

**BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION**

In the Matter of the Joint Application of)
Verizon Communications Inc. and)
Frontier Communications Corporation)
For An Order Declining to Assert) Docket No. UT-090842
Jurisdiction Over, or, in the Alternative,)
Approving the Indirect Transfer of)
Control of Verizon Northwest Inc.)

**POST HEARING BRIEF OF
VERIZON COMMUNICATIONS INC.**

AND

FRONTIER COMMUNICATIONS CORPORATION

REDACTED

February 26, 2010

**HIGHLY CONFIDENTIAL PER PROTECTIVE ORDER
IN DOCKET UT-090842**

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1. Verizon Communications Inc. (“Verizon”) and Frontier Communications Corporation (“Frontier”) (collectively, “Joint Applicants”) submit this brief in support of the Joint Application filed in this docket on May 29, 2009 (“Application”). Joint Applicants respectfully urge the Commission to approve the proposed transaction (“Transaction”), and adopt the proposed settlement agreements filed among the Joint Applicants, Commission Staff (or “Staff”), the Department of Defense/Federal Executive Agencies (“DOD/FEA”), Comcast Phone, LLC (“Comcast”), XO Communications Services, Inc., Integra Telecom of Washington, Inc., tw telecom of washington llc, Covad Communications Company, and PAETEC Communications, Inc. (collectively, “Joint CLECs”), and Level 3 Communications, LLC (“Level 3”).

I. INTRODUCTION.

2. Frontier is the ideal company to acquire control of Verizon Northwest Inc. Frontier has the financial strength, technical capability, local focus, and proven ability to build on Verizon’s record of excellent service quality in Verizon Northwest’s diverse and unique service territory in Washington. Frontier has grown through *successful* acquisitions – through integrating companies into Frontier, through increasing investment, service levels and offerings, and through having a significant local presence in the communities it services. Frontier has significant transaction experience and completed a rigorous and detailed review of Verizon’s operations and the opportunities presented by the proposed Transaction, which enabled it to negotiate terms that make sense for Frontier and consumers in Washington. For Washington, Frontier is well positioned with the expertise and sophistication necessary to utilize the substantial investment made by Verizon to bring fiber-to-the-home facilities to relatively higher

density areas such as Kirkland, Redmond and Everett, while devoting additional resources and a strategic vision to build out broadband to areas in Washington that are less dense and currently unserved or underserved.

3. The record evidence is clear. Verizon has decided that the local telephone business in Washington and certain other states is no longer in its main strategic focus, and that's where Frontier's strategic vision comes in: it views the state as a significant business opportunity, and plans to invest significantly to deploy broadband to unserved and underserved areas. Indeed, Washington will be one of Frontier's most important states once the Transaction is completed, with its access lines making up approximately 8.2% of the new Frontier.¹ And Frontier will bring to Washington the benefits of added broadband investment, both in terms of the state economy generally and for jobs in particular.

4. Frontier believes that line loss affecting the entire industry can be reduced not just through further broadband deployment, but also through a local focus and Frontier's local management engagement model. That local focus means giving Washington the kind of on-the-ground local managers in the state that can respond quickly and directly to input from customers and regulators. The result will be a parent for Verizon Northwest that takes all the positives left by Verizon, including substantial investment in the underlying network as evidenced by an excellent service quality record, but that also adds a new, more local focus and commitment that will benefit the public interest in Washington.

5. And through the myriad settlements entered into in this docket, enforceable commitments will be in place to ensure that the public interest in Washington is served by the Transaction. These settlements are designed to address specific concerns raised by other parties in the docket, and as a result, such parties now agree that the Transaction causes no harm and should be

¹ McCarthy, TR. 389: 6-14.

approved by the Commission. These commitments include: (i) specific broadband deployment commitments, including the creation of a \$40 million escrow account to be used only for broadband deployment in Washington, as well as thresholds requiring that broadband be deployed in at least 95% of Washington wire centers, with broadband services available to approximately 89% of households by 2014; (ii) ongoing high service quality, including a self-executing customer credit program based on Frontier service quality performance under the Commission's standards that puts up to \$3.6M in customer credits at risk by the third year and (iii) a testing process, with use of a third party reviewer to validate the accuracy of the results, to ensure that the replicated systems are fully functional prior to closing. As noted by the Staff at the hearing, these commitments and the "quality of the conditions in this settlement are much more stringent than they were in the CenturyTel settlement,"² an all-party settlement on a transaction very similar to this one.

6. Public Counsel stands alone in opposing the Transaction and the settlements, trying to weave together arguments based on contentions that are logically inconsistent, riddled with errors and unsupported in the record.³ Confronted with these threshold errors and unsupported allegations, Public Counsel's witnesses resort to offering up cartoonish analogies to Charlie Brown and Br'er Rabbit (including attaching a comic strip as a "workpaper") and inapposite clichéd comparisons to "clean[ing] behind the couch" and "put[ting] cookies in the oven" when a person sells a home.⁴ These superficial and fallacious analogies seem designed to divert attention from the lack of an evidentiary record to support Public Counsel's recommendation

² Weinman, TR. 527: 2-17.

³ The positions of two other parties with limited roles in the docket, the Broadband Communications Association of Washington ("BCAW") and the International Brotherhood of Electrical Workers ("IBEW"), are unclear. BCAW does not oppose the Transaction but opposes certain conditions proposed initially by Staff, and IBEW chose not to submit testimony or participate in the hearing.

⁴ See, e.g., Hill, TR. 605: 17-19; Hill, TR. 430: 18-20; Roycroft, Exh. TRR-1HCT at 8-12.

that the Transaction be rejected or its equally unsupported and unlawful pleas to the Commission to make Verizon “kick in” or “pony up some money.”⁵ Public Counsel’s recommendation of rejection would deny Washington consumers the benefits of increased broadband and the local attention and focus of Frontier, a company with a predominant business focus on serving landline telephone customers. And adopting Public Counsel’s penalty or “exit tax” recommendations would send the wrong message to companies considering investing in infrastructure in the state critical to the state’s future that their investment is not wanted. It would be very difficult for companies to justify that kind of capital investment if, as Public Counsel proposes, a company faces the prospect of a retaliatory penalty if its business focus should change in the future.

7. Public Counsel’s unsupported recommendations should be rejected, and the Transaction, as well as the settlement agreements negotiated in good faith to resolve issues of concerns raised by settling parties, should be approved as in the public interest.

II. BACKGROUND OF THE TRANSACTION AND PROCEEDING.

8. The details of the proposed Transaction, including a description of the relevant legal entities, are set forth in the Application and the accompanying transaction agreements.⁶ At its core, the Transaction will be implemented by having control of Verizon Northwest Inc., a Washington corporation and public service company, ultimately transferred from Verizon to Frontier. Following the Transaction, the corporate entity Verizon Northwest will continue to exist and provide service in Washington, but will be renamed Frontier Northwest and will be a subsidiary of Frontier. A voluminous record is compiled for Commission consideration, as a result of an active docket that commenced with the filing of the Application on May 29, 2009.

⁵ See, e.g., Hill, TR. 436:3, 9-10 and 633:1.

⁶ Application ¶¶ 6-20.

In conjunction with the large amounts of information exchanged through discovery (with over 1000 request subparts answered), workshops and testimony, the Applicants reached settlements with the Staff (“Staff Settlement”), Comcast (“Comcast Stipulation”), the Joint CLECs (“Joint CLEC Settlement”), Level 3 (“Level 3 Settlement”), and DOD/FEA (“DOD/FEA Settlement”). Those settlements were supported with testimony pre-filed on December 24, 2009 and January 28, 2010. A hearing on these settlements, as well as all other issues, was held on February 2-4, 2010.

III. LEGAL STANDARD.

9. The uncontroverted legal standard for determining whether the transaction is in the public interest is whether it will cause “harm.”⁷ If the transaction does no such harm, it is in the public interest under WAC 480-143-170, and the Commission must approve it under Chapter 80.12 RCW. In the *Scottish Power* case, the Commission described the standard as:

The standard in our rule does not require the Applicants to show that customers, or the public generally, will be made better off if the transaction is approved and goes forward. In our view, Applicants’ initial burden is satisfied if they at least demonstrate no harm to the public interest.⁸

This standard is different than the one that now applies to transactions of gas and electrical companies, which under 2009 legislation, requires a “net benefit to the customers.” (RCW 80.12.020).

10. Factors typically considered by the Commission in telecommunications transactions under WAC 480-143-170 are: (i) the technical, managerial and financial capability of the surviving entity to operate successfully; (ii) any financial impacts on cost of capital, capital structure, and access to financial markets; (iii) any potential impact on service quality; (iv) the

⁷ Application ¶ 24; McCallion, Exh. TM-2HCT at 5; Shifley, TR. 232: 2-14 (“[Public Counsel] understand[s] that the precedent sets [the standard] as a no harm standard.”).

⁸ *In the Matter of the Application of Pacific Corp. and Scottish Power, PLC*, Docket No. UE-981627, Third Supplemental Order on Prehearing Conference (April 2, 1999) at 2.

sharing of any benefits or synergies between customers and shareholders; (v) any impact on rates, terms and conditions of service; and (vi) any impact on competition at the wholesale and retail levels.⁹ As explained in more detail below, this Transaction (including all of the settlements that were reached with various parties) does “no harm” when considered under these factors.¹⁰

IV. THE PROPOSED TRANSACTION AND THE SETTLEMENT AGREEMENTS ARE IN THE PUBLIC INTEREST AND SHOULD BE APPROVED.

A. Frontier Has The Technical, Managerial and Financial Capability to Operate Successfully.

i. Frontier Has Extensive Managerial and Technical Expertise and a Strong Track Record.

11. Frontier’s professional management is very capable of continuing the successful operation of Verizon Northwest. Frontier is the sixth largest wireline telephone company in the country and successfully operates more than two million access lines in 24 states.¹¹ Frontier’s management has substantial experience successfully acquiring and integrating telephone operations, including 750,000 access lines from GTE, 1.1 million access lines from Global Crossing (an acquisition that almost doubled Frontier’s size) and most recently in 2007, more than 400,000 access lines from Commonwealth Telephone.¹² Moreover, Joint Applicants have negotiated a “turnkey” transition under which Frontier will continue operating Verizon

⁹ *In the Matter of the Joint Application of Verizon Communications Inc. and MCI, Inc.*, Docket No. UT-050814, Order Accepting Settlement, on Condition; Approving Merger, on Condition (December 23, 2005) (“*MCI Order*”) at 26.

¹⁰ As noted in the Application (¶¶ 22-23), Joint Applicants respectfully request that the Commission revisit the rationale behind its decisions asserting jurisdiction over transactions occurring at the holding company level, and not assert jurisdiction here on the grounds that the parent and holding companies in this transaction do not constitute “public service companies” as that term is used in Chapter 80.12 RCW. Because those subjects were briefed heavily in previous dockets (*see* footnote 6 to the Application), we limit the subject of this brief to whether the transaction is in public interest and thus should be approved if the Commission exerts jurisdiction over it.

¹¹ McCarthy, Exh. DM-8HCT at 56.

¹² *See* McCarthy, Exh. DM-1T at 44.

Northwest using the same personnel, systems, and processes used by Verizon prior to the closing of the Transaction.¹³

ii. Frontier Is Financially Strong and Will Become Stronger After the Transaction.

12. Frontier is one of the most financially fit wireline telephone companies in the country, and the Transaction will further strengthen Frontier – improving its balance sheet through a substantial decrease in its ratio of debt to EBITDA, increased cash flow and a reduced dividend payout ratio. Confirming this view, both Moody Investor Service and Fitch Ratings credit rating agencies and several industry analysts, including Morgan Stanley, Raymond James, Stifel Nicolaus, UBS Investment Research, have recognized that the financial characteristics of the combined company are positive as a result of this combination.¹⁴ These positive ratings actions affirm the fact that the Transaction was structured in a way that specifically serves to enhance the balance sheet and credit quality of Frontier. That financial strength will solidify Frontier’s already-proven ability to deploy improved services to customers, including those in Washington, who will benefit from new products and services in addition to current products and services that will be continued (including services provided over FiOS) and from a new service provider strategically focused on serving the needs of landline customers in Washington.

iii. Frontier’s Post-Transaction Leverage Ratio Will Be Among the Lowest in Its Class of Carriers.

13. The Transaction deleverages Frontier and results in a post-merger company with an even stronger balance sheet. As Frontier has testified, the Company’s leverage ratio (net debt divided by Earnings before Interest Expense, Taxes, Depreciation and Amortization or “EBITDA”) is

¹³ See McCallion, Exh. TM-2HCT at 25; McCarthy, Exh. DM-1T at 51-52.

¹⁴ Whitehouse, Exh. DW-1T at 30-31, Whitehouse, Exh. DW-8 (Morgan Stanley), McCarthy, Exh. DM-14 (Moody’s), DM-15 (Fitch), DM-12 (Morgan Stanley), DM-13 (Raymond James), DM-16 (Stifel Nicolaus), DM-17 (UBS).

estimated to decrease from a pre-transaction 3.8 times based on year-end 2008 financial results (which is *already* lower than both the median and average for its peer group) to 2.6 times after the combination, *before* including the benefit of expected cost savings.¹⁵ Including expected synergies, the 2008 pro forma leverage ratio is estimated to improve further to approximately 2.2 times.¹⁶ Frontier's pro forma leverage ratio after synergies is expected to be close to that of Verizon and consistent with that of an investment grade-rated telecommunications company. As Mr. Whitehouse explained, post-merger Frontier is expected to have an exceptional leverage ratio compared with the ratios of other rural local exchange carriers ("RLECs") and Qwest, which are the appropriate comparison group of companies because they are nearly "pure" ILECs (as opposed to entities which derive a significant portion of their revenues and income from cellular/wireless services).¹⁷ Indeed, as Staff witness Weinman explained in his testimony supporting the Staff Settlement, that would mean that Frontier's expected leverage ratio of 2.2 would be equal to the "investment grade" performance of CenturyTel, Inc. (pre-merger year ended 2008).¹⁸ Thus, the proposed Transaction positions Frontier from a financial perspective to provide best-in-class service to Washington.

iv. Frontier Currently Has and Will Continue To Have Very Strong Cash Flows.

14. Frontier's financial ability to successfully operate Verizon Northwest is confirmed by the fact that Frontier currently has and will continue to have very substantial cash flows that can be used to operate and fund the business. At the hearing, responding to Public Counsel's assertion that Frontier is a financially "weak" company, Frontier's Treasurer David Whitehouse explained:

¹⁵ Whitehouse, Exh. DW-1T at 15; McCarthy, Exh. DM-1T at 38. Although the legacy Frontier leverage ratio has increased slightly to approximately 3.9 times as of June 30, 2009, that does not materially change the deleveraging effect of the proposed Transaction. Whitehouse, Exh. DW-1T at 15 n.18.

¹⁶ Whitehouse, Exh. DW-1T at 15.

¹⁷ Whitehouse, Exh. DW-1T at 18-21, Table 1, Figure 1.

¹⁸ Weinman, Exh. WHW-6T at 4: 7-11. And even without expected synergy savings, Frontier would still perform better than the other comparable RLECs, with the exception of CenturyTel. *Id.*

Frontier's a company that generates approximately \$500 Million a year of free cash flow. And by free cash flow we're talking about the cash flow that is left over after the company has paid all its bills, paid its Capex, paid its interest expense, paid its taxes, and in fact it is what is left over. And indeed we do present to our board of directors a very, in my opinion, high class problem where at the end of the year we say, we have this extra cash flow, how would you like us to allocate it.¹⁹

15. In its testimony, Frontier also summarized Frontier's pro forma free cash flow expectations for the new Frontier.²⁰ Free cash flow is cash generated after funding all cash operating expenses to run the business—cash taxes, cash interest expense on the company's debt, and all capital expenditures, including the network investments that have expanded Frontier's broadband service availability to over 92% of the households in its national service territory. The proposed Transaction is expected to *increase* Frontier's annual free cash flow, based on pro forma 2008 results, to over \$1.4 billion, without synergies, and over \$1.7 billion after estimated synergies are included.²¹ In the words of Public Counsel witness Hill regarding the cash flows from Verizon Northwest, "regulated cash flows [can] do the job of building the network that needs to be there."²² The magnitude of Frontier's free cash flow post-transaction provides the Commission with assurance that Frontier will have sufficient resources and even significant cushion for capital investment *and* for supporting the company's operations in Washington.

16. Moreover, upon closing of the Transaction, Frontier will reduce its dividend by 25%, which will reduce Frontier's dividend payout of its free cash flow.²³ As Mr. Whitehouse explained at the hearing in response to criticisms of Public Counsel witness Hill, paying

¹⁹ Whitehouse, TR. 487:10-19. From 2005 through 2008, Frontier generated free cash flows that ranged from approximately \$493 million to \$562 million annually. Notably, Frontier achieved these levels of free cash flow while simultaneously investing over \$1.1 billion cumulatively over the four-year period (2005-2008) in its operations and network, including broadband facilities. Whitehouse, Exh. DW-1T at 40.

²⁰ Whitehouse, Exh. DW-1T at 39-40.

²¹ Whitehouse, Exh. DW-1T at 40.

²² Hill, TR. 627: 3-5.

²³ Whitehouse, Exh. DW-1T at 41.

dividends is not at odds with making capital expenditures. Indeed, according to Mr.

Whitehouse, the Frontier Board:

fully understand[s] that you need to invest in the company to continue generating the cash to pay the dividends.... It's only after they're comfortable that the company has the appropriate level of investment and that the capital structure and our credit metrics are where we would like them to be before we consider dividends or share repurchases or other forms of investment.²⁴

17. Post-transaction, Frontier will generate significantly greater annual free cash flow after dividends—\$681 million without synergies, and \$991 million with synergies based on the 2008 pro forma figures.²⁵ Frontier's historical data demonstrate a financially sound business approach that strikes a prudent balance among funding operations, investing in the network, and providing required returns to capital providers—all while continuing to generate sufficient amounts of cash flow to provide the Board and management with the financial flexibility to respond to market forces and opportunities.

v. Public Counsel's Investment Grade Criticisms of Frontier Are Wrong and Irrelevant to the Statutory Standard.

18. At hearing and in testimony, Public Counsel witness Hill criticized Frontier for not having an investment grade bond rating,²⁶ although he did not and can not tie that fact to the statutory standard for approval.²⁷ In prefiled testimony, Mr. Whitehouse, Frontier's Treasurer, explained that Frontier's management is "committed to a goal of achieving an investment grade rating for the combined company."²⁸ At the hearing, Mr. Whitehouse reiterated Frontier's expectations with regard to investment grade (as well as the process for obtaining an upgrade)

²⁴ Whitehouse, TR. 487:24- 488:7.

²⁵ Whitehouse, Exh. DW-1T at 41.

²⁶ See, e.g., Hill, Exh. SGH-1T at 21.

²⁷ As discussed in Section B below, Frontier has agreed that in its future alternative regulation proceeding, its cost of capital will be based on investment grade debt and equity in order to ensure that ratepayers will not bear any higher capital costs due to Frontier's debt rating. See Staff Settlement Condition 2.

²⁸ Whitehouse, Exh. DW-1T at 25.

and explained why Mr. Hill's suggestion that such expectations amounted to wishful thinking were "anything but that."²⁹

19. Moreover, contrary to Public Counsel's arguments to the contrary, the Commission's assessment of this Transaction should not be driven by comparative credit ratings. An investment grade bond rating is clearly not necessary to maintain access to capital.³⁰ As Frontier's Treasurer David Whitehouse explained: "Moody's would tell you that 73% of the companies they rate are non-investment grade, so if you use that standard that you have to be investment grade to be a strong company, that would imply that 73% of the companies operating that are rated are weak."³¹ That is clearly not a reasonable conclusion. Moreover, almost all major ILECs, including Qwest as the largest telecommunications carrier in Washington, have credit ratings that are not investment grade.³²

20. Finally, Public Counsel witness Hill's purported comparisons to Verizon Communications' credit ratings³³ make little sense and offer nothing meaningful as to the public interest, as Verizon's plans to exit the ILEC business in the state of Washington are clear. By contrast, Frontier views Washington as a business opportunity and intends to direct its capital to areas unserved and underserved with broadband in Verizon Northwest's service area, while at the same time maintaining and continuing to invest in the fiber services that currently serve denser areas in the state. Frontier's commitment to invest in and focus on the local telephone business in Washington is the most relevant and important inquiry for the Commission.

²⁹ Whitehouse, TR. 492:18 -494:17.

³⁰ Whitehouse, Exh. DW-1T at 25.

³¹ Whitehouse, TR. 488:22 -489:2.

³² Whitehouse, Exh. DW-1T at 26-28.

³³ Hill, Exh. SGH-1HCT at 21-22.

vi. Public Counsel's Criticisms of Frontier's Financial Pro Forma and Characterization of the Model Projection are Baseless and Without Any Evidentiary Support.

21. Public Counsel witness Hill suggests that Frontier's projections based on financial pro forma model are bold and overly optimistic.³⁴ These unsupported allegations are baseless for several reasons. First, it is important to recognize that Mr. Hill, the Public Counsel witness making these assertions, has no operating experience and has no experience in creating financial models used in assessing and executing ILEC transactions. By contrast, Frontier is a proven acquirer of local telecommunications assets. The company has successfully acquired and integrated properties over the last two decades and has had no major problems with those acquisitions. Frontier consistently has generated realistic projection models and has executed on those models with favorable results. Frontier's development of its Pro Forma model and its projections of revenues and expenses related to the proposed transaction were conservative and encompass "over 100 years worth of collective experience of folks that are operating managers

³⁴ Hill, Exh. SGH-1HCT at 34:1 - 38:19. Public Counsel's assertion that Frontier failed to provide Public Counsel with Frontier's financial model and that Public Counsel did not have the ability to evaluate the revenues, expenses and cash flow associated with Transaction is inaccurate. Mr. Whitehouse testified at the hearing that the Frontier model was shared with Public Counsel, along with the assumptions that went into the model. Whitehouse, TR. 505: 24-25. Frontier produced its Frontier Pro Forma financial model to Public Counsel in response to several discovery requests propounded by Public Counsel, including Frontier's response to Public Counsel Data Request #255 on September 16, 2009. Whitehouse, TR. 517: 14-22. In fact, Public Counsel identified the Frontier Pro Forma model as a cross examination exhibit for Mr. McCarthy (Exh. DM-49HC). The model provided to Public Counsel was the same model used by Frontier's financial advisors and utilized by Frontier management to evaluate the Transaction. The model is complex and contained "thousands" of detailed data points. Whitehouse, TR. 506: 1-13. The Frontier Pro Forma model was developed as a tool for Frontier management to evaluate the proposed Transaction. It was not designed for third parties to change the model input financial and operating data in an effort to manipulate the model output financial results. Whitehouse, TR. 506: 1-13. Public Counsel apparently wanted Frontier to create a model for Public Counsel, such that Public Counsel's witness could effectively create a different or new model – a reconstructed and manipulated model that would not be Frontier's model but instead would be a model based on Public Counsel's assumptions and projections. With this objective intent, Public Counsel could have created its own model to respond or compete with Frontier's model. However, for whatever reason, Public Counsel elected not to undertake this effort and analysis and instead relies on casting aspersions at Frontier's model and methodology.

and experienced acquirers.”³⁵ Real data was used to formulate the model and the assumptions used in the model were presented and considered by Frontier’s Board of Directors.³⁶

22. Second, notwithstanding Public Counsel’s unsupported statements and unfounded criticisms, Frontier’s expectations for the future financial performance of the combined company, as reflected in the Pro Forma model, are reasonable and based on the company’s extensive experience acquiring and integrating ILEC properties. Frontier’s management is confident in its understanding of trends and the company’s ability to integrate properties, as proven by its record over the last two decades. Importantly, Frontier’s management also believes that Frontier is a focused operator that can effectively respond to market conditions. If the industry forces were to be more negative than anticipated, Frontier’s proven focus on this strategic communications industry segment makes it prepared to respond quickly and effectively to changes in the marketplace.

23. Finally, as explained by Mr. Whitehouse in his testimony regarding the Transaction synergies, there is sufficient “cushion” in Frontier’s financial projections that the company’s operations could fail to meet expectations by an amount equivalent to the estimated annual synergies (\$500 million) and still remain a financially sound operator. Frontier does not believe such a scenario is realistic, but the results should provide the Commission comfort that the company has considered and accounted for any realistic range of issues.³⁷ Frontier is very comfortable that its projections are reasonable and believes that the company’s projections certainly should be given considerably more weight than the criticisms of a party who offers no evidence to the contrary and who possesses no experience in acquiring, integrating and operating a telecommunications company.

³⁵ Whitehouse, TR. 490: 1-20.

³⁶ Whitehouse, TR. 490: 1-20.

³⁷ Whitehouse, Exh. DW-1T at 51-52.

vii. Frontier's Dividend Policy Is and Will Continue to be Prudent.

24. Public Counsel witness Hill suggests that Frontier's dividend payout ratio is too high.³⁸

But his analysis is misguided because it fails to consider the analysis required by financial markets – an evaluation of dividend payments in relation to cash flow or the fact that notwithstanding its dividends policy, Frontier has continued to make substantial investments in its network – investments sufficient to allow it to make broadband available to over 92% of the households in its service territory.³⁹ Likewise, there is no reasonable basis for Public Counsel's recommendation that limitations be placed on Frontier's dividends. Such dividend limitation conditions are clearly counterproductive and potentially have an adverse effect on a company's ability to raise capital. As Mr. Whitehouse testified, Frontier, like other independent ILECs, must raise capital and equity at competitive prices.⁴⁰ The return on that capital is in part dependent on dividends, which are paid out of cash flows. Any condition that is likely to or perceived to restrict the financial and operational flexibility of the company or limit the recovery of capital will impair the company's ability to attract competitively priced capital. The result of this condition is entirely predictable, which is to make Frontier's equity and debt more costly.

viii. Frontier Committed to Numerous Financial-Related Conditions in the Staff Settlement.

25. The information included in Frontier's rebuttal testimony provided Staff with additional data that it needed to conclude that the Transaction was in the public interest on financial issues,

³⁸ See Hill, Exh. SGH-1T at 20-21.

³⁹ Whitehouse, Exh. DW-1T at 40.

⁴⁰ Whitehouse, Exh. DW-1T at 57-58.

and the commitments in the Staff Settlement ensure that detailed reports of information will continue to be provided to the Commission post-close.⁴¹

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

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

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

29. Frontier also agreed not to seek to recover from Washington ratepayers any separation, branding and transition costs (Condition 4), and will hold retail and wholesale customers harmless for increases in overall managements costs that result from the transaction (Condition 11). These conditions assuage Staff's initial concerns about ensuring that Frontier shareholders

⁴¹ McCarthy/McCallion, Exh. DM/TM-1T at 5: 22- 6:2; Weinman, Exh. WHW-6T at 3:15- 4:2.

(including former Verizon shareholders), not Washington ratepayers and wholesale customers, pay for the costs associated with the Transaction and guarantee customers will not bear any burden related to any such costs (*see* Weinman, Exh. WHW 1T at 12-13).

30. Frontier also agreed not to encumber the assets of Frontier Northwest, which means that Frontier agrees not to even *request* Commission approval to use the Frontier Northwest assets to secure debt for a period of three years (Condition 5). As Mr. Whitehouse explained at the hearing, notwithstanding criticism by Mr. Hill, this is a significant condition “because creditors would love to have a direct mortgage or pledge of the assets of the ILEC.”⁴²

B. The Transaction Will Not Create Negative Financial Impacts on Cost of Capital, Capital Structure or Access to Financial Markets.

31. As discussed above, the acquired properties, including Frontier Northwest, generate more cash from their operations than is needed to fund payment of expenses and capital expenditures. This fact was begrudgingly acknowledged by Public Counsel.⁴³ Frontier Northwest will not incur any new debt in order to fund the Transaction. Indeed, Frontier Northwest’s capital structure will improve after the cancellation of intercompany debt, and will further improve as it pays down its existing third party debt (thereby reducing its principal and interest expenses).

32. Given that Frontier Northwest will have no need for additional outside capital, its “cost of capital” is not relevant from an operational point of view. However, to address concerns that the parents’ respective bond ratings could affect the cost of capital used in future proceedings, Frontier agreed as part of the Staff Settlement to file for an AFOR, and when it does, its cost of

⁴² Whitehouse, TR. 491: 3-6.

⁴³ Mr. Hill was forced to concede the significant cash generated from Verizon Northwest’s regulated operations (“The regulated operations are – they’re, you know, just as Frontier says, they’re throwing off a lot of cash.” Hill, TR. 626: 17-19) in response to questions from the Chairman about Mr. Hill’s suggestion that Verizon subsidizes its regulated Washington business through its unregulated wireless operations (“And simply put, Verizon’s making a ton of dough on their wireless business, and they have the financial capacity to support this business in Washington, the local exchange business in Washington.” Hill, TR. 625: 23 – 626:1). He goes on to note that “regulated cash flows [can] do the job of building the network that need to be there.” Hill, TR. 627: 3-5.

capital will be based on investment grade debt and equity.⁴⁴ That condition ensures that Washington consumers are “not []required to bear higher capital costs due to Frontier’s lower [bond] ratings.”⁴⁵

33. As Frontier’s Treasurer David Whitehouse testified, Frontier is very confident in its ability to secure the financing for this Transaction on reasonable terms.⁴⁶ As Mr. Whitehouse explained in detail at the hearing in response to questions by Commissioner Jones, Frontier has begun the process to seek financing to complete the Transaction.⁴⁷

34. One indicator of Frontier’s ability to raise capital and the financial markets’ assessment of Frontier’s creditworthiness came on September 17, 2009, when Frontier was able to arrange new debt financing to raise net proceeds of \$577.6 million (gross proceeds of \$600 million), through 8.125% (8.375% yield to maturity) Senior Notes due in 2018.⁴⁸

35. The recent financing activities are significant for two additional reasons. First, with Frontier’s improved credit and financial profile at the completion of the combination, the rates and terms the combined company will attract at the time of the transaction closing will likely be *at least as, if not more, favorable* than the terms (rate of 8.375%) that Frontier achieved in its recent financing or that it could attract at that time if the merger were not completed.⁴⁹ Second, the recent financing was completed at a rate well below 9.5%; and the merger agreement

⁴⁴ Staff Settlement, Condition 2.

⁴⁵ *Id.*

⁴⁶ Whitehouse, Exh. DW-1T at 48.

⁴⁷ Whitehouse, TR. 568-576.

⁴⁸ Whitehouse, Exh. DW-1T at 45. At approximately the same time, Frontier also announced that the proceeds of the financing would be used, together with cash balances, to fund the proposed repurchase (“Tender”) of certain of its outstanding earlier-maturity debt. *Id.* At 46. On October 1, 2009, Frontier announced the completion of the debt offering. Furthermore, on October 16, 2009, Frontier announced that it had successfully completed the Tender and had applied the full “Maximum Payment Amount” of \$700 million toward the repurchase of its outstanding 9.250% Senior Notes due 2011 and 6.250% Senior Notes due 2013. As a result, Frontier’s maturities through 2011 now consist of approximately \$7 million, maturing in 2010 and \$280 million maturing in 2011. Therefore, Frontier has reduced its aggregate principal amount of debt maturing for more than one year period following the closing of the proposed Transaction to an amount that could be refinanced primarily through surplus cash on hand or through its existing \$250 million undrawn credit facility, if necessary.

⁴⁹ Whitehouse, Exh. DW-1T at 46-47.

provides a protective trigger if the Transaction financing were for some reason to require an annual interest rate above 9.5%, so Frontier does not have to accept terms that would be unduly burdensome.⁵⁰ Therefore, information based on actual debt issuance by Frontier in the market provides a reliable indication that the company will be able to attract financing at interest rates that could be lower than the most recent financing. As Mr. Whitehouse explained, these market-based data should allay concerns regarding financing costs and issues as every indication is that Frontier will be able to effectively secure the financing with the range of Frontier's expectations.⁵¹

C. The Transaction Will Not Impact the Excellent Service Quality Provided by Verizon Northwest in Washington.

36. Frontier is fully capable of continuing the excellent service quality record posted by Verizon Northwest in Washington. That service quality record was made clear throughout the docket:

- “Verizon’s statistics are so good. I mean I think in the last 12 months there’s only 1 month where the trouble index was 1.1%, and it’s been under 1, and that indicates to me that they’re not having a lot of problems, which a lot of times is caused by plant, bad plant.”⁵²
- “They still have good statistics.”⁵³
- “Verizon provides a higher level of performance, a better level of performance than the minimum standards.”⁵⁴
- “And I would point to the call center performance in 2009 by Verizon and the trouble report rate by Verizon, both of which are better than the minimum standards today.”⁵⁵
- “[I]n Washington, ... the network statistics and the trouble instances have been very good in this area.”⁵⁶

⁵⁰ Whitehouse, Exh. DW-1T at 47.

⁵¹ Whitehouse, TR. 568:7 – 576:14.

⁵² Weinman, TR. 349: 9-15.

⁵³ Weinman, TR. 350:1.

⁵⁴ Alexander, TR. 409: 24-410:2.

⁵⁵ Alexander, TR. 410:13-16.

⁵⁶ McCarthy, TR. 348: 11-14.

- “Washington has been one of the best performers of the properties that we’ve seen in the Verizon portfolio.”⁵⁷
- “[I]f you look at our service quality statistics, especially the trouble reports because I think that’s very telling, it shows that the quality of service we’re delivering to our customers is very high.”⁵⁸

37. Moreover, it is undisputed that Frontier, which operates more than two million access lines in 24 states, has substantial managerial and technical expertise in the telephone industry and provides high quality service.⁵⁹ Indeed, Billy Jack Gregg, former Director of the West Virginia Consumer Advocate, testified: “[S]tate commissions in other states where Frontier currently operates have a good opinion of Frontier. My experience has been the same.”⁶⁰ In addition, as Staff witness Weinman stated at the hearing:

we contacted other commissions on Frontier’s service quality, specifically Minnesota, Oregon, New York, Missouri, and Wisconsin, and the staff people that we talked to gave good – a good report that Frontier does have good quality of service and that they haven’t had any quality of service issues in those states.⁶¹

With the retention of current Verizon employees who are well versed in the Verizon systems and familiar with Verizon’s Washington operations and customers, Frontier will be well-positioned to operate the new Frontier ILEC business in this state and across all 14 states. And Frontier will be able to build on Verizon’s service quality record through its localized focus and management that will be nimble enough to respond quickly to any perceived problems.⁶²

⁵⁷ McCarthy, TR. 388: 10-11.

⁵⁸ McCallion, TR. 352: 17-21.

⁵⁹ See, e.g., McCarthy, Exh. DM-1T at 3-6.

⁶⁰ Gregg, TR. 485: 2-4.

⁶¹ Weinman, TR. 392: 17-23.

⁶² Application ¶¶ 34-35.

38. In the words of Staff witness Weinman, “Verizon’s service quality has been very good, very low trouble indexes, and there’s no reason to believe that Frontier won’t continue on with maintaining that type of performance.”⁶³

i. Frontier Agreed to Additional Conditions That Ensure Continuity of Service Quality.

39. In response to Staff concerns regarding ensuring service quality levels post-closing in accordance with Commission standards, Frontier committed to augment Verizon’s existing “Service Performance Guarantee” (“SPG”) program with additional credits, and to create a new retail service quality program with self-executing penalties if Frontier fails to meet the delineated standards.⁶⁴

40. Under Condition 19 of the Staff Settlement, Frontier will increase the missed commitment credit for residential customers from \$25 to \$35, and verbally notify customers of this credit offering at the time of the customer’s order. As Mr. Weinman pointed out at the hearing, “the \$35 missed commitment credit to a customer is higher than any other ILEC that is subject to missed commitments.”⁶⁵ Frontier also will offer the customer alternative services for failure to deliver basic service on time, and provide a flat-rate credit of \$5 for out-of-service conditions greater than two days.⁶⁶ As Mr. Weinman noted at the hearing, such a credit is a significant increase over Verizon’s current credit for such a miss, which is \$1.12.⁶⁷

41. Frontier also agreed to a retail service quality plan that involves customer credits in the event that any of six metrics are not met. This is a significant commitment by Frontier to

⁶³ Weinman, TR. 392: 10-14.

⁶⁴ McCarthy/McCallion, Exh. DM/TM-1T at 10-11.

⁶⁵ Weinman, TR. 520: 15-17.

⁶⁶ Ms. Alexander criticizes the dollar amounts associated with this as “very small.” Alexander, TR. 407: 14-15. That is demonstrably false, as Mr. Gregg noted that the \$5 increase amounts to approximately 30% of the basic monthly charge for premium service in Washington, which is relatively large given that this a “prophylactic,” not “remedial” plan. Gregg, TR. 484: 11-17.

⁶⁷ Weinman, TR. 520:21 – 521:1.

guarantee its performance since no such plan currently applies. Under the plan, Frontier could pay customer credits of up to \$100K per metric per year, with an escalation clause that could double the maximum level of such credits if Frontier fails to meet the metrics for two years and could triple the maximum level of credits if Frontier fails to meet the metrics for three years. As a result, the provision puts significant amounts of potential penalties at risk for non-compliance. For example, the escalator for non-compliance in the second and third years would mean that a second year penalty could be \$1.2M and a third year penalty could total \$3.6M.⁶⁸

42. As the Staff pointed out at the hearing, putting Frontier at risk for \$3.6M in potential penalties is unprecedented given the current level of service quality provided by Verizon in Washington, with nothing analogous provided for in the all-party settlement approved in Washington for the CenturyTel/Embarq merger.⁶⁹ In addition, as Mr. Weinman indicated at the hearing, references to a service quality program instituted for Qwest years ago are not relevant here:

At the time Qwest was suffering from poor quality of service, we did not have service quality rules. And by – in comparison, Verizon’s service quality has been very good, very low trouble indexes, and there’s no reason to believe that Frontier won’t continue on with maintaining that type of performance.”⁷⁰

Public Counsel witness Alexander’s suggestion that this significant financial incentive amounts to a “drop in the bucket”⁷¹ is simply wrong. Mr. McCarthy noted at the hearing that any kind of service penalty is too much, and that even if the escalator were not triggered, a \$600K penalty

⁶⁸ McCarthy, TR. 387:4 – 388:4.

⁶⁹ Weinman, TR. 527: 2-17.

⁷⁰ Weinman, TR. 392:8-14.

⁷¹ Alexander, TR. 411: 2-5. Ms. Alexander also criticizes the three year length of time on the service quality financial penalty plan. Alexander, TR. 412: 11-13. Given that the only basis for the plan is that it is designed to prevent service quality “harm” associated with the Transaction, a three year time period is more than sufficient.

would not only get his attention as Chief Operating Officer but also likely the attention of the Chief Executive Officer and Board of Directors of Frontier.⁷²

43. Indeed, as Frontier witness Gregg noted on the service quality commitments, “the agreement reached in Washington is more comprehensive than the agreements reached in other states in many ways.”⁷³ Moreover, Frontier views Washington as presenting a unique opportunity to build on the service quality success and substantial investment that Verizon has made in the state. In the words of Mr. McCarthy, “Washington has been one of the best performers of the properties that we’ve seen in the Verizon portfolio, and we’re confident that we’ll be able to meet those metrics [in the service quality plan in the Staff Settlement].”⁷⁴

44. Frontier also agreed in the DOD/FEA Settlement to file with the Commission and the Staff a quarterly report card of the averaged quarterly results for the retail service quality metrics (a) through (f) in paragraph 20 of the Staff Settlement.⁷⁵ Frontier is committed to meeting each such metric, but for each metric that is missed, Frontier will provide Commission and the Staff with a plan to identify the specific steps to be taken and the planned expenditures to address the missed service quality metrics. Frontier also committed to make the budgeted expenditures to address any such missed metric and track the expenditures until they are met. DOD/FEA witness King testified that these provisions satisfy its objectives to: (i) shorten reporting time thresholds to help identify problems; (ii) impose a specified plan to resolve any inadequacies and (iii) establish dedicated funding to resolve any such issues.⁷⁶

⁷² McCarthy, TR. 496: 18-25.

⁷³ Gregg, TR. 483: 13-15.

⁷⁴ McCarthy, TR. 388: 10-13.

⁷⁵ McCarthy, Exh. DM-83T at 3.

⁷⁶ King, Exh. CWK-7T at 4-5.

ii. Frontier Will Receive Proven, Fully Functioning Operational Support Systems That Support Washington.

45. Concerns were expressed at the outset of this docket that customers could be affected because of the potential for operational problems similar to those experienced by Hawaiian Telcom and FairPoint Communications after cutting over from Verizon's operational support systems ("OSS") to newly created systems those acquirers developed to operate the acquired assets.⁷⁷ Through workshops and the exchange of detailed information, the Staff's initial concerns were removed as they recognized the key differences between this Transaction and the others (in part because of the Staff Settlement provisions described below). Specifically, Staff witness Williamson, *who has himself worked on systems replications*,⁷⁸ noted at the hearing that he "reached a comfort level because the level of expertise that [he] found at the company and the planning following the second [workshop] in September gives me comfort."⁷⁹

46. Notwithstanding the clear differences in the systems component of the transactions, Public Counsel continues to argue that Frontier will experience problems here similar to those experienced by Hawaiian Telcom and FairPoint. This ignores the evidence in the case. As a starting point, Frontier is not analogous to the acquirers in those transactions. Pre-transaction Frontier is a much larger company than either Hawaiian Telcom and FairPoint and has extensive experience with systems transition issues. For example, just in the past five years Frontier has successfully integrated five billing systems, converting approximately 1.7 million access lines into a single scalable company-wide platform.⁸⁰ By contrast, the acquirer of Hawaiian Telcom,

⁷⁷ See Roycroft, Exh. TRR-1HCT at 29-39; Williamson, TR. 319: 14-21.

⁷⁸ Williamson, TR. 319: 5-7.

⁷⁹ Williamson, TR. 319: 2-5.

⁸⁰ McCarthy, Exh. DM-8HCT at 58.

The Carlyle Group, was an investor group with no prior experience in the telephone industry, and FairPoint also had far less relevant experience.⁸¹

47. Even more importantly, the operational problems of Hawaiian Telcom and FairPoint cannot occur here because Verizon has agreed to provide Frontier with a replicated copy of the entire suite of proven, battle-tested OSS that Verizon itself uses to operate Verizon Northwest.⁸² Public Counsel asserts that this replication process is “unusual” and that it poses risks to consumers,⁸³ but Public Counsel’s witness, who has *no background in engineering or information technology*, provides no basis for that assertion. The fact is Verizon has substantial experience replicating and/or establishing standalone systems, and the replication process is proceeding apace without problems.⁸⁴ In any event, Public Counsel’s purported concerns about the replication process are eliminated by the contractual requirements that Verizon use the replicated systems in the live operations of Verizon Northwest for at least sixty days prior to the close of the Transaction – and that the Transaction will not close unless and until Frontier has validated that the replication process has been successful.⁸⁵ Verizon’s and Frontier’s witnesses described in detail the extensive testing that will be done – both before and after the systems are put in to production by Verizon – to confirm that the success of the replication process.⁸⁶

48. The “turnkey” nature of the Transaction bears no resemblance to the Hawaiian Telcom or FairPoint transactions, where the acquirers attempted unsuccessfully to move Verizon’s data to

⁸¹ McCarthy, Exh. DM-8HCT at 59-63. Frontier has more than nine times as many access lines as FairPoint did prior to acquiring Verizon’s New England properties. *Id.* at 56. And FairPoint operated only 61,000 lines in its largest state, whereas Frontier has more than 600,000 lines in its largest state. *Id.*

⁸² See, e.g., McCarthy, Exh. DM-8HCT at 40-43; Smith, Exh. SES-1T at 4-9.

⁸³ Roycroft, Exh. TRR-1HCT at 29-33.

⁸⁴ Smith, Exh. SES-1T at 11-13, 15.

⁸⁵ See McCarthy, Exh. DM-8HCT at 40-42; Smith, Exh. SES-1T at 5-7, 13-14. Moreover, the knowledgeable and trained Verizon personnel operating Verizon Northwest prior to the close of the transaction will continue employment with Frontier, and Verizon will maintain the OSS for at least a year after closing. *Id.* at 10.

⁸⁶ See Smith, Exh. SES-1T at 13-14; McCarthy, Exh. DM-8HCT at 40-42.

newly developed operational support systems.⁸⁷ Apparently acknowledging that the Joint Applicants have planned well for a smooth systems transition at close, Public Counsel suggests that systems problems could occur *at some point in the future* if Frontier chooses to integrate the replicated systems acquired from Verizon with its own existing systems.⁸⁸ But that argument is similarly unfounded. Frontier will face no pressure – and has no plans – to transition away from the systems it will acquire from Verizon because the replicated systems function well, are royalty-free for Frontier to use, and will be fully maintained under a competitively priced maintenance contract with Verizon.⁸⁹ And to the extent Frontier does choose to migrate to its existing systems in the future, such migrations are common in the telephone industry and do not present substantial risks.⁹⁰ Frontier will be extremely familiar with the replicated systems because it will have operated them for a substantial amount of time, and will be able to plan for and execute the transaction at its own pace.⁹¹ If Frontier chooses to shift from the replicated systems, it would transition to its *existing* systems which – unlike the new systems Hawaiian Telcom and FairPoint developed – are proven and fully scalable.⁹² Accordingly, Public Counsel’s purported concerns about systems transition risks are unfounded.

49. Moreover, in response to concerns expressed by the Staff on this point, Frontier agreed to Condition 29 of the Staff Settlement. Under this condition, if Frontier plans to transition from

⁸⁷ This turnkey approach to systems transition also applies to the 911 systems and network. Verizon will hand off to Frontier a full-staffed, working 911 network and systems modeled after what Verizon has used successfully to provide state-of-the-art, reliable, redundant E911 services in Washington. See McCallion, Exh. TM-2HCT at 25; Smith, Exh. SES-1T at 24. Accordingly, Public Counsel’s attempt to raise the specter of possible 911 problems (Roycroft, Exh. TRR-1HCT at 39-40) is ungrounded.

⁸⁸ Roycroft, Exh. TRR-1HCT at 38.

⁸⁹ McCarthy, Exh. DM-8HCT at 46-49; Smith, Exh. SES-1T at 17-19. The maintenance fee Frontier will pay Verizon is a competitive, arms-length price that is much lower than the monthly fees Hawaiian Telcom and FairPoint paid for transition services. Smith, Exh. SES-1T at 18-19. Moreover, while Verizon is required to continue to provide maintenance services beyond the first year, Frontier negotiated the right to “shop around” for maintenance services after the first year, and is free to either shift to a third party or perform them in-house. *Id.*

⁹⁰ See, e.g., Smith, Exh. SES-1T at 17-18.

⁹¹ McCarthy, Exh. DM-8HCT at 47-48; Smith, Exh. SES-1T at 16-17.

⁹² McCarthy, Exh. DM-8HCT at 44-46.

the Verizon replicated systems during the three years after closing, it will prepare and submit a detailed OSS integration plan to Staff.⁹³ The plan will detail any problems that occurred in other systems integrations and explain what is being done to avoid similar problems in Washington. Frontier will provide this plan at least 180 days prior to implementing any such system transition. Mr. Williamson explained at the hearing how Condition 29 was important to Staff, and how Staff would involve the Commission if it saw an unresolvable issue during the six month period to review the plan for any such conversion.⁹⁴

iii. Pre-Production Testing and Production Results Will Confirm That the OSS is Fully Operational.

50. Building on the process for providing Frontier with a turnkey, replicated set of Verizon systems to serve Washington, Verizon agreed as part of the Staff Settlement to provide Staff with additional access to the pre-production and production systems replication processes and the right to review systems testing results. In addition, Verizon is obligated to pay for the retention of an independent third-party “reviewer” to verify the accuracy of the performance results for its replicated OSS prior to and subsequent to putting the replicated systems into production. Conditions 27-28 address Staff’s concern about being able to validate assurances by Verizon and Frontier that this transaction will have better results than previous Verizon divestitures. These conditions further ensure that the systems being transferred to Frontier are functioning both *before* and *after* the systems go into production mode.

51. Before Verizon puts the replicated systems into production mode, it will share with Staff the “Program Test Strategy” Plan to be used to review the replicated systems, and the results of pre-production tests on the customer-affecting systems that serve retail customers (Condition 27). These tests must show that the systems are working and that if there were any “full service

⁹³ McCarthy/McCallion, Exh. DM/TM-1T at 15.

⁹⁴ Williamson, TR. 319: 22- 322:17.

denials” associated with the systems, they have been resolved.⁹⁵ Also, a third party reviewer must validate that the test results are accurate. And the Settlement sets forth a process by which the Staff helped select the third party reviewer that will be retained and paid for by Verizon.

52. As for performance during production mode, Verizon will share with Staff the results for four key, specific retail measures: installation commitments met; customer network troubles per 100 access lines; repairs cleared within 48 hours; and billing error complaints (Condition 28). On these key measures, Verizon must show that by the end of the production mode, there has been no material degradation from benchmark quality of service data from 12 months prior to production mode on the replicated systems. And here, too, a third party reviewer must validate that the results are accurate.⁹⁶

53. Public Counsel witness Alexander agrees with the “intent” of Condition 28 but discounts the measures as “too small a group.”⁹⁷ That misses the point. All Washington service quality standards and measures will still apply to Verizon’s use of the replicated systems during the production period.⁹⁸ The purpose of the measures identified in Condition 28 is to allow the Joint Applicants and the Staff to monitor whether the replicated systems are fully operational. As Mr. Williamson indicated at the hearing, this Staff and the staffs of other state commissions with whom Mr. Williamson consulted believe these particular measures are appropriate because

⁹⁵ Dr. Roycroft criticizes Condition 27’s focus on full service denials. Roycroft, TR. 463: 2- 464:8. Such denials are the appropriate focus on pre-production mode because they impact the ability of the involved systems to function correctly and could result in consumer problems.

⁹⁶ Williamson, TR. 302:3 – 7; McCallion, TR. 376: 15- 377:22.

⁹⁷ Alexander, TR. 414: 2-3. Ms. Alexander also criticizes the Condition 28 measure of “billing error complaints” during the production period, claiming that “billing errors” is not sufficiently defined. Alexander, TR. 414: 15- 415:4. As Mr. Williamson indicated at the hearing, that measure was important to Staff because if the replicated systems are not producing proper bills, customers will complain to the Commission and to Verizon about their bills, and that will be an indication of the whether the replicated systems are fully operational. Williamson, TR. 523: 10 – 524:3.

⁹⁸ Williamson, TR. 522: 18-20 (“This in no way takes place of the regular quality of service reports. They will continue for Verizon as they do today.”).

they constitute indicators that are “the canary in the mine for a massive failure.”⁹⁹ It is just such a system failure that Condition 28 is designed to monitor and prevent.

54. As further assurance that the systems are working properly prior to close, the Settlement provides that the closing will not occur unless and until Frontier validates and confirms that the replicated systems are fully operational.¹⁰⁰ Also, Verizon must complete the testing and issue a report to the Commission validating that the OSS are operational (including the validation by the third party reviewer that the result are accurate) at least five days prior to close.¹⁰¹ Thus, Conditions 27-28 ensure that the systems being transferred to Frontier are functioning both *before* and *after* the systems go into production mode, and this calls for an independent third party to validate the accuracy of the relevant test results. The continued use of the Verizon systems will result in the same quality and no disruption of service for customers in Washington.

D. Although Not Required, Customers Will Share in Benefits of the Transaction.

55. Although net benefits are not required to be shown for a Transaction to meet the no harm standard applicable for approval of telecommunications transactions in Washington, the

⁹⁹ Williamson, TR. 522: 14-16. Ms. Alexander’s criticisms of the term “material degradation” in Condition 28 (Alexander, TR. 414: 4-14) are off the mark for the same reason.

¹⁰⁰ Williamson, TR. 523: 6-9 (“It’s very important to Frontier to make sure that these systems are working correctly because they will live with them after the 60 days.”).

¹⁰¹ Ms. Alexander criticizes the time period as “probably too short.” Alexander, TR. 414:2. Any problems will be identified within sixty days of usage of the replicated systems, and the five days on the back-end was requested by Staff so that the report can include data through the end of the 60 day period. Mr. Weinman noted at the hearing that the 60 days provides “one full billing cycle, and then it gives us 30 days beyond to see if the trouble or whatever metric we’re looking at here starts to become a problem or an issue for us.” Weinman, TR. 290: 8-11. Moreover, Mr. Williamson stated that “if there’s a problem it would happen more immediately, so we would know way before the 60 days was up.” Williamson, TR. 297: 12-14. As Mr. Williamson also indicated, Verizon has already been working closely with Staff on this and will be in continuing communication during the 60 day period. So, as Mr. Williamson noted, the Staff does “not expect to get to the 55th day and be shocked at what the report says. We believe we will know what it’s going to say before then, and the 5 days will give us time to analyze it in more detail.” Williamson, TR. 524: 18-21.

Commission takes into account prospective customer benefits when evaluating transactions.¹⁰²

With this Transaction, customer benefits will be plentiful. The Application and supporting testimony made clear that Frontier intends to deploy broadband in areas unserved or underserved by Verizon and Frontier has memorialized the commitment to broadband deployment in the Staff Settlement. In doing so, Frontier plans on utilizing DSL deployment tactics that “in the Verizon model they have not really focused on, and it’s one of the benefits that we bring to this transaction.”¹⁰³

56. The benefits from broadband investment have been recognized to have a multiplier effect throughout the economy.¹⁰⁴ As the Ohio Public Utilities Commission noted in its Order approving this Transaction in Ohio on February 11, 2010, in relation to Frontier’s commitment to expand broadband to 85% of the former Verizon territory in that state:

We are very pleased that Frontier North will undertake the commitment to provide broadband service to rural areas of Ohio. Without the widespread availability of broadband, Ohio cannot realize the business potential that lies dormant in its nonurban areas. Nor can rural students and teachers fairly compete with their urban counterparts. With this commitment to deploy broadband to unserved areas, we are hopeful that, ultimately, any location in Ohio will have the potential for business, learning, and communication.¹⁰⁵

As the Ohio Commission noted, the benefits of broadband are all the more important in rural areas: broadband service can unlock distance learning and telemedicine for areas lacking universities and hospitals; draw employers to rural areas to take advantage of lower labor rates

¹⁰² See, e.g., *In the Matter of the Joint Application of Embarq Corporation and CenturyTel, Inc.*, Docket UT-082119, Order 05 (May 28, 2009) (“*CenturyTel Order*”); *MCI Order*.

¹⁰³ McCarthy, TR. 498: 23-25.

¹⁰⁴ See *Interim Order Instituting Rulemaking into the Review of the California High Cost Fund B Program*, Rulemaking 06-06-028 (December 20, 2007), California Public Utilities Commission at n. 2 (citing Robert Crandall, William Lehr & Robert Litan, *The Effects of Broadband Deployment on Output and Employment: A Cross-sectional Analysis of U.S. Data*, The Brookings Institute: Issues in Economic Policy (July 2007) (which notes, at 2, that it has been estimated that a one-percent increase in broadband penetration translates into a 0.2 to 0.3 percent increase in employment)).

¹⁰⁵ Opinion and Order, *In the Matter of the Joint Application of Frontier Communications Corporation, New Communications Holding, Inc., and Verizon Communications Inc. for Consent and Approval of a Change in Control*, Case No. 09-454-TP-ACO (issued Feb. 11, 2010), at 28.

and costs of living; enable local businesses to expand; and allow local residents to enhance skills and become more attractive employees. This rural economic development, in turn, creates positive effects that ripple through Washington – which is precisely what will happen as a result of this Transaction.¹⁰⁶ Simply put, acceleration of deployment of broadband into unserved areas of Washington will not only benefit the customers affected, but will improve the quality of life and economic prospects of the entire state.

57. And in the Staff Settlement, Frontier made significant and measurable commitments to expand broadband availability in Washington. Indeed, Mr. McCarthy stated at the hearing that:

[t]he commitment in Washington really follows the same kind of evolution that we've used in our legacy markets, and that is we want to get to the most reach that we can as quickly as possible. ...But I think that the commitments that we've made here in Washington are actually as large or larger than any other state that we've done any kind of settlement with as part of this transaction.¹⁰⁷

Under Condition 15, Frontier Northwest will deploy broadband service in not less than 95% of the current Verizon Northwest Washington wire centers within two years of closing.¹⁰⁸ In the aggregate, Frontier has further agreed to make broadband services available to approximately 89% of the households in the current Verizon Northwest service territory in Washington by December 31, 2014. Condition 15 also spells out specific milestones for currently unserved, under-served and all other wire centers. For example, Frontier must make DSL available to 50% of the households in wire centers where DSL is currently not available by 2011 and to 85% of households in those wire centers by the end of 2014.¹⁰⁹

¹⁰⁶ It has been estimated that every dollar of investment in broadband produces an increase in overall economic activity of nearly three times that amount. See Jeffrey A. Eisenach, Hal J. Singer, & Jeffrey D. West, *Economic Effects of Tax Incentives for Broadband Infrastructure Investment*, at 8 (2009).

¹⁰⁷ McCarthy, TR. 499:14 -500:2.

¹⁰⁸ McCarthy/McCallion, Exh. DM/TM-1T at 8-10.

¹⁰⁹ Public Counsel Witness Roycroft dismisses the broadband deployment conditions because of what he perceives to be Frontier's pursuit of "old fashioned DSL deployment." Roycroft, TR. 448: 12. Customers who are currently not served by broadband that will receive it as a result of this Transaction would likely disagree. And the criticisms of Frontier's use of DSL technology are misinformed. As Mr. McCarthy explained at the hearing, "DSL technology

58. Frontier also will submit an initial plan and annual reports that details how these commitments will be and are being met, and will consult with the Staff regarding the geographic scope of the broadband deployment (including the specific wire centers that will be included) (Condition 17). Moreover, Frontier committed at the hearing to welcome the input of Public Counsel with respect to its plans associated with Condition 17.¹¹⁰ In order to address any unforeseen technical impediments to broadband deployment, a concern raised initially by Staff (*see* Weinman, Exh. WHW-1T at 14-15), Frontier commits to immediately identify such impediments to the Commission in a detailed report and to propose an alternative broadband deployment plan to provide a similar level of public benefit (Condition 14). This will allow the Commission an opportunity to ensure that the stated broadband deployment benefits will be delivered to Washington.

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

60. In order to address concerns expressed in initial testimony filed by Staff regarding Frontier's ability to devote financial resources to broadband deployment in Washington, Condition 13 includes a specific commitment by Frontier to expend approximately \$40 million on broadband deployment in Washington by December 2014. The condition requires Frontier

still remains the workhorse of how broadband is delivered to households over copper lines." McCarthy, TR. 498: 3-6. Frontier is constantly upgrading and improving the way it uses DSL technology, and "use[s] different types of techniques depending upon the densities and different tactics to go after home penetrations with as little as 20 to 50 homes in the area." McCarthy, TR. 498: 20-23. Moreover, it is not as though Frontier's use of DSL and FiOS technologies are mutually exclusive. As explained by Mr. McCarthy, Frontier will continue to use fiber technology from the FiOS investments made in certain areas in Washington by Verizon and will use DSL to serve areas that are currently unserved and underserved. McCarthy, TR. 497: 14-24.

¹¹⁰ McCarthy, TR. 388:14- 389:5.

to specifically deposit \$40 million in a bank account, escrow account or other account as approved by the Commission to fulfill its broadband commitments in Washington. Frontier will be able to draw down on the \$40 million fund only as it shows to the Commission's satisfaction that each broadband project in Washington is completed. This dedicated funding and the Commission's control of its disbursement, demonstrates a real commitment to broadband deployment in Washington. Indeed, Mr. McCarthy explained that the account would be set up "to only allow the disbursement back to Frontier based upon a written instruction from the Commission that it was satisfied that we had met the requirements of the broadband buildout for that period."¹¹¹

61. And the \$40 million figure that comprises the financial commitment was well developed.

At the hearing, Mr. McCarthy stated:

The \$40 Million figure was derived from using a broadband model that took into account the starting point as being the latitude and longitude of every network element that exists in Washington, for that matter across the country. We then looked at the wire centers, we looked at the equipment that was there, we looked at the transport to and from that network element, we looked at the densities around it from a customer perspective, and we developed a model that was based in our own experience in serving similar density customers around the country, and that is really the basis for the \$40 Million. We've actually subsequent to signing the deal, we've verified it again, had independent work done to verify our model, and we're very comfortable that the \$40 Million is appropriate for the commitments we're making."¹¹²

These significant, specific and measurable broadband deployment commitments by Frontier refute Public Counsel witness Roycroft's criticism in testimony that "Frontier, while making general promises regarding future benefits of the transaction, has not made a single commitment

¹¹¹ McCarthy, TR. 386: 7-11.

¹¹² McCarthy, TR. 500:23 -501:14. Dr. Roycroft attempts to confuse the \$40 million broadband DSL commitment with other capital investments that Frontier plans to make in Washington. Roycroft, TR. 452- 454. For example, Mr. McCarthy explained that the \$40 million commitment on DSL was in addition to other capital expenditures that Frontier will make in Washington, including approximately \$30 million in the first year and \$55-\$60 million in the second year. McCarthy, TR. 395: 23- 396:5.

that would result in quantifiable benefits accruing to Washington ratepayers.”¹¹³ Yet now Dr. Roycroft finds fault with the specific commitments, claiming that the broadband deployment percentages are not high enough,¹¹⁴ the deployment speeds are not fast enough,¹¹⁵ and the \$40 million commitment is not large enough.¹¹⁶ These criticisms miss the point and illustrate the unreasonable and overreaching nature of Public Counsel’s opposition. The broadband commitments, taken together, were designed to address Staff’s preferences on where broadband deployment should be targeted, and Staff’s desire for a dedicated source of funding for the deployment. As Mr. Weinman explained at the hearing:

- the \$40 million escrow fund “is a downpayment. It’s a showing of good faith that the company has the ability to escrow this kind of money and then go forward and build the plant.”¹¹⁷
- “For Staff, our primary concern was to get service to underserved and unserved areas and have a deployment over a much broader base. I mean 92% would be fairly easy to achieve if all you have to do is worry about it in the higher population centers and not worry about the areas that are underserved or unserved.”¹¹⁸
- “[W]e’re talking about a product that as far as I’m concerned has certain market pressures for [] price, speed, and limitations. Otherwise Frontier is not going to be able to achieve the penetration of high speed Internet services that are available to those customers.”¹¹⁹

62. Moreover, as Mr. McCarthy noted at the hearing, the Staff Settlement terms were designed to give the Staff concrete assurances on Frontier’s broadband deployment plans in

¹¹³ Roycroft, Exh. TRR-1HCT at 89:17-90:1.

¹¹⁴ Roycroft, TR. 456: 11- 457: 4.

¹¹⁵ Roycroft, TR. 457: 5 - 458:20.

¹¹⁶ Roycroft, TR. 449:4 -455: 10. Dr. Roycroft provides no basis for his broadband deployment recommendations and provides no information to suggest that he has undertaken any Washington specific analysis (such as deployment levels by other Washington carriers) to support his recommendation. Dr. Roycroft even criticizes the \$40 million fund because he claims that Frontier could use federal broadband stimulus funds for a broadband project and then “recoup moneys” from the \$40 million fund to the project as well. Roycroft, TR. 453:1-4. That is simply not the case. Mr. McCarthy testified that if Frontier were somehow able to obtain federal broadband stimulus funds, they “would be used for the final 5% to 7% that are not economic. It would not displace the \$40 Million that we’ve committed to get to the 89%.” McCarthy, TR. 502: 19-22.

¹¹⁷ Weinman, TR. 525: 13-17.

¹¹⁸ Weinman, TR. 525: 20 - 526:1.

¹¹⁹ Weinman, TR. 526: 8-13.

Washington.¹²⁰ Such commitments will benefit Washington customers, and Frontier will strive to exceed the commitments when possible. The broadband conditions go far beyond the deployment commitments contained in the CenturyTel/Embarq all-party settlement, which the Commission described as providing “non-regulated DSL service to 2200 customers”¹²¹

E. The Transaction Will Have No Impact on Rates, Terms and Conditions of Service.

63. As Frontier’s Chief Operating Officer McCarthy explained, the Transaction will not impact the rates, terms and conditions of regulated services provided by Verizon Northwest, as that entity (along with its tariffs and catalogs) will remain intact (with a new name and parent) after the closing.¹²² In addition, Frontier has agreed in the Staff Settlement to a number of retail rate conditions in response to concerns expressed initially by the Staff.¹²³

i. Retail Service Commitments.

64. For example, Frontier agreed to cap rates for Retail Flat and Measured Rate Residential Services at current levels for a minimum of three years (Condition 23). Thus, under the Staff Settlement, retail customers will enjoy a guarantee of no rate increase for these services for a full three years after the Transaction closing.

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

¹²⁰ McCarthy, TR. 499:19-20.

¹²¹ CenturyTel Order at 17.

¹²² Application ¶ 43; McCarthy, Exh. DM-1T at 42-43.

¹²³ McCarthy/McCallion, Exh. DM/TM-1T at 11-12.

Also consistent with a condition proposed by Staff witness Roth, Frontier has agreed that, for 90 days after the close of the transaction, it will waive presubscribed interexchange carrier (“PIC”) charges for current customers who wish to change to another carrier (Condition 25).¹²⁴

66. In response to concerns expressed by the Staff to ensure that retail customers will continue to obtain the rate benefits associated with the settlement of the regulatory treatment of the spin-off of the yellow page business in Docket UT-061777, Condition 22 of the Staff Settlement specified that the revenue imputation associated with that settlement will continue to apply post-transaction.¹²⁵ Specifically, Frontier Northwest will continue to honor the \$37.5M annual revenue increase adjustment through December 31, 2016.¹²⁶ Thus, the \$37.5M annual revenue increase adjustment will be included in any future proceeding of the Commission reviewing the earnings or revenues of Verizon Northwest for any test year from 2007 through 2016, including without limitation any rate case, or earnings review associated with a petition to be governed by an AFOR, analyzing any test year from 2007 through 2016.¹²⁷ That means that Washington ratepayers will continue to have the benefit of the revenue adjustment even with the Transaction in any future AFOR or other rate proceeding.

¹²⁴ Dr. Roycroft believes Condition 26 to be appropriate but argues that it does not go far enough to allow customers to terminate contracts without penalty in light of the transaction. Roycroft, TR. 462: 7-18. But there is no reason to waive early termination fees given that customers will continue to receive the same service, from the same service facilities and from the same legal entity, that they were receiving prior to the Transaction. See McCarthy, Exh. DM-8HCT at 73.

¹²⁵ McCarthy/McCallion, Exh. DM/TM-1T at 12.

¹²⁶ Weinman, TR. 355:24 - 356:5; Weinman, TR. 393:3-10.

¹²⁷ *Washington Utilities and Transportation Commission v. Verizon Northwest Inc.*, Docket UT-061777, Order 01 (June 30, 2008) at 3 (“in the event of any future Verizon NW rate case or alternative regulation proceeding, or any other matter in which the reported financial results of Verizon NW are being reviewed.”). In other words, the filing of an AFOR was contemplated by the settlement approved in Docket UT-061777, and the treatment of such a filing would be the same whether Verizon Northwest filed for an AFOR a year ago or whether the same legal entity (renamed as Frontier) files for one during the time period once the Transaction is completed (as is provided for in the Staff Settlement).

ii. Business Service Commitments.

67. The DOD/FEA Settlement builds on the Staff Settlement, and provides additional assurances in response to DOD/FEA concerns regarding certain business rates. Specifically, under Condition 2 of the DOD/FEA Settlement, Frontier commits that for at least three years after the close of the Transaction, it will cap the rates for Retail Flat and Measure Rate Business Services, and PBX, Centrex, and interstate and intrastate special access services at their levels in effect at the close of the Transaction.¹²⁸ DOD/FEA witness King testified for DOD/FEA that the provision ensures that during a three year transition period, business customers will receive the same stability and protection from rate increases that residential customers will enjoy under the Staff Settlement.¹²⁹

iii. FiOS Commitments.

68. Frontier also committed to continue providing services offered through Verizon's FiOS network using fiber-to-the-home technology that Dr. Roycroft described in testimony as the "gold standard."¹³⁰ Thus, Dr. Roycroft's claim that the "vision" of FiOS would "go away" with this Transaction¹³¹ is simply untrue. Mr. McCarthy made that clear at the hearing, noting that the FiOS network and technology "will be here, it will be a benefit in Washington post-close, and we plan on operating the system just as Verizon does today."¹³²

iv. WTAP Commitments.

69. In response to concerns raised by Staff regarding WTAP processing (*see* Stillwell, Exh. SLS-1T), Frontier committed to provide a one-time \$75 credit to any WTAP-qualified customer

¹²⁸ McCarthy, Exh. DM -83T at 3.

¹²⁹ King, Exh. CWK-7T at 5.

¹³⁰ Roycroft, Exh. TRR-1HCT at 67: 11-12.

¹³¹ Roycroft, TR. 447:23 - 448:3.

¹³² McCarthy, TR. 497: 14-24. And Frontier will finish the final build-out requirements on FiOS, which are already [BEGIN HIGHLY CONFIDENTIAL] 84% [END HIGHLY CONFIDENTIAL] complete. McCarthy, TR. 395: 23 - 396:5; McCallion, Exh. TM-2HCT at 34.

for which a WTAP discount, credit or waiver is not processed within the first bill cycle of application (Condition 32 of the Staff Settlement).¹³³ This credit does not exist today, and Frontier committed to apply it for three years. Frontier also committed to provide detailed monthly reports to the Commission on its processing of WTAP applications (Condition 33). Moreover, Frontier will institute a system for WTAP processing that has long been advocated by the Staff: a three-way call between Frontier, the customer and the DSHS to verify WTAP eligibility (Condition 35). This process is not currently utilized, so this commitment will constitute a benefit arising from the transaction.

F. The Transaction Will Not Adversely Affect Competition.

70. As mentioned in the Application, there are no anti-competitive effects of the Transaction at the retail level since Frontier does not currently offer service in Washington. Indeed, if anything, there is a positive impact on competition because the Verizon entities that will continue to serve in Washington (including Verizon Wireless, Verizon Long Distance, Verizon Enterprise Solutions) are not bound by any covenant not to compete and thus will compete directly with Frontier on certain services.¹³⁴

71. Wholesale competition also will be unaffected by the Transaction as Frontier committed to continue to honor Verizon Northwest interconnection agreements, wholesale commercial agreements and wholesale tariffs.¹³⁵ In addition, a number of competitors intervened in the docket and expressed various concerns regarding wholesale issues. All such issues were resolved in the settlement agreements with Comcast, Joint CLECs, and Level 3. For example, Comcast had a specific concern about having the ability to submit test orders prior to when Verizon starts using the replicated systems during “production mode,” and the Applicants

¹³³ McCarthy/McCallion, Exh. DM/TM-1T at 15.

¹³⁴ See, e.g., McCallion, Exh. TM-1T at 9:18.

¹³⁵ McCallion, Exh. TM-1T at 11:5-11.

worked out a settlement with Comcast to allow them to do that. Applicants agreed that Comcast will be able to conduct order testing on the replicated systems in a testing environment to submit particular types of test orders during a window prior to use of the replicated systems by Verizon.¹³⁶ The Comcast Stipulation also calls for the results from this order testing to be included in a testing report that will be issued prior to use of the replicated system in a production environment to serve customers showing that the functional performance of the replicated systems is at least equal to the functionality of Verizon's current systems. As a result, Comcast agrees with the Applicants that the Comcast Stipulation should be approved, and that with it, the Transaction will satisfy the "no harm" standard.¹³⁷

72. The Joint CLECS and Level 3 expressed certain other concerns about wholesale rates, terms and conditions to apply for a certain time period post-close and certain issues related to operational support systems. The Joint Applicants were able to reach settlements with those carriers, as summarized in McCarthy/McCallion/Denney, Exh. DM/TM/DD-1T and McCarthy/Thayer, Exh. DM/RT-1T, prompting them to agree that the Joint CLEC and Level 3 Settlements should be approved as in the public interest, and with it, the Transaction will satisfy the public interest/no harm standard.¹³⁸

V. PUBLIC COUNSEL'S RECOMMENDATIONS ARE BASELESS AND UNACCEPTABLE.

73. Notwithstanding all of the commitments in the settlements entered into with the other parties in this docket, Public Counsel continues to cling to its baseless recommendations that the Transaction not be approved or further conditioned with onerous and inappropriate conditions that would effectively prevent the parties from closing the Transaction and delivering its public

¹³⁶ McCarthy/McCallion/Munoz, Exh. DM/TM/RM-1T at 4: 2-12.

¹³⁷ McCarthy/McCallion/Munoz, Exh. DM/TM/RM-1T at 9.

¹³⁸ McCarthy/McCallion/Denney, Exh. DM/TM/DD-1T: 1-7; McCarthy/Thayer, Exh. DM/RT-1T: 1-4.

by Verizon in Washington (particularly in the trouble report category most relevant to the state of plant).

77. Although the “source” for Mr. Hill’s claim was conspicuously vague in his testimony, apparently he relied on Exh. SES-26HC (Hart-Scott-Rodino filing attachment 4-C-45).¹⁴⁵ Yet that document is simply an e-mail exchange with no probative value here, as is obvious on its face. Specifically, the email thread refers to a [BEGIN HIGHLY CONFIDENTIAL] xxxxx
xx
xx
xx
xxxxxxxxxxxxxxxxxxxxxxxx¹⁴⁶ [END HIGHLY CONFIDENTIAL] In other words, the email offers nothing on any “capital expenditures necessary to improve Verizon’s telephone infrastructure” in Washington. Remarkably, Public Counsel relied only on the cover email and did not engage the underlying information behind this rough estimate – or offer its own analysis.

78. That is because the information behind the email was not useful, and because Public Counsel witnesses do not have the expertise to do their own analysis (“I’m not an engineer, telephone engineer, so I can’t give a detailed answer about that”).¹⁴⁷ The information behind the email was of limited usefulness because the engineers used a small and unrepresentative sample survey of deployment sites (each site being any one of the dozens of remote terminals or other pieces of equipment within a rate center where DSL can be deployed), half of which were from Verizon’s *retained* territories. Second, and perhaps more significantly, the total costs described in that e-mail *are not even an extrapolation of the sample*; instead the business development employee generating that email arbitrarily guesstimated per-line costs for three different levels

¹⁴⁵ Hill, TR. 594: 19- 595: 18.
¹⁴⁶ Exh. SES-26HC at 1.
¹⁴⁷ Hill, TR. 631: 22-24.

of penetration unrelated to the sample costs, and then extrapolated from his arbitrarily-chosen per-line costs to a total estimate. In contrast, Frontier, which has much more experience than Verizon in bringing broadband deployment percentages up to the levels envisioned in the Staff Settlement, conducted a detailed study taking into account all relevant factors that produced a much more realistic cost estimate.¹⁴⁸

79. This one-off email, relied upon by neither Frontier nor Verizon, provides the entire and fundamental “basis” for Public Counsel’s positions that Frontier overvalued the Transaction and that Verizon should pay some sort of monetary contribution. To be clear, Public Counsel asks this Commission to extract millions of dollars from Verizon based on nothing more than an e-mail that even the recipient stated was not useful and refused to rely upon. That is hardly the type of evidence from an expert upon which the Commission could rely.¹⁴⁹

80. Incredibly, this unworthy “source” is used not just once by Public Counsel’s witnesses, but twice: to “support” Mr. Hill’s recommendation that Verizon pay \$72.4 million and also as one “basis” for Dr. Roycroft’s recommendation that Verizon create a \$40 million escrow fund for use by Frontier. Mr. Hill emphasizes that both recommended funds should be created

¹⁴⁸ McCarthy, TR. 500: 23 - 501: 14.

¹⁴⁹ A finding of a state regulatory commission in Washington must be based on competent evidence. *See Leggerini v. Dept. of Unemployment Compensation*, 15 Wn.2d 618, 131 P.2d 729 (Wash. 1942). No such competent evidence supports Public Counsel’s recommendation. Moreover, an expert’s opinion cannot be based solely on conjecture and without any supporting facts. *State v. Acosta*, 123 Wash. App. 424, 436, 98 P.3d 503, 510 (Wash. Ct. App. 2004) (in part published) (holding that the State expert’s reliance on defendant’s criminal history “was unreasonable because he did not know the facts surrounding the arrests and convictions,” he had mischaracterized some of the offenses, and he had not confirmed the accuracy of the criminal history report). Mr. Hill’s only “supporting fact” for his opinion that the Transaction is overvalued is an unreliable hearsay email which on its face states its unreliability and which has no rational connection to the value of the Transaction. The Rules of Evidence are instructive on the weight the Commission should give to Public Counsel’s “evidence.” In this case, that weight should be zero, as the cited email is not the type of evidence upon which other experts would reasonably rely. *See, e.g., Safeco Ins. Co. v. McGrath*, 63 Wash. App. 170, 817 P.2d 861, 863 (Wash. Ct. App. 1991), *review denied*, 118 Wash. 2d 1010, 824 P.2d 490 (Wash. 1992) (“It is well established that conclusory or speculative expert opinions lacking an adequate foundation will not be admitted”).

independent of each other,¹⁵⁰ while later admitting that he undertook “no such analysis” to determine if the basis for the recommended conditions overlapped in any way.¹⁵¹ When asked about the interplay between the Public Counsel recommendations at the hearing, Mr. Hill responded simply that “[y]ou have to ask Dr. Roycroft about the other [proposal].”¹⁵² Of course, the underlying email provides no basis for any sort of recommendation that Verizon create a fund for Frontier’s use – much less two separate funds – but it speaks volumes that Mr. Hill did not bother to understand the basis for Dr. Roycroft’s recommended \$40 Million fund before advocating that it be implemented “in addition”¹⁵³ to his own fund of \$72.4 Million. It is patently unreasonable that no effort was made to consider whether and to the extent their proposed conditions overlapped.

81. Mr. Hill’s continued inflammatory attacks on how the Spinco financial statements were prepared and his inference that Verizon has the incentive to “shape” Spinco’s valuation speak to his credibility as well.¹⁵⁴ At hearing, Mr. Hill stated that “if you’re a corporate president and you don’t [‘affect the allocation process in your favor’] to maximize your profits, then I think you ought to be canned.”¹⁵⁵ Mr. Hill’s reckless statements on business ethics lack any basis in record evidence and should be viewed in the same vein as the “opinions” Mr. Hill offers in areas in which he has no expertise.¹⁵⁶ But his continued inflammatory attacks offer nothing constructive on the standard allocation used for this transaction by Verizon, where as testified to

¹⁵⁰ Hill, Exh. SGH-1HCT at 50: 14-16 (“I believe that this [\$72.4 million] contribution should be in addition to the \$40 million Verizon escrow account that Dr. Roycroft recommends.”).

¹⁵¹ Hill, TR. 661: 2-11; Exh. SGH-21.

¹⁵² Hill, TR. 653: 24.

¹⁵³ Hill, Exh. SGH-1HTC at 50: 14-16.

¹⁵⁴ Hill, Exh. SGH-1HTC at 25-29; Hill, TR. 424:5 -425:6.

¹⁵⁵ Hill, TR. 424: 11-15.

¹⁵⁶ Hill, TR. 633: 25-634:2 (“I’m not an attorney But it would seem to me....”); Hill, TR. 631: 22-24 (“I’m not an engineer, telephone engineer ... but I think you have”); Hill, TR. 651: 17-18 (Are you an accountant? “No, sir.”).

by Vice President of Business Development Stephen Smith, a “manager would be ‘canned’ if he did the very thing that Mr. Hill described.”¹⁵⁷

82. The fact is that Verizon does not “shape” financial information, and Verizon would not benefit from preparing misleading financial statements for VSTO. As Mr. Smith testified, Mr. Hill’s premise is fundamentally flawed for numerous reasons, including the fact that Verizon is a publicly-traded company with strong internal and external controls governing the preparation of financial statements, whether they are prepared for the parent company or for subsidiaries, including VSTO.¹⁵⁸ Remarkably, while raising the specter that inappropriate conduct by Verizon management could have resulted in financial statements showing “higher revenues, lower operating expenses,”¹⁵⁹ Mr. Hill presents absolutely no evidence of any such problems. The facts are that the VSTO properties have verifiable revenue streams, assets and personnel, which form a significant basis for understanding the historical financial performance and future prospects of the business, and that *no entity* – including Ernst & Young, which audited the financial statements – has flagged any inaccuracies.¹⁶⁰ Moreover, in addition to having an ethical obligation to develop accurate financial statements, Verizon has made warranties and representations to Frontier on which Frontier can reasonably rely (and to which Verizon is contractually bound).¹⁶¹

83. Frontier is a sophisticated and experienced telecommunications carrier well versed in telecommunications allocations and financial matters. Frontier knows how to assess efficiently the revenue streams, the access lines, the cost structure, the condition of plant, the relative valuations of projected cash flows and the prices of comparable properties to understand that

¹⁵⁷ Smith, TR. 476:24-477:1.

¹⁵⁸ Smith, Exh. SES-1T at 33-37.

¹⁵⁹ Hill, Exh. SGH-1HCT at 27.

¹⁶⁰ See Smith, Exh. SES-1T at 35-36; Whitehouse, Exh. DW-1T at 49-50. See also Smith, TR. 474:16-477:1.

¹⁶¹ See Whitehouse, Exh. DW-1T at 50; Smith, TR. 474:16 -477:1.

because the issuing institutions had a financial stake in the outcome of the Transaction¹⁶⁶ – testimony which further confirms that Mr. Hill is “willing to assail any institution’s credibility and motives if it serves his purposes.”¹⁶⁷

85. Finally, there is no merit to Mr. Hill’s suggestion that the existence of a stock price collar in the Merger Agreement suggests Verizon is willing to accept a lower value for the Transaction.¹⁶⁸ As explained in Mr. Whitehouse’s testimony, Mr. Hill does not understand how the “collar” works.¹⁶⁹ The collar, which limits *both parties’* upside/downside potential with respect to fluctuations in Frontier’s stock price between signing and closing, is a common mechanism that increases the likelihood of closing at the targeted deal value (compared to a fixed exchange ratio/floating value structure), while protecting against significant movement in the merged firm’s post-closing financial structure and thereby increasing the certainty of closing. The parties established the collar based on what they determined to be a fair value for Frontier stock (the middle of the collar), and with a range sufficient that neither party thought it likely that the price at closing would be outside of the collar.

86. Mr. Hill is wrong to suggest Verizon is “willing” to accept less than the full \$5.247 billion in equity consideration the Joint Applicants negotiated. What Verizon is willing to accept is the risk that if Frontier’s stock falls below the low end of the collar (\$7.00 per share), Verizon’s shareholders will receive less than \$5.247 billion in equity value. Similarly, Frontier is willing to accept the risk that, if its stock is trading above the upper band (\$8.50), it will deliver shares with a value of more than \$5.247 billion. If Mr. Hill’s logic were sound, the

¹⁶⁶ Hill, Exh. SGH-1HCT at 31.

¹⁶⁷ See Whitehouse, Exh. DW-1T at 52. It is remarkable that Mr. Hill testifies that professional investment bankers from institutions such as Evercore, Citigroup, Barclays, and JP Morgan Chase would engage in deceit that would expose them to significant liability in order to receive compensation for a fairness opinion. *Id.*

¹⁶⁸ Hill, TR. at 606:4-21.

¹⁶⁹ Whitehouse, Exh. DW-1T at 33:5 -34:7.

merger consideration could be considered too low given that Frontier has agreed to a collar under which it might have to issue stock worth more than \$5.247 billion – but his logic is not sound. Mr. Hill’s incorrect premise and faulty conclusion do not show that either party has negotiated an unfair consideration for the transaction.

B. Verizon Heavily Invested In The Washington Network.

87. Public Counsel continues to repeat the allegation that Verizon has underinvested in its network in Washington.¹⁷⁰ As Mr. McCallion testified at the hearing, that is “simply incorrect.”¹⁷¹ Indeed, the concept of underinvestment by Verizon is contradicted by the testimony of Dr. Roycroft himself:

•I think it’s notable when evaluating this transaction that Washington stands out among the VSTO properties with regard to what Verizon has done. Verizon has made substantial capital investments in Washington to deploy fiber to the home, and that fiber to the home investment has certainly provided benefits to Washington consumers.¹⁷²

•Washington state already has among the VSTO service areas the highest level of broadband deployment among the 14 states.¹⁷³

Yet Dr. Roycroft continues to advocate that Verizon be required to establish a \$40 million escrow fund to “insure the condition of its outside plant in Washington.”¹⁷⁴ As discussed above, however, there are no problems with Verizon’s outside plant in Washington as evidenced by its excellent service quality record, particularly with regard to trouble reports, which shed the most light on outside plant condition. And the record is also clear on the advanced nature of Verizon’s switches in Washington:

¹⁷⁰ See, e.g., Hill, TR. 427: 10-11.

¹⁷¹ McCallion, TR. 470: 17-19.

¹⁷² Roycroft, TR. 447: 14-20.

¹⁷³ Roycroft, TR. 456:11-13.

¹⁷⁴ Roycroft, Exh. TRR- IHCT at 91: 26-27; Roycroft, TR. 669: 4-7.

- “we know that Verizon’s central offices are up to the most current generics under switches”¹⁷⁵
- “Certainly the switching is modern. They ... have ... soft switches within the territory.”¹⁷⁶
- In physical verifications of Verizon central offices in Washington, “[t]here were, as Staff said, latest revs in software on switching.”¹⁷⁷

88. Notwithstanding this record, Dr. Roycroft attempts to justify his recommendation by basing it, in part, on an “analysis” done of absolute dollars spent on maintenance expenses and non-FiOS capital expenditures over recent time periods.¹⁷⁸ That makes no sense for a number of reasons. First, there is no reason to exclude the significant investment that Verizon made in FiOS in Washington. Frontier will acquire that fiber-to-the-home network that Dr. Roycroft has complimented and referred to as the “gold standard” and plans to make good use of it.¹⁷⁹ And Verizon’s investment in FiOS in Washington is significant: in fact, Verizon invested over **[BEGIN HIGHLY CONFIDENTIAL] xxxxxxxxxxxx [END HIGHLY CONFIDENTIAL]** in FiOS in Washington from 2006 through 2009.¹⁸⁰ And on a total basis, it invested over **[BEGIN HIGHLY CONFIDENTIAL] xxxxxxxxxxxx [END HIGHLY CONFIDENTIAL]** in capital expenditures in Washington during the same time period.¹⁸¹ These staggering figures constitute anything but “underinvestment.”

89. Second, there is no reason to extrapolate investment levels from earlier in the decade and assume that they represent appropriate prospective investment levels.¹⁸² Large investments

¹⁷⁵ Weinman, TR. 275:24 -276: 5 (“we know that Verizon’s central offices are up to the most current generics under switches, and their Verizon troubles at least for the past year have been primarily below 1%. And with the line loss and then recovering pairs, we believe that also lends credibility to the fact that their plants’ in good shape.”).

¹⁷⁶ Weinman, TR. 350: 12-14.

¹⁷⁷ McCarthy, TR. 348: 21-22.

¹⁷⁸ Roycroft, Exh. TRR-1HCT at 79-80; 94 n. 192.

¹⁷⁹ McCallion, Exh. TM-2HCT at 20.

¹⁸⁰ Exh. TM-24HC.

¹⁸¹ Exh. TM-24HC.

¹⁸² McCallion, Exh. TM-2HCT at 20.

and the first quarter 2009.”¹⁸⁵ There was no such decline when examined on a per-line basis. Perhaps realizing the weakness of this approach, Dr. Roycroft takes the results of it (which he claims to be [BEGIN HIGHLY CONFIDENTIAL] xxxxxxxxxxxxxxxxxxxxxxx¹⁸⁶ [END HIGHLY CONFIDENTIAL] and combines it in some fashion with another flawed input: the useless e-mail discussed above that was also used by Mr. Hill in his recommendation for a separate fund to be paid by Verizon.¹⁸⁷ Dr. Roycroft claims that the latter input results in [BEGIN HIGHLY CONFIDENTIAL] xxxxxxxxxxxxxxxxxxxxxxx [END HIGHLY CONFIDENTIAL] so he somehow combines these two unrelated and completely flawed inputs into a recommendation that Verizon create a \$40 million escrow fund.¹⁸⁸ But combining two flawed approaches does not improve either; it simply results in a baseless recommendation. The baseless recommendation is not supported by any record evidence, and should not be adopted. This is a *legal* proceeding, with important ramifications for Washington ratepayers and both companies. Pulling numbers out of a hat because of a stated desire to get Verizon to “kick in” money does not reach even the lowest level of expert evidence. It would be arbitrary and capricious, by definition, to credit Dr. Roycroft’s recommendation with any weight.

C. Public Counsel’s System-Related Recommendations are Meritless.

92. Public Counsel proposes numerous conditions related to the replicated systems that will transfer to Frontier,¹⁸⁹ but does not even attempt to ground its proposals in any evidence showing they are needed. For example, Public Counsel asks the Commission to impose a penalty on Verizon of \$7.7 million annually if the replicated systems fail to perform “as

¹⁸⁵ Roycroft, Exh. TRR-1HCT at 94 n.192.

¹⁸⁶ According to Dr. Roycroft, the [BEGIN HIGHLY CONFIDENTIAL] xx
xxxxxx [END HIGHLY CONFIDENTIAL] if Verizon’s preliminary data for 2009 was used. Roycroft, TR. 612:
14-15.

¹⁸⁷ Roycroft, Exh. TRR-1HCT at 94 n. 192.

¹⁸⁸ Roycroft, Exh. TRR-1HCT at 94 n. 192.

¹⁸⁹ Roycroft, Exh. TRR-1HCT at 91-95.

represented in § 7.24 of the Merger Agreement.”¹⁹⁰ But the requirement that the replicated systems perform as required by § 7.24 is a *condition precedent* to the closing of the Transaction.¹⁹¹ Indeed, the conditions agreed to be Joint Applicants – including a third party review of test results and prohibitions on closing if service quality results do not meet specific metrics¹⁹² – are specifically designed to ensure § 7.24 is met.

93. The rest of Dr. Roycroft’s proposed systems conditions are similarly ungrounded or superfluous given protections already in place. For example, he asks the Commission to require status reports on the performance of the replicated systems for 12 months following closing,¹⁹³ but he ignores the fact that *prior* to handoff Frontier (and validation of the accuracy of test results by a third party verifier selected with input from Staff) will confirm that the systems are working. Any problems will be identifiable immediately, not months after close.¹⁹⁴ Similarly, there is no rationale for Public Counsel’s proposals that Verizon create an archive of customer data¹⁹⁵ (there is already redundancy of data in the replicated systems themselves¹⁹⁶) or that Verizon notify interested parties regarding its plans for replicating 911 systems¹⁹⁷ (Verizon is already in constant communication with the relevant stakeholders¹⁹⁸).

D. Public Counsel’s Service Quality Recommendations Are Inappropriate.

94. Public Counsel apparently considers the self-executing retail service penalty plan agreed to as part of the Staff Settlement to be insufficient because of the high level of service quality currently provided by Verizon. Specifically, Public Counsel witness Alexander describes as the

¹⁹⁰ *Id.* at 95.

¹⁹¹ See Merger Agreement § 8.3(a).

¹⁹² Staff Settlement, Conditions 27 and 28.

¹⁹³ Roycroft, Exh. TRR-1HCT at 95.

¹⁹⁴ As Staff witness Williamson testified, “It’s my belief if there’s a system failure ..., it will happen right away.” See Williamson, TR. 522: 22-24.

¹⁹⁵ Roycroft, Exh. TRR-1HCT at 94.

¹⁹⁶ Smith, Exh. SES-1T at 30.

¹⁹⁷ Roycroft, Exh. TRR-1HCT at 95.

¹⁹⁸ Smith, Exh. SES-1T at 32-33.

“main reason” why the Staff Settlement is insufficient in this area is because it focuses on the Commission’s own standards rather than Verizon’s performance, which exceeds those standards.¹⁹⁹ In other words, Ms. Alexander is attempting to use this docket to re-write the robust and detailed service quality standards that the Commission already has in place. In addition to that being an inappropriate goal for a transaction docket, in another context at the hearing, Ms. Alexander herself touted the breadth of the Commission’s service standards and reporting requirements as providing the tools necessary to prevent deterioration:

I might have suggestions for improving the standards that you have, the fact remains you have standards that address most of all the key issues, and you have the reporting requirements in place to monitor And if there was any significant deterioration, I think you have the tools to respond to that.²⁰⁰

The Commission should not use this docket to take up Ms. Alexander’s “suggestions for improving” Commission standards that Ms. Alexander concedes are appropriate and provide the Commission with the tools it needs to monitor service quality. Moreover, as discussed above, Frontier has agreed as part of the Staff Settlement to self-executing penalties that build on the Commission standards and provide significant financial incentives to meet those standards. Ms. Alexander’s proposal for an additional draconian service quality index plan (with penalties of up to \$9.5 million)²⁰¹ should be rejected.

VI. THE COMMISSION CANNOT AND SHOULD NOT ADOPT PUBLIC COUNSEL’S PROPOSALS THAT VERIZON “KICK IN” MONEY TO FRONTIER.

95. Public Counsel is upfront that one of its ultimate aims in this docket is to impose a monetary requirement on Verizon as a condition to exit the wireline business in Washington. Indeed, Public Counsel’s witness states explicitly (but without any basis) that they “want

¹⁹⁹ Alexander, TR. 406: 7-11; Alexander, TR. 409: 24- 410:2.

²⁰⁰ Alexander, TR 620: 18-621:1.

²⁰¹ Alexander, Exh. BRA-1CT at 42.

Verizon to kick that money in” as a condition of approval.²⁰² In order to ensure that Verizon would “kick in” or “pony up” that contribution, Public Counsel also advocates that the transaction agreements be altered to void or not apply what are referred to as the “Required Payment Amount” provisions that allocate regulatory costs between Verizon and Frontier shareholders.²⁰³ Such recommendations for what amount to an “exit fee” are unlawful, would amount to bad public policy and are unnecessary to avoid any demonstrable harm.

A. Imposing A Monetary Requirement On Verizon Would Be Unlawful.

96. *First*, any such monetary requirement would be an impermissible taking in violation of both the federal and Washington constitutions. The Takings Clause of the Fifth Amendment provides that: “[N]or shall private property be taken for public use, without just compensation.” Similarly, the Washington Constitution mandates that: “no private property shall be taken ... for public or private use without just compensation”²⁰⁴ That injunction applies directly here. Money is a form of property.²⁰⁵ Accordingly, a Commission-imposed “exit fee” upon Verizon would constitute an outright taking by the government of private property – there is nothing subtle in the government taking money from Verizon’s pocket and giving it to Frontier or even into a fund for the public good.²⁰⁶ At a minimum, a government agency may engage in a taking only where the specific taking is expressly authorized by statute *and* where the government provides adequate compensation.²⁰⁷ Here, neither condition is satisfied. There is no statute that expressly authorizes the Commission to take the property of a company that is exiting a

²⁰² Hill, TR. 436: 9-10.

²⁰³ Roycroft, Exh. TRR-1HCT at 93:36-94:2; Hill, Exh. SGH-1HCT at 50:17 – 51:20.

²⁰⁴ Wash. Const. Art. I, § 16.

²⁰⁵ *Southern Ry. Co. v. Commonwealth of Virginia ex rel. Shirley*, 290 U.S. 190, 194, 54 S.Ct. 148, 150 (1933) (“Certainly, to require abolition of an established grade crossing and the outlay of money necessary to construct an overhead would take the railway’s property in a very real sense. This seems plain enough both upon reason and authority.”).

²⁰⁶ *U.S. Fidelity v McKeithen*, 226 F.3d 412 (5th Cir. 2000).

²⁰⁷ *Bell Atl. Tel. Co. v. F.C.C.*, 24 F.3d 1441 (D.C. Cir. 1994).

particular business as suggested by Public Counsel, and the law is clear that general grants of regulatory authority are not adequate for this purpose.²⁰⁸ Nor would the Commission be providing compensation for the property taken. As such, adopting Public Counsel's recommendations that Verizon "kick in" monetary contributions would be per se unlawful.

97. In addition, even if fashioned exactly as the Public Counsel posits and analyzed as a regulatory taking, any such requirement would also amount to economic regulation that "adjusts the benefits and burdens of economic life to promote the common good" that is unconstitutional.²⁰⁹

98. The proposed monetary conditions on Verizon would fit squarely into the three factors identified by the Supreme Court in analyzing a takings claim: (i) the economic impact on Verizon of millions of dollars is *per se* significant, (ii) the payments would interfere with Verizon's reasonable economic expectations, for there is no precedent in Washington to condition the transfer of assets on a requirement that the transferor pay the monetary tributes suggested by Public Counsel,²¹⁰ and (iii) the nature of the proposed payments is unrelated to any commitment made by Verizon or to any injury caused by Verizon because there has been no showing that Verizon was obligated under any statute, rule or proceeding to invest the sums in Washington specified in Public Counsel's recommendations. To the contrary, *Verizon has exceeded by far any reasonable expectation of capital investment in the state* including for example, spending more than **[BEING HIGHLY CONFIDENTIAL] xxxxxxxxxxxx [END HIGHLY CONFIDENTIAL]** in capital expenditures in Washington from 2006 through 2009.

²⁰⁸ *Id.*

²⁰⁹ *Eastern Enterprises v. Apfel*, 524 U.S. 498, 522, 118 S.Ct. 2131, 2146, 141 L.Ed.2d 451 (1998).

²¹⁰ Indeed, even in cases where there were concerns regarding degraded plant being transferred in a telecommunications transaction (which is not the case here), the Commission has approved settlement agreements in which the *acquirer* (not the carrier disposing of the property) commits to capital expenditures to address the stated concerns. See *In the Matter of the Application of US West Communications, Inc. to Transfer Property to Telephone Utilities of Washington, Inc., d/b/a PTI Communications*, Docket No. UT-940701, Third Supplemental Order Accepting Settlement and Approving Sale of Exchanges (June 7, 1995) at 6.

Penalizing Verizon now by imposing a substantial economic penalty, contrary to any reasonable expectation and when it has met and exceeded its obligations, is precisely the type of taking that the federal and state constitutions prohibit.²¹¹

99. *Second*, in the same vein, a requirement for Verizon to pay some monetary amount as suggested by Public Counsel violates the retroactive rate-making doctrine, for the Commission would be in effect be requiring a refund from Verizon for past revenues. As explained by the Commission, retroactive ratemaking includes “ordered refunds applied to rates which had previously been paid.”²¹² Particularly when compared with other ILECs in Washington, Verizon Northwest’s rates were set recently by virtue of a rate case that was settled and concluded by the Commission in 2005.²¹³ Public Counsel’s requests for monetary set-asides from Verizon are precisely the type of refunds of revenues collected pursuant to rates established (relatively recently) that the law prohibits.

100. *Third*, a penalty imposed on carriers to exit the service area constitutes a barrier to entry, and a violation of federal law that is remediable in federal court.²¹⁴ Federal courts routinely strike down fees that “materially inhibit[] or limit[] the ability of any competitor or potential competitor to compete in a fair and balanced regulatory environment.”²¹⁵ Exit penalties will discourage parties from entering or investing in the telecommunications market, knowing that they will face significant fees should they ever choose to leave the market. Particularly in a

²¹¹ For these same reasons, an “exit fee” would also be the type of “egregious” imposition of retroactive economic liability that would violate the Due Process Clause. See *Eastern Enterprises*, 524 U.S. 498, 118 S.Ct. 2131, 141 L.Ed.2d 451 (1998) (*Kennedy, concurring*).

²¹² *Washington Utilities and Transportation Commission v. Puget Sound Power & Light Co.*, Docket U-81-41, Sixth Supplemental Order (December 19, 1988) at 31, citing approvingly *Arizona Grocery Co. v. Atchison, T. & S.F.R. Co.*, 284 U.S. 370, 52 S.Ct. 183 (1932) (“The ICC may not by finding a prior rate order erroneous require a carrier to pay reparations on traffic carried under the authorized tariff.”).

²¹³ McCallion, Exh. TM-1T at 11:13- 12:2.

²¹⁴ Under 47 U.S.C. § 253, “[n]o State or local statute or regulation, or other State or local requirement, may prohibit or have the effect of prohibiting the ability of any entity to provide any interstate or intrastate telecommunications services.”

²¹⁵ *Puerto Rico Telephone Co., Inc. v. Municipality of Guayanilla*, 450 F.3d 9, 23 (1st Cir. 2006).

capital-intensive industry such as telecommunications (as evidenced by Verizon's substantial capital expenditures in recent years in Washington), carriers would be very reluctant to enter or make significant investments in the market if the ability to exit the market is restricted.

Furthermore, such a fee would also constitute a barrier to entry under Section 253 for it is in no sense compensatory, but merely an effort to transfer Verizon's property to some other entity.²¹⁶

101. *Finally*, each of the standards set forth in Chapter 80.12 RCW and WAC 480-143-170 have been satisfied. Because the requirements of the statute and rules have been met, it would be improper to condition the Transaction on some fee from the exiting party. Indeed, for all the reasons outlined above, where Verizon is exiting the local telephone business in the state (technically, by spinning it off to existing shareholders), the Commission lacks authority to engage in a retaliatory taking of Verizon's property as Public Counsel proposes by imposing an exit fee.

102. Moreover, even if the Commission *could* impose an exit fee along the lines urged by Public Counsel, it *should* not. As discussed above, these recommendations are so contradictory in their premises, conclusions, and amounts that they clearly are an attempt to simply extract money from Verizon. Indeed, as explained throughout this Brief, Public Counsel witnesses were candid about their motivations to get Verizon to "kick in" money.²¹⁷ But, as detailed above, their recommendations lack any legitimate basis. Ordering Verizon to set aside money is unlawful and bad policy. Frontier and Verizon have agreed to reasonable terms, and Washington stands to reap substantial benefits with the approval of the Transaction. The

²¹⁶ See *New Jersey Payphone Assn Inc. v. Town of West York*, 130 F. Supp. 2d 631, 638 (D.N.J. 2001) ("Plainly, a fee that does more than make a municipality whole is not compensatory in the literal sense and risks becoming an economic barrier to entry.")

²¹⁷ Hill, TR. 436: 3-4.

Commission should and must reject Public Counsel's requests for a direct or indirect cash payment from Verizon.²¹⁸

B. Altering the "Requirement Payment Amount" Provisions of the Transaction Agreements Would Be Bad Public Policy.

103. As stated above, Public Counsel's recommendations to impose monetary contribution requirements on Verizon are presented along with proposals that the "Required Payment Amount" clauses of the transaction agreements be voided or somehow not applied. And at the hearing, the Chairman requested that the parties brief "policy" implications associated with the "Required Payment Amount" provisions in the transaction agreements.²¹⁹ In addition to the legal and constitutional issues associated with interfering with private contracts, it would be bad public policy to view such provisions in isolation, without considering their part in a comprehensive, integrated cost and risk allocation developed through arms-length negotiations between the parties.

104. There are no "policy" implications of the "Required Payment Amount" provisions because those provisions do not attempt to alter any lawful conditions that the Commission

²¹⁸ Public Counsel also makes a number of vague references to a perceived problem associated with Verizon "not being involved" post-transaction or not "providing any warranty." Roycroft, TR. 446: 9-10. It is unclear what Public Counsel suggests. But as Mr. Smith testified to at the hearing, "from a business matter, it makes no sense for Verizon to have a continuing interest in a business that it no longer operates." Smith, TR. 477: 9-17. To the contrary, some sort of guaranty or warranty could create perverse incentives for Frontier to operate inefficiently if Verizon were somehow responsible for Frontier's future performance (as could Dr. Roycroft's proposal for an "escrow fund" that would incent Frontier to try and draw from the fund). Moreover, for the reasons described above regarding a monetary penalty, a Commission-imposed guaranty or warranty would violate federal law.

Also, requiring some sort of guaranty or warranty by Verizon of Frontier's future performance could jeopardize the entire Transaction. One of the principal conditions that must be satisfied for the Transaction to close is that Verizon must obtain a favorable ruling from the IRS regarding various tax issues, including the treatment of the spin-off under Section 355 of the Internal Revenue Code. Section 355 contemplates a complete separation of the respective businesses of the distributing company in a spin-off (in this case, Verizon) and the company it is spinning off. On February 5th, 2010, Verizon received a favorable ruling from the IRS regarding the tax consequences of the spin-off and other aspects of the Transaction. The terms of the Transaction, as described to the IRS for purposes of this ruling, did not include a Verizon guaranty or warranty of Frontier's future performance, and to Joint Applicants' knowledge, the IRS has never approved such a guaranty or warranty in the context of a Section 355 spin-off. Without a favorable ruling from the IRS on the spin-off, the Joint Applicants simply would not undertake the Transaction as structured, and restructuring the Transaction as a taxable sale would be highly unlikely and the transaction would instead terminate.

²¹⁹ TR. 680:1-9.

could lawfully impose as part of a transaction approval. To the contrary, such provisions are simply an allocation of particular costs and risks associated with any such conditions imposed by a state commission or other costs associated with prospective regulatory issues that may arise in the transaction.

105. As a policy matter, the Commission should not focus on and isolate one component of the comprehensive set of agreements negotiated by the parties to allocate costs and risks associated with the Transaction. The direct and indirect costs imposed on Verizon shareholders (as well as Frontier shareholders) as part of this comprehensive sharing of costs are significant. For example, in contrast to previous transactions where the acquiring entities were left to develop their own new systems at their own expense as quickly as possible after the close of the transactions to serve acquired properties, here Verizon shareholders bear all of the costs associated with delivering a turnkey operation (including fully operational replicated versions of systems that Verizon uses today) to Frontier at close.²²⁰ Indeed, Mr. McCallion testified at the hearing that the costs incurred in this effort already had reached “a very high number in the hundreds of millions of dollars.”²²¹

106. If the Commission were to alter the “Required Payment Amount” provisions in order to require Verizon to pay some monetary contribution beyond that incurred for replication/realignment, the policy effect under the facts here would be to essentially ignore the “very high number in the hundreds of millions of dollars” currently being incurred by Verizon shareholders in the replication/realignment process. Indeed, the policy effect on future transactions of interfering with a binding contract by effectively modifying the consideration

²²⁰ McCallion, Exh. TM-2HCT at 15-16; McCallion, TR 364:23 365:2 (“it’s part of the risk allocation and the total merger agreement. There’s certain things that Verizon took the risk on responsibility, certain things Frontier did as we came up with the total merger agreement.”).

²²¹ McCallion, TR. 398: 19-21.

and costs to be paid by one party or the other would be overwhelmingly negative. Parties considering transactions would have no incentive to develop creative (and expensive) structures to avoid problems incurred in previous transactions (such as having the disposing party conduct a comprehensive realignment and systems replication in order to provide the acquirer with a “turnkey” operation) because they would fear that the Commission might inappropriately focus on and alter one threshold component of the structure to the material detriment of one party.

107. As a matter of policy, the bottom line is that the Commission must view the parties’ allocation of costs and risks associated with the regulatory process comprehensively and take into account the significant monetary burdens being shouldered by Verizon shareholders in that process. The Commission cannot reasonably or equitably consider one such key provision of the Transaction in isolation without considering the others and interfering with a binding contract, as they were part of a comprehensive negotiation regarding the merger consideration, the Transaction as a whole and the regulatory process.

108. It is also important to remember how these provisions actually work because they affect the respective shareholders of Frontier and Verizon, not Washington ratepayers. In the face of a “Required Payment” in which a new regulatory cost is imposed on Verizon, Verizon shareholders will receive a corresponding increase in the number of shares in the new Frontier.²²² Thus, the shifting of the costs is ultimately between Frontier and Verizon shareholders as to the proportion of equity ownership in a public company—hardly an area that would present policy concerns to the Commission.

109. And as a practical matter, the provisions did not cause any policy concerns from the perspective of the negotiated settlements presented to the Commission in this docket. For example, the Commission Staff testified at the hearing that the provision had no impact on its

²²² McCallion, Exh. TM-2HCT at 15-16; McCallion, TR. 364: 11-19.

ability to settle with the Applicants on the issues that concerned the Staff. Specifically, Staff witness Weinman stated:

our biggest concern was having a third party verify the IT systems. And since Verizon – that cost won't be passed along to Frontier, and other than that my answer is no. There was nothing else that I'm aware of that came up in discussions within our team that caused us to say we might like this but the contract prohibits it.²²³


110. Thus, as a policy matter, the "Required Payment Amount" provisions are a key component of the Transaction negotiated at arms length by the parties and cannot be viewed in isolation as one that the Commission may alter in some fashion without affecting the entire Transaction. The provisions were part of a comprehensive sharing of costs and risks between Verizon and Frontier shareholders relating in part to the regulatory process, and should not be disturbed.

VII. CONCLUSION.

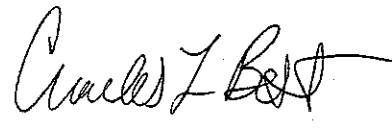
111. For the foregoing reasons, the Commission should approve the settlements entered into this docket as in the public interest as well as approve the Transaction and grant the relief requested in the Application.

DATED this 26th day of February, 2010.

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²²³ Weinman, TR 374:19-375:2; *see also* TR. 635: 3-7.