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BEFORE THE WASHINGTON STATE

2 UTILITIES AND TRANSPORTATION COMMISSION

3 In the Matter of the Joint )

Application of ) DOCKET NO. UT-090842

4 )

VERIZON COMMUNICATIONS INC. ) Volume VI

5 AND FRONTIER COMMUNICATIONS ) Pages 583 to 684

CORPORATION. )

6 )

For an Order Declining to )

7 Assert Jurisdiction Over, or, )

in the Alternative, Approving )

8 the Indirect Transfer of )

Control of Verizon Northwest )

9 Inc. )

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PORTIONS DESIGNATED CONFIDENTIAL - REMOVED

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A hearing in the above matter was held on

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February 4, 2010 from 9:40 a.m to 12:15 p.m., at 1300

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South Evergreen Park Drive Southwest, Room 206, Olympia,

14

Washington, before Administrative Law Judge PATRICIA

15

CLARK and Chairman JEFFREY D. GOLTZ and Commissioner

16

PATRICK J. OSHIE and Commissioner PHILIP B. JONES.

17

The parties were present as follows:

18

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24 Joan E. Kinn, CCR, RPR

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0584

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

2 JUDGE CLARK: Good morning it's approximately

3 9:40 a.m., February 4th, 2010, in the Commission's

4 hearing room in Olympia, Washington. This is the time

5 and the place set for continuation of the hearing in

6 Docket UT-090842. The record should reflect that

7 Commissioner Philip Jones, Commissioner Patrick Oshie,

8 and chairman Jeffrey Goltz are present for this

9 morning's proceeding.

10 Immediately before going on the record, I was

11 advised by Verizon's counsel that his inquiry of two

12 witnesses this morning, Mr. Stephen Hill and Dr. Trevor

13 Roycroft on behalf of Public Counsel, will involve

14 highly confidential information. Therefore the

15 Commission will conduct this portion of the proceeding

16 in camera. Any individuals who have not signed a

17 confidential agreement will need to exit the hearing

18 room. I'm going to make my own initial assessment of

19 that, but Verizon is the producer of the highly

20 confidential information, and so I will be asking

21 Mr. Ruggiero and Mr. Romano to confirm that no one is

22 present in the hearing room who has not signed that

23 agreement.

24 A separate transcript will be made of this

25 particular portion of the proceeding. Commissioners and

0589

1 all other parties who might have inquiry regarding the

2 highly confidential information should conduct that

3 inquiry during the in camera proceeding. In order to

4 remain in compliance with Washington's open meetings law

5 and public records acts, as soon as the inquiry

6 regarding the highly confidential material has been

7 concluded, we will conclude the in camera portion of the

8 proceeding and reopen the hearing room to those

9 individuals who have not signed those agreements.

10 So we're going to take a few moments off

11 record to allow individuals who have not signed highly

12 confidential agreements to exit the hearing room, and

13 then when we go back on record in the in camera

14 proceeding, I will be asking for verification from

15 counsel.

16 All right, we're off record for a few

17 minutes.

18 (Discussion off the record.)

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25 (CONFIDENTIAL SESSION CONCLUDED)

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

2 JUDGE CLARK: Ms. Shifley, would you call

3 your next witness, please.

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

5 to now call Ms. Barbara Alexander.

6 JUDGE CLARK: Thank you. Ms. Alexander is

7 appearing telephonically, therefore it's important for

8 everyone to speak perhaps a little more loudly and

9 slowly than you would ordinarily speak, and make sure

10 you don't overspeak Ms. Alexander.

11 Ms. Alexander, this is Patricia Clark, the

12 Administrative Law Judge assigned to the case, and I

13 just want to remind you you've previously submitted

14 testimony in this proceeding and you remain under oath.

15 THE WITNESS: Yes.

16 JUDGE CLARK: Thank you.

17 Ms. Shifley.

18 MS. SHIFLEY: Thank you.

19

20 Whereupon,

21 BARBARA R. ALEXANDER,

22 having been previously duly sworn, was called as a

23 witness herein and was examined and testified as

24 follows:

25

0618

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

2 BY MS. SHIFLEY:

3 Q. Ms. Alexander, did you previously file

4 testimony in this case which has been marked Exhibit

5 BRA-1CT?

6 A. Yes.

7 Q. And at this time do you have any additions,

8 corrections, or deletions to that testimony?

9 A. No, I don't, but I just want to make sure

10 that the document you have in front of you and that I

11 have in front of me is the one labeled revised December

12 2nd, 2009.

13 Q. Yes, I believe that that's been filed.

14 JUDGE CLARK: All right, I'm going to see if

15 there's any cross-examination for this witness. I'll

16 start with you, Mr. Ruggiero.

17 MR. RUGGIERO: Verizon has no questions for

18 this witness.

19 JUDGE CLARK: Thank you.

20 Frontier.

21 MR. SAVILLE: Frontier has no questions, Your

22 Honor.

23 JUDGE CLARK: Mr. Thompson.

24 MR. THOMPSON: No questions.

25 JUDGE CLARK: Thank you.

0619

1 Commissioner Jones.

2 COMMISSIONER JONES: No questions.

3 JUDGE CLARK: Commissioner Oshie.

4 COMMISSIONER OSHIE: No questions.

5 JUDGE CLARK: Chairman Goltz.

6 CHAIRMAN GOLTZ: I have one question to make

7 your wait worthwhile at least, Ms. Alexander. Thank you

8 for appearing.

9

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

11 BY CHAIRMAN GOLTZ:

12 Q. In your testimony, both written and what

13 we've heard before, there's a -- I believe you're

14 comparing the situation today with what you would

15 envision the situation to be should the transaction be

16 approved. My question really is to ask you to compare

17 if we accept the recommendation of Public Counsel and

18 not approve the transaction, compare the situation

19 between the hypothetical approval of the transaction and

20 a hypothetical disapproval. In other words, what I'm

21 asking for is if Verizon continues to be the service

22 provider, do you think there will be some deterioration

23 of service quality due to the fact in part that they

24 would be an unwilling service provider?

25 A. I understand your question. I'm not sure

0620

1 that I have an answer for you since I haven't evaluated

2 this transaction from that perspective. I will say that

3 the Staff at your Commission has been quite vigilant in

4 monitoring Verizon's service quality, and at least on

5 two occasions in the last four years has brought

6 specific investigations and report requirements forward

7 to address what they view correctly I believe to be less

8 than appropriate or reasonable performance. So your

9 current situation is one in which you have --

10 CHAIRMAN GOLTZ: Can you repeat that,

11 Ms. Alexander?

12 JUDGE CLARK: Ms. Alexander, I'm sorry, you

13 cut out, so if you could start at the beginning of your

14 answer, I mean that last paragraph again.

15 Ms. Alexander.

16 THE WITNESS: I'm not sure where you want me

17 to start.

18 A. The last point I was making is that while I

19 might have some suggestions for improving the standards

20 that you have, the fact remains you have standards that

21 address most of all the key issues, and you have the

22 reporting requirements in place to monitor that so that

23 you are certainly in no worse situation as the

24 regulatory agency. And if there was any significant

25 deterioration, I think you have the tools to respond to

0621

1 that.

2 BY CHAIRMAN GOLTZ:

3 Q. Would you agree that, I guess for lack of a

4 better term, that willingness of the service provider is

5 a factor that we should consider?

6 A. I would hesitate to say yes to your question

7 because it almost makes it appear as if the regulatory

8 process and the obligations that flow from Verizon's

9 obligations under its certificate of convenience and

10 necessity to network as a public utility is somehow

11 solely up to their discretion, and I guess I'm not sure

12 I would agree with the implications of that question.

13 CHAIRMAN GOLTZ: Okay, that's all I have,

14 thank you.

15 JUDGE CLARK: Is there redirect, Ms. Shifley?

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

17 JUDGE CLARK: All right, thank you,

18 Ms. Alexander, that concludes the examination we have

19 for you in this proceeding. While you're certainly

20 welcome to stay on the line, you're not obligated to do

21 so.

22 THE WITNESS: Thank you very much. Just so

23 you know, I think I will hang up. My client there can

24 give me a ring if they think I need to get back on for

25 any purpose.

0622

1 JUDGE CLARK: Thank you.

2 THE WITNESS: Okay.

3 JUDGE CLARK: Ms. Shifley, would you call

4 your next witness, please.

5 MS. SHIFLEY: I'd like to now call

6 Mr. Stephen Hill.

7 JUDGE CLARK: Thank you.

8 And of course, Mr. Hill, we've seen you

9 before, and we know that you're going to continue to

10 testify under oath.

11 THE WITNESS: Yes, ma'am.

12 JUDGE CLARK: Ms. Shifley.

13 MS. SHIFLEY: Thank you.

14

15 Whereupon,

16 STEPHEN G. HILL,

17 having been previously duly sworn, was called as a

18 witness herein and was examined and testified as

19 follows:

20

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

22 BY MS. SHIFLEY:

23 Q. Good morning, Mr. Hill.

24 A. Good morning.

25 Q. Have you previously filed direct testimony in

0623

1 this case?

2 A. I have.

3 Q. And at this time do you have any additions,

4 corrections, or deletions to the non-confidential or

5 non-highly confidential portions of that testimony?

6 A. I do. There's about 5 or 6 typographical

7 errors.

8 On page 12, line 11, first initials should be

9 HSI, not HIS.

10 Page 17, line 10, after the word debt insert

11 the two words, the transaction, so that it reads, the

12 transaction still involves.

13 CHAIRMAN GOLTZ: I'm sorry.

14 A. Page 17, line 10, after the word debt in the

15 middle of the line, insert the words, the transaction.

16 Page 26, line 19, strike the word revenues.

17 And I've just realized after I told you that

18 I wasn't going to change anything highly confidential

19 that my last change may be exactly that, but I think we

20 can do that without divulging anything secret.

21 JUDGE CLARK: We will do that without

22 divulging anything secret.

23 A. It will be pretty easy. On page 36 on line

24 6, there are 2 numbers on that line, and I'm just

25 talking about the second number, and the last digit in

0624

1 that second number should be an 8, not what it is.

2 JUDGE CLARK: Good job.

3 A. I think that was a result of dirty reading

4 glasses or something, I don't know.

5 Anyway that's all I have.

6 MS. SHIFLEY: Thank you, Mr. Hill.

7 JUDGE CLARK: All right, Ms. Shifley has

8 tendered the witness for cross-examination.

9 Mr. Ruggiero.

10 MR. RUGGIERO: Verizon has no questions for

11 this witness.

12 JUDGE CLARK: And Mr. Saville.

13 MR. SAVILLE: Nothing from Frontier.

14 JUDGE CLARK: Thank you.

15 Mr. Thompson.

16 MR. THOMPSON: Nothing from Staff.

17 JUDGE CLARK: Commissioner Jones.

18 I'm sorry, Chairman Goltz.

19 CHAIRMAN GOLTZ: Commissioner Jones wants to

20 bat cleanup on this one.

21

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

23 BY CHAIRMAN GOLTZ:

24 Q. Mr. Hill, I have a few questions, and let me

25 refer you first to your testimony, so that's SGH-1 at

0625

1 page 3, which is basically just a summary of your -- of

2 your position. And that's -- I'm looking at this at a

3 rather high level, so the summary should be sufficient.

4 Starting on line 20, you basically list some reasons

5 why, in summary fashion, why you believe we should deny

6 the application.

7 A. Yes.

8 Q. And basically saying that it's grounded on

9 optimistic forecasts with untested revenue and expense

10 allocations. And so I -- just sort of the same question

11 or type of approach that I took with Ms. Alexander, if

12 we accept your recommendation and deny this application

13 so Verizon remains the service provider, aren't some of

14 those same issues going to be present in 2011, 2012 with

15 Verizon as they would be with Frontier?

16 A. I don't, well, if you mean line losses and

17 dwindling revenues for the ILEC operations, I would say

18 yes. But the fundamental difference is that Verizon is

19 a company, and I have one of my schedules, I think it's

20 probably Schedule 6, shows what Verizon's financial

21 metrics are, and they're very positive. They're going

22 in the opposite direction of Frontier's, they're going

23 up. And simply put, Verizon's making a ton of dough on

24 their wireless business, and they have the financial

25 capacity to support this business in Washington, the

0626

1 local exchange business in Washington. Yes, they say

2 they want to get out of it, but they have the financial

3 capability to do that, and we don't know that's the case

4 with Frontier. So what you have, the difference is a

5 company that's willing to do the work they say but I

6 believe hasn't really supported their projections so

7 that we can analyze them and see if they are real and

8 you're looking at a potential financial problem in the

9 future or a company that says they don't want the

10 operations but has the money to do it. I think you're

11 better off with the latter situation.

12 Q. So but is the implication then that the --

13 that Verizon to make good on -- for Verizon to actually

14 undertake the efforts you think are necessary, they

15 would have to in effect subsidize the regulated

16 operations with their unregulated revenues?

17 A. Well, no. The regulated operations are --

18 they're, you know, just as Frontier says, they're

19 throwing off a lot of cash. I think that that money can

20 be directed instead of going, as it has for many years,

21 instead of going upstairs and actually supporting the

22 unregulated operations, they could be, you know, with

23 some oversight by the Commission can be used to fund

24 construction projects in this jurisdiction. So I think

25 just the other way around, I think that these operations

0627

1 over the years have gone to fund Verizon's unregulated

2 operations. And I don't think we'd be asking

3 unregulated operations to subsidize the regulated, just

4 use the regulated cash flows to do the job of building

5 the network that needs to be there.

6 Q. So you're not saying that the fact -- I

7 thought what you were saying earlier at the outset of

8 this was that the fact that Verizon has this broader

9 revenue source was the reason for keeping them in the

10 position of provider.

11 A. I'm sorry if I gave that impression. What

12 I'm saying is their broader revenue source gives them a

13 financial basis, a strong financial basis. It's an A

14 rated company, and there are not many out there, we've

15 heard that already from Frontier. So it has the

16 financial wherewithal to do what's necessary to build

17 the network that needs to be built in Washington, and

18 we're not frankly sure that Frontier can do that.

19 We've, you know, I've expressed my concerns about their

20 presentation to you, and I don't believe they've

21 responded to those detailed concerns.

22 Q. So the up side of Verizon remaining the

23 service provider is that they have this broader company

24 that includes wireless. The down side is that they have

25 this broader company that includes wireless, and that

0628

1 diverts their attention?

2 A. I can't disagree with that characterization.

3 Q. Yeah.

4 A. I think you're right.

5 Q. It cuts both ways?

6 A. It cuts both ways.

7 Q. And the flip of that is that the down side

8 for Frontier is that they don't have this broader

9 company that helps them access capital, but the up side

10 is they've got a focus on what they do?

11 A. Right, but I think the question, I don't

12 disagree with that either, but I think the question is,

13 is this business model going to be sustainable? I mean

14 as I said yesterday, their line losses are increasing,

15 and I mean according to their theory they push DSL out

16 into the boonies, and everybody signs up, and we keep

17 people on land lines, and that's how we -- that's our

18 business model. Well, if that were working, then they

19 wouldn't be -- their line losses wouldn't be increasing,

20 they would be stabilizing, and they're not. So unless

21 they're able to keep making deals like this, I'm not

22 sure how Frontier makes this a stable situation over the

23 long haul. Maybe they, you know, with all the

24 additional cash flow from Verizon if you allow this to

25 go through, maybe they can be sufficient to 2014, like

0629

1 their projections only go to 2014, but I'm not convinced

2 that it's a stable model.

3 Q. But the stability of that model is not

4 something that's unique to Frontier, it's just something

5 unique to the land line business as a whole, isn't it?

6 A. I think so, and that's one reason that

7 Verizon having the financial wherewithal to deal with

8 that would be I think a better option.

9 Q. In either case, the land line business is

10 going to be subject to increasing competition from new

11 technology?

12 A. That's correct. And it may not be cell

13 phones. Who knows what it could be in five years. I

14 think -- you would think that at some point there would

15 be a core of land line users that, you know, would not

16 go below that. I mean I prefer that to a cell phone, I

17 can hear better on a land line. But everybody I've

18 talked to in doing my own personal research on this

19 issue is my age. You know, everybody's 60 years old

20 that likes land lines. If you're 30 years old, you

21 don't have one, and maybe probably never did. So maybe

22 it's a thing that's going to go the way of the buffalo,

23 you know. I don't know that, but it would seem

24 logically that there's a core of people that would not

25 switch away from land lines. I think it's a better

0630

1 product, but conveniencewise it doesn't work as well as

2 cell phones.

3 Q. Let me ask you a little bit about your

4 suggestion that you think that a condition of the

5 approval we would -- and I believe the Washington number

6 would be a $72.4 Million investment by Verizon into the

7 network; is that correct?

8 A. Correct.

9 Q. And now you heard yesterday I believe

10 Mr. McCarthy state that although they didn't have a

11 precise budget, they had a plan to spend $55 Million to

12 $60 Million in the first full year on capital

13 expenditures; do you recall that?

14 A. That's what he said. I have some concerns

15 about that, but yes.

16 Q. Okay. So is this $72.4 Million intended to

17 be what is necessary to upgrade or maintain the network,

18 or is it meant to be kind of a payment because Verizon

19 got the better deal on this transaction?

20 A. It's the latter.

21 Q. It's the latter?

22 A. Yes.

23 Q. So the $55 Million to $60 Million that

24 Mr. McCarthy talked about, that's not analogous to the

25 72.4?

0631

1 A. No, sir, it's -- Mr. McCarthy's figure was

2 based on 12% times his projected nationwide revenues and

3 then allocated to Washington, so it's simply a

4 projection based on the financial model that we already

5 have, and there's no real plans backing it up. He's

6 just saying that, you know, we're spending money and

7 this is the amount that would be, you know, rationed to

8 Washington. The $72 Million is, as you describe it, as

9 I believe that Verizon has the upper hand here, it's

10 likely that the price is too high simply, and I think

11 that it would help Frontier financially if they had some

12 help from Verizon in paying for their construction that

13 they need to do.

14 Q. So let's assume again that we accept your

15 recommendation and not approve the transaction. How

16 would you suggest the Commission then ensure that

17 Verizon makes sufficient capital expenditures to keep

18 its land line network up to speed?

19 A. I think you have to look at service quality

20 issues, and I think you have to work with Verizon about

21 the condition of their financial -- I mean their

22 switching network. And, you know, I'm not an engineer,

23 telephone engineer, so I can't give a detailed answer

24 about that, but I think you have to look at the

25 facilities that are out there, where you would like to

0632

1 be, and my understanding is Washington is at (number

2 stricken) of availability. That's where I mentioned,

3 you know, when they say (number stricken) availability,

4 you realize that (number stricken) of the people don't

5 subscribe. A much smaller percent actually subscribe.

6 But they're now at (number stricken) availability, you

7 know, which compared to the rest of the nation is not

8 too shabby.

9 Q. Yesterday, and I forget which witness I asked

10 this of, but I asked about the provision whereby if

11 there's a regulatory condition that imposes costs on

12 Verizon that there would be that risk of that cost gets

13 transferred through a mechanism to Frontier.

14 A. Right.

15 Q. And I was -- you referred that to a

16 regulatory clawback provision.

17 A. That's what I called it, yes.

18 Q. And I don't know if that's the right word for

19 that or not. If in the briefs the companies have a

20 better description, that would be a good one to learn

21 about. But have you seen that provision in other sale

22 agreements in your experience?

23 A. I haven't seen it personally. My

24 understanding, and this is secondhand understanding of

25 the FairPoint deal, there was some regulatory clawback

0633

1 in FairPoint, and Verizon had to pony up some money in

2 that transaction. Again, it's not -- that's not based

3 on my personal inspection of the agreement.

4 Q. So when I asked the witness yesterday if this

5 concern about that provision was raised in either

6 proceeding, they mentioned West Virginia, so, and can I

7 assume that you raised the issue there?

8 A. Yes, I did.

9 Q. And what was the nature of the concern there,

10 was it just basically similar, Verizon didn't -- or got

11 too much money?

12 A. Yes, sir, it's the same, it's the same

13 rationale in West Virginia.

14 Q. Okay. And so if we were to accept your

15 recommendation and require as a condition a payment by

16 Verizon in some way at the $72.4 Million or some other

17 figure, that would trigger the regulatory clawback

18 provision as you termed it, and then under the agreement

19 as it stands that in effect would transfer the burden of

20 that to Frontier?

21 A. That's correct.

22 Q. So in order to get around that, you would

23 also have to, as a condition of the agreement, have that

24 provision deleted?

25 A. Well, I don't know, I'm not an attorney, I

0634

1 can't advise you about what would work and wouldn't

2 work. But it would seem to me that a codicil could be

3 arranged so that this particular amount of money could

4 be treated as something other than, I forget what the

5 magic language is, it has a definition which I have in

6 my testimony, but it has to be called not that. Just a

7 second, I'll find out what it is. It has to be declared

8 to be required payment amount. It can't -- that $72

9 Million if you ordered it, they would also have to agree

10 to declare that that amount of money is not a required

11 payment amount under the terms of the merger. In other

12 words, it's out from under that definition. And to me,

13 that seems doable. Maybe the companies would say that

14 it was not doable, but.

15 Q. So you're suggesting -- where in your

16 testimony do you suggest this, if you recall?

17 A. Well, the required payment amount, the

18 definitions are on page 5. My suggestion about the

19 Verizon payment is toward the back of my testimony.

20 It's probably in the highly confidential section.

21 Q. Okay. Well, I will look at that, but you're

22 suggesting that it may be possible to require a payment

23 without triggering the required payment amount

24 provision?

25 A. These lawyers are pretty smart, I think they

0635

1 can probably figure that out.

2 Q. I'm worried about me here, so.

3 So I also asked Mr. Weinman yesterday about

4 this provision and asked him if there was -- if that

5 provision had not been in this agreement, if there had

6 been any other conditions that Commission Staff may have

7 suggested, and he said no as I recall. And the reason

8 for that was with all the concern that you have

9 expressed about the ultimate financial ability of

10 Frontier post transaction, that if we were to impose, if

11 any commission were to impose conditions on the

12 transaction that would lead to more costs by Verizon

13 with the provisions shifting then to Frontier, that

14 would just contribute potentially to any fragility there

15 is in Frontier's ability to perform.

16 A. Exactly.

17 Q. So I guess my question is if in your -- my

18 question to Mr. Weinman was if this provision sort of

19 effectively infringed upon the Commission's or Staff's

20 ability to appropriately evaluate this sort of

21 transaction, and I wondered if you had any opinion on

22 that?

23 A. When you say this provision, you mean this --

24 Q. The clawback provision.

25 A. Yes, I think it's structured in order to

0636

1 prevent regulators from having Verizon contribute to the

2 financial wellbeing, if you will, of Frontier or lower

3 the price or however you want to put it, but I think

4 they did that in order to, you know, put a stop on

5 regulators doing that very thing. I think that's why

6 the codicil was in there.

7 CHAIRMAN GOLTZ: I have no further questions,

8 thank you.

9 THE WITNESS: Yes, sir.

10 JUDGE CLARK: Commissioner Oshie.

11 MR. RUGGIERO: Your Honor, if I might

12 interrupt briefly.

13 JUDGE CLARK: Yes, you may, Mr. Ruggiero.

14 MR. RUGGIERO: A few minutes ago, I'm sure

15 inadvertently, Mr. Hill referenced a highly confidential

16 broadband availability number, so we would just ask that

17 that portion be marked in the transcript.

18 JUDGE CLARK: All right, I'm going to ask

19 that that portion of the transcript be marked and

20 stricken, and I will personally work with the court

21 reporter to ensure that the appropriate portion of the

22 transcript is excised since I'm sure she has no idea

23 where it is.

24 And, Mr. Hill, I just do want to remind you

25 that page 4 of the settlement agreement, which is where

0637

1 this number came from, is a highly confidential

2 document.

3 THE WITNESS: Yes, ma'am, my apologies.

4 JUDGE CLARK: And now, Commissioner Oshie.

5 COMMISSIONER OSHIE: Thank you. It's good to

6 be reminded, because I was going to ask Mr. Hill about

7 that subject matter.

8

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

10 BY COMMISSIONER OSHIE:

11 Q. Well, I want to make sure that I understood

12 your testimony correctly, because it -- I believe you

13 stated that Verizon's, not their take rate but the

14 availability of broadband, was probably greater than

15 what was available to customers as a general rule

16 throughout the United States. Did I understand that

17 correctly?

18 A. Yes, sir.

19 Q. Yeah.

20 A. In Washington you mean?

21 Q. In Washington, correct.

22 A. Yes, sir.

23 Q. And as someone with your expertise in

24 economics and financial matters, you can answer yes or

25 no to this, but, you know, it's always been my

0638

1 understanding that the availability issue is greater in

2 rural areas or it is -- availability is probably

3 significantly less in rural areas than it is in more

4 densely populated areas.

5 A. Yes.

6 Q. Yes or no?

7 A. Yes, the cost to serve sparsely populated

8 areas is higher per customer.

9 Q. And I've always assumed that, you know, when

10 private capital looks at the return, in other words it

11 looks at the cost of investing in building out broadband

12 and then looks at the take rate, the projected take rate

13 in rural areas, there is a decision made that could go

14 one of a couple of ways, but in other words if I have a

15 dollar to invest, I'm going to invest it where I have

16 the possibility of the greatest return; is that correct?

17 A. That's correct.

18 Q. And I think that's just a fundamental, you

19 know, premise of capitalism entirely consistent with

20 your opinion as well that, you know, the company's going

21 to try to get as much money as they can out of a sale.

22 A. Right.

23 Q. I think that's exactly right.

24 A. Right.

25 Q. And so the issue with broadband then is to

0639

1 invest in rural areas is expensive, more expensive I

2 would venture than investing in the more densely

3 populated areas, and the return is not sufficient for

4 private capital to go in on its own.

5 A. And your question is what?

6 Q. Is that true, do you believe that to be true?

7 A. Well, it's -- I would say yes and no. I mean

8 we have a same situation with electric utilities. I

9 mean it's much more expensive to get electricity out

10 where I live in the country than it is downtown, but we

11 require electric utilities to serve those people. Now

12 the problem with telephones is that we have elected to

13 deregulate those services.

14 Q. I would agree.

15 A. That's a problem.

16 Q. And the difference between electric service

17 and particularly with broadband is that as a general

18 rule commissions, unless it's a municipal or other

19 publicly owned electric utility, that their broadband is

20 not regulated by public service or public utility

21 commissions.

22 A. That's correct in this country. In other

23 countries it is, and you'll find that they have very

24 high penetration of high speed Internet and very fast

25 rates as well.

0640

1 Q. Well, let's -- so let's get to one of the

2 provisions here in this settlement, and that is to

3 require, at least the settlement Staff requires that the

4 company invest $40 Million in broadband development over

5 a period of time in the areas that are now underserved.

6 And I know that you really -- maybe you can opine, at

7 least you can offer your opinion, would the company do

8 this if it wouldn't be required by some regulatory fiat

9 in your opinion?

10 A. I don't think I can answer that. I don't

11 know what the parameters of the Washington network are

12 like. And until you -- someone looks at that, I'm not

13 sure how you can put a dollar value on that. But your

14 question is more rhetorical, would they do it.

15 Q. Would they do it?

16 A. Without your say so. I have to go back to

17 your capitalism answer. If they can make money on it,

18 they will.

19 Q. Well, and I guess if we looked at history, I

20 mean the fact is it hasn't been done yet; is that

21 correct?

22 A. That's correct.

23 Q. So obviously the company either had a better

24 place to invest its money or decided that it wasn't

25 going to invest there?

0641

1 A. Well, that's -- you may be correct. I think

2 the question then becomes is this a utility that you

3 want delivered to the public, and then you're looking at

4 re-regulation, and that's a different kettle of fish.

5 Q. Well, and I think let's bring it around to

6 what is really pertinent or germane to this matter.

7 Your testimony is really focused on the financial

8 strength of the merged companies of Verizon and

9 Frontier, is it not?

10 A. That's certainly part of it. The rest is

11 looking at their financial projections and the

12 allocation process that went into this deal.

13 Q. And so although the amount of money in

14 question with broadband development is, in terms of the

15 actual sale price, is not large, but the $40 Million

16 that's in the settlement, I mean wouldn't that in fact

17 at least from your opinion based on your testimony erode

18 the company's financial already, in your projections,

19 already weak financial condition?

20 A. No, I don't think so. I think that building

21 out broadband is part of their story. That's what they

22 say that they're going to do. The $72 Million is an

23 estimate of what Verizon thinks it would need to build

24 out broadband, what its engineers think. And that's --

25 and ratioed down to the access lines in Washington,

0642

1 that's what we come up with. The $40 Million that's in

2 the settlement is, frankly I'm not sure what the basis

3 of that is, but that is an amount of money that in order

4 for this deal to go through the Staff requires them to

5 spend on broadband, you know, which is not a bad thing.

6 There's nothing wrong with that.

7 Q. Well, there isn't anything wrong with it

8 other than the fact that if left up to private capital,

9 it probably wouldn't invest there because the return

10 wouldn't be sufficient to attract that investment?

11 A. Well, but that's not Frontier's story.

12 Frontier's story is if we get DSL out into the

13 hinterlands, these people who formerly weren't on line

14 and didn't have access to that, their model is to push

15 it out there so they can give them, you know, the keys

16 to the city sort of.

17 Q. Well --

18 A. And then they will be -- they will sign on,

19 and that will be profitable for them. That's their

20 story.

21 Q. And I understand that, Mr. Hill. I'm asking

22 you for your story, I mean whether you think that --

23 because if you -- I haven't done any calculations, but I

24 would venture in a number of states there's been a

25 required contribution to the development for broadband

0643

1 investment, and I don't know what the total number is,

2 but let's just say that it's, you know, well, I don't

3 know. Do you know?

4 A. No, I don't.

5 Q. And is there a point in which the amount of

6 money that's required to invest in broadband at least in

7 your opinion further financially weakens the company?

8 A. Well, at some point if they were required to

9 spend moneys such that they would push broadband out to

10 100% of telephone customers, I think that would probably

11 -- the answer would be yes. At some point, yes, it's

12 going to affect their financials. There's no question

13 about it. The difficulty for me is the financials are

14 locked down and you can't get at them to see what, you

15 know, this sort of thing would make a difference.

16 COMMISSIONER OSHIE: I don't have any other

17 questions, Mr. Hill, but thank you.

18 THE WITNESS: Yes, sir.

19 JUDGE CLARK: Commissioner Jones.

20 COMMISSIONER JONES: Thank you, Judge.

21

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

23 BY COMMISSIONER JONES:

24 Q. I'm tempted to jump into this discussion that

25 Commissioner Oshie started, because it's a very

0644

1 important discussion.

2 A. Yes, sir.

3 Q. Involving a lot of policy related issues, but

4 I think I'm going to defer from that for the time being

5 and just ask you a few questions largely related to what

6 you heard yesterday in response to some of my questions

7 from the Bench.

8 A. Yes, sir.

9 Q. Some of the witnesses. I think you were

10 here, were you not?

11 A. Yes, I was.

12 Q. So let's start with maybe you can refer to

13 page 20 of your testimony. I'm going to start on the

14 earnings per share issue and free cash flow.

15 A. I'm there.

16 Q. You heard Mr. Whitehouse yesterday and read

17 his testimony on why he disagrees with you. Your

18 analysis focuses on earnings, does it not?

19 A. Yes, sir.

20 Q. Instead of free cash flow. So why is

21 earnings per share more important in your view than

22 looking at the free cash flow number that Mr. Whitehouse

23 provided in his rebuttal?

24 A. I think that earnings per share is a

25 universally accepted indication of how profitable a

0645

1 company is. It's more widely used than free cash flow

2 measures. And in this situation where the company is

3 paying out a dollar dividend and is earning 40 cents,

4 you're going to, over time, you're going to eat away

5 your equity capital. They're down to in 2009, in June

6 2009, they were down to 8%, 8%, single digits. And at

7 this rate if they don't get the deal done, if you reject

8 the transaction, Frontier is going to be I think in

9 trouble. They're going to be in a situation where they

10 have negative equity capital, and that's going to

11 continue as long as they continue to pay out a dollar

12 dividend and earn less than that. They right now have

13 the highest dividend in the Fortune 1,000 companies,

14 13.7%. And that indicates to me it's a risky company if

15 people need to be incented to invest in this company by

16 a 13% dividend.

17 Q. Right.

18 A. So I'm going beyond your question, I

19 apologize.

20 Q. Mr. Hill, just to clarify for the record,

21 that dividend yield is based on a share price today of

22 about $7.70 and the $1 per share dividend?

23 A. Correct.

24 Q. But the structure of this transaction is to

25 reduce the dividend.

0646

1 A. Right.

2 Q. As you know.

3 A. Right, but they will also --

4 Q. To 75 cents.

5 A. Right.

6 Q. And based on Mr. Whitehouse's testimony and

7 what he said yesterday is he is -- he calls it

8 delevering the company even though they're increasing

9 debt in the aggregate sense by $3 Billion, because of

10 the equity of $5.2 Billion, the post transaction company

11 is going to have a different capital structure, correct?

12 A. Well, sir, that's what he said. His

13 definition of capital structure is different than the

14 one that I have. His definition of capital structure is

15 debt to EBITDA or EBITDA to debt, whichever one you want

16 to use. It's a cash flow measure of capital structure.

17 My measure of capital structure is looking at the

18 liability side of the balance sheet, it's the capital

19 that actually finances the business, and I have a

20 problem with the capital structure that falls out of the

21 allocation process. I discuss this in my testimony.

22 Q. Right.

23 A. All right.

24 Q. And I was going to get to that, but let's

25 stay on this, I just want to wrap up this earnings per

0647

1 share versus cash flow analysis.

2 A. Yes, sir.

3 Q. So as I understand your concern, it is even

4 with the reduction in the dividend and the

5 recapitalization of this company, your concern is that

6 the company will not be able to meet its obligations on

7 operating expenses and capital expenditures, or is it

8 more that you fear share, you know, after transaction

9 closes, more shares are sold, equity, and the company is

10 forced to issue more shares, and therefore by

11 mathematical definition earnings per share, obviously if

12 you keep earnings constant, increase the number of

13 shares, EPS goes down further?

14 A. Right, that is a concern that even when they

15 drop the dividend to 75 cents, they are going to add 750

16 million more shares, so that's another 75 times 750 is

17 what, 500 something million dollars.

18 Q. Right.

19 A. In additional dividends they've got to pay.

20 And another thing that I think has not been

21 talked about in Frontier's finances is they have to buy

22 back stock every year. Because as their revenues

23 dwindle, then they have to trim their dividend

24 requirements in order for them to have cash flow, enough

25 cash to be able to invest in, you know, operating

0648

1 equipment.

2 Q. All right.

3 A. So that's another factor that's not talked

4 about very much, but that's a requirement that their

5 cash flow has to meet as well. So when they talk about

6 free cash flow, they're not really considering having to

7 buy back common equity to reduce their dividends as they

8 go into the future.

9 Q. I understand.

10 Next line of questioning is on this special,

11 what you -- I think it's on page -- the part of your

12 testimony where you take issue with the, quote, carving

13 out of Verizon's various operations.

14 A. Yes, sir.

15 Q. I think it's on page 24, 25, actually 25.

16 The point you make there is SpinCo really doesn't exist,

17 and therefore the assumptions that Verizon used to carve

18 out, quote, carve out these assets are either

19 unrealistic, optimistic, or they haven't been checked by

20 an independent third party. Now do you have any

21 responses to Mr. Smith's testimony yesterday where he

22 somewhat zealously I think and perhaps appropriately

23 defended the use of I think he referred to GAAP, to

24 Sarbanes-Oxley, to, you know, presentations to the

25 board.

0649

1 A. Yes.

2 Q. Use of an accountant. Do you -- what's your

3 response to that?

4 A. Well, sir, this is all information that we've

5 had before. The accountants as I -- in the quote I have

6 on page 26 indicate that they haven't vetted the

7 allocation process. He said that's the business of

8 management. We even have the data request or data

9 response in the record said it's not the business of

10 auditors to sign off on allocation methodologies. The

11 financial advisors say, we didn't look at this, this is

12 the management's responsibility. And Frontier didn't

13 look at it. And my position is Frontier needs this

14 deal, you know, we've reached a horse trade, okay, let's

15 go ahead. You know, all they have to, you know, I'm not

16 wedded to this position, all I want them to show me is

17 somebody says, Dear Verizon, I looked at your allocation

18 and I think it's okay, signed Arthur Andersen or

19 something. That's all I want. That we haven't seen.

20 Q. Do you have any assurance that or any

21 information in the record for example on the separations

22 freeze, the, you know, you're familiar with the

23 separations issue of unregulated to regulated operations

24 per the FCC?

25 A. I am familiar with it somewhat. The issue

0650

1 here -- and I would note that Mr. Smith's discussion of

2 allocation is a little irrational. He says that a lot

3 of these costs are directly allocable, you know,

4 revenues and plant, but the S-4 says very clearly that

5 the allocation which is some, you know, less than half

6 of the cost affects the income statement top to bottom.

7 And that determines EBITDA, which is a factor that

8 determines the value, but it also affects -- where it

9 shows up to me most obviously is the liability side of

10 the balance sheet. Because after this allocation

11 process, what you have on the liability side of the

12 balance sheet is debt, about $6 Million, and something

13 called parent capital, which they say in the S-4 is both

14 equity and debt. That's the first time I've ever seen

15 that. It appears to me that this allocation process has

16 gathered some of the parent debt and put it in with the

17 equity capital so it doesn't appear in the debt. And

18 therefore when you put it all together, the leverage

19 appears to be lower, but I think that's a process of the

20 allocation. And one thing the company could have done

21 to get me off of this is to say, okay, Mr. Hill, if we

22 add up all the income statements of the telcos in 14

23 states, it looks just like VSTO, it looks just like

24 that. If that's the case, then, you know, I'll shut up

25 about it.

0651

1 Q. Have you seen this term special purpose

2 financial statements used before in other mergers or

3 spinoffs?

4 A. I've seen it in other mergers, yes. It's not

5 unusual when you have to -- you're spinning off a

6 company, that kind of thing happens.

7 Q. But when I think of special purpose, I think

8 of things like special purpose vehicles, you know, that

9 became quite familiar during the era, I don't want to

10 describe it as an era, but the era of let's say

11 financial innovation.

12 A. Yes. You're talking about --

13 Q. And SPV's, the special purpose vehicles, are

14 off balance sheet, correct?

15 A. Correct.

16 Q. But this appears to be -- I'm not an

17 accountant; are you an accountant?

18 A. No, sir.

19 Q. Okay. So this is -- I mean I take the

20 statement at its word that the special purpose financial

21 statements have been prepared according to GAAP.

22 A. Yes, I don't doubt that at all. And the

23 accountants say -- that's the accountant's job, to make

24 sure that things balance and they add up correctly and

25 according to GAAP and everything's in the right

0652

1 categories and all, but they don't vet the management

2 allocation process.

3 Q. I'm just going to follow up briefly on the

4 Chairman's questions. Could you turn to page 51. I

5 think we have a new acronym here, Mr. Hill, it's RPA,

6 required payment amount.

7 A. Yes, sir.

8 Q. So this is what you were -- you had a

9 dialogue with the Chairman on this issue. So this is in

10 the terms of the merger agreement, Paragraph 1.144,

11 correct?

12 A. Correct.

13 Q. And what does that RPA, let's call it RPA,

14 state? Does it just state what you say here in 1 and 2?

15 A. It's -- I have it -- the definition is

16 actually on page --

17 CHAIRMAN GOLTZ: Page 5.

18 A. -- 5 of my testimony.

19 Q. Okay.

20 A. It was taken from the merger agreement.

21 Q. Okay. So my question to you is you admit,

22 you say you're not a lawyer, but do you have any, based

23 on what you've seen in this proceeding and a little bit

24 of the back and forth, do you have any further

25 recommendations on that issue?

0653

1 A. As to how we might work around it?

2 Q. Correct. You mentioned a codicil.

3 A. Not beyond what I discussed with the

4 Chairman.

5 Q. Okay. Just so I understand your

6 recommendation or Public Counsel's recommendation, and

7 we may need to hear from Mr. Roycroft on this, but the

8 settlement agreement as Commissioner Oshie said calls

9 for a broadband deployment commitment of $40 Million,

10 correct?

11 A. Right.

12 Q. You are advocating here in your

13 recommendation for an additional commitment of $72

14 Million, correct?

15 A. Yes, sir.

16 Q. And then Mr. Roycroft, I want to make sure I

17 understand this, Mr. Roycroft calls for an additional

18 commitment of $40 Million?

19 A. That's correct.

20 Q. The $72 Million and the $40 Million are

21 commitments for Verizon?

22 A. The $72 Million is a commitment for Verizon

23 to this process as sort of a fee of getting it done.

24 You have to ask Dr. Roycroft about the other one.

25 Q. Okay. I think it is, but subject to check, I

0654

1 may ask him that.

2 My question to you was, is there any overlap

3 in terms of what these funds are meant to be invested

4 for in terms of either broadband, outside plant, your

5 recommendation of $72 Million, is it meant to be just --

6 I think you state in your testimony you thought -- you

7 think the valuation is too rich?

8 A. Yes, sir, and the $72 Million is meant to be

9 a modification for Washington of that amount.

10 Q. But it's not meant to be for any particular

11 purpose post transaction, whether it be OSS, broadband,

12 service quality indicia?

13 A. That's correct.

14 Q. So it really is, as I think through this,

15 it's not a -- it's not a merger commitment in terms of

16 the Staff settlement agreement which breaks into

17 financial conditions, broadband, service quality, it is

18 more an issue between the two companies on the purchase

19 price and the valuation, correct?

20 A. Yes, sir.

21 Q. My last question is you talked about the

22 liabilities and your concern about the liability side of

23 the balance sheet, but if bankruptcy were to occur,

24 Chapter 11 were to occur.

25 A. Yes, sir.

0655

1 Q. Two or three years down the road or in the

2 future, would there be any changes to your

3 recommendation? And refer specifically to the

4 settlement agreement. There's a broadband deployment

5 fund, there's condition number 1, the reporting on

6 intercompany receivables, payables.

7 A. Oh.

8 Q. Things like that, just maybe refer to both

9 the broadband fund and the financial, the 11 financial

10 conditions.

11 A. Well, the financial conditions, I believe

12 there are 12 of them, and they are basically reporting

13 functions. They require the Commission through the

14 company's reporting to keep an eye on the cash flows and

15 what's going on at the company. And also I believe

16 number 12 had to do with sort of a capital budget,

17 what's necessary to get this percent of broadband done

18 and how far are you along. In the case of bankruptcy,

19 I'm afraid most of that -- you should certainly keep

20 track of where the money is or what money's there, but

21 any kind of requirement about pushing broadband out

22 further is going to be very, very difficult. Because if

23 you do go to bankruptcy court, then it's been my

24 experience that the commission -- they certainly can

25 have a say, but ultimately the bankruptcy court judge is

0656

1 the one that has the say about where the moneys go. And

2 if you -- if Frontier has for example $40 Million

3 escrowed and it's designated for broadband, if they go

4 bankrupt, then the judge can say no, no, that $40

5 Million over there, that's going to go to pay off your

6 debtors or going to go to the pension fund or something.

7 Q. Right.

8 A. But you don't have control of that any more.

9 Q. I perhaps meant to rephrase the question

10 another way. I know you're not an attorney.

11 A. That's correct.

12 Q. But my question was more directed as if this

13 transaction were to occur and then the financial

14 conditions, what specifically is, especially with the

15 cash flows, with the payment of dividends, the earnings

16 per share, what sorts of conditions, what sorts of

17 information and analysis should we be looking at most

18 closely to follow the integrity of this company?

19 A. Well, the financial statements of the

20 companies are most definitely the first thing. We have

21 to keep track of where the cash flows are and what's

22 necessary -- how much cash flows are being thrown off by

23 depreciation for the plant here in Washington? Is that

24 much greater than the plant investment? If that's the

25 case, then we have to -- maybe we need to dial that back

0657

1 a little bit. But just like in Hawaii in this

2 bankruptcy there, the people are still -- they still

3 have phone service. They're still paying monthly bills.

4 It's everything's simply operating under protection. So

5 I think phone service will continue, but the finances

6 will become very, very important to both the Commission

7 and the company and possibly the bankruptcy court judge

8 as well. So there would be -- I'm not sure if I can

9 name any sort of indicia that would be better than the

10 financial statements, but that certainly would be

11 primary. And cash flow, the number, the condition

12 number 1, which is reporting intercorporate cash flows,

13 would also be important.

14 Q. And as you stated, you thought that was a

15 good condition?

16 A. Yes, I don't see anything wrong with it. I

17 just don't think it does anything to protect really the

18 financial health of the company. There's no triggers,

19 there's no response.

20 COMMISSIONER JONES: Right, okay, that's all,

21 thank you.

22 JUDGE CLARK: Commissioners, any other?

23 All right, you have an anticipatory look on

24 your face, Mr. Ruggiero.

25 MR. RUGGIERO: Your Honor, just a couple

0658

1 brief questions on cross.

2 JUDGE CLARK: You want recross-examination?

3 MR. RUGGIERO: Yes, Your Honor.

4 JUDGE CLARK: All right, limited strictly to

5 inquiry by the Commissioners.

6 MR. RUGGIERO: Very strictly limited.

7 JUDGE CLARK: And specifically telling me

8 where those questions were, right?

9 MR. RUGGIERO: That is correct, Your Honor.

10 JUDGE CLARK: Thank you.

11

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

13 BY MR. RUGGIERO:

14 Q. Mr. Hill, please turn to page 51 of your

15 testimony.

16 JUDGE CLARK: And is your microphone on?

17 MR. RUGGIERO: It is.

18 A. I have it.

19 BY MR. RUGGIERO:

20 Q. Mr. Hill, Commissioner Jones asked you

21 directly whether the $72.4 Million was meant for any

22 particular purpose like capital spending or broadband

23 deployment, and you told him it wasn't. And when I look

24 at page 51, line 12, here was your testimony back then:

25 As a final part of this condition

0659

1 because it is designed to support

2 capital spending for the surviving

3 company, I recommend that the Commission

4 require Frontier to monitor those funds

5 and use them only for improving the

6 telephone plant they are purchasing from

7 Verizon. In other words, those moneys

8 are designed to supplement the capital

9 spending on the Verizon properties. And

10 as a condition of approval, Frontier

11 should ensure through quarterly

12 reporting to the Commission that those

13 additional funds contributed by Verizon

14 are being used only to improve the newly

15 acquired plant facilities and not to be

16 spent on facilities located in

17 Frontier's current service territory.

18 Now if I ask you to look back at page 50 of

19 your testimony beginning at line 3, you state:

20 It appears likely then that the capital

21 spending requirements necessary for a

22 combined Frontier SpinCo to undertake

23 the buildout promised in its testimony

24 will exceed the levels included in its

25 financial forecast due in part to the

0660

1 lack of historical capital spending by

2 Verizon.

3 Now is the purpose of your proposed $72.4

4 Million to assist with capital spending due in part to

5 the lack of historical capital spending by Verizon, or

6 is it, as you now testify, because you believe that the

7 transaction has been overvalued?

8 A. My testimony is not different. I was

9 responding to the Commissioner's question, and I thought

10 he was asking me since this $72 Million comes as a

11 function of the Verizon engineer's assessment of DSL

12 buildout if that was intended to be the only use for

13 that. My answer was no, that it's a more general, as I

14 say in my testimony in many places, I believe that the

15 sale price, if you will, of the transaction is too high,

16 and this is a way for Verizon to pitch in a little bit

17 and help Frontier out financially. I would hope that

18 that money is used for capital spending and not for

19 something unregulated, to the buildout that Frontier

20 promises to do. But my -- I believe my response to the

21 Commissioner was in general it has more to do with the

22 Verizon overpricing, which I believe is overpriced, the

23 deal valuation is too high, than -- it's not really -- I

24 used the metric of the $600 Million offered by the

25 Verizon engineer, but that's a way to get to that $72

0661

1 Million number.

2 Q. And when Commissioner Jones asked you about

3 the interplay or overlap between your proposal and

4 Dr. Roycroft's proposal -- well, let me ask you to turn

5 to SGH-21.

6 A. Okay.

7 Q. Verizon asked you if you had undertaken to

8 analyze whether your condition and Dr. Roycroft's

9 condition overlapped in any way, and you said that you

10 had undertaken no such analysis; isn't that correct?

11 A. That's right.

12 MR. RUGGIERO: No further questions, thank

13 you, Your Honor.

14 JUDGE CLARK: All right, Ms. Shifley,

15 redirect.

16 MS. SHIFLEY: Thank you, Your Honor.

17

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

19 BY MS. SHIFLEY:

20 Q. I just have one quick question, and it's

21 regarding some questions that Commissioner Oshie asked

22 you. Mr. Hill, was it your understanding that you were

23 retained in this case to look at broadband policy issues

24 or broadband deployment issues, or did Public Counsel

25 have a different expert witness on that issue?

0662

1 A. Dr. Roycroft is the expert on that.

2 Q. Okay. So would you say then that some of

3 your -- the cross-exam, or excuse me, the Commissioner

4 questions that were addressed to you might be better

5 addressed to somebody else?

6 A. It's possible. I gave the best answer I

7 could, but that's certainly possible.

8 MS. SHIFLEY: Thank you.

9 JUDGE CLARK: All right, thank you, Mr. Hill.

10 THE WITNESS: Yes, ma'am.

11 JUDGE CLARK: Why don't we take a moment off

12 record.

13 (Discussion off the record.)

14 JUDGE CLARK: Ms. Shifley.

15 MS. SHIFLEY: Thank you, Your Honor.

16 Good morning, Dr. Roycroft.

17 THE WITNESS: Good morning.

18 JUDGE CLARK: Dr. Roycroft, I just want to

19 remind you, you have previously testified several times

20 in this proceeding and you remain under oath.

21 THE WITNESS: Thank you.

22 JUDGE CLARK: Thank you.

23 Ms. Shifley.

24 MS. SHIFLEY: I would now like to call

25 Dr. Roycroft.

0663

1 JUDGE CLARK: I'm sorry, I thought you did

2 that.

3 MS. SHIFLEY: I will just continue.

4

5 Whereupon,

6 TREVOR R. ROYCROFT,

7 having been previously duly sworn, was called as a

8 witness herein and was examined and testified as

9 follows:

10

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

12 BY MS. SHIFLEY:

13 Q. Dr. Roycroft, did you previously file

14 testimony in this proceeding?

15 A. Yes, I did.

16 Q. And at this time do you have any additions,

17 corrections, or deletions to that testimony,

18 specifically the non-confidential or non-highly

19 confidential portions?

20 A. No, I do not.

21 MS. SHIFLEY: Thank you, Your Honor.

22 JUDGE CLARK: All right, Ms. Shifley has

23 tendered the witness for cross-examination.

24 Mr. Ruggiero.

25 MR. RUGGIERO: Verizon has no questions.

0664

1 JUDGE CLARK: Mr. Saville.

2 MR. SAVILLE: Nothing from Frontier, Your

3 Honor.

4 JUDGE CLARK: Mr. Thompson.

5 MR. THOMPSON: Nothing from Staff.

6 JUDGE CLARK: All right, I'll turn now to

7 Commissioner inquiry.

8 Commissioner Jones or Commissioner Oshie.

9 Commissioner Oshie's going for his

10 microphone, he has a question.

11 COMMISSIONER OSHIE: Commissioner Jones is

12 cleanup here.

13 JUDGE CLARK: All right.

14 COMMISSIONER OSHIE: So I'm just trying to

15 put somebody on base, that's all.

16 Excuse me, Dr. Roycroft, I just couldn't help

17 it.

18

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

20 BY COMMISSIONER OSHIE:

21 Q. I want to go back to your testimony in, let's

22 see, it would be in opposition to the settlement

23 agreement, and there there was a discussion that was

24 held, and I don't recall whether it was in cross or

25 whether it was in the direct testimony of your attorney

0665

1 or the direct questioning, excuse me, I've done that

2 before, but this regards the broadband stimulus fund.

3 And I think I understood your testimony to say that if

4 there were -- there's some contribution to develop

5 broadband that the company shouldn't be allowed to use

6 broadband stimulus funds to meet or to satisfy the

7 condition if there would be one and if there would be,

8 you know, an approval with that condition. Then as I

9 see it, the company would not be allowed to use any

10 proceeds, if you will, from its stimulus grant

11 application if it were awarded to satisfy, you know,

12 that particular condition. It's kind of a long way

13 around the block, but did I get your testimony correct,

14 or am I misunderstanding?

15 A. I'm not sure that you did. The point that I

16 was hoping to make was with regard to the provision of

17 the settlement agreement with regard to the $40 Million,

18 it's not clear whether those $40 Million must be

19 contributed by Frontier or whether they can also reflect

20 a contribution from stimulus funds. I would prefer that

21 the settlement be structured in a way that would push

22 beyond what Frontier has committed to with that $40

23 Million so that any additional stimulus funding that

24 became available would expand the level of broadband

25 deployment or increase the quality of broadband

0666

1 deployment.

2 Q. All right, well, that -- I think that does

3 help clarify, because I think I generally misunderstood

4 the nuance there that it would be used in addition, that

5 any broadband funds would be used in addition to

6 continue to expand broadband development in this state,

7 so thank you.

8 Just a couple questions about your position

9 too on the condition to settlement with regard to the

10 AFOR. You were here for, I believe you were here when

11 we were discussing this issue with Mr. Weinman, is that

12 true?

13 A. Yes, I was.

14 Q. Now I think your testimony, at least what I

15 have in my notes, concerns synergies and whether that

16 the AFOR would actually capture the synergies that may

17 result from this transaction.

18 A. Whether the AFOR itself would be capable of

19 capturing that, that's an uncertain element of the

20 process at this point, yes.

21 Q. Did you hear Mr. Weinman, I guess what I want

22 to question you on is whether, and maybe let's see if --

23 let's lay some foundation. You were in the hearing room

24 when I was questioning Mr. Weinman about the impact of

25 the AFOR, why Staff wanted to do it?

0667

1 A. Yes, I was.

2 Q. And I believe in response Mr. Weinman at

3 least in part said that residential rate payers are

4 already paying too much or already -- they're not

5 recovering their cost of service based on today's rate

6 structure. Did you hear that, Mr. Weinman state that?

7 It was a different way, but that was the gist of it.

8 A. Right. My understanding of what he said is

9 that the residential service was subsidized, that

10 residential customers were essentially not paying their

11 full share.

12 Q. How did you interpret that in relation to,

13 you know, should we have an AFOR, I don't know about

14 you, but I interpreted that to mean that rates for

15 residential customers would go up?

16 A. That's the way that I interpreted his

17 statement, and I will add that I strongly disagree with

18 his premise that residential service is underpriced.

19 Residential services rely on shared plant, and that

20 shared plant is providing an expanding array of

21 services, including broadband services. So absent some

22 sort of an allocation of those very significant shared

23 costs, making any statement with regard to residential

24 voice grade services being subsidized is just completely

25 unsupported.

0668

1 Q. And with regard then to the premise that we

2 would conduct an AFOR, I don't know if you testified to

3 this but I'm going to ask you, I mean I take it from

4 your answer that the only way that we would truly

5 understand that issue would be to have what I would

6 refer to as a general rate case as part of that AFOR

7 filing.

8 A. Yes, I think that would be a necessary

9 condition.

10 Q. And that would certainly clarify whether or

11 not there's been any subsidization of any customer

12 class?

13 A. That is correct.

14 COMMISSIONER OSHIE: All right, thank you,

15 Mr. Roycroft, or Dr. Roycroft, excuse me.

16 JUDGE CLARK: Commissioner Jones.

17 COMMISSIONER JONES: I will do the cleanup in

18 15 minutes, Judge.

19 JUDGE CLARK: Wow.

20

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

22 BY COMMISSIONER JONES:

23 Q. Just two rounds of questions with you,

24 Mr. Roycroft. You were present when you heard my

25 question of Mr. Hill of your recommendation on the $40

0669

1 Million condition, were you not?

2 A. Yes, I was.

3 Q. And I think counsel for Verizon followed up

4 on this a bit. The way I read your condition is it is

5 to be used to ensure that outside plant is in a, quote,

6 well, reasonable condition?

7 A. That is correct.

8 Q. So can you be a little more specific on what

9 types of activities you would see this fund being used

10 for and if it does overlap at all with what Mr. Hill

11 recommends. But maybe if you feel uncomfortable

12 answering the second part, we may see that on brief I

13 know, but just the first part of that question, what

14 will it be used for?

15 A. Well, the fund is designed to be a short-term

16 option for Frontier when Frontier takes over the

17 operations in Washington, which it will then have the

18 opportunity to gain a full understanding through

19 inspecting those outside plant facilities, it may

20 uncover conditions that require additional out-of-pocket

21 expenses. Those expenses would be potentially targeted

22 from that fund. With regard to Mr. Hill's number, as he

23 has stated it's reflecting an adjustment to the purchase

24 price designated for Frontier to expend in Washington an

25 allocation of that fund to be spent in Washington over

0670

1 an extended period of time. So my fund is essentially

2 show cause type fund from the standpoint demonstrate to

3 the Commission that you have run into an issue that you

4 did not expect and that that issue is costing you money

5 and therefore eligible to be considered to be drawn from

6 that fund.

7 Q. Could you turn to page 75 in your testimony,

8 please.

9 A. I'm there.

10 Q. And this relates to this question of outside

11 plant condition, and there you state some concerns about

12 the condition of the Verizon outside plant including the

13 loop plant and, you know, as Frontier goes out and

14 extends DSL it won't have to do line conditioning, et

15 cetera. So is this one of your concerns why you propose

16 the $40 Million fund, more specifically that Frontier

17 did not do its due diligence, and they're going to find

18 some surprises, and it may be more expensive than they

19 estimate to build out broadband in these remote areas?

20 A. That is my concern. The information that we

21 were able to obtain from Frontier indicated that they

22 had not done outside plant inspections here in

23 Washington state while they were negotiating this

24 agreement. Very recently we've gained some additional

25 information that they finally have come to Washington

0671

1 state to do some inspections. They did not provide me

2 with very much information about what they saw, but

3 that's my concern, that they did not look. And to avoid

4 Washington rate payers being burdened by surprises, I

5 think it's appropriate that the funds be available from

6 Verizon to remedy those situations should they be there.

7 Q. Mr. McCarthy in his rebuttal and on the stand

8 I think said that there had been field visits to some of

9 these wire centers, correct?

10 A. That's right. We served discovery that we

11 received last week as a follow up to a Staff discovery

12 request that identified a number of wire centers that

13 Frontier personnel had visited. Again, what they found

14 was not described even though we asked for a report on

15 what they had seen.

16 Q. So your concerns about the lack of due

17 diligence, what you describe as the lack of due

18 diligence in reviewing these assets of outside plant

19 wire centers and such, you still stand by that opinion?

20 A. Yes, I do.

21 Q. Okay. Are you an engineer? You're an

22 economist, aren't you?

23 A. I'm an economist. I have experience with

24 telephone engineering.

25 Q. And you have been -- have you been involved

0672

1 in broadband deployment issues in other state

2 proceedings? I imagine you have.

3 A. Yes, I have.

4 Q. Okay. The next round of questions go to page

5 35 of your testimony, please. It regards the Fort Wayne

6 data center.

7 A. Page 35, I'm there.

8 Q. And just describe for me again your concern.

9 You quote Mr. McCallion here during an Ohio deposition,

10 but Mr. McCarthy I think in his rebuttal testimony

11 states that 230 IT personnel are going to be transferred

12 from Verizon to Frontier upon closing, and Verizon has

13 to be in production mode 60 days prior to close,

14 correct?

15 A. That is correct.

16 Q. So you're talking about the element of risk

17 here with personnel, correct?

18 A. Yes.

19 Q. So go through that again, and is there

20 anything that you've heard in rebuttal and on the stand

21 here these last few days that would cause you to, you

22 know, reduce your concern about the risk of personnel,

23 IT personnel operating the OSS?

24 A. No, the information that I've heard here does

25 not supplement what I have gathered through the

0673

1 discovery process. My understanding of the personnel

2 issues are that there are at least a portion of the

3 personnel associated with the Fort Wayne data center

4 that will be moved there who had previously not been

5 running the VSTO OSS plant. They may be reassigned to

6 different types of positions within their

7 responsibilities, but in general it's not the -- the

8 point that I was responding to was that the claim was

9 made that these are just exactly the same folks who were

10 previously running these systems, and what the evidence

11 that I uncovered indicates is that some of those people

12 are not the same folks from the legacy operations that

13 are going to be doing their previous tasks.

14 Q. So your concern is not alleviated by

15 Mr. McCarthy's statement on the record that the 230 IT

16 personnel will be transferred and they have sufficient

17 expertise in this area?

18 A. I think the level of risk associated with

19 that transfer of personnel is reduced to the extent that

20 those individuals have the experience with the previous

21 systems. If somebody's been reassigned to a new task

22 and has the operational experience of 60 days versus a

23 longer period of time, then there's some risk associated

24 with those operations.

25 Q. And just to be clear, these are legacy GTE

0674

1 OSS systems, correct?

2 A. That is correct.

3 Q. And these systems are being transferred in 13

4 other states, correct?

5 A. That's right. The systems control the

6 operations --

7 Q. Right.

8 A. -- for 13 other states, and that will be done

9 through the Fort Wayne data center facility, which will

10 be assigned to Frontier at the closing.

11 Q. Have you been involved in any other state

12 proceedings regarding this issue and the transfer of a

13 replicated system?

14 A. Yes, I've been involved in the Ohio

15 proceeding and the West Virginia proceeding. Well, I'm

16 sorry, the West Virginia proceeding is a separate --

17 Q. Yes, no, I understand the West Virginia

18 situation quite well.

19 But just so I understand it, so all the data

20 replications and all the testing will be done at the

21 Fort Wayne, Indiana data center?

22 A. That's my understanding.

23 Q. For Washington state. So if there's any

24 concern for a Washington state operating system, it's

25 all there in Indiana? The problem has to be resolved by

0675

1 dealing with this newly created VSTO asset in Fort

2 Wayne, Indiana, correct?

3 A. That's correct.

4 COMMISSIONER JONES: Thank you, that's all I

5 have.

6 JUDGE CLARK: Does that conclude Commissioner

7 inquiry?

8 All right, redirect.

9 MS. SHIFLEY: Just one question.

10

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

12 BY MS. SHIFLEY:

13 Q. Dr. Roycroft, Commissioner Jones asked you

14 some questions about inspection of outside plant and due

15 diligence, and I believe that you referred to some data

16 request responses. Could you explain exactly what was

17 asked in the data request responses that you were

18 talking about and then what was ultimately provided, and

19 just clarify for us a little bit where your concern is

20 about lack of information?

21 A. If you could remind me, is this an exhibit to

22 my testimony that I have in hand that I could refer to?

23 Q. Certainly, and I believe that I have -- I

24 mean I have hard copies here, but they are specifically

25 WHW-3, which is a Staff Data Request 107.

0676

1 JUDGE CLARK: And that's attached to

2 Mr. Weinman's testimony, correct?

3 MS. SHIFLEY: Yes, Your Honor.

4 THE WITNESS: Ms. Shifley, I do not have that

5 document.

6 MS. SHIFLEY: With you at the stand?

7 THE WITNESS: No, I don't.

8 MS. SHIFLEY: I can bring a copy up to you.

9 JUDGE CLARK: Yeah, when we get everything

10 accumulated, Dr. Roycroft, I'm going to ask that we take

11 a brief moment off record to ensure that everybody's on

12 the same sheet of music.

13 All right, so the first document that we need

14 to line up is WHW-3. Are there others, Ms. Shifley?

15 MS. SHIFLEY: Yes, Your Honor. And then it

16 is Joint Applicants' response to Public Counsel Data

17 Request 538, which has been identified as an exhibit to

18 Dr. Roycroft's testimony.

19 JUDGE CLARK: All right, and these are the

20 TRR-28 and 29; is that correct?

21 MS. SHIFLEY: Yes, I believe that this is

22 TRR-28.

23 JUDGE CLARK: All right, are there others?

24 MS. SHIFLEY: No.

25 Your Honor, may I approach the witness?

0677

1 JUDGE CLARK: Yes. What we're going to do is

2 take a moment off record, and I want you to distribute

3 those documents, please, to Dr. Roycroft, and then I

4 want to make sure he has an adequate opportunity to

5 review them, and then we'll go back on record.

6 MS. SHIFLEY: Yes, Your Honor.

7 JUDGE CLARK: All right, we're at recess

8 until further call.

9 (Discussion off the record.)

10 JUDGE CLARK: Dr. Roycroft, have you had an

11 adequate opportunity to review the documents provided to

12 you by counsel?

13 THE WITNESS: Yes, I have.

14 JUDGE CLARK: Ms. Shifley.

15 MS. SHIFLEY: Thank you.

16 BY MS. SHIFLEY:

17 Q. I'll just briefly restate what I was asking.

18 There were some questions to you previously from the

19 Commissioners regarding the condition of outside plant,

20 and you had made some statements referring to some what

21 was provided during discovery. Could you just clarify

22 or elaborate on that?

23 A. Yes. In order to understand whether

24 additional evaluations of outside plant had been

25 performed in the period after the due diligence should

0678

1 have been performed initially, Public Counsel issued

2 this data request asking to follow up on Staff Data

3 Request 107. Staff Data Request 107 had asked for some

4 very specific information regarding the due diligence

5 conducted by Frontier personnel in Washington,

6 specifically wanting to know which exchanges and CLLI

7 codes were examined, who did the examination, what type

8 of outside plant was inspected, and, you know, including

9 specifics about cable sizes and root miles and how much

10 did they look. Frontier responded on January 29th, last

11 Friday, that they had done site inspections at several

12 wire centers, but in their response make no comment

13 about who did the inspections, how long the inspections

14 took, which was another aspect of the Data Request 538,

15 asked to update 107 but also identify any dates on which

16 the inspections took place. The response indicates that

17 the equipment is similar to Frontier's current network

18 but does not make any comments about the condition of

19 that equipment.

20 Q. And just to clarify, what was the response to

21 the initial Data Request 107?

22 A. The initial response was that Frontier did

23 not conduct a field visit in Washington as part of the

24 due diligence process.

25 MS. SHIFLEY: Thank you, no further

0679

1 questions, Your Honor.

2 JUDGE CLARK: Just for the clarification of

3 the record, Dr. Roycroft, the second document you're

4 referring to which is the 538 is marked for

5 identification purposes as TRR-28; is that correct?

6 THE WITNESS: I believe so.

7 JUDGE CLARK: All right, thanks.

8 All right, anything further?

9 All right, thank you, Dr. Roycroft.

10 THE WITNESS: Thank you.

11 JUDGE CLARK: And I believe that concludes

12 the presentation of the evidence in this case. Given my

13 track record with Mr. Thompson yesterday, I'm going to

14 inquire. All right, is there anything further to be

15 considered on this record?

16 CHAIRMAN GOLTZ: I just wanted to thank

17 everybody, all the parties, and I thought all the

18 witnesses were very helpful and very forthcoming, and

19 all counsel did a great job in moving this along and

20 clarifying all the issues, so I thank you for that. I

21 have one request for the -- there are post hearing

22 briefs, correct?

23 JUDGE CLARK: Post hearing briefs are due

24 February 26.

25 CHAIRMAN GOLTZ: I have one request for

0680

1 something to include, not to dominate the brief, but I

2 would like to hear about the issue of whether or not in

3 general the required payment amount provisions, or as

4 Mr. Hill called them the clawback provisions, are

5 acceptable as a matter of policy, and if not, what

6 should the Commission do about the provision in this

7 case or how the Commission should address the provision

8 in this case, so in addition to whatever else is in the

9 brief.

10 JUDGE CLARK: Are there any other

11 Commissioner closing remarks?

12 All right, then thank you very much for your

13 participation, and we are adjourned.

14 (Discussion off the record.)

15 JUDGE CLARK: It appears I guess for lack of

16 a better term I'm going to call this a post hearing

17 conference, because it doesn't involve any evidentiary

18 matters but rather the wrapup of some procedural

19 details, and I'm going to turn to you first, Mr. Romano.

20 MR. ROMANO: Thank you, Your Honor. Verizon

21 would like to withdraw a number of exhibits that we had

22 identified for cross-examination, and I'll start with --

23 JUDGE CLARK: And you're going to do that for

24 me very, very slowly, aren't you?

25 MR. ROMANO: Yes, Your Honor.

0681

1 JUDGE CLARK: Thank you.

2 MR. ROMANO: The first would be what has been

3 marked as a cross-examination Exhibit SGH-10.

4 JUDGE CLARK: Okay, so we're going to start

5 with Mr. Hill, if you will give me a moment.

6 All right, I'm there, thank you.

7 MR. ROMANO: Okay, so SGH-10, SGH-11, SGH-13,

8 JUDGE CLARK: 10.

9 MR. ROMANO: 11.

10 JUDGE CLARK: 11. I'm sorry, I'm

11 experiencing technical difficulty.

12 SGH-10, 11, and 13.

13 MR. ROMANO: As well as 16 and 17.

14 JUDGE CLARK: All right, 16 and 17, SGH-16

15 and 17.

16 MR. ROMANO: Yes, Your Honor.

17 And then the other exhibits would have been

18 marked for cross-examination of Dr. Roycroft, so they

19 would start with TRR.

20 JUDGE CLARK: So if you'll give me a moment.

21 All right.

22 MR. ROMANO: Okay, TRR Number 6, 7, 9, 10,

23 12, 13, 14, 15, 16, 17, 19, and then 23HC as well as

24 24HC.

25 MS. SHIFLEY: Your Honor, I would just like

0682

1 to interject, I believe that Verizon referred to TRR-16

2 during the highly confidential portion of the

3 cross-examination.

4 JUDGE CLARK: Yes, and I think there may have

5 also been, but I'm not sure if my notes reflect it, that

6 there may have also been a discussion of either 23 or

7 24HC.

8 MS. SHIFLEY: Trying to verify which ones

9 were asked about.

10 MR. ROMANO: We believe it was TRR-22HC,

11 which I had left in the record.

12 JUDGE CLARK: And I'm going to give a moment

13 off record just to make sure that Ms. Shifley confirms

14 with Dr. Roycroft. Is that all for the TRR

15 designations?

16 MR. ROMANO: Yes.

17 JUDGE CLARK: Okay, let me start at the

18 beginning then, let's go with the non-controversial ones

19 and make sure I have them all, and I have marked TRR-6,

20 TRR-7, TRR-9, TRR-10, TRR-12, 13, 14, 15, 16, 17, 19,

21 and then we're going to get confirmation on 22, 23, or

22 24 in just a second.

23 MR. ROMANO: Ms. Shifley, just to clarify, I

24 think you had referred to TRR-16, and that happens to be

25 a duplicate of TRR-22HC, which is one we used.

0683

1 MS. SHIFLEY: That's true, we're just

2 confirming 23 and 24 now, but we do believe 16 and 22

3 are identical.

4 JUDGE CLARK: They're not, are they?

5 MS. SHIFLEY: I think that there is actually

6 a difference regarding the highly confidential portion,

7 and we're just trying to clarify.

8 So, Your Honor, I believe it's 22 that

9 contains the highly confidential information that was

10 referred to, so that one should stay in the record, and

11 16 could be withdrawn, it wasn't referred to.

12 MR. ROMANO: Right, which is what I did.

13 JUDGE CLARK: That's exactly what Mr. Romano

14 did. And, Dr. Roycroft, if you can confirm my paranoia,

15 and that is we were not dealing with TRR-23 or 24HC?

16 DR. ROYCROFT: That's my understanding, yes.

17 JUDGE CLARK: All right, then we're going to

18 add TRR-16, 23HC, and 24HC as the documents withdrawn by

19 Verizon.

20 MR. ROMANO: Thank you, Your Honor.

21 JUDGE CLARK: All right.

22 Mr. Saville.

23 MR. SAVILLE: Your Honor, we just have one

24 document we would like to withdraw as an exhibit, it is

25 TRR-25.

0684

1 JUDGE CLARK: All right, TRR-25 by Frontier.

2 All right, are there any other procedural

3 matters we should address?

4 MS. SHIFLEY: No, Your Honor.

5 JUDGE CLARK: Thank you very much.

6 (Hearing adjourned at 12:15 p.m.)

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