 2 COMMISSIONER OSHIE: No.

 3 JUDGE CLARK: All right.

 4 Chairman Goltz.

 5

 6 E X A M I N A T I O N

 7 BY CHAIRMAN GOLTZ:

 8 Q. Mr. McCarthy, did you respond to the sort of

 9 11th hour suggestion of Mr. Hill that there be a

10 separate corporate entity created for Frontier

11 Northwest?

12 A. (McCarthy) I did not. When I heard him say

13 that, that was the first time anyone has ever raised

14 that to me, so I just don't have any basis to --

15 Q. But the current plan would be that there

16 would not be a separate corporate entity for -- in

17 effect it would just be an operating unit of the main

18 corporation?

19 A. (McCarthy) That's correct.

20 Q. And did the -- was there any consideration to

21 having separate corporate entities?

22 A. (McCarthy) No, there wasn't.

23 Q. And do you, off the top of your head, do you

24 see a problem with that?

25 Mr. Whitehouse, that's fine.

0515

 1 A. (Whitehouse) I would be glad to respond. I

 2 think the issue that I would raise with that is the

 3 whole -- the efficiencies that you gain in running a

 4 telco on a national basis is that you are able to

 5 generate scale, economies of scale by having common

 6 support functions like an executive team, corporate

 7 accounting, human resources, et cetera. To completely

 8 ring fence an entity and confine it to a single state

 9 would mean you would have to have a state CEO and a

10 state CFO and a state treasurer and a state chief

11 counsel and a state HR department, so it certainly is

12 not a cost efficient way to establish a corporate

13 entity.

14 Q. But you still have central functions being

15 performed at the parent level though, correct?

16 A. (Whitehouse) That was not the way I

17 understood what was being called for. In order to have

18 a true ring fence, you would have to have a completely

19 stand-alone self-functioning entity. I may have

20 misunderstood what was being proposed.

21 MR. SAVILLE: Your Honor, can I just clarify

22 something. I'm not sure that the witnesses have

23 accurately characterized the structure of the

24 transaction. I think this calls for legal counsel to

25 explain. The transaction as it's structured, Verizon

0516

 1 Northwest Inc. is the operating entity that operates

 2 here in the state of Washington, also the state of

 3 Oregon and the state of Idaho. Under the proposed

 4 transaction, that operating legal entity Verizon

 5 Northwest Inc. will come over in totality as a separate

 6 corporation that will be under the Frontier

 7 Communications Corporation umbrella. The only change

 8 that will transpire with respect to that legal entity

 9 that again operates in Washington, Oregon, and Idaho

10 will be a name change. It will be renamed from Verizon

11 Northwest Inc. to Frontier Northwest Inc., so that will

12 still be a separate legal entity that is the ILEC

13 providing service in the state of Washington.

14 MR. ROMERO: And just to add to that just to

15 help here, Verizon Northwest Inc. is incorporated in the

16 state of Washington, and so I didn't quite understand

17 the suggestion this morning either, but I think that

18 would help with the discussion.

19 BY CHAIRMAN GOLTZ:

20 Q. So basically you will have a separate legal

21 entity then. You stand corrected.

22 A. (Whitehouse) Maybe I -- I was viewing it

23 less so from a legal concept but more practically as the

24 Treasurer of the company, which I also meant to address

25 is if you have a ring fence around an entity, then it

0517

 1 also has to be self financed just because to the extent

 2 you block the ability for the cash flow to move outside

 3 of that entity. I would not be able to borrow on a

 4 senior unsecured basis at the parent level. Those

 5 creditors would demand the ability to have cash, so it

 6 would require a separate capital structure for that

 7 entity as well as a separate credit rating. It simply

 8 wouldn't be as efficient as a capital structure. It

 9 would be more expensive for the company.

10 CHAIRMAN GOLTZ: I have no further questions.

11

12 E X A M I N A T I O N

13 BY JUDGE CLARK:

14 Q. I have just one point of clarification for

15 you, Mr. Whitehouse, and that is can you let me know

16 when the much argued about model was provided?

17 A. (Whitehouse) It was provided on September

18 16th.

19 Q. To Public Counsel?

20 A. (Whitehouse) That is correct.

21 Q. And all other parties?

22 A. (Whitehouse) That is my understanding.

23 JUDGE CLARK: All right, thank you.

24 Redirect.

25 MR. SAVILLE: Your Honor, just to clarify

0518

 1 Mr. Whitehouse's last statement.

 2 JUDGE CLARK: Okay, I don't really want to

 3 get into the habit of having counsel paraphrase the

 4 testimony of a witness, all right. I think that

 5 Mr. Whitehouse has adequately answered the inquiry and

 6 under oath.

 7 MR. SAVILLE: I understand, Your Honor.

 8 There's no further redirect.

 9 JUDGE CLARK: All right, thank you.

10 Thank you for your testimony, Mr. McCarthy,

11 Mr. Whitehouse, Mr. Gregg.

12 It's my understanding that the next phase of

13 this hearing will be the cross-examination of the Joint

14 Applicants on broader issues.

15 Yes, Mr. Thompson. Oh, I'm sorry, I ignored

16 Staff oral surrebuttal.

17 MR. THOMPSON: Correct.

18 JUDGE CLARK: And you would like to call a

19 witness in oral surrebuttal?

20 MR. THOMPSON: I would.

21 JUDGE CLARK: Please.

22 MR. THOMPSON: Two in fact.

23 JUDGE CLARK: Please call your witnesses, Mr.

24 Thompson.

25 MR. THOMPSON: Thank you.

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 1 JUDGE CLARK: You were so quiet for a while

 2 there, I forgot you were in the room.

 3 MR. THOMPSON: Staff would call back to the

 4 stand William Weinman and Robert Williamson.

 5 JUDGE CLARK: Thank you.

 6 (Discussion off the record.)

 7 JUDGE CLARK: I will just remind Mr. Weinman

 8 and Mr. Williamson that you remain under oath.

 9 Mr. Thompson.

10 MR. THOMPSON: Thank you.

11

12 Whereupon,

13 WILLIAM H. WEINMAN AND ROBERT T. WILLIAMSON,

14 having been previously duly sworn, were called as

15 witnesses herein and were examined and testified as

16 follows:

17

18 D I R E C T E X A M I N A T I O N

19 BY MR. THOMPSON:

20 Q. Let's see, I think the first question is for

21 Mr. Weinman, and this pertains to some testimony from

22 Ms. Alexander about the condition 19 of the settlement

23 agreement of the SPG or service performance guaranty

24 program, and I think she criticized that as essentially

25 being not enough and having a minuscule impact when

0520

 1 applied to Verizon historical data. What's your

 2 response to that?

 3 A. (Weinman) Well, first of all I would like to

 4 start off with just a brief explanation on quality rules

 5 within the Washington Administrative Code. We have

 6 approximately eight items that are in the service

 7 quality standard, missed appointments, installation,

 8 major outages, trouble reports per hundred by central

 9 office, switching, trunk blockage, repair times, and

10 business office average speed of answer. So those are

11 the service quality standards that Frontier can expect

12 to enjoy when and if they become a company in the state.

13 With regard to item number 19 though,

14 Ms. Alexander did make a comment that there wasn't

15 enough. One thing I would point out is the $35 missed

16 commitment credit to a customer is higher than any other

17 ILEC that is subject to missed commitments. The

18 company's also required to provide alternative service

19 if they can't get the repairs done timely. And the $5

20 credit for out of service was criticized as being

21 inadequate. If we look at what would happen if Frontier

22 did not become an entity in this state, we would drop

23 back to Verizon's pro rate, which to give you an example

24 if the customer is out of service for two days, the

25 amount of the credit that would be given to them is

0521

 1 $1.12. So while $5 in and of itself may not be huge, it

 2 really is quite a bit more in terms of money. And these

 3 provisions are really not intended to be punitive, but

 4 really to let the customer recognize that we do perceive

 5 some value if they're -- if the company doesn't meet

 6 their commitments.

 7 I also look at item 20 with the credits for

 8 missed service over the three year period. The credits

 9 go to the customers. Total value of that is about $3.6

10 Million, which has been mentioned previously. Staff's

11 proposal is that this really is a temporary transition

12 piece during the cutover times to integration and to

13 give the customer more value from any services that may

14 have been missed in those particular metrics. I would

15 just like to point out that when we looked at the

16 CenturyTel/Embarq merger, none of these items in terms

17 of the credits and the cumulative three year provisions

18 for the $3.6 Million was required of those companies.

19 So it is a much greater standard that we're holding

20 Frontier to with these items even though Public Counsel

21 seems to think they're not very adequate, or at least

22 that's my impression of the testimony they gave today.

23 Q. Thanks, Mr. Weinman.

24 My next question is actually for

25 Mr. Williamson.

0522

 1 Ms. Alexander also made some comments with

 2 regard to the measures chosen under condition number 28

 3 pertaining to the operation of the replicated systems

 4 prior to the close of the transaction. Could you just

 5 comment on why those particular measures were chosen?

 6 A. (Williamson) The items in 28, installation

 7 commitment, network trouble per 100 access lines,

 8 repair, percent out of service trouble cleared in 48

 9 hours, and billing error commitments, were chosen after

10 studying the failure in New England and the indicators

11 that were seen early that a major problem had arisen.

12 We discussed these with Oregon, Oregon staff. Oregon

13 staff had actually traveled to the New England states

14 and talked to staff in those states, and they agreed

15 that these indicators were the canary in the mine for a

16 massive failure. Again, that's what we're trying to

17 look for here.

18 This in no way takes place of the regular

19 quality of service reports. They will continue for

20 Verizon as they do today. In 60 days we'll have only

21 one full 30 day report, but along with these indicators

22 should show us if there's a massive failure. It's my

23 belief if there's a system failure similar to what

24 happened in New England, it will happen right away.

25 These indicators came up immediately when they cut over

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 1 the systems. And if that's the kind of failure -- and

 2 that's the kind of failure we're looking for to make

 3 sure our friends in Verizon don't get to walk away if

 4 there's system problems. It's also our belief that our

 5 friends at Verizon wouldn't do that, but Frontier would

 6 hold them at the door if they tried. It's very

 7 important to Frontier to make sure that these systems

 8 are working correctly because they will live with them

 9 after the 60 days.

10 Q. What about the complaint about, well, I

11 shouldn't use the word complaint, what about the

12 criticism of the use of the term billing error as a

13 measure?

14 A. (Williamson) Well, it is true that a billing

15 error is not one of our normal quality of service

16 reporting metrics, but it was a strong indicator in the

17 New England states as well as Hawaii for system failure.

18 It is not just a billing error, it's a billing error

19 complaint. So it's our understanding that the company

20 would tell us how many complaints they've had. Probably

21 will take a few days after the first bill goes out for a

22 customer, well, maybe, depending what the error is, to

23 complain. We also have a stand-alone, a very important

24 piece that also showed up in New England with commission

25 complaints. If we see the kind of problem they had in

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 1 New England, we will get Commission complaints as well

 2 as billing complaint reports from the company. That's

 3 why we chose those particular items.

 4 Q. What about the criticism that Staff will only

 5 have -- Staff and the Commission will only have five

 6 days to review the final report prior to closing?

 7 A. (Williamson) Well, it would sound like Staff

 8 would be asleep at their desk for 55 days waiting for

 9 the report, which obviously would not be true. We've

10 been working closely with the company and will be with a

11 third party provider. They've agreed to provide us with

12 information along the way on a regular basis along with

13 Oregon and Ohio staff and any other staff that we can

14 pull in with us. We're discussing who might be the

15 point of contact for that. It could be some staff here

16 in Washington state or another, but we're looking for

17 one point of contact so that they can give us the

18 information. We do not expect to get to the 55th day

19 and be shocked at what the report says. We believe we

20 will know what it's going to say before then, and the 5

21 days will give us time to analyze it in more detail.

22 Q. Thank you.

23 Back to Mr. Weinman, one of the points that

24 Dr. Roycroft brought up was I guess a question about the

25 efficacy of the $40 Million escrow account as a means of

0525

 1 assuring broadband buildout. Could you respond to that,

 2 please?

 3 A. (Weinman) Certainly. From my point of view,

 4 the $40 Million is a downpayment in that it's based on

 5 an estimate, and we take the estimate at the face value

 6 of the company. But when we look at what the company

 7 actually has to do, if we look at page 4 of settlement,

 8 we have three groups of customers, unserved,

 9 underserved, and all other wire centers, and they have

10 to make certain percentage commitments by the end of

11 2011, 2013, and 2014. The percentage of availability

12 dictates the final amount of money needed to be expended

13 by the company to meet this settlement. So $40 Million,

14 like I said, I believe is a downpayment. It's a showing

15 of good faith that the company has the ability to escrow

16 this kind of money and then go forward and build the

17 plant.

18 The other things that I think I heard

19 criticism was is that Frontier could have at least gone

20 to 92% like they did in their other areas. For Staff,

21 our primary concern was to get service to underserved

22 and unserved areas and have a deployment over a much

23 broader base. I mean 92% would be fairly easy to

24 achieve if all you have to do is worry about it in the

25 higher population centers and not worry about the areas

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 1 that are underserved or unserved. So we have a

 2 different priority set for achieving a certain amount of

 3 DSL penetration.

 4 The DSL pricing has pricing bundles, I

 5 believe there's five of them that are bundled in which

 6 Frontier is committed to continue to offer DSL

 7 customers. And as far as criticism of DSL speeds and

 8 speed limitations or choking of the data, we're talking

 9 about a product that as far as I'm concerned has certain

10 market pressures for both price, speed, and limitations.

11 Otherwise Frontier is not going to be able to achieve

12 the penetration of high speed Internet services that are

13 available to those customers. They'll take somebody

14 else unless Frontier happens to be the only choice, and

15 then they'll probably be glad to get whatever speed

16 they're deploying at that point in time anyway. Because

17 we hear complaints from customers that I can't get DSL,

18 so I believe that minimum speed set up to get the

19 service out to the customers, and after that the market

20 will really dictate what kind of speeds need to be

21 produced for them to be competitive in the future.

22 Q. Mr. Weinman, just one last question, in

23 response to just the various criticisms from the Public

24 Counsel witnesses about the quality of the settlement,

25 do you have any general thoughts about the quality of

0527

 1 the settlement?

 2 A. (Weinman) I do have some general thoughts

 3 about the quality of the settlement. I went back and

 4 looked at the CenturyTel/Embarq merger, we had 12

 5 conditions in the settlement. That was an all party

 6 settlement so that everybody that was participating in

 7 that agreed to that. We have 35 conditions in this, and

 8 the quality of the conditions in this settlement are

 9 much more stringent than they were in the CenturyTel

10 settlement. Things like credit refund provisions, item

11 20, that puts about $3.6 Million in jeopardy for

12 Frontier, are not in CenturyTel/Embarq merger. And so

13 Staff believes that there may be items in the settlement

14 that we can take shots at, but on the whole this is a

15 very good settlement, and it resolves many of the risk

16 issues that we were concerned about when we started this

17 process.

18 MR. THOMPSON: Thank you, that's all I have

19 on the surrebuttal.

20 JUDGE CLARK: All right.

21 Ms. Shifley.

22 MS. SHIFLEY: Thank you, Your Honor, I just

23 have a couple brief questions.

24

25

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 1 C R O S S - E X A M I N A T I O N

 2 BY MS. SHIFLEY:

 3 Q. Mr. Williamson, you testified to the fact

 4 that Staff will be working with other parties and the

 5 third party evaluator and will be getting information

 6 before the 60 day period. Is any of that laid out in

 7 the settlement agreement?

 8 A. (Williamson) No, it is not.

 9 Q. Okay.

10 And now I just have a couple questions for

11 Mr. Weinman. Mr. Weinman, you testified about the

12 service quality conditions that are included in the

13 settlement. Would it in your understanding be possible

14 for the level of service quality from Verizon's historic

15 and current performance to deteriorate under the

16 settlement agreement without any penalties or bill

17 credits occurring?

18 A. (Weinman) I know of no reason for that. I

19 suppose somebody could make it hypothetical to get me

20 there, but my response generally is no from a practical

21 standpoint.

22 Q. So the service that is now being delivered by

23 Verizon, could that -- if that goes down at all from

24 what's occurring currently -- is the settlement

25 agreement based on Verizon's current performance, or is

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 1 it based on the Commission minimum standards?

 2 A. (Weinman) It's based on the Commission

 3 standards.

 4 Q. Thank you. And one more question for you,

 5 Mr. Weinman, you testified concerning the

 6 CenturyTel/Embarq settlement?

 7 A. (Weinman) Correct.

 8 Q. Is it your understanding that the Commission

 9 actually imposed additional terms on that settlement

10 above and beyond what all parties had agreed to in the

11 proposed settlement?

12 A. (Weinman) They did and I wouldn't be

13 surprised if they imposed additional conditions on this

14 one also.

15 MS. SHIFLEY: That's all, Your Honor, thank

16 you.

17 JUDGE CLARK: Let's see if there's any

18 Commissioner inquiry.

19 Commissioner Jones?

20 COMMISSIONER JONES: No.

21 JUDGE CLARK: Commissioner Oshie?

22 Chairman Goltz?

23

24

25

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 1 E X A M I N A T I O N

 2 BY JUDGE CLARK:

 3 Q. I have just one clarifying question for you,

 4 Mr. Williamson, that is when you say you conferred with

 5 Oregon and Ohio staff, you're referring to the

 6 regulatory commissions in those states?

 7 (Williamson) I apologize, yes, Your Honor.

 8 JUDGE CLARK: Thank you.

 9 Oh, redirect.

10 MR. THOMPSON: No redirect.

11 JUDGE CLARK: All right, thank you, Mr.

12 Williamson, thank you, Mr. Weinman.

13 And unless I'm misstepping again, maybe we're

14 now ready to have examination on broader issues. Okay,

15 then we're going to take our afternoon break, which is

16 approximately 15 minutes, and then during that recess we

17 can talk about the order of the witnesses. I think we

18 have it, but I just want to confirm that. We're at

19 recess for 15 minutes.

20 (Recess taken.)

21 JUDGE CLARK: Good afternoon, we're back on

22 the record. Mr. Romano, would Verizon call their first

23 witness, please.

24 MR. ROMANO: Yes, thank you, Your Honor,

25 Verizon calls Timothy McCallion.

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 1 JUDGE CLARK: Thank you.

 2 Mr. McCallion, I will just remind you you

 3 remain under oath.

 4 MS. SHIFLEY: Your Honor, I'm sorry to

 5 interrupt here, I just thought that now might be a good

 6 time to notify the parties and the Bench that Public

 7 Counsel is going to waive its cross-examination of the

 8 joint applicant witnesses.

 9 JUDGE CLARK: All of them?

10 MS. SHIFLEY: Yes, Your Honor.

11 JUDGE CLARK: Just confirmation for the

12 record, you will have no cross-examination of

13 Mr. McCallion, Mr. Smith, Mr. McCarthy, Mr. Gregg, or

14 Mr. Whitehouse?

15 MS. SHIFLEY: That's correct, Your Honor.

16 JUDGE CLARK: All right, thank you.

17 CHAIRMAN GOLTZ: I guess I'll make my dental

18 appointment on Friday after all, darn.

19 JUDGE CLARK: All right, I'm certainly not

20 going to allow any friendly cross-examination from the

21 party I like to ignore, I mean Mr. Thompson.

22 MR. THOMPSON: Thank you.

23 JUDGE CLARK: So what we are going to turn to

24 then is any Commissioner inquiry that there might be for

25 any of these witnesses, and I'm going to turn to you

0532

 1 first, Commissioner Jones.

 2

 3 Whereupon,

 4 TIMOTHY J. MCCALLION,

 5 having been previously duly sworn, was called as a

 6 witness herein and was examined and testified as

 7 follows:

 8

 9 E X A M I N A T I O N

10 BY COMMISSIONER JONES:

11 Q. Good afternoon, Mr. McCallion.

12 A. Good afternoon, Commissioner.

13 Q. I just have a few clarifying questions on I

14 think it's in your direct testimony, and it's in the

15 first TM-1T, and I'm just trying to get clear in my own

16 mind what assets are being transferred and what assets

17 are remaining in the state of Washington. So maybe you

18 could just generally go through that again in terms of

19 long distance assets, global IP assets, FiOS assets,

20 what is being transferred and what is not? Maybe the

21 best way to answer the question is what assets will

22 Verizon continue to own other than wireless in the state

23 of Washington?

24 A. Okay. Commissioner, the assets that we will

25 transfer will be the assets of our ILEC, Verizon

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 1 Northwest Incorporated, so that will be the local

 2 telephone business. In addition to that, we will be

 3 transferring the Verizon Long Distance customers who are

 4 associated with the customers of the land line business.

 5 So for example if we have customers for Verizon Long

 6 Distance and they are in Qwest area or CenturyTel/Embarq

 7 area, those will not be transferred. Verizon Long

 8 Distance will stay in the state and continue to compete.

 9 And then you asked in addition Verizon Wireless, yes,

10 Verizon Wireless will continue to maintain a strong

11 presence in the state of Washington, as will Verizon

12 Business. And Verizon Business is our Enterprise

13 Business that's largely focused on large private

14 companies and also government entities, and it primarily

15 consists of the assets that we acquired several years

16 ago when we acquired the assets of the former MCI. We

17 added to that the larger business accounts that Verizon

18 already had.

19 Q. So to clarify, you will, on the long distance

20 side you will continue to operate what you call VLD,

21 Verizon Long Distance, and VES, Verizon Enterprise

22 Solutions, in the state of Washington?

23 A. Yes, we will.

24 Q. Okay. Turn to page 5 of your testimony, line

25 18, if you would. Tell me when you're -- do you have it

0534

 1 in front of you?

 2 A. Yes, I do, Commissioner.

 3 Q. On line 18 it says:

 4 The proposed transaction with Frontier

 5 will allow Verizon to focus on its ILEC

 6 local IP and wireless operations.

 7 So what do you mean by, given your previous

 8 answer, I -- my understanding -- it's just confusing to

 9 me. This transaction is you're divesting of all ILEC

10 operations in our state, are you not?

11 A. Well, Commissioner, you bring up a good

12 point. I think I probably could have structured that

13 sentence a little bit clearer. We're keeping our ILEC

14 operations in our high density states, so I use the word

15 high density later in the sentence, and that's referring

16 to the ILEC business because we're staying in the

17 wireless business in all states for example.

18 Q. So are you staying in the ILEC business in

19 California?

20 A. Yes, we are, and we serve high density areas

21 primarily surrounding Los Angeles.

22 Q. FiOS?

23 A. We have significant FiOS in California.

24 Q. Okay, I think -- oh, just one more question.

25 Are you responsible for Hawaii in the West Region?

0535

 1 A. Yes.

 2 Q. Did you have any personal involvement in the

 3 negotiations to sell the assets of or divest the assets

 4 of Hawaii Telecom to The Carlyle Group?

 5 A. I wasn't involved in the negotiations of the

 6 transaction with The Carlyle Group. I did get involved

 7 in some of the regulatory discussions before that

 8 transaction was consummated, but I wasn't involved in

 9 the negotiation of the transaction itself.

10 COMMISSIONER JONES: I have some questions on

11 the Fort Wayne data center and something I think that

12 was in Mr. Roycroft's testimony on some depositions you

13 made in the state of Ohio, but I will wait on that. I

14 assume that Public Counsel Mr. Roycroft will address

15 that, thank you.

16 JUDGE CLARK: Commissioner Oshie?

17 COMMISSIONER OSHIE: No questions.

18 JUDGE CLARK: Chairman Goltz?

19 CHAIRMAN GOLTZ: No questions.

20 JUDGE CLARK: All right, I'm assuming -- yes,

21 go ahead, Mr. Romano.

22 MR. ROMANO: Yes, thank you, Your Honor.

23

24

25

0536

 1 D I R E C T E X A M I N A T I O N

 2 BY MR. ROMANO:

 3 Q. One thing we neglected to do is I wanted to

 4 ask you about your rebuttal testimony which is marked as

 5 Exhibit TM-2HCT, did you have any corrections to that

 6 testimony?

 7 A. Yes, I had one correction on page 34, line 9.

 8 Q. And the correction involves a highly

 9 confidential number, so, Mr. McCallion, please when you

10 explain the correction try to avoid referring to the

11 number.

12 JUDGE CLARK: All right, and we just were

13 handed an errata that perhaps addresses this issue?

14 MR. ROMANO: Yes, Your Honor.

15 JUDGE CLARK: Then you don't need to go into

16 any great details other than to ask him if the errata

17 makes the correction he wants to make.

18 BY MR. ROMANO:

19 Q. Does the errata before you make the proper

20 correction?

21 A. I need to see the errata, please.

22 Q. (Complies.)

23 A. Yes, the errata makes the proper correction.

24 MR. ROMANO: Thank you.

25 JUDGE CLARK: All right, then the record

0537

 1 should reflect that page 34 of Exhibit TM-2T is

 2 replaced.

 3 MR. ROMANO: Thank you, Your Honor.

 4 JUDGE CLARK: Is that it?

 5 MR. ROMANO: That's it.

 6 JUDGE CLARK: All right, thank you for your

 7 testimony, Mr. McCallion.

 8 THE WITNESS: Thank you.

 9 MR. ROMANO: Would it be appropriate to now

10 move the testimony in?

11 JUDGE CLARK: Actually all of the, and we'll

12 address this just a little bit later, but just to say

13 very, very briefly all of the testimony of all witnesses

14 has already been received in evidence, was received in

15 evidence on Tuesday morning. There are a few exceptions

16 which we will address at the end of the day, some

17 exhibits that were moved from one witness to another and

18 some that I affectionately refer to as dangling

19 exhibits, and we'll address all that. But the remainder

20 of the exhibits for which there were no objections have

21 already been received.

22 MR. ROMANO: Thank you, Your Honor.

23 JUDGE CLARK: I think it might facilitate the

24 remainder of the hearing day if we took a few moments

25 off record, because as you know I'm not going to allow

0538

 1 any friendly cross and Ms. Shifley has already indicated

 2 she does not have any examination, so I would like the

 3 opportunity to confer with Commissioners regarding

 4 examination they might have for any of the joint

 5 applicant witnesses, so we're at recess until further

 6 call.

 7 (Recess taken.)

 8 JUDGE CLARK: During the recess the

 9 Commissioners confirmed that there is no inquiry for any

10 of the joint applicant witnesses other than Mr. McCarthy

11 and Mr. Whitehouse, so Mr. Saville.

12 MR. SAVILLE: Thank you, Your Honor.

13

14 Whereupon,

15 DANIEL MCCARTHY AND DAVID R. WHITEHOUSE,

16 having been previously duly sworn, were called as

17 witnesses herein and were examined and testified as

18 follows:

19

20 D I R E C T E X A M I N A T I O N

21 BY MR. SAVILLE:

22 Q. Just briefly, Mr. McCarthy, can you just

23 identify yourself for the Commissioners.

24 A. (McCarthy) My name is Daniel McCarthy, I'm

25 the Executive Vice President and Chief Operating Officer

0539

 1 of Frontier Communications.

 2 Q. And you caused to be filed in this docket

 3 direct testimony, supplemental testimony, and rebuttal

 4 testimony?

 5 A. (McCarthy) I did.

 6 Q. And, Mr. Whitehouse, your name and title?

 7 A. (Whitehouse) David Whitehouse, Senior Vice

 8 President and Treasurer of Frontier Communications.

 9 Q. You caused to be filed in this proceeding

10 rebuttal testimony?

11 A. (Whitehouse) Yes, I did.

12 MR. SAVILLE: Your Honor, Commissioners,

13 they're both available for questions.

14 JUDGE CLARK: And do you have any additions,

15 corrections, or deletions to any of that testimony?

16 MR. MCCARTHY: I do not.

17 MR. WHITEHOUSE: I do not either.

18 JUDGE CLARK: All right, I remind you both

19 that you remain under oath, you've already been sworn

20 in.

21 Commissioner Jones.

22

23 E X A M I N A T I O N

24 BY COMMISSIONER JONES:

25 Q. Good afternoon.

0540

 1 A. (McCarthy) Good afternoon.

 2 A. (Whitehouse) Good afternoon.

 3 Q. My first series of questions will revolve

 4 around the ratings agency issues, and I think,

 5 Mr. Whitehouse, you may want to address those, but,

 6 Mr. McCarthy, could you turn to page what I have marked

 7 in my testimony as page 65 of your rebuttal testimony,

 8 DM-8HCT.

 9 A. (McCarthy) Yes, sir.

10 Q. And actually it's both pages, in pages 64 and

11 65 you are quoting a Morgan Stanley report, a Raymond

12 James report, and then you get into a discussion of

13 Moody's and Fitch, do you not?

14 A. (McCarthy) Yes, I do.

15 Q. How many analysts follow your company?

16 A. (Whitehouse) at the moment I actually have a

17 count. There are 14 that currently have ratings on us,

18 15 if you include the analyst at J.P. Morgan who is

19 currently reserving rating at the moment until the

20 transaction closes given J.P. Morgan's role as an

21 advisor to Verizon. And that is to be clear equity

22 analysts.

23 Q. So of the equity analysts, I'm going to get

24 to one analyst in a minute, but what would you say is

25 the majority opinion on both the credit metrics and the

0541

 1 financial strength of the company post transaction of

 2 those 14 analysts?

 3 A. (Whitehouse) I think, well, we can start

 4 with what their actual recommendation is at the moment,

 5 and they're at 3 buys on the stock, there are 8 holds

 6 and they view it to be a market perform, and 3

 7 underperforms, which I would say that the median is

 8 clearly that the company's expected to have market level

 9 performance taking into account this transaction since

10 everyone is clearly aware of it and factoring that into

11 their analysis of the stock.

12 Q. So probably, there's more for you,

13 Mr. Whitehouse, so please continue, I have -- are you

14 familiar with the D.A. Davidson analyst rating, I think

15 it's in Mr. Hill's Exhibit SGH-29?

16 A. (Whitehouse) I am familiar with that, yes.

17 Q. Okay. And he, well, that analyst downgraded

18 you from neutral to underperform?

19 A. (Whitehouse) That's correct.

20 Q. So just let -- what were the primary reasons

21 in your view that he downgraded your stock?

22 A. (Whitehouse) I believe the primary reason

23 was driven by what I view to be a technical overhang on

24 the stock given the fact that there is going to be a

25 large distribution of Frontier shares to Verizon

0542

 1 holders, many of which may be precluded from holding

 2 them based on the charter of their investment mandate,

 3 especially as it relates to institutional investors.

 4 And I believe this analyst was merely saying that on a

 5 short-term basis there would be an opportunity to buy

 6 the stock at a lower level. I don't believe they were

 7 casting any long-term views on the viability of the

 8 company as a whole. I think if you look at the target

 9 stock price, it is still I believe $6.75, which clearly

10 indicates that they view it as a viable company going

11 forward and certainly make no indications that it's

12 going to be in any level of financial distress, so. And

13 I think that's fair to say of many analysts is that

14 remember they are picking stocks from the perspective of

15 an equity holder, not from a creditor or someone like a

16 commission such as yours that might be more focused at

17 the overarching long-term viability of the credit

18 metrics of the company.

19 Q. I think, just for the record, I think I'm

20 reading from the, you may want to get it in front of

21 you, but the target price he quoted was $6.25 per share.

22 A. (Whitehouse) I stand corrected.

23 Q. Just let me go through a few of his points.

24 I think he points out some good points about the merger

25 or some positives as well as some potential negatives.

0543

 1 One of the issues, and maybe you can tell me if other

 2 analysts are bringing this up too, it regards the

 3 synergy issues, and I think Commissioner Oshie and

 4 Chairman Goltz and I have asked some questions on that,

 5 but to read from one part of that opinion, it says:

 6 Frontier has not given shareholders a

 7 detailed breakdown for the savings but

 8 expects to gain efficiencies in the

 9 accounting and regulatory systems that

10 it will acquire.

11 And he's basically questioning the $500

12 Million of synergy savings. So what's your response to

13 that?

14 A. (Whitehouse) Well, I don't mean to cast

15 aspersions on this particular analyst, but I don't see a

16 lot of backup behind this. You know, this analyst in my

17 view is not a highly rated analyst. There's no model

18 attached here to indicate that there's any level of

19 significant analysis that was done on the company. And

20 I don't think they fully grasp the concept that we've

21 discussed and Mr. McCarthy has discussed at length that

22 indeed many of these synergies are very realizable right

23 out of the gate because a large portion of them do come

24 out of the, you know, the lower corporate allocations

25 that would come with a more leanly operated Frontier

0544

 1 organization versus Verizon. And I think -- by the way

 2 it is a she is the analyst, she makes reference to

 3 synergies associated with billing conversions when in

 4 fact the company has a very strong track record of

 5 making such conversions just as we did in the

 6 Commonwealth of Pennsylvania acquisition, and we have --

 7 and we've been very forthright in acknowledging that

 8 that would take some time to occur, so that is -- she's

 9 not stating anything that we would necessarily disagree

10 with, but we just -- we still view the fact that it

11 takes two or three years to still be a very significant

12 and valuable source of synergies.

13 Q. Maybe there's more for Mr. McCarthy, but she

14 also points out that you won't be able to achieve your

15 synergy savings because 74% of the acquired work force

16 will be unionized. Now is that roughly an accurate

17 statement?

18 A. (McCarthy) That's probably accurate from the

19 percentage of the work force, but I don't think she was

20 taking into account the wage and non-wage savings that

21 we were anticipating. Again, I did not speak to that

22 analyst, maybe Mr. Whitehouse did, but I don't think she

23 appreciates the fact that there will be those level

24 synergies immediately. There will be network synergies,

25 not necessarily in Washington but in states like West

0545

 1 Virginia where we operate together where we actually

 2 purchase a lot of transport services and we'll be

 3 integrating those networks. So there is undoubtedly a

 4 fair amount of synergies. Some of them are very state

 5 specific where we operate today. Others are more around

 6 the corporate types of overhead that we talked about

 7 this morning and yesterday.

 8 Q. But is it true that the unionized or the

 9 wages and benefits associated with the unionized work

10 force are not part of your synergy savings estimates,

11 correct?

12 A. (McCarthy) They're certainly -- we had made

13 a commitment as part of the transaction that for 18

14 months we were not going to affect any of the field

15 forces.

16 Q. Okay.

17 A. (McCarthy) So we had not planned on that as

18 part of the synergies.

19 Q. So what percent of your work force is

20 unionized and what is non-unionized?

21 A. (McCarthy) Today on the legacy Frontier

22 side?

23 Q. Yeah.

24 A. (McCarthy) Today the percentages would be

25 approximately 65% to 70% is unionized today.

0546

 1 Q. So if there are any wage and benefit synergy

 2 reductions to be achieved in the first 18 months, they

 3 will be taken from the non-unionized employees, correct?

 4 A. (McCarthy) To the extent that there is

 5 redundant functions that would be coming over, yes.

 6 Q. Okay. The last point I want to raise in this

 7 analyst's opinion, this is for you, Mr. Whitehouse, I

 8 think, is there's a concern about the dilution of stock

 9 or the, no, not dilution, I withdraw that, the sale of

10 stock once it's close of transaction. The Verizon

11 shareholders especially after they saw what happened to

12 the IDEOC and FairPoint Communications stock that they

13 may, to put it crudely, dump the stock or sell it

14 quickly, so what is your response to that?

15 A. (Whitehouse) I think the company has done an

16 excellent job over the last -- over the period from when

17 we've announced this transaction very clearly addressing

18 what we view to be the critical differences between this

19 transaction and those prior Verizon line divestitures.

20 And, you know, the institutional investors I believe get

21 that. I know as I am responsible for investor relations

22 so I do have direct contact with our largest

23 shareholders and have not received any significant push

24 back or concerns once we walked them through the

25 significant differences between these two transactions.

0547

 1 I believe, you know, and institutional investors

 2 represent, you know, approximately 50% of the holdings

 3 out there. I think there certainly could be an element

 4 of retail investors that perhaps feel that they did not

 5 do well holding FairPoint stock and they do sell.

 6 There's nothing we can do about that, and nor are we

 7 trying to. I mean we are managing the business for the

 8 long term.

 9 As I mentioned earlier, we fully expect that

10 there will be some reshuffling of shares, which is

11 typical of any spinoff transaction. It will take, you

12 know, maybe 60 to 90 days for all those shares to find

13 their home. But if you look at, you know, the share

14 performance post announcement, it has been pretty solid.

15 We are trading I believe today in the 7.70 ish range,

16 which is more or less where the trade went out. So I

17 believe if there was any resounding problem with the

18 shares, you know, it would have already been reflected

19 in that share price. In fact, the stack traded up over

20 $8.50 at one point in the not too distant past. So I

21 simply think that there is going to be some shaking out

22 to occur.

23 Some of that is not an indication of an

24 investor's view of management or the prospects of the

25 company either. For example, a very, very large mutual

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 1 fund that might have a specific mandate to invest in a

 2 wireless company clearly would, you know, would not want

 3 to hold Frontier, not because they don't think it's a

 4 well managed company that will have strong financials

 5 going forward, it just doesn't fit their mandate, and

 6 they would sell. But to counter that as part of our

 7 role in the investor relations arena, you know, we do

 8 speak with these holders, and we make sure that to the

 9 extent there is another fund within the complex, you

10 know, a fidelity certainly would have a large megacap

11 fund that it might have a dividend driven growth or

12 income related fund, and we try to make sure that all

13 the other potential holders that will now find the stock

14 even more attractive that we're getting their attention

15 as well. And so, you know, we've followed the

16 announcement of this transaction, hired a director of

17 investor relations who spends all day basically making

18 sure that our investors are well informed and potential

19 investors are well informed about the transaction.

20 Q. What percentage, this is the final question

21 on this point, what percentage of your stock is owned by

22 large institutions such as mutual funds and how much by

23 retail investors?

24 A. (Whitehouse) I believe it's, I should -- I

25 can confirm it, but it is in the ball park of 50/50. It

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 1 might be a little more heavily weighted. It's roughly

 2 -- it's fairly comparable to Verizon's current

 3 ownership.

 4 Q. Next series of questions is on the ratings

 5 agencies. You discuss how the ratings agencies such as

 6 S&P and Fitch and Moody's will view the transaction

 7 after it closes and suggest that achieving an investment

 8 grade rating is possible or likely. I think we have had

 9 an exchange of views on this. What's the basis for that

10 statement? Maybe, Mr. McCarthy, you can start because

11 that was in your testimony.

12 A. (McCarthy) Certainly.

13 Q. You said it's likely.

14 A. (McCarthy) When we went forward and moved

15 forward with consummating the transaction,

16 Mr. Whitehouse, our Chief Financial Officer, met with

17 each one of the rating agencies and gave them an

18 overview of what the transaction entailed as well as a

19 pro forma look at what the credit metrics would look

20 like in the revised company post close. Based on that,

21 two of the rating agencies actually came out with that

22 positive outlook change. And as Mr. Whitehouse

23 described, Standard & Poor's, as I understand it, they

24 are waiting for consummation of the transaction. So I

25 think that was the basis for the change that the two

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 1 rating agencies have.

 2 A. (Whitehouse) And I can address that in

 3 greater granularity if you would like.

 4 Q. Sure.

 5 A. (Whitehouse) Obviously we keep an ongoing

 6 dialogue with the rating agencies. We speak with them

 7 several times a year giving them, you know, business as

 8 usual updates, and certainly in advance of a transaction

 9 like this we bring them completely into the loop on

10 that. But as part of the regular updates we get from

11 them, it's not a one-way conversation. We get back from

12 them dialogue on how do they rate companies, what are

13 the qualitative and criteria that they use to rate a

14 company. And using that information, which is pretty,

15 you know, explicit, and looking at comparable companies

16 out there like a CenturyLink, we have a very good

17 benchmarking out there to know what sort of credit

18 metrics would need to be realized by the pro forma

19 company to with a straight face petition the agencies

20 for an upgrade in investment grade.

21 And our commitment to delever, you know,

22 right out of the gate a full turn, which I can't

23 emphasize how meaningful that is. I mean typically

24 companies delever one tip at a time, you know, 1/10 of a

25 turn. This is a full turn plus of leverage right out of

0551

 1 the gate that we're going to realize. That's why the

 2 outlook was immediately refreshed by two of the three

 3 agencies.

 4 And I think when you get to, if you just want

 5 to pick one key metric being the debt to EBITDA earnings

 6 before interest, taxes, depreciation, and amortization,

 7 when you get inside 2 1/2 times and you are squarely --

 8 and you are in the range of the metrics that are

 9 appropriate for a triple B rated company.

10 Furthermore, over 25% according to Moody's of

11 a rating is simply driven by scale. So simply being a

12 larger company carries a lot of weight with the

13 agencies, and so that in and of itself, being a larger

14 company, adding more states, presumably more

15 diversification to the portfolio, is a very positive

16 thing. And access to capital is very much driven by

17 size. You know, investors like very large liquid

18 issuers because they like to -- it just allows them to

19 come in and out of the bonds if they were to wish to do

20 so.

21 Not to say that we weren't a very liquid

22 issuer to begin with. As I alluded to in my earlier

23 testimony, we have been a frequent issuer in the market.

24 Our credit is very well known. We have a full range of

25 maturities that trade every day and are very liquid, so

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 1 we have a very good idea of how the market views the

 2 credit.

 3 And finally, just we do get input from our

 4 investment bankers. Investment bankers have in-house

 5 ratings advisory teams that are able to provide input on

 6 what they would view to be the necessary metrics

 7 necessary to achieve investment grade. And that was,

 8 you know, again I said it before earlier, but when a

 9 management team makes a public statement that they are

10 going for investment grade rating, meaning it is their

11 target, it means something, and you don't do it lightly.

12 So that was a very calculated decision by the management

13 of Frontier and the board of directors.

14 Q. Who are your investment advisors?

15 A. (Whitehouse) On this particular transaction

16 it was Citibank and Evercore advisors, but on the

17 routine capital markets and funding there are a few

18 other banks I deal with including J.P. Morgan, Credit

19 Suisse, First Boston, Citibank, a whole host of them.

20 Q. This Commission and this Commissioner is

21 quite familiar with mergers and with debt equity ratios

22 and ratings agency issues. Are you familiar with the

23 merger that came to this Commission last year, electric?

24 A. (Whitehouse) Are you referring to

25 CenturyTel?

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 1 Q. No.

 2 A. (Whitehouse) Then I don't believe I am.

 3 Q. Okay. Well, it was a large merger in the

 4 electric and gas area. Did you consider basically your

 5 attitude or your, excuse me, your testimony from both of

 6 you is I regard as kind of trust us, here's the

 7 evidence, here's some preliminary indications of what

 8 may happen, but it's kind of trust us, we are a

 9 financially viable company and we will be more viable

10 based on what you said on the delevering even though you

11 are taking on a substantial amount of debt, correct, at

12 least --

13 A. (Whitehouse) On an absolute basis, yes.

14 Q. So did you consider obtaining some sort of a

15 letter from S&P or other ratings agencies during the

16 pendency of this transaction so that they could review

17 the financial model you developed, opine on the credit

18 metrics, and maybe submit it to the Commission even if

19 it were informal so the Commissioners could have some

20 assurance, greater assurance on this issue?

21 A. (Whitehouse) We did not do that in advance.

22 I am aware that such services are available from the

23 agencies where you can submit certain scenarios that

24 they will rate. I believe our concern with this was

25 given, you know, there were so many -- there would be

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 1 potential moving variables that they would not

 2 necessarily get comfortable with so far out in advance

 3 of the actual closing. So we did not pursue that but

 4 instead relied upon advice from in-house agency experts

 5 including many of them that were previously employed by

 6 the agencies to provide us with that input.

 7 But I would say that it's a little more than

 8 just trust us, because clearly we have taken steps in

 9 terms of cutting our dividend. I mean essentially we've

10 recapitalized this company to the net harm, harm is not

11 the right word, but our shareholders are going to bear

12 the brunt of that in terms of lower potential free cash

13 flow they would realize by having a lower amount of

14 debt. So we felt strongly that having a more

15 conservative and prudent capital structure given what we

16 all saw passing through 2008 and early 2009 that that

17 was prudent. I myself was previously the treasurer of

18 an investment grade company that was very large,

19 International Paper, and personally believe that the

20 larger you get, the more value there is to being

21 investment grade issuer, and thus why we set that target

22 and made that commitment to work towards that. But

23 recognizing that the agencies, as I alluded to earlier,

24 are much more reluctant to really stick their necks out.

25 They basically say, well, come back to us when you're

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 1 ready, and then we'll give you a rating.

 2 Q. I understand. And it also costs money to get

 3 an opinion like that, doesn't it?

 4 A. (Whitehouse) It does, yes.

 5 Q. Could you turn to page 25 of your testimony,

 6 please.

 7 A. (Whitehouse) I'm there.

 8 Q. And the question posed is, should the

 9 Commission assume that an investment grade rating is

10 necessary for carriers serving Washington, and your

11 answer is no. And I would like to go through this

12 reasoning again.

13 A. (Whitehouse) Okay.

14 Q. The first question is, are you familiar with

15 the precedents that this Commission has in addressing

16 the investment grade status issue for all regulated

17 utilities, electric, gas?

18 A. (Whitehouse) I would not say that I am an

19 expert on that in any capacity.

20 Q. You're not?

21 A. (Whitehouse) No.

22 Q. Okay. Do you mean to imply that the

23 Commission in one of its orders or in a rule or whatever

24 would conclude that an investment grade rating is not

25 necessary for any regulated utility?

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 1 A. (Whitehouse) I think I can really only speak

 2 to the telecommunications side in simply looking at the

 3 universe of ILEC's out there and recognizing that

 4 there's really only two large RBOC's, being AT&T and

 5 Verizon, and then CenturyTel, and that the majority of

 6 ILEC's are not investment grade that it certainly didn't

 7 seem, all of which are operating in good standing within

 8 their states for all intents and purposes, it didn't

 9 appear to be a critical gating item for a LEC to be a

10 strong provider in a particular state.

11 Q. So you're not saying that this Commission in

12 a previous case with Qwest for example or CenturyTel or

13 even CenturyLink during the merger proceeding opined on

14 this issue and said something to the effect that below

15 investment grade rating is okay?

16 A. (Whitehouse) I'm not sure I'm following your

17 question exactly. I want to make sure I'm answering it.

18 Q. Are you referring to any specific Commission

19 order or any policy that we have when you state that an

20 investment grade rating is not --

21 A. (Whitehouse) No, no, I'm sorry if it was

22 construed that way. I think it was simply rebuttal to

23 one of the other witnesses involved for other parties.

24 It was nothing directed at the Commission itself.

25 Q. So as I understand your reasoning, it is that

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 1 Qwest is junk status or below investment grade, you are

 2 below investment grade, CenturyLink is not but it's

 3 based on maybe 2/3 or 3/4 of the telecom carriers in the

 4 country are below investment grade and therefore that's

 5 good enough?

 6 A. (Whitehouse) No, I wouldn't be that -- I

 7 wouldn't -- I would be a little more -- I think the

 8 company's saying a little more than that. I mean the

 9 fact that we are in fact acknowledging the value of an

10 investment grade rating by making the commitment to

11 delever to target levels that we think will help us to

12 get there. We certainly could have set a capital

13 structure that had leverage a half a turn higher, which

14 would likely have been potentially to the benefit of

15 higher free cash flow accretion to our shareholders.

16 But as I said, we do recognize the value of investment

17 grade. I would like to be an investment grade issuer.

18 I think it will give me better access to the capital

19 markets. I believe I have them now, but I would like to

20 have even better access as always. So I think we're

21 saying that we would like to put ourselves in that

22 higher echelon of issuers that are high grade, and thus

23 we do agree that there is value to it.

24 Q. And, Mr. Whitehouse, I know you had

25 experience, you state in the record that you were

0558

 1 treasurer for International Paper?

 2 A. (Whitehouse) That is correct.

 3 Q. And that's an investment grade carrier?

 4 A. (Whitehouse) It is.

 5 Q. But what was the experience for Frontier

 6 during the financial implosion I guess you would say

 7 that started in September of 2008? You cite it your

 8 testimony the debt issuance of $600 Million in October

 9 of 2009, correct?

10 A. (Whitehouse) Correct.

11 Q. But during this period of 18 months,

12 especially after September 2008, didn't high yield debt

13 have a tough time getting financed in the market?

14 A. (Whitehouse) I believe that's -- that is a

15 fair statement, but I would also elaborate to say that

16 Frontier has a very conservative approach to

17 refinancing. In fact, the company did at one point have

18 a large 2009 maturity tower which was refinanced I

19 believe it was just before I arrived at the company, a

20 good, you know, year plus, maybe even 18 months in

21 advance of it being coming due, so we've always -- we've

22 never waited until the last minute to deal with near

23 term maturities. So as we looked at that challenging

24 market of the fourth quarter of last year and the first

25 quarter this year, as Treasurer I really did not lose

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 1 that much sleep, because I had no pending maturities.

 2 The nearest maturity at that time was not until May of

 3 2011. We had a fully available revolving credit

 4 facility, $250 Million that we have never drawn in its

 5 existence. And the company has a policy of keeping

 6 greater than $100 Million of cash on hand. So we're

 7 very focused on not finding ourselves caught short. I

 8 mean that really is -- if there's one way to lose your

 9 job as the Treasurer, it's to not be able to make

10 payroll. I learned that long ago in my career.

11 And I think that carries through into 2009

12 where even though we actually had in addition to the

13 September issuance, we went into the market in early

14 April. We were one of the earlier companies to in

15 effect help reopen the high yield market, which I think

16 speaks to us as being somewhat of a bellwether issuer in

17 the high yield market. We were receiving a lot of

18 reverse inquiry, meaning accounts, investors were coming

19 to our bankers and saying, hey, you know, here's a list

20 of companies, if you brought a deal to the market, we

21 would buy, and we were often on those types of lists due

22 to the predictability of our cash flow.

23 And with that in mind, even though April, and

24 you're talking about two years in advance of the actual

25 maturity, we thought it prudent, and at that point this

0560

 1 deal wasn't something we were even contemplating, it

 2 wasn't done in any sort of anticipation of this, we

 3 simply felt that it was prudent to take some of that

 4 risk off the table even though that did incur us paying

 5 a premium to buy some of that debt back and some

 6 negative carry, we just thought it was the right thing

 7 to do. That is my personal view and that is my boss,

 8 the Chief Financial Officer, as well as our CEO and

 9 board felt the same way. So we really were fine through

10 that entire process.

11 And I think it's fair to say too that I

12 think, you know, the markets were very choppy, but I

13 think a lot of companies do approach it the way we do.

14 I mean conservative companies, the goal is to borrow

15 money when you can, not when you need to, and if you

16 found yourselves in a position in fourth quarter of last

17 year or first quarter, you could have borrowed money.

18 You wouldn't have liked the price, but there's always

19 money at a certain price.

20 Q. Right. Mr. Whitehouse, what were the spreads

21 on high yield, the spread compared to either corporate

22 double or single A rated corporate bonds with treasuries

23 at the peak?

24 A. (Whitehouse) I don't have that handy. I

25 could produce that if you would like to see that. I can

0561

 1 say generally, I've been looking more recently, I track

 2 more, you know, how would we price relative to say a

 3 triple B issuer like CenturyTel, and I would say on

 4 average there's probably a 1, maybe a 1 1/2%, maybe --

 5 it varies depending on the maturity, but there certainly

 6 is a meaningful benefit to being an investment grade

 7 issuer.

 8 Q. So just wrapping up on this question, what is

 9 the, in your view based on what you just said and based

10 on the fact that if this transaction is approved by this

11 Commission you would continue to be a regulated utility

12 in this state.

13 A. (Whitehouse) Correct.

14 Q. What is the risk in your view to rate payers

15 of continuing to rely on below investment grade debt and

16 be a BB, be a double B rated company?

17 A. (Whitehouse) I'm not an expert on how that

18 all plays into the regulatory rate making process.

19 Maybe Mr. McCarthy is.

20 Q. Mr. McCarthy.

21 A. (McCarthy) I would think, Commissioner, that

22 that was one of the key parts of the settlement that as

23 we went forward into the AFOR or if it was the

24 Commission decides that an AFOR isn't appropriate and

25 should be a traditional rate making proceeding, that we

0562

 1 would impute a capital structure that's similar to what

 2 Verizon has today in investment grade, so in that case I

 3 don't think that there would be a harm to customers from

 4 purely a rate making perspective. And I think as

 5 Mr. Whitehouse said, we don't feel that we're inhibited

 6 from going into the market. In fact, we're planning on

 7 entering the market as I said hopefully at the end of

 8 the first quarter to finance this transaction, so we

 9 don't think there will be any harm from that.

10 Q. So you think that provision in the settlement

11 agreement will protect rate payers even though the

12 company, let's say spreads widen, the company could be

13 issuing debt at 400 basis points over investment grade

14 so that increased interest cost would in essence be

15 borne by your shareholders, not by the rate payers?

16 A. (McCarthy) That is our intention with the

17 settlement condition.

18 Q. Mr. Whitehouse, could you turn to page 39 of

19 your testimony, table 4.

20 A. (Whitehouse) Yes, I'm there.

21 Q. I think this is a very important summary of

22 your testimony, is it not?

23 A. (Whitehouse) I certainly agree that it is

24 important.

25 Q. Isn't free cash flow the basis of the

0563

 1 valuation of the company?

 2 A. (Whitehouse) I believe the company's --

 3 Q. Excuse me, aren't investors primarily looking

 4 at your dividend and dividend yield when they purchase

 5 your stock?

 6 A. (Whitehouse) Yes, it is a very important

 7 element of the purchase decision given the yield driven

 8 nature of our typical investor.

 9 Q. And then what supports the dividend, isn't

10 free cash flow, FCF, the basis of almost everything

11 including the dividend?

12 A. (Whitehouse) It absolutely is.

13 Q. Okay. So this chart if I understand it

14 correctly the way -- and I don't want to get into the

15 weeds of the financial model that we were discussing

16 previously. I know it's important, but I'm going to try

17 to keep it at a summary level here. But the -- just so

18 I understand the financial model that you're using, it

19 calls for an increase in free cash flow in 2008 before

20 the transaction to $1.423 Billion after the transaction

21 presynergy.

22 A. (Whitehouse) I believe what that column is

23 meant to be is really more illustrative in that we

24 wanted to give investors some sense for what the pro

25 forma entity would look like. We're not able to share

0564

 1 the proprietary out year projections. What we were able

 2 to give them as a reference point is the audited 2008

 3 number.

 4 Q. Okay.

 5 A. (Whitehouse) So that was meant to be just

 6 really illustrative, but also making it very clear that

 7 some of the key assumptions that would go into the out

 8 years, in particular our need to enhance our capital

 9 expenditures.

10 Q. Sure. But isn't one of your -- one of the

11 key points in your testimony as I understand it is debt

12 is going up in the absolute sense, and you have to issue

13 roughly $3 Billion more in debt, but free cash flow is

14 increasing at a more rapid pace than that increase in

15 debt to finance the transaction.

16 A. (Whitehouse) That is correct.

17 Q. Okay.

18 A. (Whitehouse) That there is on a relative

19 basis it is actually less leverage, correct.

20 Q. So I wanted to understand, and if you can

21 answer this based on what was the exchange with Public

22 Counsel before if you can answer, but I think it's

23 important to understand the assumptions of several

24 things behind this free cash flow estimate that is in

25 your testimony. What is the specific access line loss?

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 1 I think, Mr. McCarthy, you said that you had stanched

 2 the loss in other territories from 11% to maybe 6%, is

 3 it roughly 6%, 7%?

 4 A. (McCarthy) I believe the model,

 5 Commissioner, had the assumptions declining from current

 6 run rates down to at the end of the period 7.9%.

 7 Q. Okay. What are the assumptions that you're

 8 using on broadband connection hands?

 9 A. (Whitehouse) I don't believe we've furnished

10 that in open forum if I'm not mistaken.

11 Q. That's confidential?

12 A. (Whitehouse) I think it is presented in the

13 board of directors materials.

14 Q. And the revenue per subscriber, that's

15 confidential as well?

16 A. (Whitehouse) Yes, anything 2009 onward would

17 be.

18 Q. Okay, I struck out there. Let's go to what

19 are your estimates and what sources do you go to for cut

20 the cord subscribers? Mr. McCarthy, you know this,

21 you've been around the industry a long time, there are a

22 lot of people who are, quote, cutting the cord and just

23 going to a wireless only subscriber, so what estimates

24 did you use for cut the cord in the VSTO states?

25 A. (McCarthy) Well, we consider that part of

0566

 1 the access line losses today are in that category.

 2 Q. Okay.

 3 A. (McCarthy) I mean we certainly see that.

 4 Probably the bigger cut the cord in our personal

 5 experience are people that move into a home and have a

 6 cell phone and decide not to activate a phone, so we see

 7 more of that kind of activity. So as we looked at the

 8 access line losses, we tried to factor in and temper our

 9 ability to reduce it to our current run rate levels

10 which are down in more like the 6% level on a legacy

11 basis, and we kept the line losses up there to reflect

12 those kind of losses.

13 Q. Okay. I think the Pew Center, the most

14 recent estimate I have seen, this is not in the record,

15 but the Pew Center is a reputable organization that

16 follows these trends, is it not?

17 A. (McCarthy) Yes.

18 Q. And the latest number I saw was 18%

19 nationally, something like that.

20 Last question on the free cash flow,

21 Mr. Whitehouse, is I think in your testimony in several

22 areas you say that even without the synergy savings, you

23 had built a, quote, cushion, financial cushion into

24 these estimates, so just to summarize where is the

25 cushion?

0567

 1 A. (Whitehouse) I think the way I think about

 2 it, and maybe we could even use this illustrative

 3 example on page 40, is that -- actually no, I would take

 4 you to page -- there's another table that shows the

 5 actual leverage before and after if you give me a second

 6 to find it. It's on if you turn to page 20 of my

 7 rebuttal testimony, if you -- and again this is looking

 8 at the leverage ratios calculated using the pro forma

 9 actual numbers June 30, 2009, that even without

10 synergies, the actual delevering that takes place goes

11 from 3.9 to 2.6, which is certainly a meaningful

12 reduction, and it's knocking on the door of our target

13 level of 2 1/2. And I recognize this is illustrative

14 and using, you know, numbers looking backwards, you

15 can't apply synergies to something you don't own yet.

16 But I do think it is illustrative to say that by virtue

17 of the recapitalization going on here, the tremendous

18 amount of Frontier shares being used to pay for this

19 asset, that we are almost instantly even without the

20 effect of synergies showing very strongly improved

21 credit metrics, and certainly adding the synergies would

22 be, you know, icing on the cake and further allows us to

23 get to that rating even quicker.

24 Q. And again the basis for this information is

25 you cite here is the SEC filings of the 10-Q's?

0568

 1 A. (Whitehouse) That's correct.

 2 Q. Okay.

 3 A. (Whitehouse) We have been, in addition to

 4 our quarterly reports, the VSTO properties have been

 5 reporting on a quarterly basis, Verizon has been showing

 6 those to the SEC.

 7 Q. Okay. My last series of questions revolves

 8 around the credit, the proposed credit facility to

 9 finance this transaction.

10 A. (Whitehouse) Okay.

11 Q. There are two numbers that I have been --

12 I've been rereading both of your testimonies,

13 Mr. McCarthy and Mr. Whitehouse, and there's a range

14 from 2.9 Billion to 3.3 Billion. Which is the correct

15 number of the aggregate amount of credit facility that

16 you will have to come up with at close?

17 A. (Whitehouse) I can take that one. The way

18 to think about the transaction is there is indeed a $3.3

19 Billion cash payment required to Verizon. Of course to

20 the extent that we assume any of their existing debt,

21 that would be netted off of that. So if you take 3.3

22 less what will likely be $250 Million, that is the

23 actual amount of cash. And then if you add some of the

24 expenses, you know, the underwriting discount associated

25 with raising the capital, it is indeed closer to a 3.1,

0569

 1 3.2 type of number that I would anticipate raising in

 2 advance of the closing of this transaction.

 3 Q. There is very little evidence in the record

 4 even in confidential documents on the syndication of the

 5 facility, who is the lead syndicator, the joint book

 6 runner, you know, the usual stuff that you deal with.

 7 Why is that, and why isn't there more in the record on

 8 this?

 9 A. (Whitehouse) Well, I would be happy to give

10 a little more color on that, and I would probably roll

11 all the way back to our thinking around this transaction

12 and what were the risks that we were looking to mitigate

13 here. And certainly there have been examples of

14 companies that in advance of a transaction will go out

15 and get a bridge loan of some sort. A bridge loan

16 really only provides you certainty that a bank will show

17 up and lend you the money. It doesn't really guaranty

18 at what price that money will come or what covenants it

19 will come. And we've certainly seen precedence of

20 companies who, you know, agreed to close a transaction,

21 did not have an appropriate financing out, they went and

22 got a bridge loan from a bank, and certainly as the

23 markets deteriorated they found themselves actually

24 having to use the bridge loan. I mean that's your worst

25 case scenario, because typically a company doesn't ever

0570

 1 really intend to use the bridge loan. You hope to put

 2 the permanent financing, the long-term financing, in

 3 place in advance of the closing.

 4 Banks used to love to write bridge loans,

 5 because they got paid very big fees, you know, sometimes

 6 2%, 3% of the amount borrowed or advanced, and yet they

 7 never really had to deliver on them. Well, as the

 8 markets softened in 2007 and 8, a lot of banks were

 9 stuck, you know, having companies draw on those bridge

10 loans. But they also found themselves because the loans

11 did not -- that they basically had variable rates and

12 market flex as it's called meaning the banks can

13 basically dictate the terms to you at that time.

14 And, you know, both Frontier and Verizon,

15 given Verizon's shareholders are going to continue to

16 own roughly 70% of this company, did not want to find

17 themselves in a position where all of their conditions

18 had been met to close and we had to rely upon a bridge

19 loan that could cost us, you know, 15%, 14%, and I think

20 that was indeed some of what we saw in New England with

21 the FairPoint transaction, they had a very onerous

22 capital structure thrust upon them.

23 So what Frontier sought to do to care for

24 that was to in fact give ourselves a financing out that

25 said, look, we need a capital structure that makes sense

0571

 1 for this company on a long-term basis, and if we find

 2 ourselves -- and of course we, it was our -- my expert

 3 opinion and the expert opinion of the Verizon treasury

 4 team, that we would be able to source this capital at

 5 less than 9 1/2%, but, you know, God forbid we couldn't,

 6 we all can walk away. We wouldn't be happy about it,

 7 because we would have gone through all of this exercise

 8 and expense for not, but we weren't going to saddle the

 9 company with a capital structure that didn't make sense.

10 And we didn't quite frankly want to shell out, you know,

11 60, $75 Million for that piece of paper from the bank

12 that was really nothing more than a pig in a poke.

13 So what we instead agreed to do was to

14 basically prefund the transaction in one or several

15 stages where we would go into the high yield bond

16 market, we would borrow that money, and that is what I

17 am doing as we speak, and the Verizon team and my team

18 are gearing up preparing documentation to be ready to go

19 into the bond market this quarter and set a very large

20 amount of the capital aside in an escrow account so

21 these banks -- you will -- we will know at that point

22 the exact coupon, the exact terms and conditions, and

23 the escrow would be released upon the closing of the

24 transaction. And that is what we're gearing up, we

25 think that provides the ultimate certainty.

0572

 1 We've had the very high class problem, or not

 2 problem, we've had the really -- have been very grateful

 3 about the performance of the high yield markets, they

 4 have been extremely constructive as we've moved through

 5 2009. Our rates just continue to get lower and lower,

 6 and at this point I'm very comfortable that we're going

 7 to be able to place this debt probably around the same

 8 rate that we did back in September or potentially even

 9 better for some of the shorter. So it isn't a

10 traditional credit facility to a limited number of

11 banks.

12 Q. Now this is new information to me, I was

13 going to ask you what sort of progress you've made since

14 your filing of rebuttal testimony. So just so I

15 understand this, you were in the market or have been in

16 the market for the past couple of months raising money?

17 A. (Whitehouse) I wouldn't say we've been in

18 the market. We have been preparing to go to market.

19 Q. Preparing to go to market.

20 A. (Whitehouse) Of course the FCC will require

21 certain blackout windows to be cleared.

22 Q. Sure.

23 A. (Whitehouse) We believe that there will be a

24 window that opens later in the first quarter when both

25 Frontier's year end results are out, Verizon year end

0573

 1 results which are already out but the VSTO results are

 2 not out yet, when that is all out it provides the

 3 ultimate, the preferred platform to go to investors and

 4 say, look, here's a whole year of audited results for

 5 you to make your decision. And to be honest, these

 6 proceedings play into that as well. The further along

 7 we are with the regulatory process, the more comfort we

 8 can provide to everyone on our ability to get approval

 9 for the deal. It just provides impetus for a better

10 execution of the transaction, because investors just

11 want to know that these boxes have been checked as it

12 relates to the risks associated with the financing.

13 Q. So as I understand this, you -- this isn't

14 going to be a traditional credit facility with a lead

15 bank and a lead syndicator, it sounds like something a

16 little more diverse?

17 A. (Whitehouse) The complete financing package,

18 the permanent drawn financing will be a bond offering.

19 There will be lead book runners named and a syndicate of

20 book runners that will place that.

21 Q. Have you chosen those yet?

22 A. (Whitehouse) We have not named them as of

23 yet.

24 Q. Okay.

25 A. (Whitehouse) It's not that I don't know who

0574

 1 they will be, I believe, you know, at the appropriate

 2 time we will name them.

 3 Q. Sure, I understand.

 4 A. (Whitehouse) But I would like to add

 5 alongside of that facility we will be putting in place a

 6 larger backstop revolving credit facility, which is just

 7 part of our core liquidity. The current $250 Million

 8 facility will -- I would like to increase that to $750

 9 Million. And I will use the underwriting of the bonds

10 as the stick to, you know, provide incentive to those

11 banks to provide commitments to that new facility. And

12 so that is all, you know, work in progress as we sit

13 today.

14 Q. Well, I don't want to inquire if -- given the

15 delicacy of the situation and the competitive reasons

16 for your response.

17 Just a final question, isn't there a

18 substantial difference, Mr. Whitehouse, between a $600

19 Million facility versus a $3 Billion facility?

20 A. (Whitehouse) I certainly would agree, but

21 the point I was trying to make is the, you know, that

22 facility was essentially issued off of our current

23 leverage because there is no certainty that this deal

24 closes. And yet there was extremely strong demand for

25 that, you know, almost, you know, more than 3 times

0575

 1 oversubscribed, almost 4 times. So I was simply trying

 2 to show that there's tremendous demand for the credit,

 3 and I can say that, you know, based on again in my role

 4 as Treasurer and investor relations, I spend a lot of

 5 time speaking to our fixed income investors as well, and

 6 I've noticed a spike in the inquiry from investment

 7 grade investors that now have a piqued interest in this

 8 credit, because clearly they're looking at this as a

 9 potential attractive investment where you buy in and

10 you're going to get initially a high yield coupon, and

11 if the company, when the company achieves its investment

12 grade rating, that piece of paper will appreciate

13 significantly.

14 Q. Sure.

15 A. (Whitehouse) So we're getting a lot of as

16 they say crossover investors showing appetite for this

17 deal.

18 Q. Those are called crossovers?

19 A. (Whitehouse) Yes.

20 Q. People who buy high yield debt with the

21 anticipation that it will cross the barrier into

22 investment grade?

23 A. (Whitehouse) They will dip into high

24 non-investment grade but usually with the anticipation

25 that it will migrate upward.

0576

 1 Q. But are you shopping this facility around as

 2 a junk, excuse me, as a below investment grade issue or

 3 as an investment grade issue?

 4 A. (Whitehouse) The reality is that as a -- as

 5 I spoke to earlier, the reality is that the rating

 6 agencies at upon issuance this will still be likely a

 7 double B rated company.

 8 Q. Okay.

 9 A. (Whitehouse) There's always the potential it

10 could maybe get a one notch up to double B plus, but I

11 do not have any anticipation it will be investment grade

12 out of the gate.

13 COMMISSIONER JONES: Thank you, Judge, that's

14 the end of my questioning.

15 JUDGE CLARK: Is there any other inquiry for

16 either Mr. Whitehouse or Mr. McCarthy?

17

18 E X A M I N A T I O N

19 BY JUDGE CLARK:

20 Q. I just have one clarifying question for you,

21 Mr. Whitehouse, and in your discussion with Commissioner

22 Jones regarding deleveraging you used a term I think it

23 was a full turn or a half turn, just for the clarity of

24 the record can you explain more fully what you mean by

25 those terms.

0577

 1 A. (Whitehouse) Yes. A turn would be if a

 2 company went from say our current leverage of 3.8 times

 3 net debt to EBITDA just for sake of illustration if you

 4 went to 2.8 times, it would -- that would be 1 full turn

 5 of leverage. And that is a significant movement when

 6 generally deleveraging tends to occur in tenths of turns

 7 so, 3/8, 3/6, 3/4, so this is somewhat of a quantum

 8 shift in our capital structure.

 9 JUDGE CLARK: Thank you, I appreciate that.

10 Is there any redirect?

11 MR. SAVILLE: No, Your Honor.

12 JUDGE CLARK: All right, thank you,

13 Mr. Whitehouse, thank you, Mr. McCarthy.

14 I think rather than starting with -- and that

15 concludes the presentation of the joint applicants'

16 cases, right?

17 MR. SAVILLE: That's correct.

18 JUDGE CLARK: All right.

19 MR. ROMANO: Yes, Your Honor.

20 JUDGE CLARK: After my earlier misspeaking,

21 I'm a little nervous here. So we have nothing left

22 except for the presentation of Public Counsel's case; is

23 that correct?

24 MS. SHIFLEY: That's correct, Your Honor.

25 JUDGE CLARK: I'm reticent to start that at

0578

 1 4:45, especially knowing that we have a number of

 2 evidentiary and procedural matters to address this

 3 afternoon, so I suggest that we take a brief recess and

 4 allow the Commissioners to vacate the hearing room while

 5 we discuss exhibits, unless there are some other matters

 6 you would like to bring to the Commissioners' attention.

 7 All right, then we are at recess for about 5 minutes.

 8 (Recess taken.)

 9 JUDGE CLARK: The record should reflect that

10 the Commissioners are not present for this portion of

11 the hearing regarding procedural matters. And as we

12 discussed very briefly on the record with the

13 Commissioners present, the majority of the exhibits that

14 were offered in this proceeding have already been

15 admitted, so maybe we'll start with the exceptions to

16 that. And if you'll bear with me, I know you're going

17 through a less recent version of what I'm looking at

18 because I've been updating it as we've been going

19 through the hearing, but starting on page 1, Exhibit

20 Number 3 has not yet been admitted because that is --

21 we're just reserving that number for Public Counsel so

22 that at the conclusion of the hearing any public

23 comments that are received in this docket will be filed

24 as an exhibit.

25 Exhibits, and I'm on, let's see, where am I,

0579

 1 I believe approximately page 5 under Mr. McCallion, I

 2 have 4 exhibits that were previously designated for

 3 Timothy McCallion TM-20HC through TM-23HC that were

 4 moved to SES-24 through SES-27. SES-5 was withdrawn by

 5 Public Counsel. SES-11, 12, and 13 were withdrawn by

 6 Public Counsel. SES-18 was withdrawn by Public Counsel.

 7 SES-22 was moved to DM-88. And then of course we are in

 8 Mr. Smith's testimony now, so we have the new Exhibits

 9 24HC, 25HC, 26HC, and 27HC that I mentioned earlier

10 being moved from Mr. McCallion. And we have the new

11 Exhibit DM-88 which was moved from Mr. Smith's SES-22.

12 MR. ROMANO: Your Honor.

13 JUDGE CLARK: That's on about page 12.

14 Yes.

15 MR. ROMANO: Sorry to jump backwards, but

16 just to clarify on the TM-24HC and 25HC, those were the

17 new exhibits we had.

18 JUDGE CLARK: Those are already admitted. I

19 already checked on that, had you move their admission,

20 and those were admitted.

21 MR. ROMANO: Okay, thank you, Your Honor.

22 JUDGE CLARK: Sure.

23 And if anybody else has questions as we're

24 going through this, jump in. It's easier to do when

25 we're there than to go back and try to find where we're

0580

 1 supposed to be.

 2 I think that's it, but I just want to skim

 3 through the remainder of the exhibit list and make sure

 4 there's not something else that I've forgotten.

 5 SGH-30 was withdrawn by Public Counsel in

 6 advance of hearing.

 7 TRR-28 and 29 I don't have as yet. That's

 8 one of my -- those are two of my dangling exhibits,

 9 Joint Applicants response to Public Counsel Data Request

10 Numbers 538 and 539, and those were handed out at the

11 onset of our hearing, no, those were distributed over

12 the weekend I believe electronically to everyone. Why

13 don't we deal with those now. Ms. Shifley do you want

14 to move the receipt of TRR-28 and 29?

15 MS. SHIFLEY: Your Honor, I believe I just

16 want to confirm that those two documents are already in

17 the record as WHW-36.

18 JUDGE CLARK: I believe TRR-29 is, but I'm

19 not sure about TRR-28.

20 MS. SHIFLEY: And I believe that, yes, and

21 TRR-28 is in the record as DW -- sorry, Your Honor.

22 JUDGE CLARK: That's all right, take your

23 time.

24 MS. SHIFLEY: Yes, I will go ahead and move

25 for the admission of those two exhibits at this time.

0581

 1 JUDGE CLARK: Is there any objection to the

 2 receipt of TRR-28 or 29?

 3 MR. BEST: Your Honor, not unless we've

 4 already objected to them, and I've lost track of whether

 5 we did or not.

 6 JUDGE CLARK: And I'll tell you what,

 7 Mr. Best, you're keeping track of your own objections,

 8 not me.

 9 All right, so no one else is indicating

10 objection, so TRR-28 and TRR-29 are admitted.

11 Oh, I remember now, there's one more chunk of

12 dangling exhibits I believe. Yes, on approximately page

13 16 in conjunction with Mr. Lafferty, Public Counsel had

14 initially indicated cross-examination exhibits for

15 Mr. Lafferty. However, when we got to the point of

16 actually estimating time, Public Counsel indicated that

17 they did not intend to cross-examine, so I asked if they

18 wanted to withdraw those cross-examination exhibits.

19 Ms. Shifley kind of reserved what Public Counsel would

20 like to do on that particular issue to see if they

21 wanted to use those in conjunction with some other

22 witness. And given the fact that there has been no

23 examination on Joint Applicant witnesses this afternoon,

24 I'm assuming that you want to withdraw these.

25 MS. SHIFLEY: I'm just confirming that now.

0582

 1 JUDGE CLARK: That's what I suspected.

 2 MS. SHIFLEY: We can withdraw those exhibits,

 3 Your Honor.

 4 JUDGE CLARK: All right, so FWL-3 through 5

 5 will be withdrawn by Public Counsel.

 6 And I believe that takes care of all of the

 7 issues regarding exhibits that I had, and I understand

 8 there may also be one the parties wanted to raise.

 9 MR. ROMANO: Your Honor, I will withdraw that

10 issue, just let it lie.

11 JUDGE CLARK: All right, are there any other

12 procedural or evidentiary matters that would aid up the

13 expeditious and efficient conclusion of this case?

14 MS. SHIFLEY: Not at this time, Your Honor.

15 JUDGE CLARK: All right.

16 MR. SAVILLE: No, Your Honor.

17 JUDGE CLARK: All right, if there's nothing

18 further to be heard, we are at recess until 9:30 a.m.

19 tomorrow morning.

20 (Hearing adjourned at 5:05 p.m.)

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22

23

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