BEFORE THE WASHINGTON UTILITIES & TRANSPORTATION COMMISSION

IN THE MATTER OF THE JOINT APPLICATION OF

VERIZON COMMUNICATIONS INC. AND FRONTIER COMMUNICATIONS CORPORATION

FOR AN ORDER DECLINING TO ASSERT JURISDICTION OVER, OR, IN THE ALTERNATIVE, APPROVING THE INDIRECT TRANSFER OF CONTROL OF VERIZON NORTHWEST INC.

DOCKET NO. UT-090842

DIRECT TESTIMONY OF TREVOR R. ROYCROFT, Ph.D. (TRR-1T)

ON BEHALF OF

PUBLIC COUNSEL

NOVEMBER 3, 2009

REDACTED

DIRECT TESTIMONY OF TREVOR R. ROYCROFT, Ph. D. (TRR-1T)

VERIZON-FRONTIER WIRELINE DIVESTITURE
DOCKET NO. UT-090842

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I. INTRODUCTION / SUMMARY

Q: Please state your name and business address.

A: My name is Trevor R. Roycroft. My business address is 51 Sea Meadow Lane, Brewster, MA, 02631.

Q: By whom are you employed and in what capacity?

A: I am an independent consultant providing economic and policy analysis related to telecommunications, public utility, and information technology industries.

Q: On whose behalf are you testifying?

A: I am testifying on behalf of the Public Counsel Section of the Washington Attorney General's Office (Public Counsel).

Q: Please describe your professional qualifications.

A: I have eighteen years of experience in the public utility field. With regard to my educational background, I hold three degrees. I received the Bachelor of Arts degree in Economics with a minor in Statistics from California State University, Sacramento. The degree was awarded with honors. I also hold the Masters and Doctor of Philosophy in Economics from the University of California, Davis. My Ph.D. fields of specialization are Economic Theory, Industrial Organization, Public Sector Economics, and Economic History.

My experience in the telecommunications field began with my employment at the Indiana Office of Utility Consumer Counselor (OUCC) during the years 1991 to 1994. For most of my tenure at the OUCC, I was Chief Economist. My primary areas of analytical responsibility at the OUCC related to telecommunications regulation and policy, including incentive regulation plans. I was also involved in natural gas, electric, and water utility cases, and filed testimony and supervised staff involved in these areas.

I have been involved in higher education related to the telecommunications field. From 1994 to 2004, I was a professor in the J. Warren McClure School of Communication Systems Management at Ohio University. At Ohio University I was granted tenure and promoted to Associate Professor in the spring of 2000. My primary areas of teaching responsibility were graduate and undergraduate courses covering regulatory policy, the economics of the telecommunications industry, consumer issues with telecommunications markets, and telecommunications technology. I left Ohio University to pursue consulting on a full-time basis at the end of 2004.

I have published research in refereed journals including *The Journal of Regulatory Economics, Contemporary Economic Policy,* and *Telecommunications Policy*. I have contributed chapters that have been published in book volumes related to the telecommunications field. I have provided referee service to various academic journals including: *The Journal of Regulatory Economics, Telecommunications Policy, Social Science Computer Review, Utilities Policy, Journal of Economic Studies,* and *Communications of the Association for Information Systems*.

I have provided analysis and testimony as an independent consultant since 1994. In my role as a consultant, I have addressed a wide variety of issues including: incentive regulation plans, cost-of-service studies, cost modeling, service quality, merger review, and competition. I have filed testimony, reports, and affidavits before state regulatory commissions, before the Federal Communications Commission (FCC), and before the Canadian Radio-Television and Telecommunications Commission. I have also provided expert services in class action lawsuits associated with the public utility field. Attached hereto as Exhibit No.___(TRR-2) is a true and correct copy of my most recent curriculum vitae.

Q: What exhibits are you sponsoring in this proceeding?

A: In addition to Exhibit No.___(TRR-2), which is a copy of most recent curriculum vitae, I am sponsoring Exhibits No.___(TRR-3), Exhibit No.____(TRR-4), and Exhibit No.___(TRR-5) which provide publicly available discovery material from Ohio[1] and West Virginia[2].

Q: What have you done to prepare your testimony?

A: To prepare this testimony, I have reviewed the Joint Application filed with the Washington Utilities and Transport Commission (WUTC or Commission) by the Joint Applicants: Verizon Communications Inc. (Verizon) and Frontier Communications Corporation (Frontier).[3] In addition I have reviewed the supporting testimony filed by the Joint Applicants. I have also reviewed Verizon

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[1] PUCO Case No. 09-454-TP-ACO.
[2] WVPSC Case No. 09-0871-T-PC.
[3] When appropriate, I will refer to the Joint Applicants separately as Verizon or Frontier. I will refer to Verizon Northwest's operations in Washington State as "Verizon WA."

and Frontier's Consolidated Application filed at the FCC.[4] I have reviewed filings made by Verizon and Frontier with the Securities and Exchange Commission (SEC), including Form S-4. I have reviewed the Joint Applicants' Hart-Scott-Rodino (HSR) Filing with the Department of Justice and Federal Trade Commission. I have served discovery on the Joint Applicants, and reviewed the responses to that discovery, preparing follow-up as necessary. I have reviewed discovery responses made by the Joint Applicants to other parties in this proceeding. I have also reviewed various articles in the business and trade press regarding this merger.

Q: Have you filed testimony in any other jurisdiction regarding this merger?

A: Yes, I filed testimony in Ohio regarding this transaction on October 14, 2009, and will file testimony in West Virginia on this transaction on November 16, 2009. I have relied on public information associated with my activities in these other jurisdictions to prepare this testimony.

Q: What is the purpose of your testimony?

A: I was asked by Public Counsel to review the Joint Applicants' Application, and to evaluate, from an economic and public policy perspective, whether the proposed merger is in the public interest, and whether or not it is likely that the merger will result in "no harm to the public interest." Specifically, I was asked to evaluate the

[4] *In the Matter of Verizon Communications Inc. and Frontier Communications Corporation Application for Consent to Assign and Transfer Control of Authority to Provide Global Facilities-Based and Global Resale International Telecommunications Services and to Assign and Transfer Control of Domestic Common Carrier Transmission Lines, Pursuant to Section 214 of the Communications Act of 1934, as Amended.* WC Docket 05-95, May 29, 2009 (Hereinafter *FCC Application*).

potential for risks and benefits associated with the merger related to: (1) broadband deployment; (2) the replication and cutover of Verizon's systems; and, (3) customer transition issues, including pricing and service marketing. Public Counsel is also sponsoring testimony from Steven Hill and Barbara Alexander. Mr. Hill examines the financial aspects of the merger and Ms. Alexander discusses service quality.

Q: What conclusions have you reached?

A: The Joint Application places this Commission in a situation similar to the one faced periodically by Charlie Brown during the run of the *Peanuts* comic strip. Lucy would tee-up a football and invite Charlie Brown to take a kick. Invariably, Charlie Brown accepts, Lucy pulls the ball away, and Charlie Brown finds himself flat on his back. In this case, Verizon, which has been party a string of asset-divestiture disasters in recent years, is now asking this Commission to believe that *this time everything will be all right*. However, as I will discuss in detail below, the proposed transaction introduces a substantial degree of risk and will likely inflict harm to Washington ratepayers. I believe that if the merger is approved as the Joint Applicants' request, there is a good chance that this Commission will also find itself flat on its back, gazing at the gathering clouds of another Verizon-inspired disaster—one that, in this case, will harm Washington consumers. Thus, I recommend that the Commission reject this merger as it has been proposed. In the event that the Commission allows this merger to go forward, it is appropriate that the Commission place enforceable conditions on the merger to address its risks and harms, and ensure consumer benefits.

II. BACKGROUND

A. Description of the Proposed Merger and the Joint Applicants

Q: Can you provide a brief overview of the Joint Applicants?

A: Yes. Verizon Communications Inc. has achieved its current status as one of the two largest telecommunications providers in the U.S., serving 35.2 million wirelines in 25 states, through a series of acquisitions. Verizon's lineage traces to the Regional Bell Operating Company (RBOC) Bell Atlantic, which was created following the AT&T divestiture in the early 1980s. Bell Atlantic later acquired fellow-RBOC NYNEX. On June 30, 2000, Verizon Communications was formed as result of the merger of GTE and Bell Atlantic. This merger changed the character of Bell Atlantic, as GTE generally had operations in more rural areas, and in Midwestern, Southern, and Western states where Bell Atlantic did not operate. GTE itself was the result of various mergers and acquisitions, with the more notable including Contel, and Southern Pacific's long distance operations, which came to market under the Sprint name.[5] Verizon also acquired the long distance provider and competitive local exchange carrier (CLEC) MCI in 2005.

Similarly, Frontier is also the product of various mergers and acquisitions, which has led to its current status of serving 2.2 million access lines in 24 states. Frontier's legacy traces to Citizens Communications. Citizens acquired GTE and Contel properties from GTE in the early 1990s, prior to GTE's merger with Bell

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[5] J. Alleman and L. Cole, "Sprint—GTE's lost opportunity," Chapter 10 in *World Telecommunications Markets: The International Handbook of Telecommunications Economics, Vol. II,* (Edward Elgar Publishing 2003). GTE later sold the Sprint assets to United Telephone.

Atlantic.[6] Citizens acquired AllTel properties in West Virginia and Oregon in the mid-1990s, and Frontier Communications in 2001, taking on the Frontier name following that transaction.

Q: Would you briefly describe the proposed transaction?

A: The proposed transaction will transfer certain Verizon assets to Frontier, in exchange for a merger consideration. In order to facilitate the transaction, the Verizon business in question will be transferred to an intermediary organization named "Spinco," which will then be merged into Frontier. According to documents filed with the SEC the "Spinco Business" is identified as follows:

> (i) all of the incumbent local exchange carrier business activities and operations of Verizon and its Affiliates in the Territory[7] (consisting of local exchange service, "intraLATA" toll service, network access service, enhanced voice and data services, digital subscriber line ("DSL") services, wholesale services, operator services, directory assistance services, customer service to end users, and, in connection with any of the foregoing, repairs, billing and collections); and
>
> (ii) all of the following activities of Verizon and its Affiliates in the Territory:
>
> (A) originating central office voice switched Long Distance ("LD") services in the Territory switched by wire centers that are otherwise Spinco Assets; and
>
> (B) the provision by Verizon Online LLC of dial-up, DSL and dedicated Internet access services and related value added services taken by DSL customers located in the Territory;

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[6] Citizens also acquired GTE and Contel properties in 2000. Joint Applicants' Response to Public Counsel Data Request No. 164.

[7] With regard to the Spinco transaction, "Territory" means the local franchise area of the Contributing Companies in the states of Arizona, Idaho, Illinois, Indiana, Michigan, Nevada, North Carolina, Ohio, Oregon, South Carolina, Washington, West Virginia and Wisconsin, the franchise area of Verizon West Coast Inc. and the franchise areas in California associated with several wire centers bordering Nevada and Arizona.

(C) the resale of satellite to terrestrial video services.[8]

It should be noted that the Spinco does not obtain any of the following Verizon subsidiaries or operations: (1) Verizon Wireless; (2) Verizon Network Integration Corp.; (3) Verizon Select Services Corp.; (4) Verizon Avenue Corp.; (5) Federal Network Systems LLC; (6) ongoing MCI operations; (7) Verizon Business Global, LLC; (8)Verizon Global Networks; (9) Verizon Long Distance LLC; (10)Verizon Enterprise Solutions LLC; or, (11) Verizon operator and directory services, as well as other similar lines of business.[9]

Thus, in summary, the Spinco business that Frontier will be acquiring reflects the legacy ILEC operations of Verizon, as well as related lines of business including toll, DSL, and Verizon's FiOS operations in Washington and other Spinco states, and will exclude the wireless, enterprise-oriented, and international business operations of Verizon.

The proposed acquisition of the Verizon lines by Frontier will substantially impact the structure of both Verizon and Frontier. The transfer of the Spinco business to Frontier will result in Frontier gaining 4.8 million access lines, resulting in Frontier more than tripling in size, from 2.2 million access lines to 7 million access lines.[10]

Q: Was a similar application filed with the FCC, or in other states?

A: Yes. The Joint Applicants have filed an application at the FCC, and in nine (9) other states. At the FCC the Joint Applicants indicate that they believe that this

[8] Distribution Agreement, p. 16.
[9] Distribution Agreement, pp. 17-19.
[10] "Welcome to the New Frontier," Frontier Communications, May 13, 2008, p. 22, *available at* http://www.sec.gov/Archives/edgar/data/20520/000095015709000249/form425.htm.

transaction is in the public interest, and that the acquisition of rural exchanges from large incumbents are beneficial, pointing to an FCC conclusion that such transactions "'d[o] not raise public interest issues' and 'are unlikely to raise the potential of competitive harm.'"[11] It is most ironic that the FCC Order from which Applicants draw this quote is the FCC's Order approving the Verizon/FairPoint transaction, as the potential pitfalls associated with rural divestitures are clearly illustrated by the Verizon/FairPoint deal.

Q: What types of problems emerged with the FairPoint and Hawaiian Telcom divestitures?

A: FairPoint and Hawaiian Telcom customers have experienced extensive problems with poor service quality following the handover of Verizon assets, including service outages, billing system issues, call center problems, and 911 system failures.[12] Furthermore, each of these transactions involved burdensome increases in the acquiring company's debt, which contributed to both Hawaiian Telcom's and FairPoint's bankruptcies.[13] A substantial increase in debt is also the case with the new Frontier transaction.

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[11] *FCC Application*, p. 1.

[12] *See e.g.*, "FairPoint Outage Affects 12,000 Vermonters, WPTV News, Jun. 10, 2009, *available at* http://www.wptz.com/news/19712692/detail.html. *See also*, "A Report on the Partial Outage of the Vermont Enhanced 911 System on September 3, 2008," Vermont Department of Public Service, Dec. 18, 2008, pp. 5-6, *available at* http://publicservice.vermont.gov/telecom/E911%20Outage%20Report.pdf . *See also*, "FairPoint chief grilled about service issues: The company has 30 days to show that it has the money and know-how to serve Vermont customers," *Portland Press Herald*, Aug. 11, 2009, *available at* http://pressherald.mainetoday.com/story.php?id=275981. *See also* Testimony of Carlito P. Caliboso, Chairman of the Public Utilities Commission, State of Hawaii before the Committee on Energy and Commerce, Subcommittee on Telecommunications and the Internet, U.S. House of Representatives, Mar.11, 2008, *available at* http://archives.energycommerce.house.gov/cmte_mtgs/110-ti-hrg.031108.Caliboso-testimony.pdf.

[13] Joan E. Solsman, "FairPoint Enters Chapter 11 Protection in Deal Giving Control to Lenders," *Wall Street Journal*, Oct. 26, 2009, *available at* http://online.wsj.com/article/SB10001424052748704335904574496942316622698.html.

The Joint Applicants' witnesses provide a less-than-complete perspective on the problems associated with these asset line divestitures, and ignore parallels between those transactions and the current one. For example, the Joint Applicants state:

> FairPoint encountered operational problems with the new systems it had designed and built to completely replace Verizon's systems and to run the business it acquired — primarily problems related to the billing process, order flow, and call center response for both retail and wholesale operations. Those operations have translated into increased costs for manual processing of order, lost billing cycles for customers whose services orders were delayed, and possibly some customer attrition.[14]

However, it is also important to note that the problems that FairPoint has encountered extend beyond those associated with FairPoint's cutover of systems. For example, prior to the sale of assets to FairPoint, the Maine Public Utilities Commission identified problems with Verizon's operations in Maine, specifically related to Verizon's ability to keep its network operating during power outages. In addition, the Maine Commission identified problems associated with Verizon's failure to properly communicate with emergency agencies during extended outages.[15] As noted by the Maine Commission, these pre-existing problems were inherited by FairPoint, which resulted in the need for an investigation:

> [This investigation] will focus on two areas of importance: (1) FairPoint's ability to keep DLCs operational during commercial electricity outages; and (2) the need for communications between FairPoint, emergency management personnel, and municipal officials during outages. Because both of these topics are implicated in the Harpswell Complaint, and, because we are not satisfied with the response provided by Verizon on March 17,

[14] Direct Testimony of Timothy McCallion, p. 22, lines 4-10.
[15] State of Maine Public Utilities Commission, Investigation into FairPoint Communications—NNE's Compliance with Docket No 2002-151; Investigation into Loss of Verizon Telephone Coverage During Power Outages, Docket Nos. 2008-172 and 2008-103, Apr. 16, 2008.

> 2008, we will conduct our investigation in both proceedings simultaneously. Specifically, while Verizon did install new batteries, the underlying problem in the Harpswell Complaint is Verizon's failure to properly manage its generators so as to keep DLCs operational during commercial power outages.[16]

Thus, the condition of Verizon facilities was an issue contributing to the problems that FairPoint experienced. Similarly, the New Hampshire Public Utilities Commission conditioned its approval of the FairPoint transaction on FairPoint's agreement to "improve service quality standards that Verizon failed to meet in 2007."[17] Thus, the New Hampshire Commission also pointed to pre-existing deficiencies that Verizon passed on to FairPoint. As noted in an April 2009 article[18] assessing the FairPoint and Hawaiian Telcom asset divestitures:

> [I]t's difficult to imagine this sort of Bell asset divestiture absent a fairly complicated deal structure — like the Reverse Morris Trust — and the fact that much of the aging assets Bells might like to unload could be unappealing to buyers for the same reasons — Consolidated Communications CEO Bob Currey told me last year that although he was open to buying Bell assets, "historically some of the stuff they wanted to get rid of, you wouldn't want or you wouldn't pay for because of the requirements to get those lines up to speed."[19]

It is notable that this industry observer identified the "Reverse Morris Trust" as a precondition for further asset divestitures. A Reverse Morris Trust was used in

[16] *Id.* at 3.
[17] State of New Hampshire Public Utilities Commission, *Verizon New England, Inc., Bell Atlantic Communications, Inc., Nynex Long Distance Co., Verizon Select Services, Inc. and FairPoint Communications, Inc., Petition for Authority to Transfer Assets and Franchise Order Approving Settlement Agreement with Conditions*, DT 07-011 Order No. 24,823, Feb. 25, 2008, p. 33.
[18] Specifically, two weeks prior to the announcement of the proposed transaction between Frontier and Verizon.
[19] Ed Gubbins, "Fairpoint warning," *TelephonyOnline*, Apr. 29, 2009, *available at* http://telephonyonline.com/independent/commentary/fairpoint-warning-0429/index.html.

the FairPoint divestiture,[20] and the Reverse Morris Trust is the device being employed by the Joint Applicants.[21]

With regard to the Hawaiian Telcom experience, the Joint applicants point to problems associated with new back office systems that the Carlyle Group, a private equity investment firm, created to administer Hawaiian Telcom's operations:

> The Carlyle Group was not an operating company with extensive experience in the telephone business, but its business plan was based on building brand new systems and to expeditiously end its lease of the Verizon systems to reduce costs.[22]

While it does appear that the Hawaiian Telcom experience was driven by problems with new back-office systems,[23] the Frontier/Verizon transaction involves building new "replicated" systems, and has a similar set of incentives for Frontier to expeditiously end its use of Verizon systems to reduce costs. As I will discuss in detail below, the Frontier/Verizon transaction presents new risks, in addition to the types of risks associated with the FairPoint and Hawaiian Telcom experiences.

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[20] "Finding the Next Fairpoint," *TelephonyOnline*, Jul. 14, 2008, *available at* http://telephonyonline.com/independent/news/telecom_finding_next_fairpoint/.

[21] Welcome to the New Frontier," Frontier Communications, May 13, 2008, p. 22, *available at* http://www.sec.gov/Archives/edgar/data/20520/000095015709000249/form425.htm.

[22] Direct Testimony of Timothy McCallion, p. 24, lines 16-19.

[23] Testimony of Carlito P. Caliboso, Chairman of the Public Utilities Commission, State of Hawaii before the Committee on Energy and Commerce, Subcommittee on Telecommunications and the Internet, U.S. House of Representatives, Mar. 11, 2008, *available at* http://archives.energycommerce.house.gov/cmte_mtgs/110-ti-hrg.031108.Caliboso-testimony.pdf.

B. Standard for Merger Review

Q: Can you please explain your understanding of the standard that the Commission applies to determine whether a proposed merger should be approved?

A: While I am not an attorney, my understanding as a policy analyst is that RCW 80.12.020 prohibits a public utility from merging or consolidating any of its franchises, properties or facilities, by any means whatsoever, whether directly or indirectly, without an order from the Commission authorizing it to do so. It is also my understanding that under WAC 480-143-170, if the Commission finds after examination that a proposed merger is not in the public interest, it shall deny the application.

I understand that in Docket No. UE-981627, the application of Scottish Power to acquire PacifiCorp, the Commission set forth the standard for approval of a merger transaction, as follows:

> 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.[24]

The Commission elaborated on this standard in 2005 Verizon and MCI merger:

> [T]he Commission determines whether the transaction is consistent with the public interest, balancing the costs and the benefits for the public and for affected customers. If the costs outweigh the benefits, the result is harm and the Commission should deny or condition the approval so no net harm results.[25]

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[24] *In re Application of PacifiCorp & Scottish Power PLC,* Docket No. UE-981627, Third Supplemental Order, pp. 2-3.

[25] *In the Matter of the Joint Application of Verizon Communications, Inc. and MCI, Inc. For Approval of Agreement and Plan of Merger,* Docket No. UT-050814, Order Accepting Settlement, On Condition; Approving Merger, On Condition (Order No. 07), ¶59.

Finally, I understand that applicants bear the initial burden of demonstrating that the transaction does no harm to the public interest.[26] I have relied upon this interpretation of the standards in preparing my testimony.

Q: Have the Joint Applicants met their burden of showing that this merger will result in no harm to the public interest?

A: No, I do not believe that the Joint Applicants have provided sufficient information to demonstrate that the merger will result in no harm to the public interest. As I discuss in greater detail throughout my testimony, the Joint Applicants do not address important issues regarding how the merger will impact consumers. These issues will result in harm to Washington consumers.

III. RISKS AND ALLEGED BENEFITS OF THE PROPOSED TRANSACTION

A. Risks of the Merger

Q: What merger risks will you address?

A: I will address (1) risks demonstrated by other recent Verizon access line divestitures, and (2) from changing industry structure. I will also address risks arising for Verizon Washington ratepayers associated with (3) the integration of Verizon operations into Frontier's; (4) risks associated with the replication of Verizon systems; (5) risks associated with the physical cutover of Verizon and Frontier networks in Washington; and (6) risks arising from the parallel cutover of Verizon West Virginia customers to Frontier's systems; (7) risks associated with Frontier's pricing strategies; and, (8) risks associated with financial aspects of the

[26] *Id.*

merger. While I mention risks associated with service quality and Frontier's finances, Ms. Alexander will address risks associated with service quality and Mr. Hill will address risks associated with Frontier's smaller size and less favorable financial ratings.

1. Risks Akin to the FairPoint and Hawaiian Telcom Experience

Q: Frontier is described as having a "track record of smooth transitions,"[27] and Verizon assures this Commission that the problems experienced by FairPoint and Hawaiian Telcom will not occur in this transaction.[28] Do you believe that the Commission should be assured by these statements?

A: No. "Smooth transitions" have been promised before. For example, in testimony before the New Hampshire Public Utilities Commission, Verizon's witness stated that "the parties have agreed to establish a comprehensive planning and management structure to ensure a smooth and seamless transition from reliance on Verizon support service to [FairPoint's] own support systems."[29] Thus, promises of smooth transitions have proved faulty in the past, and I believe that the evidence indicates that Verizon Washington ratepayers will face substantially increased risk as a result of the transaction.

It is important to note that the "track record" of Verizon asset divestitures has been dismal. As the *Wall Street Journal* recently noted:

> Verizon Communications Inc. boss Ivan Seidenberg may be one of the best deal makers of his time, or one of the worst.

[27] Direct Testimony of Timothy McCallion, p. 19, lines 4-5.
[28] Direct Testimony of Timothy McCallion, pp. 19-22.
[29] Direct Testimony of Stephen E. Smith, New Hampshire Public Utilities Commission Docket No. DT 07-011, Mar. 23, 2007, p. 27.

> Today, three of Verizon's most significant divestitures are either in bankruptcy or near it. As they say on Wall Street, it all depends on what side of the trade you're on.
>
> Verizon's former yellow-pages unit, which goes by the ungainly name of Idearc, sought court refuge from creditors in May; Verizon's former Hawaiian telecom franchise, purchased by Carlyle Group, filed for bankruptcy in December, and FairPoint Communications, which absorbed landlines from Verizon in a complicated divestment, is close to going under, the company said in a July securities filing. In all, these companies have lost upward of $13 billion in value and counting.
>
> This should make Mr. Seidenberg a hero to Verizon investors. Not only did he bail out of the assets at the right moment, he extracted prices that literally sucked the life out of the buyers.[30]

The Commission should not underestimate the risks associated with this transaction. Verizon has proven itself to be highly opportunistic in the past, and has taken steps in this transaction to insulate itself from any negative downsides associated with regulatory conditions that may be placed on this merger. This is highly troubling because Frontier will depend on Verizon following the close of the transaction, but Verizon will face no consequences if things go wrong. As a result, Verizon faces few incentives other than to "take the money and run."

Q: How has Verizon insulated itself from regulatory risks associated with the merger approval process?

A: The Agreement and Plan of the Merger specifies that to close the merger, Frontier must deliver $5.247 billion to Verizon. However, during the course of regulatory approval it is possible that Verizon could be required to take some actions that would result in expenditures made by Verizon due to regulatory requirements

[30] Dennis K. Berman, "The Two Sides of Verizon's Deal Making," *The Wall Street Journal*, Aug. 11, 2009, *available at* http://online.wsj.com/article/SB124994640773620919.html.

associated with the merger approval process. If this should occur, however, Verizon is held harmless. The Agreement and Plan of the Merger makes this fact clear:

> 1.167 "Spinco Closing Equity Value" means the amount equal to the sum of (A) $5.247 billion plus (B) the Required Payment Amount, if any.
>
> 1.144 "Required Payment Amount" means the aggregate amount, if any, of all amounts required to be paid, refunded, deferred, escrowed, or forgone pursuant to an order, settlement agreement or otherwise…by Verizon or its Subsidiaries, other than post-Closing obligations of Spinco or any Spinco Subsidiary, as a condition to obtaining any consent of any governmental Authority in the Territory required to consummate the Distribution or the Merger or to complying with any order approving the Distribution and the Merger.[31]

In other words, the price that Frontier will pay Verizon will go up dollar-for-dollar if Verizon incurs any regulatory costs that Verizon may encounter as the merger-approval process unfolds. This provision of the Merger Agreement thus absolves Verizon for any deficiencies in the merger that may be uncovered through the regulatory process. The Agreement and Plan of the Merger allows Verizon to avoid the consequences of any regulatory actions taken that might improve the public interest profile of this transaction. It also closes the circle regarding the weak incentives that Verizon has to deliver the Spinco properties to Frontier in a manner that will assure that those properties do not have defects that may be inconsistent with public interest considerations. This escape clause for Verizon shifts the risk to Frontier, and ultimately to Frontier's ratepayers.

[31] Agreement and Plan of Merger dated as of May 13, 2009 By and Among Verizon Communications Inc., New Communications Holdings Inc. and Frontier Communications Corporation, pp. 21 & 22 (hereinafter *Agreement and Plan of the Merger*).

Q: Do you believe that Verizon should have a continuing stake in the operations of its divested properties?

A: Yes. Economic theory predicts that if Verizon has a continuing interest in these properties, its performance in critical areas, such as the replication of systems and system cutovers, will be superior to the case where Verizon is "off the hook" for any potential problems associated with the transition and post-closing operations of the divested properties. Furthermore, the incentives Verizon faces are even more perverse as Frontier must pay Verizon for Verizon's support of the replicated systems on which Frontier will depend to run the Spinco business. I will discuss this issue, and options for improving Verizon's incentives, should this Commission approve the merger, which may increase the likelihood that Verizon will do its best to ensure that the divested properties perform as represented to Frontier.

Q: Do you believe that this transaction is more complicated than the FairPoint or Hawaiian Telcom transactions?

A: Yes, for a number of reasons. This transaction involves a much larger number of access lines, stretching from coast-to-coast. This transaction requires a large-scale replication of existing Verizon retail and wholesale systems that will be handed off to Frontier at closing. These replicated systems will have had only a limited run prior to the hand-over to Frontier.[32] This transaction also requires the

[32] According to discovery responses, Verizon plans on having the replicated customer facing systems operational 60-days prior to closing. *See* Joint Applicants' Response to Staff Data Request No. 104.

immediate cutover of a large number of Verizon customers (those residing in West Virginia) to Frontier's systems at the closing of the merger.

The success of this transaction depends on Frontier's ability to quickly improve broadband capability in Verizon's former service area, however, Frontier has not evaluated the condition of the outside plant in that service area, but has instead relied on representations regarding the condition of this plant made by Verizon.[33] Frontier also makes highly unrealistic assumptions regarding the cost of upgrading the DSL capacity in the former Verizon properties, which I will address later in my testimony.

Frontier must also substantially increase its debt to complete this transaction, and at this time cannot inform this Commission of the cost of securing the needed debt financing. Furthermore, the ongoing macroeconomic financial instability and economic downturn may impact the cost that Frontier will face when raising the debt-funded payment to Verizon, as well having an impact on consumers' ability to sustain purchases from multiple telecommunications platforms. These uncertainties only add to the complexity of the transaction, and increase the risks facing Washington consumers.

2. Risks Associated with Changing Industry Structure

Q: Does the current state of the telecommunications industry have an impact on the risks associated with the merger?

[33] Verizon Response to Public Counsel Data Request No. 62. Frontier indicates that "Frontier expects that prior to close it will request or need additional information or prepare reports based on OSP plant conditions." Joint Applicants' Response to Public Counsel Data Request No. 229.

A: Yes. The telecommunications industry continues to undergo technical transformation, faces evolving consumer preferences, and is also being affected by the ongoing economic downturn. With regard to voice services, telecommunications providers like Verizon and Frontier have experienced declines in switched access line counts. For example, in recent years Frontier has experienced average switched line loss of about 7 percent per year, and Verizon access line counts in the Spinco service area have declined by 10 percent per year.[34] Of course, these switched lines losses ignore the fact that Verizon and Frontier have been promoting and selling broadband services, which has cut into their switched line sales. However, even when accounting for Frontier's broadband sales, it has begun to see declines in the overall number of switched and broadband lines that it sells. In other words, switched line loss is exceeding DSL growth. The switched line losses reflect the impact of the growing availability of cable voice services, which have proved to be attractive to some consumers.[35] In addition, some consumers in Verizon's Washington service area have cut the cord and gone "wireless only."[36] Finally, declining consumer incomes are pressuring consumer decisions regarding wireline services.[37] This environment increases the risks for wireline operators as they must recover the

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[34] Direct Testimony of Daniel McCarthy, p. 11, lines 6-8.
[35] Cable companies promote the "triple play" of voice, broadband, and video services.
[36] According to the most recent data available from the National Health Interview Survey (NHIS), about 20 percent of households nationwide are now wireless only. There is substantial regional variation in cord cutting. According to a study released based on the NHIS, about 16.3 percent of Washington households are wireless only. *See* "Wireless Substitution: State-level Estimates From the National Health Interview Survey, January–December 2007," Mar. 11, 2009, *available at* http://www.cdc.gov/nchs/data/nhsr/nhsr014.pdf.
[37] According to results of the NHIS, lower income households are more likely to abandon wireline service. *See* "Wireless Substitution: Early Release of Estimates From the National Health Interview Survey, July-

largely fixed costs of their operations from a shrinking customer base. It is possible that this confluence of factors will test the proposition that the local telecommunications industry is subject to destructive competition.[38] Given the growth of cable voice in some areas, whether two wireline facilities-based providers will be sustainable is a key point of policy evaluation, and one which this Commission should keep in mind as the much smaller and less diversified Frontier attempts to acquire the assets that Verizon no longer views as profitable.

Q: Have ILECs developed strategies to offset the impact of wireline losses?

A: Yes. Service diversification provides one means to offset the negative financial impact of wireline losses. For example, the two largest ILECs, AT&T and Verizon, are also the two largest U.S. wireless carriers. This diversification into wireless has mitigated the impact of wireline losses. Network upgrades to enable broadband Internet access also provides new revenue streams, and a means to retain customers. In addition, both AT&T and Verizon have pursued video-delivery strategies by upgrading portions of their networks to enable the provision of video services. These diversification efforts have allowed AT&T and Verizon to mitigate some of the negative impact of the loss of switched wirelines.

Companies like Frontier, which do not have wireless affiliates, and provide video primarily through a partnership with a satellite television company,

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December 2008," May 6, 2009, a*vailable at* http://www.cdc.gov/nchs/data/nhis/earlyrelease/wireless200905.pdf.

[38] Destructive competition has been described as a market that is not a natural monopoly, but that nonetheless does not have a stable equilibrium, resulting in bankruptcies and unstable supply. Thus, even though consumers have a limited number of alternatives, "competition" may lead to even fewer choices. Tendencies toward destructive competition are typically associated with industries that have high fixed and/or sunk costs. *See e.g.*, Eldad Ben-Yosef, *Evolution of the U.S. Airline Industry: Theory, Strategy, and Policy,* Chapter 3 (Springer 2005).

face strong pressures to cut costs, and increase revenues from remaining landline customers. Merger-driven growth provides one avenue to achieve cost savings. The Frontier/Verizon transaction marks another step in what is likely to be a ongoing stream of consolidations among rural ILECs.[39] This reshaping of the industry, with the potential for the emergence of a "rural supercarrier,"[40] will have profound impact on key public policy issues that face this Commission, such as the continued availability of affordable services, broadband deployment, the viability of intermodal competition, and universal service funding.

Q: Does Verizon believe that the shift in the industry is permanent?

A: Apparently it does. According to recent statements by Verizon's CEO, Ivan Seidenberg, wireline voice no longer provides a sustainable business model:

> Roll over in your grave, Alexander Graham Bell. That was in effect what Ivan Seidenberg, the chief executive of Verizon Communications -— one of the largest descendants of the old Bell System — declared this morning. Speaking to a Goldman Sachs investor conference, Mr. Seidenberg said Verizon was simply no longer concerned with telephones that are connected with wires . . . .
>
> "Video is going to be the core product in the fixed-line business," Mr. Seidenberg declared. And the focus will move from selling bundles of video and landline to video and cellphones, he added.[41]

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[39] The Commission's recent approval of the CenturyTel/Embarq merger, as well as the instant proceeding provides ample evidence of this consolidation. As noted by an industry observer: "We are in an era of massive consolidation among Tier 2 telcos and rural LECs." *Xchange Magazine,* Jun. 24, 2009, *available at* http://www.xchangemag.com/articles/rural-telco-m-a-activity-at-a-glance.html.

[40] "Rise of the Rural 'Super' Carrier," *Telecompetitor*, May 14, 2009, *available at* http://www.telecompetitor.com/rise-of-the-rural-%E2%80%98super%E2%80%99-carrier/.

[41] Saul Hansel, "Verizon Boss Hangs Up on Landline Phone Business," *New York Times Online*, Sept. 17, 2009, *available at* http://bits.blogs.nytimes.com/2009/09/17/verizon-boss-hangs-up-on-landline-phone-business/?scp=2&sq=verizon&st=Search.

If Mr. Seidenberg is correct, and the wireline business is no longer profitable absent the core capability of the delivery of facilities-based video services, then presumably Verizon would view Frontier's business model as flawed.

Whether the "core video" wireline business model is the only way to succeed in the wireline business remains an open question, and telephone companies executives have certainly been wrong before.[42] However, this Commission has the obligation to ensure that the shift in the thinking of Verizon's management, leading it to divest wirelines that it views as less desirable, does not result in harms to Washington consumers. It is important that this Commission be aware of the risks that Washington consumers now face given this latest round of "innovative" thinking on the part of telephone company executives.

Q: Do you believe that the shifts in the industry represent a permanent shift in industry structure?

A: While it is difficult to speculate about "permanent" shifts in this dynamic industry, I believe that the confluence of factors that I mentioned earlier will test the management of all telecommunications firms, including ILECs. Given the increased pressure on all telecommunications providers, the Commission's responsibility to ensure the continued availability of high-quality and affordable telecommunications services, including basic service, is all the more important.

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[42]Consider the legacy AT&T's decision to abandon its broadband and wireless operations. AT&T in the early part of this century, by purchasing MediaOne and TCI Cable became the nation's largest cable provider, capable of delivering voice, video, broadband, and wireless to consumers. AT&T's then-CEO C. Michael Armstrong subsequently decided, a relatively short time later, that shareholder value would be improved if AT&T would spin-off those assets. Given the legacy AT&T's failure to survive, Mr. Armstrong's vision was apparently flawed. *See e.g.*,, "Sale of AT&T Broadband could rock industry," CNET News.com, Aug. 17, 2001, *available at* http://news.cnet.com/Cutting-the-cable/2009-1033_3-271710.html?tag=mncol.

Q: Given that Frontier does not have wireless or facilities-based video capabilities, what else can it do to offset the negative impact of wireline losses?

A: Frontier is pursuing a two-prong approach to address negative trends. First, Frontier believes that it can improve its operating results through acquisitions, as is evidenced by this proceeding, and other recent Frontier transactions. Frontier believes that it can achieve synergies by acquiring the Verizon Spinco operations.[43] According to Frontier, its going forward business model will continue to seek additional opportunities for expansion. Frontier anticipates that **[Begin Highly Confidential]** XXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXX **[End Highly Confidential]**.[44] Frontier is apparently pursuing an aggressive growth strategy, and may become *the* "rural supercarrier."

The second prong of Frontier's approach is to increase revenues associated with the Spinco operations.[45] Frontier believes that it can improve the revenue profile of its new Verizon customers through aggressive marketing:

> The combined company will utilize targeted and innovative promotions to attract new customers, including those moving into the combined company's territory, win back former customers, upgrade and up-sell existing customers on a variety of service offerings including HSI (high-speed Internet), video, and enhanced

[43] "The increased scale and scope of the combined company will allow Frontier to leverage its common support functions and systems (such as corporate administrative functions and information technology and network systems) to achieve both operating expense and capital expenditure synergies. Frontier currently anticipates that the combined company will achieve annualized cost synergies of approximately $500 million, which represents approximately 21 percent of the cash operating expenses of Verizon's Separate Telephone Operations in 2008." Frontier Communications, Second Amended Registration Statement (Form S-4), at 155 (Sept. 14, 2009).

[44] Joint Applicants' Response to Staff Data Request No. 11, Attachment 4(c)(55) to Verizon's HSR filing, "The New Frontier, Presented to Verizon March 11, 2009," pp. 3 and 15.

[45] Frontier Communications, Registration Statement (Form S-4), at 158 (Jul. 24, 2009).

> long distance and feature packages in order to maximize the average revenue per access line (wallet share) paid to the combined company.[46]

Frontier views the "up-selling" of customers as providing a means to offset revenue declines that Frontier expects will continue in the future:

> While the number of access lines is an important metric to gauge certain revenue trends, it is not necessarily the best or only measure to evaluate Frontier's business. Frontier management believes that understanding different components of revenue is most important. . . . Despite the decline in access lines, Frontier's customer revenue, which is all revenue except switched access and subsidy revenue, has declined in the first quarter of 2009 by less than 3 percent as compared to the prior year period. The average monthly customer revenue per access line has improved and resulted in an increased wallet share, primarily from residential customers.[47]

Thus, Frontier hopes to extract more revenues from its remaining customer base.

Q: Does Frontier's business strategy raise policy concerns?

A: Yes, if Frontier continues to grow through acquisition, the strategy may impact Frontier's efforts to integrate Verizon operations into the new Frontier structure. Frontier is not planning on immediately integrating the operations of Verizon's back office and customer support systems. However, this integration must occur over time if Frontier hopes to achieve the cost savings that it is projecting for this merger. Thus, the eventual integration of Verizon operations may come at a time when Frontier's management is facing additional distractions from potential future acquisitions.

A second set of concerns arise due to Frontier's pricing strategy. Verizon

[46] *Id*.
[47] *Id.* at 117-118.

Washington customers may face rising prices and increased pressure to spend more with Frontier. It is important that the marketing practices utilized by Frontier do not disadvantage consumers. I will discuss the risks to consumers associated with Frontier's pricing strategies in a later section of this testimony.

A third set of concerns relates to the financial sustainability of Frontier's merger-directed growth strategy. Frontier must substantially increase its debt to complete this merger. While the impact on Frontier's national financial profile that results from the transaction is favorable when compared to Frontier's pre-merger profile, the financial impact on Verizon's Washington ratepayers is anything but favorable. Mr. Hill's testimony addresses these concerns.

3. Risks Associated with Frontier's Ability to Integrate Spinco

Q: Does Frontier have experience with an acquisition of the size proposed in this case?

A: No. This merger will dramatically increase Frontier's size. Frontier has integrated other operations in the past, notably, taking over 750,000 access lines from Verizon between 1993 and 2000, and taking over 1.1 million local exchange lines from Global Crossing in 2001.[48] However, the 4.8 million access lines targeted in this acquisition represent a much larger transaction than any that Frontier has previously pursued. This fact has been recognized by Frontier's management, which has noted:

[48] Verizon's Response to Public Counsel Data Request No. 58.

[Begin Highly Confidential] XXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXX.[49]

XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX, **[End Highly Confidential]** the Joint Applicants responded:

> Frontier is reviewing organizational, procedural and system similarities and differences between Frontier and Verizon. This process will enable Frontier to assess potential changes it may make to operational execution; however, changes to operational execution will be less about the size and complexity of this transaction and more about "best practices" as well as ease of implementation of changes."[50]

However, Frontier also admits that it has "not conducted any analysis regarding the identification and/or adoption of 'best practices' associated with the consolidation of Frontier and Verizon's operations."[51] Thus, Frontier will be developing its approach to integrating the much larger Spinco operations as it goes along. Frontier's lack of experience with such a large integration introduces numerous risks.

Q: Has Frontier's management expressed concerns regarding the integration risks associated with the merger?

A: Yes. Frontier has advised its investors that there are numerous risks associated with the merger, including risks associated with integration:

> The acquisition of the Spinco business is the largest and most significant acquisition Frontier has undertaken. Frontier management will be required to devote a significant amount of

[49] Frontier's Response to Public Counsel Data Request No. 35, Attachment titled "Project North Board of Directors Discussion Materials," Apr, 16, 2009, p. 6. Additionally, Mr. McCarthy conceded during his Ohio deposition that this transaction is larger and more complex than any other previously undertaken by Frontier. *See,* Exhibit No. ___(TRR-3), PUCO Case No. 09-454-TP-ACO, Transcript of Deposition of Daniel McCarthy, p. 8, line 20.
[50] Frontier's Response to Public Counsel Data Request No. 242.
[51] Verizon's Response to Public Counsel Data Request No. 58.

> time and attention to the process of integrating the operations of Frontier's business and the Spinco business, which may decrease the time they will have to serve existing customers, attract new customers and develop new services or strategies. Frontier expects that the Spinco business will be operating on an independent basis, separate from Verizon's other businesses and operations, immediately prior to the closing of the merger (other than with respect to the portion operated in West Virginia, which is expected to be ready for integration into Frontier's existing business at the closing of the merger) and will not require significant post-closing integration for Frontier to continue the operations of the Spinco business immediately after the merger. However, the size and complexity of the Spinco business and the process of using Frontier's existing common support functions and systems to manage the Spinco business after the merger, if not managed successfully by Frontier management, may result in interruptions of the business activities of the combined company that could have a material adverse effect on the combined company's business, financial condition and results of operations. In addition, Frontier management will be required to devote a significant amount of time and attention before completion of the merger to the process of migrating the systems and processes supporting the operations of the Spinco business in West Virginia from systems owned and operated by Verizon to those owned and operated by Frontier. The size, complexity and timing of this migration, if not managed successfully by Frontier management, may result in interruptions of Frontier's business activities.[52]

Thus, the parallel processes associated with the take-over of the Verizon Spinco systems and the separate migration of the large number of West Virginia customers to Frontier's existing platform presents a complex process for Frontier's management. While the narrative quoted above is reflective of "standard" disclosure practices, it nonetheless provides a frank assessment of the complexity of the proposed merger, and the risks that it poses, in terms of integration problems. The next three sections of my testimony will address in greater detail the complexity of the integration process.

[52] Frontier Communications Second Amended Form S-4, September 14, 2009, pp. 24-25.

4. Risks Associated with the Replication of Verizon's Systems

Q: What must occur for Frontier to gain efficiencies from the merger.

A: As Frontier notes, economies of scale associated with the merger will arise through the "consolidation and standardization of systems and functions."[53] However, if this consolidation and standardization is to take place, there must be changes in the way that, for example, customer service functions in call centers, repair office operations, and billing systems operate. Achieving integration and economies of scale requires that Frontier adopt standardized systems that perform these functions. But this is where the Frontier integration plan departs from other mergers, which have either involved "cutting over" customers to the acquiring company's back office systems,[54] or continuing to operate the legacy systems that the target of the acquisition had previously operated.[55]

Q: How will Verizon Washington ratepayers be served by Frontier following the closing of the merger in areas such as business and repair office, and billing?

A: According to Frontier, there will be no change in the systems that are utilized to serve customers:

> In situations where systems that have been used to support local exchange carrier operations remain exclusively with the seller, the buyer must develop new, or modify existing systems to provide service to the customers after the transaction is completed. Then the seller and the buyer must complete a cutover at a specific date/time, whereby the customer's data and service support functions are moved to the newly developed systems and the buyer assumes responsibilities for providing service on an ongoing basis using those systems. This scenario does not exist in

[53] "Welcome to the New Frontier," p. 12. Frontier Communications, May 13, 2008, p. 22, *available at* http://www.sec.gov/Archives/edgar/data/20520/000095015709000249/form425.htm.
[54] Such a cutover was pursued, for example, in the access line divestitures associated with FairPoint Communications and Hawaii Telecom.
[55] For example, Verizon did not integrate the GTE operations, but utilized GTE's systems.

> Washington because Frontier will be using the *same systems* in place at Verizon prior to the transaction and will have the advantage of employees experienced with those systems that will continue with the business.[56]

However, Mr. McCarthy's assessment does not tell the whole story. Frontier will not be using the "same systems" that Verizon currently utilizes, but will instead be using a set of replicated systems.

Q: What is a replicated system, and why does the need for a replicated system arise?

A: Since its acquisition of the GTE properties, Verizon has never adopted a uniform platform of billing, customer ordering and support, or repair center support. Instead, it maintained two separate systems, one for the former GTE properties, and one for its legacy Bell Atlantic properties. Because Verizon is keeping portions of the former GTE service area after the merger,[57] it apparently has elected to continue using the legacy GTE systems. Rather than handing over the full set of legacy GTE systems to Frontier, Verizon will create a "separate instance" of these systems, and then turn these "replicated" systems over to Frontier.[58] In other words, Verizon will attempt to create a "clone" of the systems that it currently utilizes to run the former GTE properties, and turn the clone over to Frontier.

This approach introduces new problems, and undermines one of Frontier's claimed benefits of the merger. An analogy with regard to the proposed

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[56] Direct Testimony of Daniel McCarthy, p. 52, lines 9-18, emphasis added.
[57] Verizon is retaining former GTE properties in California, Texas, Virginia, and Pennsylvania.
[58] *Agreement and Plan of the Merger* §7.24(c).

replication process helps to illustrate the basic problem faced by Frontier, and its ratepayers. Suppose a consumer is in the market for a used car. After shopping around, the consumer observes that a neighbor has a vehicle for sale. The consumer has observed that their neighbor's car has provided reliable transportation service for a number of years, so the consumer believes this vehicle will perform in a reasonable fashion in the future. However, after approaching the seller, the buyer is informed that due to some sentimental reason, the seller does not want to part with the car that they have put on the market, but instead promises the buyer that they will create a "replica" of the car that the buyer has evaluated. Once the replicated vehicle is created, the consumer will get to take it for a "test drive." Obviously, replicating a motor vehicle is also a complex process, and the test drive may leave certain defects in the replicated vehicle undiscovered. However, perhaps more importantly, the consumer's observations regarding the performance of the original vehicle will have little bearing on the potential future performance of the replicated vehicle.

Frontier faces a problem similar to this hypothetical consumer. When acquiring Verizon's replicated system, the performance levels observed with Verizon's existing systems may not be a good indicator of the performance that can be expected from the replicated system. Furthermore, stress testing these complex and interrelated systems will be a difficult task, and I believe that it is unlikely that any "test drive" of these systems that Frontier takes will result in a complete assessment of the systems' performance under real-world operating conditions. Only after it takes over will discover how they operate under the maximum strains that seasonal peak periods, incidents of extreme weather, or other emergencies will generate.

Q: When will the replicated systems come online?

A: The replicated systems will come online approximately 60 days prior to the closing.[59] Thus, the initial system cutover will take place when Verizon is still in control of the systems, and the customers served by the systems. Thus, the risks associated with the cutover to the replicated systems will begin prior to the close.

Q: How will the use of replicated systems increase the risks associated with the merger?

A: The large-scale replication of systems is unusual. Frontier indicates that it has only utilized replication in one other instance, associated with its sale of its CLEC operations (Electric Lightwave) in 2006.[60] During his Ohio deposition, Mr. McCallion admitted that Verizon has never replicated systems for a "transaction such as this," stating further that any system replication previously conducted by Verizon was associated with system testing and emergency backup.[61]

The replication as envisioned by the Joint Applicants requires that the software and hardware systems associated with the current legacy GTE systems utilized by Verizon be recreated and handed over to Frontier:

> Prior to March 31, 2010, Verizon shall create a separate instance in the Fort Wayne, Indiana data center (the "Fort Wayne Data Center") of Verizon proprietary software systems that will enable Spinco (and following the Merger, the Surviving Corporation) in all states in the Territory (other than West Virginia) to provide

[59] *Agreement and Plan of the Merger* §7.24(c). *See also*, Joint Applicants' Response to Public Counsel Data Request No. 358.
[60] Verizon's Response to Public Counsel Data Request No. 276.
[61] *See*, Exhibit No. ___ (TRR-4), PUCO Case No. 09-454-TP-ACO, Transcript of Deposition of Timothy McCallion, p. 18, line 20 to p. 19, line 8.

> functionality substantially similar to, but no less favorable to the Spinco Business than, that which the Spinco Business received from Verizon and its Affiliates as of the date of this Agreement. As of the Closing Date, the Fort Wayne Data Center (i) shall be owned by the Surviving Corporation or an Affiliate thereof and (ii) shall have on site a majority of the hardware reasonably required to provide functionality to the Spinco Business in accordance with the foregoing (and the balance of such hardware, if not held at the Fort Wayne Data Center, shall be available on a firewall basis from Verizon or a Verizon Subsidiary for up to one year following the Closing to allow for Verizon to transfer such hardware to the Fort Wayne Data Center within one year following the Closing).[62]

The replication process will not only include **[Begin Confidential]** XXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX.[63] **[End Confidential]**

Q: How will the replicated Verizon system be tested?

A: Verizon witness Mr. McCallion indicates that Frontier will take possession of a "tested functional replication of Verizon's existing systems at closing."[64] When asked about how this testing would be done, Verizon indicates that it will "take numerous steps" to confirm that the replicated systems perform at the same level of quality at which they currently perform.[65] Verizon goes on to say:

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[62] *Agreement and Plan of the Merger* §7.24(c), p. 112.
[63] Verizon's Supplemental Response to Comcast Data Request No. 18, Attachment "WA Comcast Set1 Realignment Overview CONFIDENTIAL.pdf," p. 11.
[64] Direct Testimony of Timothy McCallion, p. 20, lines 7-8.
[65] Verizon's Response to Public Counsel Data Request No. 87.

> Verizon will develop system readiness acceptance criteria to ensure that the separate instance created for Spinco will perform in a like manner as it did before close. Systems will not be transferred unless Frontier is reasonably satisfied that the condition to the closing of the Merger Agreement has been met.[66]

It is notable that Verizon is given primary control of the testing process, and the right to refuse Frontier requests associated with system replication:

> Verizon shall undertake to segregate the operation of the Spinco Business in the Territory (other than West Virginia) from the Verizon Business (including the completion of the actions contemplated by Section 7.24(c) and the identification, testing and validation of personnel, processes and systems to be working properly). . . . If in connection with the Realignment the Company (Frontier) wishes to remove or omit particular functions or services that are used or held for use in the conduct of the Spinco Business or to replace certain third party vendors of the Spinco business with other third party vendors, the Company will promptly notify Verizon in writing to this effect. Verizon will have the right to disapprove such proposed omissions or replacements to the extent Verizon determines that such omissions or replacements may materially delay or increase the expense of completing the Realignment.[67]

I am concerned about Frontier's ability to adequately evaluate tests of the replicated systems. Frontier suffers from an asymmetric information problem with regard to the Verizon systems, *i.e.*, Verizon presumably knows these systems inside and out, while Frontier does not have this advantage. As discussed above, these systems are highly complex, and not only include customer support operations and billing systems, but also include **[Begin Confidential]** XX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXX. **[End Confidential]** Thus, whether Frontier has the information

[66] Verizon's Response to Public Counsel Data Request No.87.
[67] *Agreement and Plan of the Merger* §7.24(a).

needed regarding the operational nuances of these systems is doubtful, and this lack of information may limit Frontier's ability to evaluate the replicated systems.

Q: Mr. McCallion states that the replicated systems will be operated by "Verizon personnel that move over to Frontier with the transaction."[68] Will the same personnel be operating the replicated systems?

A: No. Mr. McCallion stated during his Ohio deposition:

> It won't be exactly the same people. It will be personnel who are located in the data center, which is in Fort Wayne, Indiana. Those people are operating former GTE systems today. They'll continue to operate them, but not all of the systems today are in Fort Wayne, Indiana, so we actually have to create all of those systems in the Fort Wayne data center. So to the extent that someone might be operating a different system today, then they become the computer operator for the replicated systems from an operations standpoint.[69]

Thus, the replication process may not result in systems being operated by the same individuals before and after the merger closing, and this change of personnel introduces an additional element of risk.

Q: Will Frontier be able to modify the replicated systems?

A: Yes. Frontier indicates that the replicated systems will be taken over by Frontier with Verizon's product set in place. However, Frontier will have the ability make modifications, such as adding Frontier's product line to replace Verizon offerings.[70] This modification process introduces an element of risk to the systems performance. Specifically, Frontier's ability to modify the replicated systems may create difficulties in the support of the replicated systems.

[68] Direct Testimony of Timothy McCallion, p. 3, line 3.
[69] *See*, Exhibit No. ___ (TRR-4), PUCO Case No. 09-454-TP-ACO, Transcript of Deposition of Timothy McCallion, p. 27, lines 3-12.
[70] Verizon's Response to Public Counsel Data Request No. 89.

Q: Does Verizon provide any warranty regarding the performance of the replicated systems?

A: According to the Merger Agreement, Verizon does not provide an explicit guarantee associated with the performance of the replicated systems.[71]

Q: When Verizon replicates its existing systems, does that process replicate customer records?

A: No. After the system is replicated, customer records, including billing history, payment records, and Verizon services (and third-party services for which Verizon bills) utilized by the customer will be separately loaded into the replicated system. Then Verizon will delete the customer records associated with customers that are not being transitioned to Frontier. Thus, the replication process will involve duplicating the systems and the data, loading the data into the systems, and then deleting the data that is not relevant to Spinco.[72] The loading of customer records into the replicated systems, and then deleting certain data also adds risk to the replication process.

Q: Frontier indicates that the use of the replicated systems will prevent the types of cutover problems that have been associated with FairPoint and Hawaiian Telcom from emerging. How long will Frontier rely on the replicated Verizon systems?

A: Frontier does not know how long it will rely on the replicated systems.[73] However, Frontier expects to realize substantial integration economies in the first

[71] Verizon's Response to Comcast Data Request No. 33. *See also*, *Agreement and Plan of Merger*, §7.24.
[72] Joint Applicants' Response to Public Counsel Data Request No. 362.
[73] Verizon's Response to Public Counsel Data Request No. 29.

three years following the closing.[74] Frontier also faces strong financial incentives to rely on the replicated systems for as short a time as is possible. Primary incentives emerge from the need to capture merger synergies. Until Verizon's Spinco operations are fully integrated into Frontier's operations, the full extent of synergies cannot be captured.[75] Furthermore, Frontier has agreed to pay Verizon $94 million per year for maintenance services associated with the replicated systems.[76] The structure of the maintenance fee is "flat rate." Verizon will be paid whether or not problems are solved, or are solved in a timely fashion. As a result, Verizon may not be incented to solve problems in the most efficient fashion as they arise.

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[74] "The realization of . . . annualized cost savings is expected to be achieved during the first two and a half years after the closing of the merger as the Spinco business's network and information technology systems and processes are fully integrated with those of Frontier." Frontier Form S-4, September 9, 2009, pp. 156-157.

[75] "The benefit to the combined company from capital and operating synergy opportunities that are expected to result from the combination of Frontier's business with the Spinco business (such as leveraging Frontier's existing common support functions and systems to manage the Spinco business), including an anticipated $500 million annual reduction in operating costs for the combined company." Frontier Communications, Amended Registration Statement (Form S-4), at 52 (Sept. 14, 2009).

[76] Frontier Communications, Registration Statement (Form S-4), at 107 (Jul. 24, 2009).

[77] Joint Applicants' Supplemental Response to Public Counsel Data Request No. 118, Exhibit F to the *Agreement and Plan of the Merger*, "Verizon Software License Agreement," §7.3.

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The combined set of incentives could lead Frontier to transfer Spinco customers to its systems in an expedited fashion, especially if the replicated systems do not perform as expected, or if disputes arise with Verizon. Thus, the cutover risks associated with the transition are not mitigated to the extent that the Joint Applicants represent through their claim that Frontier will be using the "same systems" following the merger. At some point Frontier is likely to transfer customers to its systems, and this future cutover will present risks to customers.

Q: Will Verizon charge Frontier for the replication process?

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[78] Joint Applicants' Supplemental Response to Public Counsel Data Request No. 118, Exhibit F to the *Agreement and Plan of the Merger*, "Verizon Software License Agreement," §7.4.
[79] Joint Applicants' Supplemental Response to Public Counsel Data Request No. 118, Exhibit F to the Distribution Agreement, "Verizon Software License Agreement," §7.4.

A: No. Verizon indicates that Frontier will not be charged these costs.[80] This adds another dimension to the risks associated with the process. Verizon, because it is in business to make a profit, will have every incentive to minimize the costs that it incurs in replicating its systems. Given Frontier's less than perfect ability to evaluate the replicated systems, Verizon may cut corners, and Frontier may have difficulty identifying where those corners have been cut.

5. Risks Associated with the Replication of 911 Systems

Q: How will 911 systems be affected by the replication process?

A: According to Verizon, its existing 911 systems will be cut over to replicated 911 systems approximately 60 days prior to the merger's closing.[81] The treatment of 911 systems is outlined in the "Realignment Plan." However, "outline" may be too strong a term to describe the level of detail associated with that Plan's discussion of the realignment of 911 systems—the Realignment Plan contains few details associated with the 911 cutover process. [**Begin Highly Confidential]** XX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXX[82] XXXXXXXXXXXXXXXXXXXXXXXXXXXX

[80] Verizon's Response to Staff Data Request No. 63.
[81] Joint Applicants' Response to Public Counsel Data Request No. 358(f).
[82] *Realignment Plan*, pp. 65-70. The Realignment Plan also provides a list of public safety answering points affected by the cutover.

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Public Counsel requested additional information regarding the treatment of 911 systems. The Joint Applicants provided the following response:

> As a first step, Verizon will complete the internal process of establishing for its North Central region all of the replicated systems described in the Realignment Plan, including the E911 OSS network and functionality described at pages 65-70 of Verizon's Realignment Plan. Then, prior to placing the replicated E911 systems into production, Verizon will test the systems. . . . Verizon will then share its testing results with Frontier, and Frontier will have the opportunity to review them and to propose additional tests. Once the E911 systems are in production, Frontier will validate and confirm that the systems are providing at least the same level of functionality that Verizon provides to itself. Frontier will make a determination prior to closing that Verizon's representation in Section 5.17 will be correct as of the closing date and that Verizon's obligations under 7.24 have been met, including Verizon's obligations to create separate instances of operating systems that will enable Frontier to provide service with functionality substantially similar to, but no less favorable than, that provided by Verizon using its existing systems. Replicated operations support systems are a condition precedent to closing the transaction.[83]

This information causes concern. Frontier should not be allowed to be given the sole sign-off on whether 911 systems are properly functioning.

With regard to the testing the Verizon plans, the following description of the process is offered:

> Prior to being put into production at least 60 days prior to close, the replicated systems will be port-scanned by Verizon to ensure all valid ports are available and that non-essential and non-secure ports are not open. The systems will be tested for network connectivity, correct data pass-through, and correct data handling. All processes will be tested for functionality and error generation.[84]

[83] Joint Applicants' Response to Public Counsel Data Request No. 358.
[84] Joint Applicants' Response to Public Counsel Data Request No. 359.

The results of these tests will impact more than Frontier. Should this Commission approve the merger, I believe that reporting of the test results of 911 systems should be shared with the Commission and other interested parties. The Commission should also ensure that interested parties are aware of the transition of 911 systems, and of the results of the testing process. While the Joint Applicants state that they will, with regard to the 911 cutover, "follow industry-standard procedures for any required notifications,"[85] it is not clear whether those procedures will be sufficient given the unique cutover of Verizon's current 911 systems to new and untested, replicated systems. Given the 911 problems experienced by FairPoint, which included an E911 outage that occurred under Verizon's supervision,[86] this Commission must ensure that no 911-related issues will impact Washington.

Q: Can you summarize your concerns regarding the system-replication risks associated with this transaction?

A: The Commission should not accept Frontier's claims that it will be using the "same systems" to serve Verizon WA's former customers. The replication of complex Verizon systems introduces risk that customers will face service disruptions, or other negative consequences. Furthermore, it is also likely that Frontier, to capture merger synergies, will eventually cut over the customers that are served by the replicated systems to its own systems. This too introduces risk of service disruptions, or other negative consequences. Should the Commission

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[85] Joint Applicants' Response to Public Counsel Data Request No. 358(e).

[86] *See* "A Report on the Partial Outage of the Vermont Enhanced 911 System on September 3, 2008," Vermont Department of Public Service, Dec. 18, 2008, pp. 5-6, *available at* http://publicservice.vermont.gov/telecom/E911%20Outage%20Report.pdf.

approve the merger, it must carefully monitor how Frontier performs during the transition.

6. Risks associated with the Washington Cutover

Q: Is there also a "physical network" side to the cutover process in Washington?

A: Yes. Currently, Verizon controls integrated network facilities in Washington that provide local voice services, long distance services, and Internet access services. As was discussed earlier, Frontier is taking possession of Verizon's local facilities that provide local services and Internet access. Frontier is not taking possession of any Verizon facilities that provide InterLATA long distance services, nor is Frontier taking possession of Verizon's Internet access facilities that connect the "last-mile" Internet access facilities to the overall Internet. Thus, Joint Applicants must establish the physical separation of Verizon's network facilities in Washington. Once the physical separation is completed, Frontier must reestablish connections for its new customers, both long distance and Internet access, so that the "island" of Verizon voice and data facilities that it will take over in Washington can be connected to the rest of the world. It is notable that the Joint Application and the supporting testimony do not mention that such a process will take place, and thus provide no detail regarding how the physical network separation and reconnection will be accomplished in Washington.

Q: Have you been able to obtain any details regarding this physical network cutover in Washington?

A: I have been able to obtain a few details, but it appears that here too Frontier has yet to establish a plan that it can share with the Commission. Joint Applicants were asked to identify the point of network demarcation for voice long distance services, and whether Frontier would be taking possession of any long distance facilities from Verizon on the trunk-side of the toll serving office. Joint Applicants responded:

> Verizon is not transferring any assets to Frontier or Spinco specifically associated with providing long distance services. It will be Frontier's responsibility to enter into an arrangement with a long distance provider to provide long distance service to end users. Verizon will not transfer to Spinco any tangible assets, facilities, or agreements with facilities vendors relating to long distance (InterLATA) facilities supporting customer traffic. Frontier will make arrangements for facilities to support long distance customers.[87]

This response does not provide much detail. When asked a similar question in the West Virginia merger-approval proceeding, a few more details were provided:

> Frontier will take control of Verizon's assets and facilities used to deliver local exchange telephone services. All other facilities and assets that may be used to deliver InterLATA toll service are not included in the transaction. Each LD [long distance] carrier establishes a POP (Point of Presence) for hand-off and receipt of LD traffic. The POP is the demarcation point for LD traffic and is typically within a local or Tandem switching central office.[88]

Thus, while Frontier will take over the local-service customer relationship and the Verizon facilities previously utilized to provide local services as part of the transaction, Frontier will not be acquiring any Verizon facilities that were previously utilized to provide long distance services to these customers.

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[87] Joint Applicants' Response to Public Counsel Data Request No. 356.
[88] *See*, Exhibit No. ___ (TRR-5), WVPSC Case No. 09-0871-T-PC, Verizon response to Consumer Advocate Division's 5th Set, question M79(a).

Q: What are Frontier's plans with regard to providing long distance services to the Verizon long distance customers that will be acquired by Frontier on the merger closing date?

A: Frontier indicates that it will use the facilities of a third party for carrying toll traffic.[89] Frontier indicates that it may use the existing network arrangements from end offices and tandems to the points of presence maintained by Verizon's IXC affiliate.[90]

Q: How will the physical separation of Frontier and Verizon's data networks be accomplished?

A: To provision DSL service, the ILEC establishes a dedicated physical connection from the telephone company central office to the customer using the existing local loop.[91] The subscriber's traffic is then terminated on a digital subscriber line access multiplexer (DSLAM) that will split the voice and data traffic, with the data traffic being passed onto "middle-mile" data facilities, that will ultimately connect to regional hubs, and ultimately to backbone networks. These middle-mile facilities may include gateway routers, Asynchronous Transfer Mode (ATM) switches, and LATA core routers.[92] However, the Joint Applicants state that the point of demarcation between Verizon and Frontier data networks has not yet

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[89] Joint Applicants' Response to Public Counsel Data Request No. 357.
[90] *Id*.
[91] The loop may be all copper, or a hybrid of fiber and copper. All copper loops bring the customer's data traffic directly into the central office on a dedicated facility. With a hybrid copper/fiber loop, the customer's connection is on a dedicated copper facility from the customer's premise to a remote terminal, and then will be carried over a shared fiber-based data connection from the remote terminal to the central office.
[92] Joint Applicants' Response to Public Counsel Data Request No. 354(a).

been established.[93] With regard to the higher levels of the data networks to which these middle-mile facilities ultimately connect, the Joint Applicants state:

> The uplinks from these devices are currently being planned and have not been finalized. One potential option is for Frontier to uplink these devices to the Frontier National Data Backbone that transports Internet traffic to Frontier's peering partners. Frontier's Internet access network would begin with the facilities at the customer premises and the termination point is in the planning process.[94]

Frontier also indicates that, in the areas of Washington where it is not taking possession of Verizon facilities, it will lease the transport facilities needed to connect its new customers to higher levels of the Internet.[95] Thus, the fact that Frontier must establish the necessary physical connections to enable both long-distance voice and data connections adds to the complexity of the cutover process. Not only must Frontier be prepared on day-one to service all Washington local-exchange customers, but Frontier must be able to provide, either though its own facilities, or facilities that obtains from others, sufficient voice and data network capacity to enable voice long distance services, and Internet access services.

Q: Frontier states that it connects state-level data networks to frontier's national backbone. Does Frontier's pre-merger backbone have sufficient capacity to handle the more than tripling of Frontier's customer base?

A: No. Frontier indicates that it will be upgrading its backbone network as part of the transition process.[96] Public Counsel requested information regarding the traffic engineering studies performed by Frontier to assure that the backbone

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[93] Joint Applicants' Response to Public Counsel Data Request No. 354(d).
[94] Joint Applicants' Response to Public Counsel Data Request No. 354(a).
[95] Joint Applicants' Response to Public Counsel Data Request No. 355(b).
[96] Joint Applicants' Response to Public Counsel Data Request No. 243(b).

upgrade would be sufficient given the more than tripling of Frontier's customer base, but Frontier has not provided the requested information.[97]

Q: Do you believe that the physical separation of Verizon's voice and data networks and Frontier's need to re-establish the connection of local voice and data networks to voice long distance and data backbone networks increase the risks associated with the transaction?

A: Yes. Viewed in its entirety, Frontier faces a challenging process that not only involves taking possession of replicated Verizon systems, but also requires substantial actions associated with the physical separation of network facilities, and the re-establishment of long distance voice and data connections that will be under Frontier's control. As I will discuss further below, should this Commission approve the merger, careful monitoring of Frontier's performance is necessary.

7. Risks Associated with the West Virginia Cutover

Q: How will Frontier's transition of Verizon's West Virginia operations impact transition?

A: Because Verizon West Virginia is part of the legacy Bell Atlantic operations, it is served by a set of systems separate from the former GTE systems that Verizon is replicating for Frontier. For these customers, Frontier plans on a "cutover" to Frontiers systems at the closing of the merger rather than the replication process to be used in other states. West Virginia is the largest of the state operating territories that Frontier will acquire, with over 700,000 access lines.[98] Frontier

[97] Joint Applicants' Response to Public Counsel Data Request No. 360.
[98] "Welcome to the New Frontier," p. 9. Frontier Communications, May 13, 2008, p. 22, *available at* http://www.sec.gov/Archives/edgar/data/20520/000095015709000249/form425.htm.

will thus be making this cutover at the same time that it is taking possession of the replicated operating system, and cutting over long-distance voice and data networks throughout the Spinco service areas. Thus, the West Virginia cutover facing Frontier adds an additional level of complexity to the merger.

8. Risks Associated with Rate Changes and Up-Selling

Q: Do the Joint Applicants indicate that the merger will result in rate changes for Verizon Washington ratepayers?

A: No. The Joint Applicants indicate that:

> Upon completing the transaction, existing retail customers will continue to receive the same regulated intrastate services on the same terms and conditions under their existing contracts, agreements, and tariffs, and the transfer will be closely coordinated to ensure a smooth transition. Frontier has no plans to make any changes to the services in Washington at closing. . . . Frontier will honor existing tariffs and contracts to make the transition seamless for retail customers. This will ensure that the transaction will be transparent to current customers in Washington, who generally will continue to receive the same services on the same terms.[99]

Thus, while Frontier appears to be committing to continue to offer regulated intrastate services at identical rates, terms and conditions as those associated with Verizon services, there is some hedging on Frontier's part, as they indicate that Washington customers will "generally" receive the same services on the same terms. I believe that it is appropriate that Verizon's tariffs continue to remain in force following the merger, and that any changes that Frontier may seek in those tariffs should only be pursued through the Commission's established procedures.

[99] Direct Testimony of Daniel McCarthy, pp. 42-43.

Q: Does Verizon's provision of bundles and packages make evaluation of changes in the rates, terms and conditions more complex?

A: Yes. Washington customers also purchase services from Verizon that are not subject to tariff, including bundles and packages.[100] Verizon and Frontier do not provide identical packages or bundles, and Frontier has not been able to identify to which Frontier packages Verizon customers will be migrated.[101] In some cases, Frontier does not have the same ability to provide services that Washington customers currently purchase from Verizon. For example, Frontier's satellite video services are provided by DISH Network®, while Verizon provides satellite video services through DIRECTV®. Other differences across Verizon and Frontier packages may exist.[102] Table 1, below on the following page, provides a comparison of Verizon and Frontier package and bundle offerings. In selecting the plans that are shown in Table 1, I sought out plans that offered similar functionality. It can be seen in Table 1 that Verizon's plans tend to include more features, at a lower price, than Frontier's. For example, Frontier's "Digital Phone

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[100] I refer to "packages" to describe combinations of Verizon local exchange services such as basic local exchange service, vertical features, and voice mail. I use the term "bundle" to distinguish combinations of Verizon basic local exchange service (either alone or in a package) with other services provided by Verizon, such as high-speed Internet access, wireless calling, or video services.
[101] Verizon and Frontier's Responses to Public Counsel Data Request No. 326.
[102] Public Counsel requested that Frontier identify the Frontier services to which Verizon Washington customers who purchase Verizon packages will be transferred. Frontier indicates that its "investigation into comparable services is not yet complete. *See* Joint Applicants' Response to Public Counsel Data Request No. 326.

Unlimited" offering is priced $10 per month more than is the comparable Verizon plan.

Table 1: Comparison of Verizon and Frontier Packages and Bundles

Company	Verizon Plan	Frontier Plan	Verizon Plan	Frontier Plan	Verizon Plan	Frontier Plan
Plan Name	**Freedom Essentials**	**Digital Phone Unlimited**	**Freedom Value**	**Digital Phone Essentials***	**Good Triple Play**	**Connections Premium with Digital Phone Basic**
Local Calling	Unlimited	Unlimited	Unlimited	Unlimited	Unlimited	Unlimited
Long Distance	Unlimited to U.S., Canada, and Puerto Rico	Unlimited to U.S., Canada, Puerto Rico, Guam, and other U.S. territories.	Unlimited to U.S., Canada, and Puerto Rico	100 minutes	Unlimited to U.S., Canada, and Puerto Rico	30 minutes
Voice Mail	Yes	Yes	No	No	No	No
Caller ID	Yes	Yes	No	No	No	No
Call Waiting	Yes	Yes	No	No	No	No
Internet Access	No	No	No	No	Up to 1 Mbps	Yes, speed not specified, includes wireless modem.
Video	No	No	No	No	DIRECTV (150 channels)	Dish Network (100 Channels)
Price	$49.99	$59.99	$44.99	$29.99	$79.99	$109.99

***Digital Phone Essentials also includes "Speed Call 8."**

Frontier's prices for various add-on features are also relatively higher than Verizon's Washington rates. Table 2, below on the following page, compares Verizon NW rates with Frontier's California rates. Frontier's California operations are likely to be among those where Frontier faces the highest degree of competition from facilities-based rivals.[103] However, Frontier CA feature rates are substantially higher than Verizon's Washington rates.

Table 2: Verizon NW and Frontier CA Feature Rates

Feature	Verizon NW Monthly Rate	Frontier CA Monthly Rate	Ratio of Frontier to Verizon Prices
Call Forwarding	$3.00	$5.99	1.997
Call Waiting	$3.75	$5.99	1.597
Three-Way Calling	$3.75	$5.99	1.597
Speed Dial Eight	$3.00	$5.99	1.997
Speed Dial Thirty	$4.50	$5.99	1.331
Caller ID	$10.00	$9.99	0.999
Call Trace (per use)	$2.00	$2.99	1.495

The fact that Frontier tends to offer services at higher prices than Verizon was recognized in a **[Begin Highly Confidential]** XXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXX:XXXXXXXXXXXXXX:

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Thus, when Frontier indicates that, following the merger, customers will "generally" receive the same services on the same terms, given Frontier's current

[103] In Frontier's Elk Grove service area, in addition to cable presence, SureWest, another independent ILEC, has overbuilt portions of the area with FTTH.
[104] Joint Applicants' Response to Staff Data Request No. 11, Attachment 4(c)(52) to Verizon HSR filing, Verizon "Telecom Strategy and Planning" document (Highly Confidential) titled "East Due Diligence Out Report Project North Marketing," Aug. 21, 2009, emphasis in the original.

pricing practices, it seems likely that Washington customers may actually experience price increases as a result of the transaction.

Q: Do some Verizon customers current face early termination fees if they terminate service with Verizon?

A: Yes. According to Verizon:

> Beginning June 21, 2009, a minimum 12-month term is required for all discounted Verizon bundles that include Regional Value or Regional Essentials along with a qualifying unlimited long distance calling plan and Verizon Online Broadband.[105]

Under these agreements, if any customer cancels either the voice or broadband service after the first month, they will face and early termination fee of $120, and the Joint Applicants indicate that they will "honor the terms of their contracts with customers,"[106] which indicates that Frontier would enforce the early termination charges.

Early termination fees exacerbate the general problem of rising prices for residential services that are likely following the merger. The existence of early termination fees limit consumer choice, and may negatively impact competition, should the consumer have an alternative source of supply. Given the change of service provider and doubts regarding the ability of Frontier to provide similar services, customers that are under contract should be given a "fresh look" once the changes in their service and prices become known.

Q: Does Frontier have early termination fees associated with term contracts?

[105] Verizon's Response to Public Counsel Data Request No. 248.
[106] Verizon's Response to Public Counsel Data Request No. 246(a).

A: Yes. Frontier customers that purchase services under Frontier's "Price Protection Plan" face early termination fees of $200.[107]

Q: Have Frontier customers had problems with early termination fees?

A: Yes. On October 5, 2009, the New York state Attorney General's Office announced a settlement with Frontier regarding its practices with early termination fees:

> "Frontier failed to spell out in its contracts the existence of costly fees," said Attorney General Cuomo. "The company is now fixing the issue by providing written notices of these fees and paying back consumers who were wrongfully charged."
>
> Frontier, located on South Clinton Avenue in Rochester, provides high speed broadband Internet service (FrontierHSI) and local and long distance telephone service. Between January 2007 and September 2008, Frontier sold bundles of various services under one-, two- or three-year agreements known as Price Protection Plans that offered a lower rate than month-to-month service as well as a promise that the subscription rate would not increase during the term of the plan. However, Frontier charged early termination fees to consumers who terminated a service before the end of the term. These fees typically ranged between $50 and $400, depending on the contents and services included in the package.
>
> The Attorney General's investigation determined that consumers who purchased one-year bundle agreements were never provided with written notice of the term or the existence of an early termination fee. The investigation also uncovered that consumers were not notified in their monthly billing statement that their agreements contained early termination fees. Therefore, many consumers first learned about the fee only after they cancelled their service with Frontier and the charge appeared on their final bill.
>
> In at least one instance, Frontier automatically re-enrolled a consumer to a term commitment after the initial term expired and then charged an early termination fee when she cancelled after the initial term.[108]

[107] *See e.g.*, the following terms and conditions of various Frontier contracts: http://www.frontier.com/terms/2009Q3Q4HSI/; http://www.ctsi1.com/terms/DPStateHSITVPlan/.
[108] Press release, *available at* http://www.oag.state.ny.us/media_center/2009/oct/oct5a_09.html.

The settlement in New York State provides further evidence of Frontier's aggressive marketing practices that are likely to cause harm to Washington consumers.

Q: You mentioned up-selling earlier in this testimony and Verizon's management report also uses this term. What is "up-selling"?

A: "Up-selling" refers to the practice of attempting to convince consumers to purchase more services than they initially seek. For example, a customer calling to connect basic telephone service may hear sales pitches designed to convince the consumer to purchase vertical features, long distance services, broadband, and/or video services. The up-selling practice reflects Frontier's belief that it can increase revenues in Washington by applying Frontier sales and pricing practices to Verizon WA's operations.

Q: Is up-selling a benefit of the merger?

A: No, to the contrary, up-selling practices are likely to harm consumers. Purchasing telecommunications services is a complex undertaking, and consumers may be misled into purchasing services that provide more than the consumer needs, or do not need at all. Research conducted by the Illinois Citizens Utility Board, based on proprietary billing data and on consumer surveys, found evidence of

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significant over-buying, which if corrected, could generate significant savings:

> The biggest savings were produced when customers on expensive, all-you-can-eat phone packages—plans that provide unlimited calling and a host of extra features that are rarely used— switched to one of AT&T's Consumer's Choice plans or the company's standard pay-per-call rates. Additional savings were seen by dropping unnecessary features such as "inside-wire maintenance" plans, called Line-Backer by AT&T, that cover certain telephone-wire repairs needed about once every 20 to 30 years, on average.[109]

Frontier's marketing approach, as evidenced by its web site, shows a variety of package offerings that could easily lead to consumer confusion regarding what best suits their needs. Likewise, if Frontier customer service representatives actively up-sell, consumers could be led to make purchases that are not in their best interests.[110]

Q: But isn't it true that up-selling is simply a matter of consumer choice?

A: Consumer choice continues to be highly limited.[111] As a result, "market forces" are unlikely to provide consumer protection from up-selling abuses. As discussed earlier, Frontier prides itself on increasing its "wallet share," and these activities may result in consumers paying more for services post-merger than they currently do with Verizon. The impact of this up-selling is compounded by the fact that Frontier prices, as noted by Verizon's own analysis, are generally higher than those charged by Verizon.

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[109] "The Right Call: A $1.5 Billion Economic Stimulus Plan for Illinois," Feb. 2009, *available at* http://www.citizensutilityboard.org/pdfs/NewsReleases/20090210_stimulusreport.pdf.

[110] Frontier's web site also shows that Frontier is taking inside wire maintenance into the information age by offering plans that bundle hard-drive back-up, technical support, and good old-fashioned inside wire maintenance, for $12.99 per month. *See* http://www.frontier.com/products/ProductOverview.aspx?type=1&p=292.

[111] It may seem paradoxical that customer choice is limited, but that firms like Frontier are pressured by access line losses. As was mentioned earlier, if symptoms of destructive competition are emerging, it is entirely possible that consumers have few choices, but that firms are struggling.

9. Financial Risks of the Merger

Q: The Joint Applicants stress the financial upside of the merger for Frontier.[112] Do you believe that the Joint Applicants have overlooked some risks in their presentation to this Commission?

A: Yes. This is certainly an instance of the coin having two sides. While it is true that current projections indicate that Frontier will have an improved financial profile following the close of the transaction, the same is not true for Verizon WA. Rather, Verizon Washington ratepayers will be migrated to a much weaker and more financially risky company.[113] This increased risk facing Verizon Washington ratepayers should be fully understood by this Commission. While Public Counsel Witness Steve Hill has provided a detailed evaluation of financial issues in his testimony, I will briefly address financial aspects of the merger below, specifically risks associated with Frontier's dividend policy and debt levels. I will discuss how these financial aspects impact and are related to other issues discussed in my testimony such as broadband deployment, and upward pressure on prices.

10. Risks Associated with Frontier's Dividend Policy

Q: Have you evaluated Frontier's dividend policy, and does that policy raise any concerns?

A: Yes, I believe that Frontier's dividend policy increases the risk associated with this transaction for Verizon Spinco ratepayers. Frontier has pursued a dividend policy that has resulted in Frontier paying dividends in excess of earnings per

[112] *See e.g.*, Direct Testimony of Daniel McCarthy, pp. 22-28.
[113] For example, while Verizon Communications has an investment grade rating, Frontier Communications does not.

share.[114] This is an unsustainable policy, and indicates that Frontier is using sources of funds other than earnings to pay dividends. Figure 1, below on the following page, illustrates Frontier's history of dividend payouts, compared to Frontier's net income, based on filings made with the Securities and Exchange Commission.[115]

Figure 1: Frontier Communications Net Income and Payments to Shareholders Compared

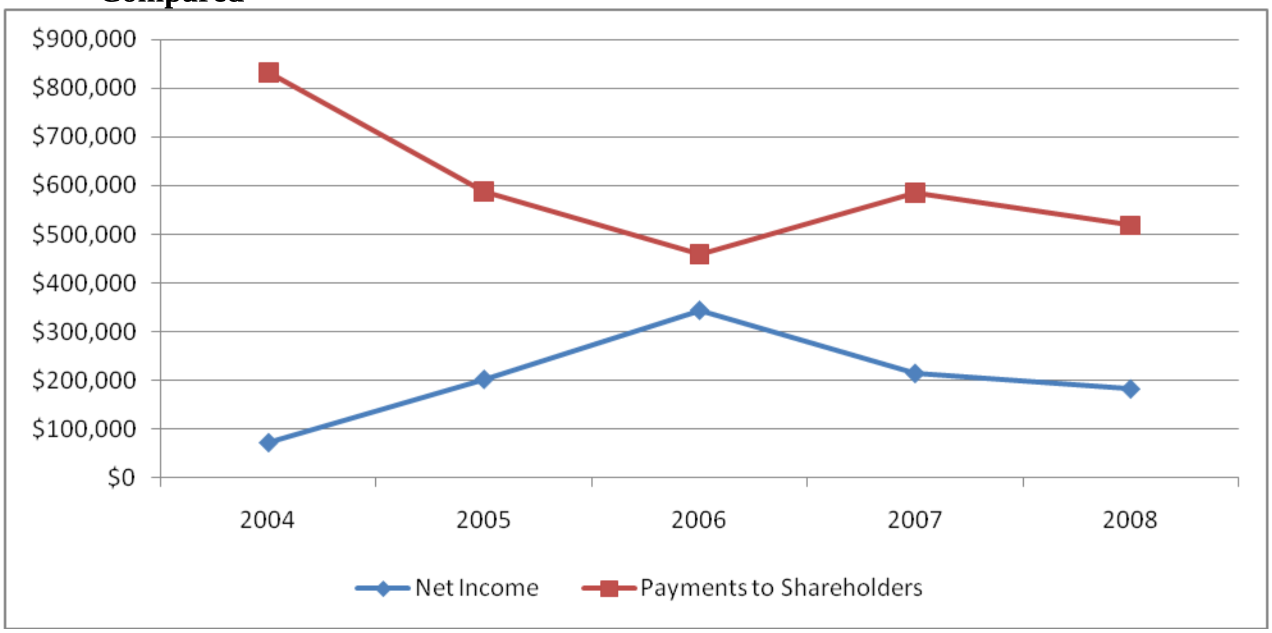

Figure 1 shows that Frontier has consistently paid dividends in excess of earnings per share. While this policy is highly favorable to shareholders, it ultimately has a bearing on Frontier's ability to deploy broadband, and increases the risks

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[114] Frontier Communications, Annual Report for the year ending Dec. 31, 2008 (Form 10-K), at F6-F7.
[115] Frontier Communications, Annual Report for the year ending Dec. 31, 2004 (Form 10-K); Frontier Communications, Annual Report for the year ending Dec. 31, 2005 (Form 10-K); Frontier Communications, Annual Report for the year ending Dec. 31, 2006 (Form 10-K); Frontier Communications, Annual Report for the year ending Dec. 31, 2007 (Form 10-K); Frontier Communications, Annual Report for the year ending Dec. 31, 2008 (Form 10-K).

associated with servicing a growing debt burden from a declining revenue stream.

Q: How is it possible for Frontier to pay more in dividends than its net income?

A: In order to achieve this outcome, Frontier must generate cash from other sources. One major source of cash for payment to shareholders that Frontier has tapped is its depreciation cash flows. If Frontier does not replenish its capital stock as that capital stock depletes over time, then a cash flow is generated through the under-investment. Figure 2, below on the following page, illustrates Frontier's policies regarding depreciation and capital expenditures.[116]

Figure 2: Frontier's Depreciation and Amortization Expense and Capital Expenditures Compared

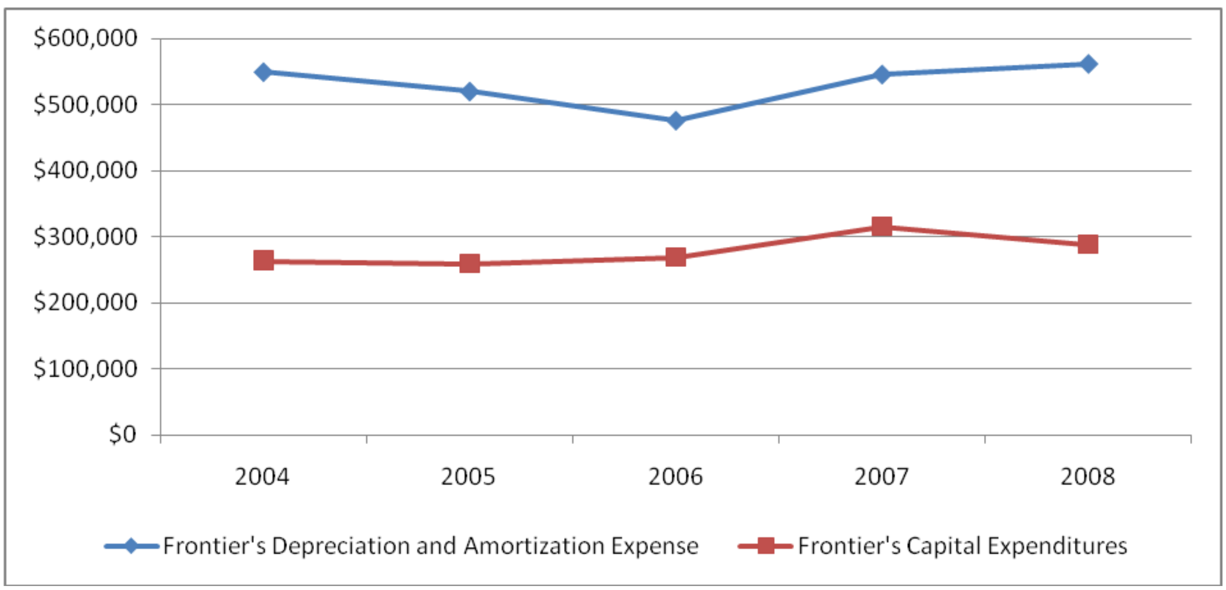

Figure 2 shows that Frontier has consistently spent less on capital investments than it has taken in depreciation charges. Of course, there need not be a one-to-one relationship between depreciation expenses and capital expenditures. However, the persistent practice of allowing capital expenditures to fall below

[116] *Id.*

depreciation expenses is cause for concern, given Frontier's other operating indicators. For example, as by Public Counsel Witness, Barbara Alexander, Frontier exhibits relatively low levels of service quality in key areas, such as trouble reports per 100 access lines. Similarly, while making broadband widely available in its service area, the quality of Frontier's broadband is certainly not cutting edge, and some Frontier service areas continue to exhibit low DSL availability.

Q: In the company's testimony in this proceeding, Frontier focuses on its history of generating strong "free cash flow," and the stresses potential of this merger to continue this tradition.[117] Does the generation of free cash flow improve the financial profile of this merger?

A: No. While free cash flow is an important point of evaluation of the financial performance of a firm, this metric must be carefully considered, especially with regard to the sources of the cash flow and its sustainability. As indicated above, a key driver in Frontier's free cash flows is the fact that its depreciation and amortization expenses exceed new capital expenditures. However, actual cash available for earnings must be coming from somewhere, i.e., it must come either from revenues and retained earnings, or from borrowing. While Frontier's revenues increased by about 10 percent between 2005 and 2008, Frontier's long-term debt has increased by 18 percent during that same period. Between 2005 and 2008 Frontier paid out over $370 million more in dividends than its earnings

[117] Supplemental Testimony of Timothy McCallion, p. 13, lines 11-19.

per share.[118] Some of this money came from retained earnings, other likely from borrowing. What is certain is that if earnings per share had reached $1.00 per share (Frontier's then-target dividend payment) in each of the years, there would have been reduced pressure on borrowing and/or retained earnings, and more funds available for capital expenditures.

Q: Could Frontier remedy the situation by decreasing its dividend payout?

A: Yes, however, this action also comes with its own risks. Frontier plans to decrease its dividend per share as part of its overall strategy in this transaction. However, its proposal to decrease the dividend from $1.00 per share to $0.75 per share still leaves Frontier paying 30 percent more per share than its most recent earnings per share.[119] To remedy the problem, Frontier could also increase earnings per share. However, given the line loss recently experienced by Frontier, and in the Verizon service areas that Frontier is acquiring, it would appear that Frontier will face continued negative pressure on earning per share for the foreseeable future. Frontier's revenues declined between 2007 and 2008, and Frontier projects that following the Spinco acquisition, that **[Begin Highly Confidential]** XXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXX[120] **[End Highly Confidential]** The economic downturn, which shows little sign of abating from the consumer's perspective, will also contribute to negative pressure on Frontier's ability to improve earnings per share.

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[118] Frontier Communications, Annual Report for the year ending Dec. 31, 2008 (Form 10-K), at F-32; Frontier Communications, Annual Report for the year ending Dec. 31, 2007 (Form 10-K), at F33

[119] Frontier Communications, Annual Report for the year ending Dec. 31, 2008 (Form 10-K).

[120] Project North Presentation to the Board of Directors, May 12, 2009, p. 32. Provided with Joint Applicants' Response to Public Counsel Data Request No. 35.

Frontier is in something of a box on the financial side. If it cannot increase earnings per share, it will need to continue to pay dividends from sources of funds other than net income to maintain its dividend policy. Alternatively, if it decreases its dividend further, its stock price will fall, and it could become overleveraged, thus undermining the gains it may achieve from executing this transaction. In either case, Frontier's ability to upgrade and expand broadband facilities in the Verizon service areas that it is acquiring will continue to face competition for funds to service Frontier's dividend policy. Thus, a major component of any resolution of the Joint Applicants' request will be a set of commitments regarding the deployment of broadband in Washington.

11. Risks Associated with Frontier's Debt

Q: Does this transaction require that Frontier increase its debt?

A: Yes. Frontier must substantially increase its debt to complete this transaction. While the financial projections offered by Frontier for its post-merger financial structure may appear favorable,[121] it is important to also keep in mind that even after the merger it is unlikely that Frontier will reach investment grade status.[122] Furthermore, Frontier overlooks troubling debt-related aspects of this transaction.

Q: What new debt financing must Frontier secure to complete this transaction?

A: Frontier has agreed to provide Verizon with cash, debt reduction, and/or special debt securities valued at $3.3 billion.[123] In order to satisfy this condition, Frontier

[121] *Joint Application*, p. 2.
[122] "Frontier Communications Corporation Q2 2009 Earning Conference Call Transcript," Aug. 4, 2009. Response of Frontier's Donald Shassian to question from Banc of America's Anna Gushko, *available at* http://seekingalpha.com/article/153702-frontier-communications-corporation-q2-2009-earnings-call-transcript.
[123] Frontier Communications, Registration Statement (Form S-4), at 3 (Jul. 24, 2009).

must secure debt financing of $3.3 billion.[124] At this time, Frontier has not secured the needed financing, and appears to be preparing for the potential of adverse market conditions:

> . . . as it relates to the financing of the transaction, we have been in active discussions with our bankers to develop funding strategies for the necessary $3.3 billion of Spinco financing. Our strategy has multiple contingency paths to account for various market conditions, giving us the ability to optimize the cost and certainty of financing at the time of funding.[125]

Frontier expects that it will go to capital markets to raise this debt sometime in early 2010, with the process completed by March or April.[126] Given the significant size of the debt financing, the results of this process may have an impact on the operating results of the combined company. However, because Frontier cannot inform this Commission as to the cost of servicing this debt, the evaluation of the prudency of the transaction is more difficult.

What is certain, however, is that the merger will result in a substantially higher debt service obligation for customers of the combined company, and a dramatic increase in debt service obligations for Verizon Washington customers.

Q: Do you believe that the Commission can rely on the Company's pro forma projections as they relate to debt service issues?

A: No. I believe that the Commission should carefully consider the assumptions

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[124] "Welcome to the New Frontier," May 13, 2009, p. 15, *available at* http://phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9MzM3NTc4fENoaWxkSUQ9MzIyMTk3fFR5cGU9MQ==&t=1.

[125] "Frontier Communications Corporation Q2 2009 Earning Conference Call Transcript," Aug. 4, 2009. Opening statement of Frontier's Maggie Wilderotter, *available at* http://seekingalpha.com/article/153702-frontier-communications-corporation-q2-2009-earnings-call-transcript.

[126] "Frontier Communications Corporation Q2 2009 Earning Conference Call Transcript," Aug. 4, 2009. Response of Frontier's Donald Shassian to question from Banc of America's Anna Gushko, *available at* http://seekingalpha.com/article/153702-frontier-communications-corporation-q2-2009-earnings-call-transcript.

underlying Frontier's pro forma projections. Frontier's pro forma projections assume an optimistic scenario regarding the cost of debt associated with the $3.3 billion merger consideration. The Agreement and Plan of the Merger specifies that Frontier can pull out of the transaction if it cannot secure debt financing at a rate less than 9.5 percent, although the company is allowed to proceed at higher rate if Frontier "reasonably determines in good faith that such Coverage Costs would not be unduly burdensome."[127] However, Frontier's pro forma projections rely on a much lower **[Begin Highly Confidential]** XXXXXXX **[End Highly Confidential]** assumed cost of debt associated with the merger consideration.[128] While financial markets have exhibited a higher degree of calm than was the case one year ago, they certainly have not returned to their pre-crisis stability. As a result, whether Frontier will be able to secure financing at its projected rates is uncertain. At this time, Frontier cannot inform the Commission with certainty of what the ultimate debt burden of this transaction will be.

Q: What impact will Verizon Washington ratepayers experience as a result of the increases in debt?

A: Unfortunately, the consequence of increasing the debt levels of the combined company, to approximately $8 billion, is highly unfavorable for Verizon Washington ratepayers. According to documents filed with the Securities and Exchange Commission, the Verizon Spinco properties, in 2008, had $622 million in long term debt.[129] Verizon Spinco properties serviced this debt out of total

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[127] *Agreement and Plan of the Merger* §7.18(e)(ii).
[128] "Project North Presentation to the Board of Directors," May 12, 2009, p. 31.
[129] Frontier Communications, Registration Statement (Form S-4), at 150 (Jul. 24, 2009).

revenues for 2008 of $4.352 billion.[130] Verizon Washington ratepayers, following the closing of this transaction, will become part of a company holding total debt of approximately $8 billion, which must be serviced out of less than $6.5 billion in revenues. In other words, Verizon Spinco ratepayers will face the prospect of contributing to the servicing of almost $7.5 billion in increased debt out of a pool of revenues that increases by slightly more than $2 billion for the combined company. When viewed in terms of total debt to earnings before interest, taxes, depreciation and amortization, (EBIDTA) it is clear that while the transaction may have a favorable impact on Frontier's profile, the impact on Verizon Spinco is highly negative. Highly Confidential Figure 3, below, illustrates the impact, based on Frontier data.[131]

Figure 3: Long-Term Debt to EBIDTA, Before and After Transaction

[Begin Highly Confidential]

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(End Highly Confidential)

[130] *Id.* at 145.
[131] Based on data contained in "Project North Presentation to the Board of Directors," May 12, 2009. Provided with Joint Applicants' Response to Public Counsel Data Request No. 35.

Figure 3 shows that the debt level, as expressed as a ratio to EBIDTA, increases from a value of 0.34 to 2.67, *i.e.*., by a factor of 7.85 for Verizon Spinco ratepayers, while Frontier experiences a favorable decrease in the ratio. This increased level of debt, which must be serviced from a pool of total revenues from the combined companies that even Frontier projects will decline by **[Begin Highly Confidential]** XXXXXX **[End Highly Confidential]** between 2010 and 2014, will increase the risks that ratepayers of the combined company faces, and placing a negative burden on Washington ratepayers.

That the burden of servicing this debt will weigh more heavily on Verizon Spinco ratepayers is evident from the fact that Frontier's pro forma projections indicate that Verizon Spinco ratepayers will be **[Begin Highly Confidential]** XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXX.[132] **[End Highly Confidential]** The increase in debt-related risk for Verizon Spinco customers is notable.

Q: Does Frontier's pro forma analysis contain other assumptions that indicate that Verizon Spinco customers will face negative consequences as a result of the merger?

A: Yes. For example, the pro forma results make aggressive assumptions regarding the revenue per access line that can be generated. Frontier assumes that by 2010 revenue *per access line* for the combined company can be increased by **[Begin Highly Confidential]** XXXXXXXX **[End Highly Confidential]** from their 2008

[132] Project North Transaction Overview, Apr. 2009. Attachment 4(c)(36) to Verizon's HSR filing, p. 19.

levels.[133] Frontier goes on to assume that between 2010 and 2014 that revenue *per access line* can be increased by an additional **[Begin Highly Confidential]** XXXXXX **[End Highly Confidential]**.[134] Frontier's ability to increase revenue per access line by these amounts, in light of the ongoing economic downturn may be doubtful, thus the favorable outcome projected in Frontier's pro forma analysis appears to be less than certain. What is certain, however, is that Verizon Spinco ratepayers will be pressured through Frontier testing exactly how much revenue per line it can extract.

Q: Can you summarize your concerns?

A: The financial aspects of the proposed transaction are troubling. While Frontier gains some financial advantage from this transaction, it does so only at the expense of Verizon Spinco ratepayers, including those currently served by Verizon WA. These ratepayers will be transferred from a firm that has a much stronger financial profile to one that has a weaker profile. Frontier may be able to keep going, but is likely to need additional infusions of access lines down the road.[135] These access line infusions may require Frontier to take on additional debt financing, which may further burden Verizon Washington ratepayers.

The Commission, however, does not need to speculate regarding what may happen over the next three to five years regarding Frontier's future

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[133] *Id.*

[134] Based on line count and revenue projections contained in "Project North Presentation to the Board of Directors," May 12, 2009. Provided with Joint Applicants' Response to Public Counsel Data Request No. 35.

[135] **[Begin Highly Confidential]** XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXX. **[End Highly Confidential]** Joint Applicants' Response to Staff Data Request No. 11, Attachment 4(c)(55) to Verizon's HSR filing "The New Frontier, Presented to Verizon March 11, 2009," pp. 3 and 15.

acquisition plans in order to find risks to Washington ratepayers as a result of this deal. As addressed above, there is clear evidence that Verizon Spinco ratepayers will face increased risk as a result of the transaction. Furthermore, Frontier has placed the Commission at a distinct disadvantage to be able to assess the full risk of this transaction as the company cannot tell the Commission what the cost of the new debt required to complete this transaction will be. I do not believe that Frontier has demonstrated to this Commission that it has the financial capability to complete this merger in a manner so that there is "no harm to the public interest."

B. Claimed Benefits of Merger

Q: What benefits of the merger do the Joint Applicants identify?

A: Frontier witness Daniel McCarthy identifies three benefits of the merger. First, Frontier claims that Washington consumers will benefit from greater investment in broadband and greater broadband availability. Frontier also indicates that it will "offer many of the same innovative promotions and service offerings that have focused on the adoption of broadband by consumers." Second, Frontier indicates that consumers will benefit from "Frontier's track record of successfully providing high-quality service" in the markets that it serves. Frontier states that "Frontier will be able to generate improved operational performance through the deployment of Frontier's technology and processes in the acquired service areas in Washington." Third and finally, Frontier states that Washington customers will benefit because "Frontier will become larger and stronger." Frontier argues that because of its larger size, it will become a "more robust carrier with the financial capability to make the investments needed to increase broadband penetration and provide better service."[136]

Q: Do you believe that the Joint Applicants have met their burden of proof on these alleged benefits?

A: No. The alleged benefits are either not reasonably supported by Frontier's filing, or are not benefits at all. I will address the three alleged benefit areas below.

1. Alleged Broadband Benefits of the Merger

Q: What is the current status of Verizon's broadband in Washington?

A: Verizon has deployed broadband using both fiber optic cable deployed to the home (FTTH) and DSL service. Washington is one of four states in the Spinco entity where Verizon has deployed FTTH.[137] From a policy perspective FTTH is the gold standard for broadband Internet access. FTTH is a "future-proof" technology that will allow bandwidth to be increased as consumer needs expand. In addition, FTTH offers the potential for symmetrical bandwidth, *i.e.*, both downstream and upstream data speeds can provide very high bandwidth. As deployed by Verizon, FTTH also provides video services and has thus resulted in a new source of video programming for some Washington consumers. According to Verizon, as of December 2008 there were **[Begin Confidential]** XXXXX **[End Confidential]** homes in its Washington service area that are capable of receiving

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[136] All quotes from the Direct Testimony of Daniel McCarthy, pp. 18-19.
[137] Verizon FiOS video assets in Spinco are located in Washington, Oregon, and Indiana. *See* Verizon Communications, Second Amended Registration Statement (Form S-4), at F-79 (Sept. 14, 2009).

FiOS FTTH services.[138] However, these FiOS facilities are concentrated in **[Begin Highly Confidential]** XXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXX **[End Highly Confidential]**.[139]

With regard to DSL service availability, I was able to examine information on an individual wire center basis only. Verizon was unable to provide data that separately addressed DSL availability for business and residential customers. Given that business customers are more likely to be located in areas that have the shorter loop lengths needed for DSL service delivery, I believe that the percentages reported by Verizon likely overstate DSL availability in the residential market segment. DSL availability to all customer locations by wire center ranges from **[Begin Highly Confidential]** XXXXXXXXXXXXXXXXX. XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX. **[End Highly Confidential]** This data indicates that there is a large number of households in Verizon's service area with either no broadband option, or if cable facilities are present in the area, facing a broadband monopoly.

Q: Frontier indicates that it has achieved over 90 percent broadband availability in its service areas.[140] Have you evaluated this claim?

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[138] Verizon Response to Public Counsel Data Request No. 12. Verizon was unable to identify the percentage of homes in its service area that have FiOS available. Using publicly available line count information, I believe that a reasonable estimate is about **[Begin Confidential]** XXXXX **[End Confidential]** of households in Verizon's Washington service area are likely to have FiOS service available.

[139] Joint Applicants' Response to Staff Data Request No. 77, Highly Confidential Attachment "FIOS data and DSL by wirecenter," and Joint Applicants' Response to Public Counsel Data Request No. 302.

[140] *Joint Application,* ¶40.

A: Yes. It is important, when considering Frontier's claims regarding broadband benefits to evaluate the distribution of broadband availability. While it is true that overall Frontier has achieved over 90 percent, Frontier has not pursued 90 percent as a target deployment across its service areas. For example, in five (5) states where Frontier operates, DSL availability is below **[Begin Confidential]** XX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX **[End Confidential].**[141] Thus, the fact that Frontier serves a state does not guarantee that consumers will see 90 percent DSL availability.

Q: Does Frontier promote advanced DSL throughout its service area?

A: No. Frontier's DSL offerings are generally much lower than those available from Verizon and other carriers. Table 3 shows advertised download and upload speeds for various service providers.

Table 3: Advertised DSL Speeds (Based on Carrier Web Sites)		
Company	**Advertised Download Speed**	**Advertised Upload Speed**
Verizon FiOS	15 Mbps to 50 Mbps	5 Mbps to 20 Mbps
Verizon DSL	1 Mbps to 7.1 Mbps	384 kbps to 768 kbps
Time Warner Cable Modem	7 Mbps to 15 Mbps	512 kbps to 768 kbps
Comcast Cable Modem	1 Mbps to 16 Mbps	384 kbps to 2 Mbps
Charter Communications	1 Mbps to 20 Mbps	128 kbps to 2 Mbps

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[141] Verizon's Response to Public Counsel Data Request No. 70.

A location-based search of Frontier DSL service offerings shows that Frontier's two most prevalent DSL speeds are 3 Mbps and 768 kbps (for download). Table 4 summarizes these results.[142]

Table 4: Frontier Advertised DSL Download/Upload Speeds[143]

City, State	Frontier "Fast" DSL	Frontier "Lite" DSL
Rochester, NY	10 Mbps / 384 kbps	768 kbps / 128 kbps
Keeseville, NY	3 Mbps / 384 kbps	768 kbps / 128 kbps
Elk Grove, CA	3 Mbps / 384 kbps	Not Listed
Concord, MI	3 Mbps / 384 kbps	768 kbps / 128 kbps
Mt. Pulaski, IL	3 Mbps / 384 kbps	768 kbps / 128 kbps
Shawano, WI	3 Mbps / 384 kbps	768 kbps / 128 kbps
Fairmont, MN	3 Mbps / 384 kbps	768 kbps / 128 kbps
New Holland, PA	3 Mbps / 384 kbps	768 kbps / 128 kbps
Cookville, TN	3 Mbps / 384 kbps	768 kbps / 128 kbps
Atmore, AL	3 Mbps / 384 kbps	768 kbps / 128 kbps
Ft. Dodge, IA	3 Mbps / 384 kbps	768 kbps / 128 kbps

It can be seen that outside of Rochester, NY, the DSL download speeds associated with Frontier offerings are comparably slow. It is also notable that Frontier's upload speeds are also low when compared to Verizon's. Consumers are increasingly relying on upload capabilities to share large files, such as videos, which makes Frontier's upload speeds even less desirable.

Q: Frontier also indicates that it has been able to achieve a higher level of DSL uptake in its service area than Verizon, and points to an innovative program that helps with the transition new broadband customers face.[144] As compared to Verizon service areas that have broadband available, does Frontier's program result in higher uptake?

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[142] Frontier's web site does not reveal Frontier upload speeds. According to Frontier's response to Public Counsel Data Request No. 342, Frontier's DSL services offer upload speeds of either 384 kpbs or 128 kbps.
[143] Based on zip code search of Frontier's web site (last accessed Sept. 30, 2009).
[144] Direct Testimony of Daniel McCarthy, p. 25, lines 13-20.

A: No. **[Begin Highly Confidential]** XXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX[145].XX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX.**End Highly Confidential]** Frontier's service includes a technician coming to the customer's home and assisting with the set-up of the service. To receive the services of the technician, the customer must pay a $134 fee, unless the customer signs up for a term contract (but still must pay a $34 fee for the on-site set-up).[146] Furthermore, the technicians that Frontier dispatches to new broadband customers' homes are also sales agents.[147] Thus, while it may be that these individual technicians can help with system set-up and the like, they also are part of Frontier's overall up-selling strategy.

Q: How do Frontier and Verizon DSL prices compare?

A: Frontier's DSL prices are significantly higher. Table 5 summarizes Verizon and Frontier DSL price points.[148] The data shown in Table 5 shows that Frontier's DSL prices, either with telephone service or on a stand-alone basis, are significantly higher than Verizon's. For example, the entry-level Frontier plan

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[145] Joint Applicants' Response to Public Counsel Data Request No. 35, Attachment titled "Project North Board of Directors Discussion Materials, May 1, 2009," p. 33.
[146] Joint Applicants' Response to Staff Data Request No. 46.
[147] Joint Applicants' Response to Public Counsel Data Request No. 328.
[148] Prices from Verizon and Frontier websites (last accessed Sept. 24, 2009). In Joint Applicants' Response to Public Counsel Data Request No. 346, Frontier identified speeds and prices associated with 6 Mbps and 9 Mbps plans that are available in some areas.

has a nominal price that is 100 percent higher than Verizon's. However, when considering the per Mbps price, Frontier's price is 160 percent higher.[149]

Table 5: Comparison of Verizon and Frontier DSL Prices

Company	Plan Name	Speed	Price with Phone	Stand Alone Price
Verizon	Starter Plan	Up to 1Mbps Down; Up to 384 kbps Upstream.	$19.99 per month (two year agreement); $19.99 per month (one year agreement).	$19.99 per month (one-year agreement)
Verizon	Power Plan	Up to 3 Mbps Down; Up to 768 kbps Upstream.	$29.99 per month (two year agreement); $29.99 per month (one year agreement).	$29.99 per month, (one-year agreement)
Verizon	Turbo Plan	Up to 10 Mbps Down; Up to 768 kbps Upstream.	$39.99 per month (two year agreement); $39.99 per month (one year agreement).	$42.99 per month, (one year agreement)
Frontier	High-Speed Lite	Up to 768 kbps Down; Up to 128 kbps upstream.	$39.99 per month (month-to-month); $24.99 per month (term agreement).	"Starting at" $34.99 per month.
Frontier	Fast Internet	Up to 3 Mbps down; Up to 384 kbps upstream.	$49.99 per month (month-to-month); $44.99 per month (term agreement).	"Starting at" $54.99 per month.
Frontier	Fast Internet	Up to 6 Mbps down; Up to 384 kbps upstream.	$64.99 per month (month-to-month); $54.99 per month (term agreement).	
Frontier	Fast Internet	Up to 9 Mbps down; Up to 768 kbps upstream.	$76.99 per month (month-to-month); $66.99 per month (term agreement).	

Q: Would broadband customers face the prospects of usage-based restrictions on their broadband service if Frontier takes over Verizon's Washington service territories?

A: Yes. Frontier has instituted a "download cap," which restricts the amount of data that a customer can download. According to Frontier's acceptable use policy:

> Customers must comply with all Frontier network, bandwidth, data storage and usage limitations. Frontier may suspend, terminate or apply additional charges to the Service if such usage exceeds a reasonable amount of usage. A reasonable amount of usage is defined as 5GB combined upload and download consumption during the course of a 30-day billing period. The Company has

[149] According to Verizon's web site, Verizon's Starter Plan offers speeds of up to 1 Mbps for $19.99 per month, or $19.99 per Mbps. Frontier's High-Speed Lite only offers speeds of up to 768 kbps at $39.95 per month, or $52.02 per Mbps.

> made no decision about potential charges for monthly usage in excess of 5GB.[150]

Customers may face action by Frontier if they exceed the usage cap. The overall impact of this cap is Frontier providing a much lower grade of broadband service than does Verizon.[151] Frontier's DSL services are priced much more restrictively because the prices reflect both speed and download volume limits. Verizon's DSL service does not include similar limits.[152] Should they be implemented in Washington, Frontier's DSL pricing policies and usage restrictions will represent a significant negative impact on Washington consumers, should these policies be implemented in Washington.

Q: At least one cable operator, Comcast, has implemented a download limit, alleging that the shared nature of cable Internet access facilities in the last mile require usage restrictions.[153] Could Frontier's usage restriction be justified, even though DSL is not a "shared" network in the last mile?

A: No. While DSL provides dedicated bandwidth to the customer in the last mile, DSL subscribers will share network capacity in the "middle mile." For example, shared data networks will carry consumer traffic from the telephone company central office to an Internet gateway. I believe that Frontier's policy is more

[150] Frontier DSL Acceptable Use Policy, *available at* http://www.frontier.com/policies/residential_aup/.

[151] A non-broadband analogy may be helpful. Suppose a consumer must decide between two rental cars. Option (1) features a car that can go 75 mph, and has unlimited miles for $19.99 per day. Option (2) features a car that can go 60 mph, and includes only 500 miles of driving for $40.00 per day. Clearly Option (1) delivers more value to the customer. Verizon's DSL offering is similar to Option (1), Frontier's DSL offering is similar to Option (2).

[152] According to Verizon's web site "We don't charge extra or otherwise limit your Internet usage." *See* http://www22.verizon.com/Residential/HighSpeedInternet/HSIvsCable/HSIvsCable.htm.

[153] *See e.g.*, "It's official: Comcast starts 250GB bandwidth caps October 1," *ars Technica*, August 28, 2008. http://arstechnica.com/old/content/2008/08/its-official-comcast-starts-250gb-bandwidth-caps-october-1.ars

likely to reflect an unwillingness on Frontier's part to invest in "middle mile" Internet access facilities that would require capacity additions as customer demand increases, and choose to restrict customer usage instead of investing in the capacity needed to meet customer demand. Furthermore, when Comcast implemented its download-cap policy, its limits are dramatically higher than Frontiers. For example, Comcast's acceptable use policy identifies 250 gigabytes as the threshold at which Comcast may take action against a customer.[154]

Q: Has Frontier made any specific commitments regarding broadband deployment in Washington?

A: No. In the Joint Application and supporting testimony, Frontier mentions its 90 percent broadband reach in its existing service territory and states that increasing broadband availability is a "business imperative for Frontier in order to retain customers and to reduce the access line loss Verizon has recently been experiencing in these areas."[155] However, Frontier does not make any specific promises regarding the ultimate broadband penetration levels in Washington or the balance of the Spinco service areas.[156] The lack of specific commitments or details regarding Frontier's plans for broadband deployment in Washington leaves the Commission with no basis for determining whether broadband benefits can be counted in the evaluation of benefits and costs associated with this merger.

Q: Do you have specific concerns regarding Frontier's broadband promises?

[154] http://www.comcast.net/terms/use/
[155] *FCC Consolidated Application*, p. 2.
[156] *See e.g., Joint Application* at ¶¶3 and 28; Direct Testimony of Daniel McCarthy, p. 19, line 8 to p. 27, line 16.

A: Yes. In the larger context of this merger, Frontier faces a number of hurdles that may interfere with its ability to improve broadband capability in Washington. One concern relates to Frontier's failure to assess the status or condition of Verizon's outside plant in Washington or elsewhere.

Q: Why is the status or condition of Verizon's outside plant important?

A: Deploying DSL requires conditioning of existing loop plant. Loop lengths may limit deployment, and the vintage and physical condition of outside plant will impact the cost of deploying DSL. Furthermore, the extent of additional line conditioning, *e.g.*, the removal of loading coils and bridged tap, also will impact the cost of DSL upgrades. Thus, the condition of Verizon's outside plant, both in Washington and across the Spinco service area, will have a significant impact on both the ability of Frontier to provide DSL to unserved areas, and its ability to upgrade DSL quality where DSL is already deployed. When asked whether it had assessed either the condition of Verizon's outside plant or the maintenance of that outside plant, Frontier indicated that it has not.[157] Frontier is purchasing assets that it has not fully assessed. Thus, its ability to keep even its general promises that it has made regarding broadband improvement is questionable.

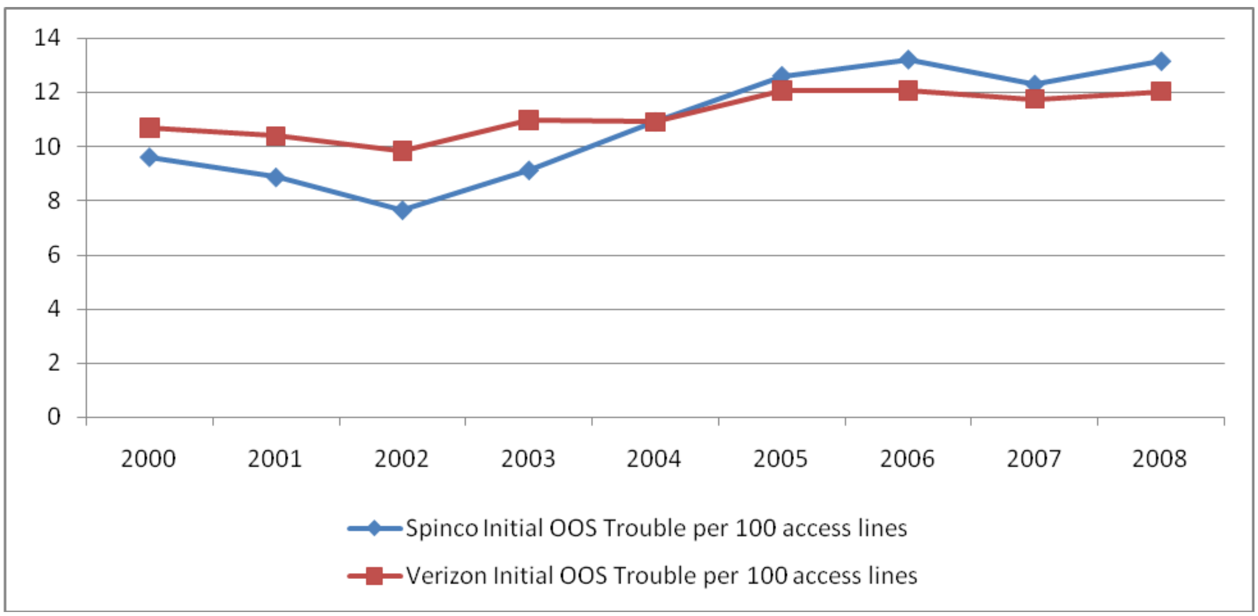
Q: Do you have any concerns regarding the condition of Verizon's outside plant?

A: Yes. It is no secret that Verizon has set as its priority deployment of fiber optic cable associated with FiOS, and the spin-off itself confirms that Verizon does not have a commitment to serving more rural areas.

[157] Joint Applicants' Response to Public Counsel Data Request Nos. 62 and 63.

There is also physical evidence that raises concerns. One indicator of outside plant conditions is the number of out-of-service trouble reports. Figure 4, below, compares initial out-of-service (OOS) trouble reports per 100 access lines for the Spinco properties and the properties that Verizon retains following the transaction.

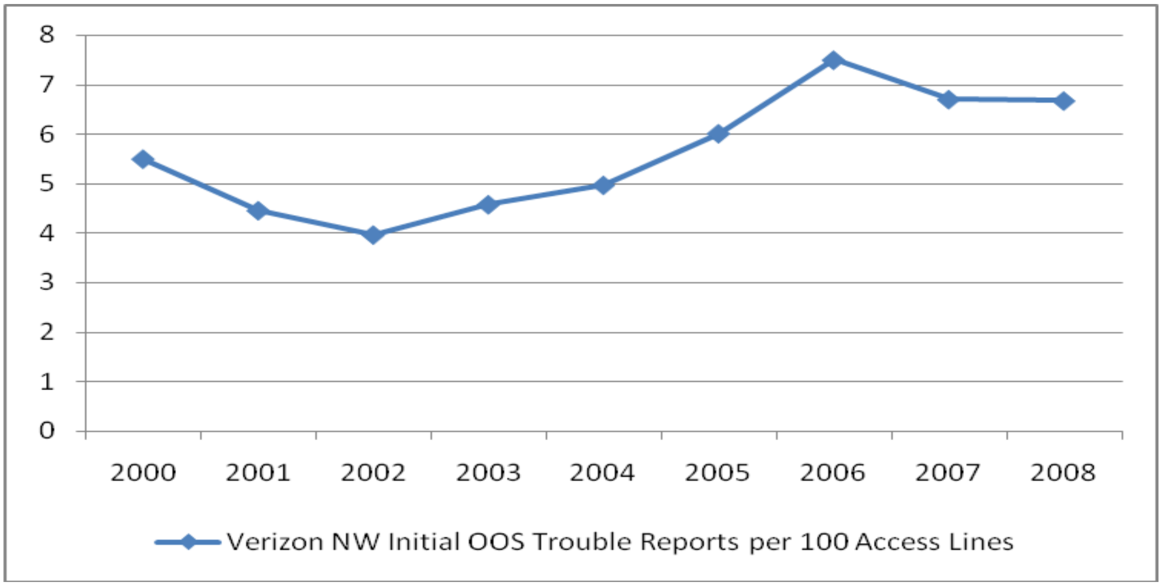
Figure 4: Spinco OOS Trouble Compared to Remaining Verizon Properties



It can be seen in Figure 4 that the Spinco properties which Verizon acquired from GTE initially had lower OOS trouble report rates, and these rates declined until 2002. However, between 2002 and 2008 the Spinco initial OOS trouble reports nearly doubled, from 7.6 per 100 access lines to 13.1 per 100 access lines. The remaining Verizon properties also exhibit an upward trend during the 2002 to 2008 period, however, the increase is not as dramatic. The differential in OOS trouble reports indicates potential problems with the Spinco outside plant.

While Verizon's Washington operations have experienced a rate of OOS trouble reports that is lower than the Spinco average, a similar trend is evident, as is shown in Figure 5, below on the following page.

Figure 5: Verizon Washington Initial OOS Trouble Reports



Q: Has Frontier's Management Acknowledged that there may be problems with the plant that it will acquire from Verizon?

A: Yes. Frontier advised investors as follows:

> Verizon's historical capital expenditures in connection with the Spinco business have been significantly lower than Frontier's level of capital expenditures. Replacing or upgrading the combined company's infrastructure will require significant capital expenditures, including any expected or unexpected expenditures necessary to make replacements or upgrades to the existing infrastructure of the Spinco business. If this capital is not available when needed, the combined company's business will be adversely affected.[158]

[158] Frontier Communications, Registration Statement (Form S-4), at 34 (Jul. 24, 2009).

However, as is discussed elsewhere in this testimony, in spite of this risk, Frontier has not undertaken any specific evaluation of the condition of Verizon's outside plant.

Q: Are you aware of any other mergers where the failure of the acquiring party to assess outside plant led to problems?

A: Yes. In 1999, the RBOC, SBC, acquired Ameritech, another RBOC. In 2000, service quality in the former Ameritech region deteriorated dramatically. During a December 21, 2000 teleconference with securities analysts, SBC's then-CEO Edward Whitacre, stated his assessment of the source of the problems:

> Our service at Ameritech, as you all know, is not up to the standards SBC would like. It is a question of outside plant. It is not a question of switching mechanisms. It is not a question of trunking. It's strictly an outside plant problem, and we don't have enough capacity in some places, and perhaps in previous years not enough maintenance was done on it, . . . we had to divert some dollars there.[159]

SBC and regulators linked the problems to the poor condition of Ameritech's outside plant.[160]

Q: What trend do maintenance expenses exhibit in the Verizon Washington service area?

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[159] Quotations contained in a letter from the Chair of the Illinois Commerce Commission to the Chair's of the four other state PUC Chairs in the Ameritech region. This letter is available from the ICC's web site at: http://www.icc.illinois.gov/downloads/public/edocket/20458.PDF.

[160] *See e.g.*, "Investment, Capital Spending and Service Quality in U.S. Telecommunications Networks: A Symbiotic Relationship," Telecommunications Industry Association, Nov. 13, 2002, *available at* http://www.tiaonline.org/gov_affairs/fcc_filings/documents/Nov13-2002_CapEx_QoS_Final.pdf. *See also*, *In Re The Matter of the Commission's Investigation into the Service Quality of Indiana Bell Telephone Co., Inc. D/B/A Ameritech Indiana Under IC § 8-1-2-4; IC § 8-1-2-58; and 170 IAC 7-1.1, IURC,* Cause No. 41911, Jan. 18, 2001. *See also* "Top Ameritech official in state has tough task to fix service," *Indianapolis Star*, Oct. 9, 2000, *available at* http://www2.indystar.com/library/factfiles/ business/utilities/ameritech/stories/2000_1009.html.

A: Maintenance expenses have been declining. **[Begin Confidential]** XXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX.[161] **[End Confidential]** This decline in maintenance expenses also raises concern regarding the condition of Verizon WA's outside plant. Trends in capital construction expenditures also show that Verizon has favored fiber deployment over improvements to copper plant. In Washington, capital construction expenditures associated with FiOS have commanded over **[Begin Highly Confidential]** XXXXX **[End Highly Confidential]** of all Verizon capital construction expenditures in the period 2006 to March 2009. Given that FiOS in Washington is currently available only to **[Begin Highly Confidential]** XX XXXX [**End Highly Confidential]** households in Verizon's service area, most of Verizon's network in Washington has seen declining capital construction expenditures.[162] Verizon Washington Trends in non-FiOS capital expenditures show that Verizon Washington has exhibited reduced capital expenditures, with a decline of close to **[Begin Confidential]** XXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX

[161] Based on ARMIS reports for the years 2004 to 2007, and Verizon Response to Public Counsel Data Request No. 47 for 2008.
[162] *See* Joint Applicants' Response to Public Counsel Data Request Nos. 48 and 309. In the Spinco properties where FiOS has not been deployed, ARMIS data shows that additions to cable and wire facilities are below the Verizon's overall average level of additions.

XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXX.[163] **[End Confidential]**

The condition of Verizon NW's outside plant has a direct impact on the ability of Frontier to deploy broadband services. It also limits Frontier's ability to provide high quality service over voice-grade facilities. Absent specific commitments from Frontier regarding broadband upgrades and service quality performance and reporting, I do not believe that Frontier has demonstrated that the benefits it claims associated with broadband will occur.

Q: Has Verizon identified impediments associated with improving broadband deployment in Washington?

A: Yes. Verizon indicates that the areas where it has not deployed broadband are the areas where it is most expensive to do so.[164] Verizon also indicates that technical limitations and substantial capital investment requirements are impeding improvements in DSL deployment levels.[165] When taking over the Spinco operations, Frontier will be acquiring 4.8 million access lines, of which only 60 percent are DSL capable.[166] In other words, Frontier's new Spinco properties will have almost as many access lines that do not have DSL capability as the total number of Frontier switched access lines prior to the merger.[167]

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[163] *See* Verizon Response to Public Counsel Data Request Nos. 48 and 309. The projection to year-end 2009 is based on the annualized 1st quarter capital expenditures reported by Verizon.
[164] PUCO Case No. 09-454-TP-ACO, Transcript of Deposition of Timothy McCallion, p. 70, lines 14-15.
[165] Verizon's Response to Public Counsel Data Request No. 11.
[166] *Joint Application*, p. 16.
[167] According to Frontier documents, Spinco has approximately 4.8 million access lines, of which 60 percent are DSL capable. Forty percent of 4.8 million is 1.9 million, which compares to Frontier's pre-merger switched line count of 2.2 million.

Q: Has Verizon estimated the cost of upgrading DSL in the Spinco service areas?

A: Yes. **[Begin Highly Confidential]** XXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXX.[168] XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXX.[169] **[End Highly Confidential]** This substantial capital requirement may impede Frontier's ability to upgrade network facilities in a timely manner. Given that Frontier must access capital markets to raise the $3.3 billion merger consideration that will be used to reduce Verizon's debt,[170] raising additional capital at reasonable rates may not be assured.

Q: What is Frontier's opinion of Verizon's projected costs of upgrading Verizon's network to improve DSL deployment?

A: Frontier indicates that it has not reviewed Verizon's estimate.[171]

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[168] Joint Applicants' Response to Staff Data Request No. 11, Attachment 4(c)(45) to Verizon's Hart-Scott-Rodino filing.

[169] Joint Applicants' Response to Public Counsel Data Request No. 35, Attachment "Project North Board of Directors Discussion Materials, April 16, 2009," p. 13.

[170] *See e.g.*, "Frontier Communications Corporation Q2 2009 Earnings Call Transcript," Aug. 04, 2009, *available at* http://seekingalpha.com/article/153702-frontier-communications-corporation-q2-2009-earnings-call-transcript?page=-1.

[171] Joint Applicants' Response to Public Counsel Data Request No. 325.

Q: Has Frontier developed more than one estimate of what the costs of upgrading Verizon Spinco facilities to be DSL capable?

A: Yes. Earlier this year, Frontier reduced the projected costs of DSL upgrades the Spinco properties **[Begin Highly Confidential]** XXXXXXXXXXXXXXXXX XXXXXXXXXXXX.[172] XXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX.[173] **[End Highly Confidential]** This is an unrealistic assumption, and I do not believe that Frontier will find it this easy or economical to upgrade Verizon's outside plant to provide DSL service.

Q: Does Frontier have an explanation for its assumption?

A: **[Begin Highly Confidential]** XXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX:

> XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXX.[174]

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[172] Joint Applicants' Response to Public Counsel Data Request No. 35, Attachment titled "Project North Board of Directors Discussion Materials," May 1, 2009, p. 34.
[173] Grooming of lines could include the removal of loading coils and bridged tap, or addressing subpar plant conditions, such as moisture in cable. *See* Joint Applicants' Response to Public Counsel Data Request No. 324.
[174] Joint Applicants' Response to Public Counsel Data Request No. 324.

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Q: How does Frontier's assumption of the lower levels of capital expenditures associated with upgrading DSL impact its pro forma financial projections?

A: The projected reduction in capital expenditures improves pro forma projections and makes the projected operating results more favorable. **[Begin Highly Confidential]** XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX. **[End Highly Confidential]** Frontier's failure to evaluate or inspect Verizon's outside plant, and its unrealistic assumption regarding the costs of upgrading that outside plant, are not reasonable actions and increase the risks associated with this transaction.

Q: How does DSL deployment in Washington compare to that in other Spinco states?

A: **[Begin Highly Confidential]** XXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXX.[176] **[End Highly Confidential]** While this deployment is well below the DSL-availability level in some Frontier states, I am concerned that, because of its relative position among Spinco states, Washington will take a back seat when it comes to broadband investment

[175] *Id.*

[176] Attachment 4(c)(45) to Verizon's Hart-Scott-Rodino filing.

decisions. Frontier indicates that it "generally makes investment decisions in favor of those projects that favorably impact a larger number of customers over those projects that impact a smaller number of customers."[177] While it may be that Washington will generate individual projects that can benefit larger numbers of customers relative to projects in other Spinco states, viewed overall, Frontier must upgrade many customer locations outside of Washington, and Washington will be competing with this larger priority. As a result, should this Commission approve the merger, enforceable conditions must be put in place to ensure that broadband benefits actually do arise in a timely fashion.

Q: Does the availability of broadband stimulus funding offer an avenue for Frontier to supplement its broadband deployment objectives?

A: Yes. However, Frontier's handling of the broadband stimulus raises concerns regarding Frontier's priorities, and its managerial foresight. While Frontier witness Mr. McCarthy urges the Commission to "act expeditiously" so that Frontier can pursue broadband stimulus funding, the main impediments to Frontier seeking stimulus funding in the Spinco service areas are the result of its own actions and not the Commission's schedule. It is notable that the Agreement and Plan of the Merger does not allow the merger to close before April 30, 2010, thus it is unlikely that this Commission's schedule will have any impact on the ability of Frontier to seek broadband stimulus funding.[178] Furthermore, Frontier has applied for stimulus funding in the Verizon West Virginia service area, both

[177] Verizon's Response to Public Counsel Data Request No. 75.
[178] *Agreement and Plan of the Merger* at 29.

as an ILEC and as a CLEC.[179] Frontier has apparently decided not to pursue broadband stimulus funding options in the Verizon's Washington service area at this time.

Frontier has not acted in a manner that enables it to take advantage of broadband stimulus funding in the Verizon Washington service area. When asked whether Frontier has prepared any reports, analysis, or memoranda regarding broadband stimulus funding, Frontier indicates that it has not prepared any for Verizon properties in Washington.[180] Furthermore, while Frontier and Verizon have drawn up an Agreement and Plan of the Merger that delineates certain actions that each company must take in fine detail, Frontier failed to include any provisions that would require that Verizon seek broadband stimulus funding, or work with Frontier to secure broadband stimulus funding in the period prior to the merger's closing. When asked why Frontier had not taken this action, they replied:

> At the time of the transaction negotiations, NTIA had not yet released its Notice of Funding Available (sic), which details the application rules and requirements for applicants seeking federal broadband stimulus funding, thus making it impractical to include any provision related to this funding as part of the transaction.[181]

I do not find this explanation to be compelling. I believe it would have been practical to include in the Agreement and Plan of the Merger some provisions such as the creation of a joint Frontier/Verizon task force to pursue federal

[179] Verizon's Response to Public Counsel Data Request No. 327.
[180] Verizon's Response to Public Counsel Data Request No. 14.
[181] Verizon's Response to Public Counsel Data Request No. 61.

broadband stimulus funding once the Notice of Funding Availability was released.

2. Alleged Benefit of High-Quality Services

Q: Frontier indicates that as a result of the merger, consumers will benefit "from Frontier's track record of successfully providing high quality services," adding that "Frontier will be able to generate improved operational performance through the deployment of Frontier's technology and processes in the acquired service areas in Washington."[182] Will new Frontier technology be introduced?

A: No. Because Frontier will be using replicated GTE systems, there will be no new Frontier "technology and processes" introduced soon after the merger. Instead:

> Upon closing, Frontier will use the *same operational systems* – ordering, billing, etc. – that Verizon uses at closing to provide service in Washington. Verizon will separate these systems prior to closing and Frontier will control fully functional independent systems following the close. In other words, Frontier will simply take over tested, functional operational systems. Frontier will then have the option to use the systems for as long as it wishes.[183]

However, as discussed above, Frontier will be using replicated systems, and I believe this approach introduces an additional dimension of risk for Washington consumers.

Q: Have you reviewed Ms. Alexander's testimony regarding Frontier's service quality performance?

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[182] Direct Testimony of Daniel McCarthy, p. 18, lines 11-14.
[183] Direct Testimony of Daniel McCarthy, p. 51, lines 7-12, emphasis added.

A: Yes. I believe that Ms. Alexander's testimony strongly supports the proposition that Verizon WA's recent service quality performance has deteriorated and that Frontier's performance generally falls far short of Verizon WA's performance in many key areas. It is reasonable to conclude that Frontier's service quality record introduces a *risk* for Washington ratepayers, as opposed to the *benefi*t that Frontier alleges.

3. Alleged Benefit of a "Larger and Stronger" Frontier

Q: Frontier indicates that there is a third benefit of the merger. What is this alleged benefit?

A: The Joint Applicants indicate that "Frontier will become larger and stronger, which in turn will benefit Washington customers."[184] While it appears accurate that Frontier will become a larger company, there is no guarantee that becoming larger will result in a stronger company. Frontier's claim overlooks the more important fact that, as a result of the transaction, Verizon Washington ratepayers will become part of a *smaller* company than is currently the case. If being a customer of a larger-sized company is a benefit as Frontier indicates, then this transaction cannot be claimed to provide any benefit to Washington ratepayers based on size alone. Indeed, Washington ratepayers will face increased risks associated with Frontier's smaller size and lack of diversification. As is discussed in Mr. Hill's Direct Testimony, Frontier, in addition to being a smaller company, has a higher degree of financial risk, as demonstrated by its lack of an investment grade rating, and other factors.

[184] Direct Testimony of Daniel McCarthy, p. 18, lines 14-15.

4. Competitive Impact of the Merger

Q: Do the Joint Applicants indicate that there will be harms to competition resulting from the merger?

A: No, the Joint Applicants indicate that the transaction will have no negative impact on competition.[185] While it is true that Frontier and Verizon do not have overlapping ILEC service areas, there are still potential competitive impacts of the merger. First, as addressed earlier in my testimony, Verizon has locked some residential customers into long-term contracts. These customers will experience a change of providers following the closing of this transaction not resulting from their own choice. Thus, I recommend, should the Commission approve the merger, that customers who are bound by Verizon term agreements be given a "fresh look" regarding whether they want to transfer service to Frontier. Similarly, Frontier indicates that "Frontier will also acquire the customer relationships for long distance, high speed Internet, and, where provided, wireline video and broadband data (*i.e.*, FiOS) services. . ."[186] For some customers, these services may be available from alternative providers. Thus, should the Commission approve this transaction, customers must receive adequate notice of the merger, and that notice should inform customers that they are free to select an alternative source of supply, should they prefer a service provider other than Frontier.[187]

Q: Does the merger have the potential to negatively impact CLECs?

[185] Direct Testimony of Daniel McCarthy, p. 53, line 2.
[186] Direct Testimony of Daniel McCarthy, p. 14, line 18 to p. 15, line 2.

A: Yes. Due to Frontier's plan to rely on "replicated" Verizon customer support systems, CLECs face similar risks as retail customers. The replicated systems may or may not perform as well as the original Verizon systems. The Joint Applicants indicate that they have no plans to conduct any interoperability testing for the operations support systems (OSS) currently utilized by CLECs.[188] Given that the replicated OSS systems are subject to the same potential for problems that the retail systems, should it approve the transaction, the Commission should closely monitor the performance of the systems that service CLECs, just as it should monitor the impact of these replicated systems for retail customers.

IV. RECOMMENDATIONS

Q: Do you recommend that the Commission approve this merger?

A: No. I believe that this merger, as structured, results in an unacceptable level of risk being shifted onto Verizon Washington ratepayers. As my testimony has discussed, Washington ratepayers are likely to be harmed as a result of this transaction. The structure of the merger inappropriately releases Verizon from responsibility for the success of this transaction, which is heavily dependent on Verizon's continued support.[189] Furthermore, Frontier, while making general promises regarding future benefits of the transaction, has not made a single commitment that would result in quantifiable benefits accruing to Washington

[187] Given the rural nature of much of Verizon's service area, it is likely that many Verizon customers have little choice for wireline services other than Verizon. However, all Verizon customers should be notified of their ability to choose another source of supply, should one be available that the customer would prefer.
[188] Verizon and Frontier's Responses to Comcast Data Request No. 19.
[189] Recall that §1.144 of Merger Agreement shelters Verizon from any negative financial consequences that may result from the regulatory approval process, by increasing the "Required Payment Amount." In other words, Frontier must make Verizon whole for any regulatory approval costs.

ratepayers. In the Scottish Power Order, the Commission set forth the standard for approval of a merger transaction, as follows:

> 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.[190]

The Commission elaborated on this standard in 2005 Verizon and MCI merger:

> [T]he Commission determines whether the transaction is consistent with the public interest, balancing the costs and the benefits for the public and for affected customers. If the costs outweigh the benefits, the result is harm and the Commission should deny or condition the approval so no net harm results.[191]

I do not believe that this transaction, as structured, is consistent with the "no net harm" standard, and thus, I believe that the Commission should reject this merger as submitted.

A. Recommended Merger Conditions

Q: If the Commission decides to approve the merger, do you believe that conditions should be placed on this merger?

A: Yes. The merger introduces a substantial degree of risk, and the Commission must ensure that Verizon Washington ratepayers are insulated from this risk. Thus, should the Commission allow the merger, it is appropriate to place conditions on the merger to benefit Verizon Washington ratepayers. The Commission should ensure that ratepayers receive some benefits from this

[190] *In re Application of PacifiCorp & Scottish Power PLC*, Docket No. UE-981627, Third Supplemental Order, pp. 2-3.

[191] *In the Matter of the Joint Application of Verizon Communications, Inc. and MCI, Inc. For Approval of Agreement and Plan of Merger,* Docket No. UT-050814, Order Accepting Settlement, On Condition; Approving Merger, On Condition (Order No. 07), ¶59.

merger, as there are quantifiable harms to Verizon Washington ratepayers that could result from the merger, and merger benefits can act to offset these harms.

Given the timing of its debt financing, the Commission will not know the cost at which Frontier secures the necessary debt until March or April of 2010. As discussed above, the Merger Agreement contains a provision that allows Frontier to proceed with the transaction even if the cost of debt is above 9.5 percent. As a preliminary requirement to enable even the conditional approval of the merger, Frontier should demonstrate to the Commission that it has not financed the new debt at a rate above 9.5 percent. Once Frontier secures the necessary debt financing for this transaction, it should file a report summarizing the results with the Commission.

Assuming that the preliminary condition associated with the cost of debt is satisfied, the following additional conditions should be placed on this merger. The conditions are presented in summary form below, and then will be discussed in more detail:

- Verizon should commit to modifying the Merger Agreement to eliminate the "Required Payment Amount" provision that frees Verizon from any burden of regulatory costs associated with the approval of the merger in Washington.

- Verizon should be required to create an archive of customer records that will be maintained for 12 months following the closing of the merger. This archive should be available to Frontier, and its customers, to verify data that is transferred to Frontier.

- Verizon should establish a fund to insure the condition of its outside plant in Washington. The amount of the fund should be set at $40 million. If Verizon chooses, it can seek adjustment to the fund size through a third-party audit, paid for by Verizon, which addresses the condition of Verizon's outside plant in Washington. Problems with outside plant that are identified as a result of the audit should be remedied at Verizon's expense.

- Verizon should face penalties of up to $7.7 million per year associated with the performance of the replicated systems that it supplies Frontier.

- Frontier should commit to making broadband services available in 100 percent of its wire centers, and to 90 percent of its Washington customers by the end of 2013. Frontier should expand broadband availability to 100 percent of its customers by 2015.

- Frontier should deploy and promote broadband services so that, by the end of 2013, at least 90 percent of its customers can achieve download speeds of 3 Mbps; 75 percent of its customers can achieve download speeds of 6 Mbps; and 50 percent of customers can achieve download speeds of 10 Mbps.

- Frontier should complete all fiber build-out obligations in Washington to which Verizon has currently committed.

- To achieve these broadband objectives, Frontier should commit to exceed Verizon's baseline level of capital investment by at least $89 million during the period ending December 31, 2013, or by an amount sufficient to meet the broadband objectives.

- Frontier should commit to offer broadband services at prices that do not exceed those currently offered by Verizon for 1 Mbps and 3 Mbps services, *i.e.*, Frontier should offer services at Verizon's advertised prices for 1 Mbps and 3 Mbps service (respectively, $19.99 per month and $29.99 per month) for a period of 24 months following the merger.

- Frontier should not impose its broadband "download cap" in Washington.

- Frontier should provide individual written notice to its customers regarding the merger, and should notify customers of any change in services that result from the merger. Changes in billing format should also be clearly explained to customers, both in writing, and through a web-based tutorial.

- Frontier should not be allowed to migrate any Verizon customer to a Frontier plan that either increases rates, or diminishes the level of service. Washington customers should experience a rate freeze for a period of 24 months.

- Customers should be allowed to take a "fresh look" at their purchases, including those customers who have term contracts with Verizon. All early termination charges should be waived for a period of 90 days following the merger, and the long-distance PIC charge should also be waived for Verizon long-distance customers who select a long-distance provider other than Frontier.

- Thirty days following the cutover of any replicated systems by Verizon, Verizon should provide a status report on the performance of the replicated systems. The report should identify what systems have been cut over, and whether any problems have occurred with the cutover. The report should specifically address the cutover to replicated 911 systems, and how these systems perform, and any problems that have occurred with 911 systems. Verizon should continue to issue monthly reports on the performance of all replicated systems for the first 12-month following the closing.

- Verizon should be required to notify all interested parties of the plans associated with 911 system replication, results of testing replicated 911 systems, and the date on which the cutover takes place.

- Frontier should be required, for a period of three years following the closing, to submit quarterly reports on the integration of business and repair office operations and billing systems to the Commission.

- Frontier should be required, for a period of three years following the closing, to submit quarterly reports on any consolidation of network operations, and staffing levels associated with network operations in Washington.

These conditions are discussed below in more detail.

Q: Do you believe that the Commission, if it approves the merger, should condition its approval on a modification of the merger agreement?

A: Yes. As a condition of approving this merger, the Commission should instruct the Joint Applicants to amend the Merger Agreement so that the §1.144 "Required Payment Amount" (RPA) provision is removed for regulatory costs imposed on Verizon by the regulatory approval process in Washington. Removal of this provision, in combination with the conditions that I recommend, will ensure that Verizon has a continuing stake in the outcome of this merger.

Q: Which of your recommended conditions have the potential to trigger the RPA?

A: The following conditions could trigger the RPA:

- Verizon should be required to create an archive of customer records, separate from the replicated system that it will provide to Frontier, containing each customer's billing and payment history for the twelve months prior to the transfer of customers to Frontier. This archive should be maintained by a third party at Verizon's expense for a period of 12 months following the close of the merger
- Verizon should be required to establish a fund to insure the condition of Verizon's outside plant in Washington. I believe that $40 million should be placed in this fund, which can be structured as an interest-bearing escrow account overseen by the Commission. With Commission approval, Frontier can draw from this fund to correct problems that it discovers with the outside plant in the acquired Verizon services areas in Washington, including costs of basic line conditioning (removal of load coils and bridged tap), for a period of 24 months following the close of the merger. To draw from the fund, Frontier should document problems with the outside plant it has acquired in Washington, as well as the projected costs of remedying the problems, and present this information to the Commission. The Commission should verify Frontier's expenditures of these funds. As part of this condition, Verizon should be, at its expense, allowed to sponsor a third-party audit of its outside plant that would adjust the baseline $40 million.[192] This potential audit should focus on the identification of problems with outside plant that could contribute to service quality problems, and on the status of Verizon's outside plant with regard to its potential to be upgraded to provide DSL services. The audit, if Verizon decides to pursue this option, should be

[192] **[Begin Highly Confidential]** XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX. **[End Highly Confidential]**

conducted by a third party, selected with input from Verizon, Frontier, Commission Staff, and Public Counsel. If Verizon chooses to pursue this audit, the audit should be initiated by Verizon within 30 days, and completed within 120 days, of the approval of the merger by this Commission. The results of the audit should be presented to the Commission in a publicly docketed proceeding.

- Verizon should face penalties if its replicated systems fail to perform as represented in §7.24 of the Merger Agreement, *i.e.*, if the replicated systems do not "provide functionality substantially similar to, but no less favorable to the Spinco Business than, that which the Spinco Business received from Verizon and its Affiliates as of the date of this Agreement." If systems fail to perform as described in §7.24, interested parties should be able to seek relief from the Commission. For Washington, the penalties faced by Verizon should be set at $7.7 million per year. These penalties should be used to compensate Washington ratepayers for any consequences of system failures associated with improperly replicated systems, including disruptions in service, improper transfer of customer records, and/or decreased performance in Commission service quality metrics attributable to the replicated systems. The $7.7 million annual penalty represents Washington's pro rata share of the annual $94 million payment that Frontier will make to Verizon, as specified in the Software License Agreement discussed earlier in my testimony.

- Verizon should be required to issue monthly reports on the performance of the replicated systems, with the reports beginning 30 days following the first cutover of any replicated system, and continuing for 12 months following the hand-over of replicated systems to Frontier.

- Verizon should be required to notify interested parties regarding its plans for the replication and cutover of 911 systems, test results, and the date(s) of system cutovers.

Q: What benefits do these conditions provide?

A: These requirements will reduce risks consumers face following the closing of the transaction. The first requirement will improve the proposed transaction by ensuring that the replication process does not result in customer information being lost. As Verizon cannot retain access to customer information for the former Spinco customers following the closing of the transaction, Verizon should create an archive of customer information that should be maintained by a third-party. This archive of customer information should be created prior to the transfer of customer information to Frontier. Frontier should have access to these customer records, and Frontier customers should be able to request that Frontier compare the archived information to the information passed to Frontier in the replicated systems, should the customer believe that there are inconsistencies in their billing and/or payment history.

With regard to the second provision, the condition of Verizon's outside plant will have a critical impact on Frontier's ability to provide high-quality services, and on the cost of upgrading outside plant to provide broadband services. As discussed in this testimony, Verizon maintenance expenses and capital expenditures have declined in recent years. Furthermore, Verizon's internal evaluation of the costs of DSL upgrades shows a substantially higher level of costs than those assumed by Frontier. The $40 million fund, which should be structured as an interest-bearing escrow account overseen by the Commission, will provide a potential source of funds to ensure that problems with Verizon's outside plant are remedied, so that service quality can be improved, and to assist with the timely deployment of DSL. Verizon should also be given the opportunity to demonstrate that the size of the fund should be adjusted. If Verizon chooses, it can sponsor an audit of its outside plant. Through this audit process, this Commission will be further informed of the condition of Verizon's outside plant. If the audit discovers problems with Verizon's outside plant that have the potential to cause service quality problems, or impede DSL deployment, these problems should be remedied at Verizon's expense.

The third provision provides an incentive to Verizon to ensure that its replication process does not result in harm to consumers. If Verizon is subject to penalty should the replicated systems fail to perform as described in the Merger Agreement, it will have a stake in the performance of the replicated systems.

The fourth provision will ensure that this Commission has timely information regarding the performance of the replicated systems that Verizon will create, cut over, and supervise on Frontier's behalf. The Agreement and Plan of the Merger envisions that replicated systems will begin operation approximately 60 days prior to the merger's closing, thus indicating that Verizon will operate the replicated systems for a period, prior to their being handed off to Frontier. Verizon will, under the terms of the Software License Agreement associated with the replicated systems, provide support for these systems. This reporting requirement continues the flow of information from Verizon to the Commission following the closing of the merger, which is appropriate given the important role that Verizon will play in supervising Frontier's use of these systems.

Finally, 911 systems provide critical public safety services, and the performance of these systems must not be negatively affected by the replication and cutover process. The Commission and interested parties must be informed of Verizon's planning for 911 system replication, the results of testing of the replicated 911 systems, and when these systems will be cut over.

Q: Do you believe that Verizon should commit to satisfy these conditions and also waive its right to trigger the RPA?

A: Yes. If Verizon waives its right to trigger the RPA with regard to these conditions, it will face improved performance incentives. However, with regard to the $40 million fund, if Frontier finds Verizon's outside plant does not need remedial action, no funds will be drawn from the fund, and the monies will be returned to Verizon, with interest, after 24 months. Similarly with the performance guarantee associated with the replicated systems, if the systems perform as Verizon represents, there would be no financial impact on Verizon.

If Verizon does not agree to waive the provisions of the RPA, the Commission should still require these provisions, as they will provide benefits to Washington ratepayers that partially offset the increases in risk that they will face, even if Frontier must provide additional compensation to Verizon.

B. Further Discussion of Merger Conditions

Q: Should Frontier be required to commit to broadband deployment in Washington?

A: Yes. I believe that this merger should be conditioned on a broadband commitment from Frontier. Frontier has made broadband the centerpiece of its application, and Frontier's claims regarding broadband improvements should translate into quantifiable benefits.

Q: What broadband deployment conditions do you believe should be required?

A: I believe that Frontier must make broadband available to 100 percent of its Washington wire centers, and to at least 90 percent of its customers within three years, and make broadband available to 100 percent of its customers in five years.[193]

Frontier should be required to develop a broadband improvement plan that will be presented to the Commission within 90 days of the Commission granting merger approval. This improvement plan should include specific annual milestones that will allow the Commission to track progress toward the availability objectives. Frontier should also, as part of the plan, include provisions to improve the quality of DSL available, or deploy FTTH, so that 90 percent of its broadband customers should be able to achieve download speeds of 3 Mbps at the end of the three-year period,[194] and so that at least 75 percent of its broadband customers can achieve download speeds of at least 6 Mbps, and at least 50 percent of its broadband customers can achieve download speeds of at least 10 Mbps by the end of the three-year period. The broadband improvement plan should also specifically identify all fiber build-outs to which Verizon had committed, and that Frontier will complete as part of the plan.

The Broadband Improvement Plan should identify the capital budget projected for completion of the Plan, and should identify expected sources of

[193] "Broadband availability" should be understood as the deployment of facilities that enable the provision of broadband in a geographic area, such as a wire center. The 100 percent broadband availability to the wire center and 90 percent availability to customers means that each Frontier wire center should be able to provide broadband service at the end of three years, and this service should be technically available to 90 percent of Frontier's customers in the aggregate. The 100 percent customer availability by 2015 means that Frontier would have to make investments that would potentially enable broadband to all customers. This requirement would not necessarily require that Frontier upgrade its outside plant so that every customer location was broadband-enabled, but would permit Frontier to make the final investments/expenditures to enable broadband as broadband service was requested by a customer in a wire center. Furthermore, I believe that it is reasonable, for the last 10 percent of customers, to allow Frontier to deploy technologies other than FTTH or DSL, such as wireless, to satisfy the build-out requirement.

[194] Mr. McCarthy states in his deposition that Frontier targets 3 Mbps as a baseline for DSL deployment. Transcript of Deposition of Daniel McCarthy, p. 25, line 4.

funding, including any governmental grants associated with any broadband grants, loans, or other subsidies.

Q: Do you believe that there are identifiable sources of funding for this broadband improvement program?

A: Yes. Merger synergies will generate a cash flow for Frontier, and according to Frontier, companywide annual synergies can be achieved that will total at least $500 million per year, by the end of a three-year period.[195] Frontier has not provided any information in the Joint Application, or in the supporting testimony, as to how any of these synergies will generate benefits in Washington. I believe that it is reasonable to associate a portion of the synergy savings with Washington, and to apply that portion to broadband improvement. As discussed above, the merger raises considerable risks for Verizon Washington ratepayers. Sharing of merger synergies provides a reasonable means of contributing to the satisfaction of the statutory requirement that the merger serve the public convenience. Merger synergies should contribute to the timely completion of the Broadband Improvement Plan.

Q: What portion of the synergies should be associated with Verizon Washington and Frontier?

A: It is reasonable to associate $41 million per year of the run rate synergies with Verizon WA's operations.[196] I developed this value based on the $500 million in

[195] "Welcome to the New Frontier," p. 14. Frontier Communications, May 13, 2008, p. 22, *available at* http://www.sec.gov/Archives/edgar/data/20520/000095015709000249/form425.htm.
[196] "Run-rate" synergies are the level of synergies expected once integration has been completed. In the analysis that follows, I follow Frontier's assumption that these run rate synergies will not be fully achieved until the third year following the merger.

company-wide synergies identified by Frontier, and on access line counts for Verizon Washington and the overall post-consolidation Frontier. I also believe that it is reasonable to estimate that a total of $89 million in synergies are associated with the Washington operations of the combining companies through the end of 2013.[197]

Q: Is the amount of synergies that you have identified sufficient to fund the Broadband Improvement Plan's objectives?

A: It is likely that the $89 million in synergies will provide a substantial "jump start" in the process. Capital construction expenditures made in Washington, exclusive of FTTH investments, averaged **[Begin Confidential]** XXXX **[End Confidential)** per year over the 2006-2008 period. Thus, the synergy sharing could increase annual capital spending on copper by **[Begin Confidential]** XX XXXX **[End Confidential]**. However, I believe that Frontier could be successful in obtaining some broadband stimulus funding, and should contribute capital from its ongoing capital budget to the fulfillment of the broadband improvement plan. Thus, I propose that Frontier should demonstrate that it spends the $89 million on broadband improvements above the average copper-investments discussed above, and in addition to any broadband stimulus funding, with the outcome of the 100 percent wire center/90 percent customer availability objective being fulfilled.[198]

As a condition of the merger associated with the Broadband Improvement Plan, the Commission should require an annual filing that reports on the progress

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[197] I conservatively assumed that the $41 million in run-rate synergies "ramp-up" during the period.
[198] This discussion focuses on the three-year period ending December 31, 2003. The ability of Frontier to invest to meet the availability to 100 percent of customers by 2015 will have the benefit of the full amount

of the broadband upgrades, and shows the sources and uses of funds used to complete the plan.

Q: Should Frontier commit to continuing Verizon's policies regarding DSL pricing and usage limits?

A: Yes. Frontier's DSL prices are substantially higher than Verizon's nominal prices, even more so when measured on a per Mbps basis. Furthermore, Frontier's usage cap adds another dimension to the higher costs of Frontier's DSL services. Thus, Frontier should commit to adopt Verizon's DSL pricing structure for 1 Mbps and 3 Mbps download services for a period of at least 24 months following the closing of the merger. Both Washington consumers and the Washington economy will be harmed if Frontier's DSL pricing strategies are implemented for these services. Thus, Verizon's advertised prices for 1 Mbps and 3 Mbps service ($19.99 per month and $29.99 per month respectively) should be offered by Frontier. If Frontier offers DSL services at speeds above these levels, Frontier can set prices based on market conditions.

In addition, Frontier should commit to offer its broadband services in Washington without the download cap that it imposes in its existing service area. Finally, Frontier should not downgrade any existing broadband service level in Washington.

Q: Does this sharing of merger benefits to fund broadband deployment ensure that the merger will serve the public convenience?

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of the annual run-rate synergies ($41 million per year) to fund the needed investment. Frontier should continue to report to the Commission on progress to achieve this goal.

A: Not alone, no. It is appropriate that other conditions be placed on the merger to offer additional protection to Frontier and Verizon WA's ratepayers.

Q: What customer notice conditions should be imposed on this transaction?

A: Verizon Washington should be required to provide individual written notice to their ratepayers regarding the merger, the new company name, and any changes to the customer's services, and any change to the bill format. Prior to the issuance of the first Frontier bill, customers should be notified of any outstanding account balance that will be transferred to Frontier.

Frontier should also be required create a web-based tutorial that will provide customers a side-by-side comparison of the customer's former Verizon services, and Frontier's replacement services. Each difference in the services that results from the migration of customers from Verizon's services to Frontier's services should be clearly identified. In addition, Frontier should be required to create a web-based tutorial that will provide a side-by-side comparison of billing formats, and clearly identify any changes in the way that Frontier presents information to customers, as compared to the former Verizon billing format.

For Verizon customers that have arranged for automatic payment of their Verizon systems, Frontier must provide those customers with advance opportunity to alter their choice to utilize automatic payments with Frontier. Frontier should be required to work with the Commission's Staff and Public Counsel on all notice issues associated with the merger.

Q: Should Frontier be allowed to migrate any former Verizon customer to a service plan that increases the customer's monthly bill for regulated services?

A: No. For services that are under this Commission's jurisdiction, the transfer of customers from Verizon to Frontier services should not result in an increase in the customer's monthly bill, or decreases in the functionality associated with the purchase price of the service that the customer experienced as a Verizon customer. Washington ratepayers should experience a "rate freeze" for a period of 24 months following the closing of the transaction, and also should not be forced into a lower-quality set of services at the frozen rate.

Q: Should customers have the opportunity to take a "fresh look" at their purchase decision when the time comes for Frontier to take possession of Verizon's systems?

A: Yes. As discussed above, Frontier offers services under different products at potentially different price points than does Verizon WA. Customers should have the opportunity to review their choice of services. Thus, for example, customers should be able to select a long distance provider other than Frontier without penalty. Thus, I recommend that Frontier waive the primary interexchange carrier (PIC) charge if the customer decides to select a service provider other than Frontier. Similarly, if any Verizon residential customer is bound by a term agreement, these customers should be allowed to terminate that agreement without penalty, beginning at the date when Frontier takes possession of Verizon's operations, and for a period extending for 90 days.

Q: Should the Commission place conditions on the merger regarding call center and billing system changes?

A: Yes. Given the lack of specifics that the Joint Applicants have provided regarding integration of operations, I believe that the Commission should require that Frontier file quarterly report on the integration of business and repair office operations and billing systems for the first three years following the merger, and annually after that. The report should identify changes in staffing or operations at the Frontier call centers that will serve Washington customers, and how newly integrated call centers are being designed and staffed to satisfy Washington's service quality standards regarding speed of answer. The speed of answer should also be included in the report as well as whether the Company has met the standard. The report should also describe remedial action taken by the Company in the event that standard is not met.

Q: Should the Commission place conditions regarding network maintenance and repair?

A: Yes. The Commission should require, for the first three years following the merger, a quarterly report that discusses network operations, investment, maintenance, and staff in Frontier's Washington service areas, and annually after that. This report should identify the number of Company personnel that are associated with the maintenance and repair of Frontier's network facilities, including outside plant. Annual reports should be filed thereafter. The level of, and changes to the level, of maintenance and repair expense and maintenance and repair personnel should be described in this report, and changes in staffing and expense levels should be explained. The company should also report out-of-service trouble reports, and out-of-service restoral intervals in these reports.

Q: Does this conclude your testimony at this time?

A: Yes.