STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Frontier Communications Corporation, Verizon Communications, Inc., Verizon North Inc., Verizon South Inc., and New Communications of the Carolinas, Inc.	:	**09-0268**
	:	
Joint Application for the approval of a Reorganization pursuant to Section 7-204 of the Public Utilities Act; the Issuance of Certificates of Exchange Service Authority pursuant to Section 13-405 to New Communications of the Carolinas, Inc.; the Discontinuance of Service for Verizon South Inc. pursuant to Section 13-406; the Issuance of an Order Approving Designation of New Communications of the Carolinas, Inc. as an Eligible Telecommunications Carrier Covering the Service Area Consisting of the Exchanges to be Acquired from Verizon South Inc. upon the Closing of the Proposed Transaction and the Granting of All Other Necessary and Appropriate Relief.	:	

ORDER

DATED: April 21, 2010

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ORDER

By the Commission:

I. INTRODUCTION AND PROCEDURAL BACKGROUND

On June 4, 2009, Frontier Communications Corporation ("Frontier"), Verizon Communications Inc. ("Verizon"), Verizon North, Inc. ("Verizon North"), Verizon South, Inc. ("Verizon South"), and New Communications of the Carolinas, Inc., (collectively, "Joint Applicants") filed a verified Joint Application with the Illinois Commerce Commission ("Commission") pursuant to Section 7-204 of the Public Utilities Act ("Act"), 220 ILCS 5/1-101, *et seq.*, seeking approval of a reorganization (the "Transaction" or "reorganization") and for other regulatory approvals and relief.

Pursuant to 83 Ill. Adm. Code 1700.20(d), the Commission received public comments from 54 individuals. Forty-one of the comments opposed the reorganization. Five of the comments supported the reorganization. Seven comments did not specifically indicate whether they opposed or supported the reorganization but stated they were concerned. One comment was in regards to other issues.

Petitions seeking leave to intervene were filed by the People of the State of Illinois through the Attorney General ("AG"), Citizens Utility Board ("CUB"), Comcast Phone of Illinois, LLC d/b/a Comcast Digital Telephone ("Comcast"), International Brotherhood of Electrical Workers Locals 21, 51, and 702 ("IBEW"), Illinois Public Telecommunications Association ("IPTA"), Level 3 Communications, Inc. ("Level 3") and the United States Department of Defense and All Other Federal Executive Agencies ("DoD-FEA"). All petitions to intervene were granted.

At the direction of the Administrative Law Judge, Verizon provided a list of the affected municipalities within its local exchanges and, on or about June 24, 2009, the Commission notified those municipalities of this proceeding. Pursuant to proper notice, this matter came for hearing before a duly authorized Administrative Law Judge ("ALJ") of the Commission at its offices in Springfield, Illinois on July 28, 2009 and on August 7, 2009. Appearances were entered by counsel on behalf of Joint Applicants, the AG, CUB, Comcast, IBEW, IPTA, Level 3, DoD-FEA and Staff of the Commission ("Staff"). At the August 7th hearing, the ALJ set a procedural schedule for this docket. The Commission held an additional status hearing on January 11, 2010 and evidentiary hearings on January 19, 2010 and January 20, 2010.

Daniel McCarthy, Executive Vice President and Chief Executive Officer of Frontier Communications Corporation; Kim L. Czak, Assistant Vice President – Carrier Services of Frontier Communications Corporation; Timothy McCallion, President of the West Region for Verizon Communications; Carl E. Ehart, President, Central Region for Verizon Communications, Inc.; Stephen Edward Smith, Vice President of Business Development for Verizon's Telecom Group; and Billy Jack Gregg, an independent consultant and the principal in the firm Billy Jack Gregg Universal Consulting, testified and presented evidence on behalf of Joint Applicants in support of the Joint Application.

Lee L. Selwyn, President of Economics and Technology, Inc., a research and consulting firm specializing in telecommunications economics, regulation management and public policy, testified and presented evidence on behalf of the AG and CUB, opposing the Joint Application.

Susan M. Baldwin, a consultant specializing in telecommunications economics, regulation and public policy and Randy Barber, President for the Center for Economic Organizing, testified and presented evidence on behalf of IBEW, opposing the Joint Application.

Charles W. King, President of the economic consulting firm of Snavely, King Majoros O'Connor & Bedell, Inc., testified and presented evidence on behalf of DoD-FEA.

The following witnesses testified and presented evidence on behalf of Staff: Samuel S. McClerren, an Engineering Analyst IV in the Engineering Department of the Telecommunications Division; Mike Ostrander, an Accountant in the Accounting Department of the Financial Analysis Division; Rochelle Phipps, Senior Financial Analyst in the Finance Department of the Financial Analysis Division; Qin Liu, a Rate Analyst III in the Telecommunications Department in the Telecommunications Division; Karen Chang, an Economic Analyst in the Rates Section of the Telecommunications Division; and Stacy Ross, a Program Assistant for the Telecommunications Division.

On January 27, 2010, the ALJ caused the matter to be marked "Heard and Taken."

Joint Applicants, Staff, IBEW, IPTA and DoD-FEA each filed Initial Briefs on February 9, 2010. Reply Briefs were filed by Joint Applicants, Staff and IBEW on February 18, 2010. An ALJ Proposed Order was issued on March 9, 2010. Briefs on Exceptions were filed by Joint Applicants, Staff, and DoD-FEA on March 19, 2010, and Reply Briefs on Exceptions were filed by Joint Applicants, Staff, IBEW and DoD-FEA on March 25, 2010.

II. DESCRIPTION OF JOINT APPLICANTS PROPOSED TRANSFER OF CONTROL AND REORGANIZATION

On May 13, 2009, Frontier, Verizon and New Communications Holdings Inc. ("NCH," referred to as "Spinco" in the Distribution and Merger Agreements), a newly created subsidiary of Verizon, formed solely for the proposed reorganization, entered into an Agreement and Plan of Merger (the "Merger Agreement") under which Frontier will acquire approximately 4.8 million access lines (and certain related assets) currently owned by subsidiaries of Verizon in Arizona, Idaho, Illinois, Indiana, Michigan, Nevada, North Carolina, Ohio, Oregon, South Carolina, Washington, Wisconsin and West Virginia as well as portions of California bordering Arizona, Nevada and Oregon ("Territory"). On the same date as the original Merger Agreement, Verizon and NCH entered into a Distribution Agreement.

The Merger and Distribution Agreements are designed to: (a) establish a separate entity (*i.e.*, NCH) as the holding company for Verizon's local exchange, long distance and related business activities in the acquired Territory described above; (b) spin-off the stock of that new entity to Verizon shareholders; and then (c) immediately merge the new entity into Frontier.

The Transaction will be completed through several steps: NCH will serve as the holding company for the local exchange, long distance and related businesses in Illinois and the other affected states that are being transferred to Frontier. NCH currently a subsidiary of Verizon will be merged into Frontier. Frontier will be the surviving entity,

and will then own and control the Verizon assets being transferred through the Transaction as well as its current business operations in Illinois.

NCH has two newly formed subsidiaries: (a) New Communications ILEC Holdings Inc. (“NCIH”) which will own the stock of Verizon North, New Communications of the Carolinas Inc. (sometimes referred to as “NewILEC”) and the other operating ILECs ("incumbent local exchange carrier") in the affected states; and (b) New Communications Online and Long Distance Inc. (“NewLD”) which will hold the accounts receivables and customer relationships related to the long distance operations (and other operations) in Illinois and the other affected states.

Through a series of intra-corporate stock transfers, Verizon will transfer (or cause to be transferred) the stock of Verizon North, NewILEC, and the other affected ILECs to NCIH. Similarly, Verizon Long Distance LLC (“VLD”) (f/k/a Bell Atlantic Communications, Inc., d/b/a Verizon Long Distance) and Verizon Enterprise Solutions LLC (“VES”) (f/k/a NYNEX Long Distance Company d/b/a Verizon Enterprise Solutions) will transfer its accounts receivables and customer relationships related to its long distance operations in Illinois and the other affected states to NewLD.

The stock of NCH will then be distributed to Verizon shareholders – *i.e.,* NCH will be “spun off” from Verizon to Verizon’s shareholders. Immediately following this spin-off, NCH will be merged into Frontier, and Frontier will be the surviving holding company owning all of the stock of NCH’s subsidiaries, NCIH and NewLD. Once the merger is completed, NCH will cease to exist; thus, NCIH and NewLD will be direct subsidiaries of Frontier.

Frontier will acquire Verizon North’s operations, but it will not acquire all of Verizon South’s operations – it will acquire only Verizon South’s operations in South Carolina, North Carolina, and Illinois. Post-merger, Verizon will continue to own Verizon South, which will continue to serve the territory in Virginia that Verizon currently serves. Accordingly, prior to the spin-off of NCH and its merger into Frontier, Verizon South will assign its assets, liabilities, and customer relationships relating to its ILEC operations in Illinois, South Carolina and North Carolina to NewILEC. Verizon also will transfer the stock of NewILEC to NCIH through a series of intermediate transfers, such that NewILEC will become a direct, wholly owned subsidiary of NCIH and an indirect, wholly owned subsidiary of NCH. After the merger of NCH into Frontier, Frontier will be the parent of NewILEC.

At the completion of the Transaction, Frontier will own and control, and its board of directors and management will manage, the Verizon free-standing telephone operation (or “VSTO”) assets being transferred through the Transaction. Verizon North will be renamed using a “Frontier” name because Frontier will not operate under the Verizon name in any state. For purposes of this Joint Application, however, the name “Verizon North” is used in describing the pre- and post-Transaction structures. Also, Frontier will rename NewILEC to reflect the “Frontier” business name. Frontier will comply with all applicable Commission requirements associated with renaming and/or establishing doing business names for Verizon North, NewLD and NewILEC.

III. APPLICABLE STATUTORY AUTHORITY

A. Section 6-103 of the Act

Section 6-103 of the Act, provides, that:

> The capitalization of a public utility formed by a merger or consolidation of two or more corporations shall be subject to the approval of the Commission, but in no event shall the Commission approve a capitalization exceeding the sum of the capital stock of the corporations so consolidated, at the par value thereof, and any additional sum actually paid in cash for improvements; nor shall any contract for consolidation or lease be capitalized in the stock of any corporation whatever; nor shall any corporation hereafter issue any bonds against or as a lien upon any contract for consolidation or merger. In any reorganization of a public utility, resulting from forced sale, or in any other manner, the amount of capitalization, including therein all stocks and stock certificates and bonds, notes and other evidences of indebtedness, shall be such as is authorized by the Commission, which in making its determination, shall not exceed the fair value of the property involved. Issuance of stocks and stock certificates, and bonds, notes or other evidences of indebtedness in connection with any consolidation, merger, or reorganization shall be subject to all the terms of Sections 6-101 and 6-102 of this Act.

B. Section 7-204 of the Act

Section 7-204 of the Act provides that:

(a) For purposes of this Section, "reorganization" means any transaction which, regardless of the means by which it is accomplished, results in a change in the ownership of a majority of the voting capital stock of an Illinois public utility; or the ownership or control of any entity which owns or controls a majority of the voting capital stock of a public utility; or by which 2 public utilities merge, or by which a public utility acquires substantially all of the assets of another public utility; provided, however, that "reorganization" as used in this Section shall not include a mortgage or pledge transaction entered into to secure a bona fide borrowing by the party granting the mortgage or making the pledge.

In addition to the foregoing, "reorganization" shall include for purposes of this Section any transaction which, regardless of the means by which it is accomplished, will have the effect of terminating the affiliated interest status of any entity as defined in paragraphs (a), (b), (c) or (d) of subsection (2) of Section 7-101 of this Act where such entity had transactions with the public utility, in the 12 calendar months immediately preceding the date of termination of such affiliated interest status subject

to subsection (3) of Section 7-101 of this Act with a value greater than 15% of the public utility's revenues for that same 12-month period. If the proposed transaction would have the effect of terminating the affiliated interest status of more than one Illinois public utility, the utility with the greatest revenues for the 12-month period shall be used to determine whether such proposed transaction is a reorganization for the purposes of this Section. The Commission shall have jurisdiction over any reorganization as defined herein.

(b) No reorganization shall take place without prior Commission approval. The Commission shall not approve any proposed reorganization if the Commission finds, after notice and hearing, that the reorganization will adversely affect the utility's ability to perform its duties under this Act. In reviewing any proposed reorganization, the Commission must find that:

(1) the proposed reorganization will not diminish the utility's ability to provide adequate, reliable, efficient, safe and least-cost public utility service;

(2) the proposed reorganization will not result in the unjustified subsidization of non-utility activities by the utility or its customers;

(3) costs and facilities are fairly and reasonably allocated between utility and non-utility activities in such a manner that the Commission may identify those costs and facilities which are properly included by the utility for ratemaking purposes;

(4) the proposed reorganization will not significantly impair the utility's ability to raise necessary capital on reasonable terms or to maintain a reasonable capital structure;

(5) the utility will remain subject to all applicable laws, regulations, rules, decisions, and policies governing the regulation of Illinois public utilities;

(6) the proposed reorganization is not likely to have a significant adverse effect on competition in those markets over which the Commission has jurisdiction;

(7) the proposed reorganization is not likely to result in any adverse rate impacts on retail customers.

Finally, Section 7-204(c) of the Act states that the Commission shall not approve a reorganization without ruling on (i) the allocation of any savings resulting from the proposed reorganization; and (ii) whether the companies should be allowed to recover any costs incurred in accomplishing the proposed reorganization and, if so, the amount of costs eligible for recovery and how the costs will be allocated.

C. Section 13-405 of the Act

Section 13-405 of the Act, provides, in relevant part, that:

> The Commission shall approve an application for a Certificate of Exchange Service Authority only upon a showing by the applicant, and a finding by the Commission, after notice and hearing, that the applicant possesses sufficient technical, financial, and managerial resources and abilities to provide local exchange telecommunications service.

D. Section 13-406 of the Act

Section 13-406 of the Act, provides, in relevant part, that:

No telecommunications carrier offering or providing noncompetitive telecommunications service pursuant to a valid Certificate of Service Authority or certificate of public convenience and necessity shall discontinue or abandon such service once initiated until and unless it shall demonstrate, and the Commission finds, after notice and hearing, that such discontinuance or abandonment will not deprive customers of any necessary or essential telecommunications service or access thereto and is not otherwise contrary to the public interest. No telecommunications carrier offering or providing competitive telecommunications service shall discontinue or abandon such service once initiated except upon 30 days notice to the Commission and affected customers. The Commission may, upon its own motion or upon complaint, investigate the proposed discontinuance or abandonment of a competitive telecommunications service and may, after notice and hearing, prohibit such proposed discontinuance or abandonment if the Commission finds that it would be contrary to the public interest.

E. Section 13-517 of the Act

Section 13-517 of the Act, provides, in relevant part, that:

(a) Every Incumbent Local Exchange Carrier (telecommunications carrier that offers or provides a noncompetitive telecommunications service) shall offer or provide advanced telecommunications services to not less than 80% of its customers by January 1, 2005.

(c) As used in this Section, "advanced telecommunications services" means services capable of supporting, in at least one direction, a speed in excess of 200 kilobits per second (kbps) to the network demarcation point at the subscriber's premises.

F. Section 13-900 of the Act

Section 13-900 of the Act provides, in relevant part, that:

(a) The General Assembly finds that it is necessary to require the certification of 9-1-1 system providers to ensure the safety of the lives and property of Illinoisans and Illinois businesses, and to otherwise protect and promote the public safety, health, and welfare of the citizens of this State and their property.

(b) For purposes of this Section

…

"9-1-1 system provider" means any person, corporation, limited liability company, partnership, sole proprietorship, or entity of any description whatever that acts as a system provider within the meaning of Section 2.18 of the Emergency Telephone System Act.

…

(c) Except as otherwise provided in this Section, beginning July 1, 2010, it is unlawful for any 9-1-1 system provider to offer or provide or seek to offer or provide to any emergency telephone system board or 9-1-1 system, or agent, representative, or designee thereof, any network and database service used or intended to be used by any emergency telephone system board or 9-1-1 system for the purpose of answering, transferring, or relaying requests for emergency services, or dispatching public safety agency personnel in response to requests for emergency services, unless the 9-1-1 system provider has applied for and received a Certificate of 9-1-1 System Provider Authority from the Commission. The Commission shall approve an application for a Certificate of 9-1-1 System Provider Authority upon a showing by the applicant, and a finding by the Commission, after notice and hearing, that the applicant possesses sufficient technical, financial, and managerial resources and abilities to provide network service and database services that it seeks authority to provide in its application for service authority, in a safe, continuous, and uninterrupted manner.

(d) No incumbent local exchange carrier that provides, as of the effective date of this amendatory Act of the 96th General Assembly, any 9-1-1 network and 9-1-1 database service used or intended to be used by any Emergency Telephone System Board or 9-1-1 system, shall be required to obtain a Certificate of 9-1-1 System Provider Authority under this Section. No entity that possesses, as of the effective date of this amendatory Act of the 96th General Assembly, a Certificate of Service Authority and provides 9-1-1 network and 9-1-1 database services to any incumbent local exchange carrier as of the effective date of this amendatory Act of the 96th General Assembly shall be required to obtain a Certificate of 9-1-1 System Provider Authority under this Section.

(e) Any and all enforcement authority granted to the Commission under this Section shall apply exclusively to 9-1-1 system providers granted a Certificate of Service Authority under this Section and shall not apply to incumbent local exchange carriers that are providing 9-1-1 service as of the effective date of this amendatory Act of the 96th General Assembly.

G. Eligible Telecommunications Carrier Status

As a new corporate entity, NewILEC will require a Commission determination under 47 U.S.C § 214(e), which authorizes the Commission to designate carriers as Eligible Telecommunications Carriers or "ETCs" if they offer all the services supported by federal universal support, advertise the availability of charges for such services using media of general distribution within their service areas, and make Lifeline services as defined by 47 C.F.R § 54.401 available to qualifying low-income consumers in their service area.

IV. COMPLIANCE WITH SECTION 7-204 OF THE ACT

A. Section 7-204(b)(1) of the Act provides that "the proposed reorganization will not diminish the utility's ability to provide adequate, reliable, efficient, safe and least cost public utility service."

1. Position of Joint Applicants

Joint Applicants asserted that the proposed Transaction meets the requirements of 7-204(b)(1) of the Act, that "the proposed reorganization will not diminish the utility's ability to provide adequate, reliable, efficient, safe and least cost public utility service." Nevertheless, in order to facilitate the Commission's consideration and approval of the Joint Application and allow the Joint Applicants to close on the proposed transaction as soon as reasonably possible, Joint Applicants reached agreement on a number of conditions with Staff, IPTA, AG/CUB, DoD/FEA and with Comcast and Level 3. The conditions proposed by Staff, AG/CUB, DoD/FEA are enumerated in the Conditions Appendix attached to this Order. IPTA's conditions are incorporated into IPTA's position statement and the ordering paragraphs. The conditions negotiated with Comcast and Level 3 are made effective through the settlement agreements entered into the record.

Joint Applicants testified that the proposed Transaction would ensure a seamless transition from Verizon to Frontier, with no degradation and no immediate change in service other than the change in name. For example, no change will occur with respect to Frontier's existing operating entities in Illinois, including any of the Frontier ILECs in Illinois or with respect to any entity holding a controlling interest in them, because the control of these companies will remain with Frontier as it is today. These companies will continue to operate as separate entities under their existing tariffs and Commission

regulatory requirements immediately following the Transaction. According to Joint Applicants, Frontier's existing customers will continue to receive the same services, service rates, and service terms and conditions.

Similarly, Joint Applicants stated, the Verizon employees who currently support Verizon's Illinois operations will continue to support those same ILEC operations under Frontier. In each case, Verizon North through the same corporate entity and Verizon South through a new corporate entity will have the same assets and personnel to ensure that the proposed reorganization will not diminish the utility's ability to provide adequate, reliable, efficient, safe and least cost public utility service. In addition, the Verizon properties will be operated on the local manager-based management structure.

Joint Applicants explained that Verizon's existing systems are currently used to support customers in Illinois. These systems support retail ordering and billing, wholesale ordering and billing, network monitoring and maintenance, and all customer support functions. Prior to closing, Verizon will replicate and physically separate these systems from the systems it will continue to use for its own operations after the close. These separate centralized systems that will be dedicated to the operations being acquired by Frontier will be operated on a stand-alone basis for at least 60 days prior to closing. Frontier will coordinate and be in continuous dialog with Verizon as Verizon undertakes the process of replicating its existing systems and establishing standalone versions.

After closing, the customer records and information for customers located in Illinois will be maintained on Frontier's systems that Verizon has replicated, which will be maintained independently from the systems Verizon retains and utilizes to provide service in other states. Therefore, the Verizon customers will not be served on a new system (which was the case for Hawaiian Telcom and for the Verizon FairPoint Communications, Inc. "FairPoint" transaction in New England), because after closing Frontier will be using replicated versions of the same systems in place and used prior to closing in Illinois and will have the advantage of employees experienced with those systems who will continue with the business.

FairPoint experienced operational problems after it moved retail and wholesale customers to new customer care and billing systems that FairPoint had designed and built to completely replace Verizon's systems and to run the business it acquired. Similarly, Hawaiian Telcom encountered problems as a result of creating and cutting over data to new systems. Thus, in both the Hawaiian Telcom and FairPoint transactions, the buyers chose to develop operational, business or customer support and financial systems from scratch and then cutover to those new systems to operate the acquired businesses.

By contrast, Frontier will not be developing any new systems and will not be cutting over from Verizon's existing systems. Instead, Frontier will use the same operational systems used by Verizon prior to closing to provide service. Even if Frontier decides to transition to its own existing systems several years from now, it would be moving data to a currently functioning operations support system ("OSS"), which can

accommodate and be used to serve the Verizon customers. The $94 million maintenance fee that Verizon and Frontier have negotiated may be reduced over time if Frontier chooses to perform the maintenance in-house, if it transitions to its own existing systems, or if it finds an alternate vendor for those maintenance services. In other words, Frontier's experience and the structure of this Transaction will avoid the problems those buyers experienced.

Frontier also argued that it is a very different company than FairPoint in New England or Hawaiian Telcom in Hawaii. Frontier is a successful business with a strong management team that provides service to over two million access lines and a strong financial position. Frontier has substantial experience successfully acquiring and integrating telephone operations, including 750,000 access lines from GTE and 1.1 million access lines from Global Crossing, an acquisition that almost doubled Frontier's size and that included a large number of lines in Illinois.

Joint Applicants disputed the assertions of IBEW witness Susan Baldwin that Verizon's service quality in the VSTO areas has been diminishing, stating that she has inappropriately attempted to apply the Federal Communications Commission's ("FCC"), Automated Reporting Management Information System ("ARMIS"), data on state-by-state basis. Joint Applicants also disputed Ms. Baldwin's quality comparisons between Frontier and Verizon, explaining that FCC ARMIS data is not gathered consistently between different companies, resulting in an apples-to-oranges comparison and explaining that ARMIS data is only a starting point. In response to Ms. Baldwin and other intervenors' assertions about Frontier's quality of service, Joint Applicants pointed out that Staff witness Samuel S. McClerren concluded that both Verizon and Frontier have a history in Illinois of successfully meeting the Commission's service quality standards.

Joint Applicants similarly refuted IBEW's attempt to leverage the transactional risks listed in the Security Exchange Commission's ("SEC") Form S-4 into a parade of horribles about what is likely to occur in the Transaction. Rather, Joint Applicants stated, it is a list of potential risks to any merger transaction, and the Form S-4 is not intended to assign any probability to those risks.

The Joint Applicants stated that any residual question regarding this criterion is addressed by Staff Conditions 1 and 2 which were proposed by Staff witnesses Mr. McClerren and Ms. Rochelle Phipps. Condition 1 requires Frontier to meet or exceed Verizon's current average service metrics or have the dividends related to those services restricted until service meets the specified metrics. Condition 2 requires Frontier to keep no less than $50 million available for the capital expenditures by the New Frontier Illinois ILECs. Both of these conditions will remain in effect for five years or until Frontier achieves investment grade credit ratings with at least two of the reporting services, whichever occurs first, but will be re-implemented whenever Frontier's credit rating falls below its current level. Staff Reporting Requirement 2 will allow the Commission to monitor changes in Frontier's credit ratings.

Similarly, Staff witness Mr. McClerren proposed Condition 3, which will require Frontier to coordinate closely with Staff, particularly with the Chief Engineer of the Telecommunications Division, to ensure that the Commission is aware of any future cutover of systems from the replicated Verizon systems to a Frontier system. They will provide plans and obtain the prior written approval of the Chief Engineer.

Staff's proposed conditions are supported by AG/CUB Conditions 1-5. Particularly, AG/CUB Condition 5 will help the Commission monitor Frontier's provision of responsive customer service in its business offices. AG/CUB Conditions 15-21 will provide further stability to retail customer service for the New Frontier Illinois ILECs by assuring that Staff, as well as the AG and CUB, are kept apprised of OSS changes within Frontier that could have customer impacts.

Joint Applicants contended that with or without the imposition of those conditions, this reorganization meets the requirements of Section 7-204(b)(1) of the Act.

2. Position of Staff

Staff opined that the Transaction with conditions satisfies the requirements of Section 7-204(b)(1) of the Act.

Mr. McClerren offered Staff's analysis and evaluation of the financial implications of the proposed reorganization on the New Frontier ILECs under Section 7-204(b)(1) of the Act. Mr. McClerren recommended that the Commission place two conditions on approval of the proposed reorganization to assure that it will not diminish the New Frontier ILEC's ability to provide adequate, reliable, efficient, safe and least cost service. One condition addressed service quality, and the other addressed the OSS.

Staff pointed out that both Frontier and Verizon currently have service territories in Illinois, so Mr. McClerren has substantial knowledge regarding certain aspects of the Illinois operations of both companies. Mr. McClerren noted that both of these companies are generally able to provide telecommunications services, and have done so in Illinois for many years. He further observed that the companies generally achieve reasonable levels of service quality, and both companies have a history of successfully meeting the requirements in 83 Ill. Adm. Code 730 ("Part 730").

Of particular interest to Staff, and in Mr. McClerren's estimation a basis for approval of the proposed Transaction, was the fact that Frontier appears to focus its business upon serving in smaller, primarily rural markets. On the other hand, Verizon's corporate focus, based upon the testimony of Verizon witness Carl E. Erhart, was on its wireless business and "high density urban and suburban areas."

Mr. McClerren observed, the properties that are subject to this reorganization are primarily rural. In Mr. McClerren's opinion, if a company wishes to focus on its operations in high-density urban and suburban areas, it is less likely to expend either effort or capital to properly support its rural operation, resulting in less than optimal investment, service and growth in the rural operation. Mr. McClerren also considered

the converse to be true; if a company's management considers the rural operation to be both important to the company's long term business plan and potentially lucrative, it will likely expend both effort and capital to properly support that area. In short, Mr. McClerren considered Frontier's acquisition of the Illinois telephone properties that are subject to this reorganization to be consistent with its long-term plan, and with the interests of the customers in those areas.

However, Mr. McClerren expressed reservations regarding the proposed Transaction. Mr. McClerren's reservations were as follows:

1. Both Frontier and Verizon have, in recent years, had difficulty satisfying all Part 730 service quality standards, including, in the case of Verizon, Business Office Answer Time, Service Installations, and Out of Service < 24 Hours, and in the case of Frontier, Repair Office Answer Time, Business Office Answer Time and Out of Service < 24 Hours;

2. Companies which recently purchased ILEC properties from Verizon, including Hawaii Telecom, FairPoint and Idearc, have experienced significant problems, both financially and with their service quality;

3. Additionally, in their direct testimony, Joint Applicants, rather than describing in any detail the manner in which the transition of operations support systems functions from Verizon to Frontier will be conducted, merely indicated that any integration would not take place for at least 12 months after the merger is complete. This lack of detail was troubling; since customers of ILEC properties in both New England and Hawaii have recently experienced severe service quality deterioration after other entities acquired those properties from Verizon;

4. Mr. McClerren considered Frontier's due diligence in review of this reorganization to be lacking.

Accordingly, with respect to Section 7-204(b)(1) of the Act, Mr. McClerren opined that the reorganization, as proposed, would diminish the utility's ability to provide adequate, reliable, efficient, safe and least-cost public utility service, and for that reason he was compelled to recommend that the Commission not approve it as proposed.

Mr. McClerren formulated two conditions which would, were the Joint Applicants to accept and the Commission to impose, cause him to no longer recommend rejection of the proposed Transaction pursuant to Section 7-204(b)(1) of the Act. One of these conditions addresses service quality, and the other addresses the operations support systems.

Regarding service quality, Mr. McClerren observed that the Commission has in approving recent Section 7-204 of the Act reorganizations of incumbent local exchange telecommunications carriers, ordered that service quality in the acquired territories will not diminish relative to current levels, which is typically above the minimum levels of service quality required by Part 730. To derive current levels for this purpose, the most

recent 12-month performance has been averaged and used as a service quality "floor." If the service quality in the acquired territory diminishes relative to its pre-merger levels, stated Mr. McClerren, monetary transfer payments from the Illinois properties or operating subsidiaries to the corporate parent will be halted. In effect, if service quality diminishes relative to pre-merger levels, additional resources are to be invested in Illinois telecommunications facilities until the service quality degradation is resolved. Accordingly, with that concept in mind and in conjunction with Staff witness Ms. Phipps, Mr. McClerren recommended the Commission condition its approval of the reorganization on Staff Conditions 1 and 2.

While the Joint Applicants disputed Mr. McClerren's analysis and recommendation, Frontier nonetheless stated that it was willing to accede to the imposition of the conditions proposed by Mr. McClerren. During cross examination, Mr. Daniel McCarthy presented Frontier Corrected Exhibit 8.4.A, which contained all of the conditions Staff recommended, with minor modifications to address Frontier's stated implementation concerns. Mr. McClerren indicated that with the changes contained in Frontier Corrected Exhibit 8.4.A and all of which are restated above, Staff would not object to the approval of the proposed Transaction relative to Section 7-204(b)(1) of the Act.

3. Position of IBEW

IBEW raised concerns about Frontier's ability to meet the requirement of Section 7-204(b)(1) of the Act. IBEW contended that Frontier's lack of financial fitness would jeopardize the company's ability to provide safe, reliable, efficient, least-cost service to its customers. According to IBEW, the Transaction that was presented to the Commission is not in the public interest. The risks and uncertainties are enormous. Whatever benefits may exist from Frontier's promises or intentions to increase broadband penetration are meaningless if Frontier cannot afford to spend the money or if Frontier does not have enough people to do the work.

4. Commission Analysis and Conclusion

The parties agree that this Transaction is subject to Section 7-204 of the Act. As such, we are required to (a) find that the Transaction satisfies each and every one of the Section 7-204(b) standards, and (b) rule on the allocation of savings. Further, we may, in our discretion, impose such conditions upon the Transaction as are, in our view, necessary to protect the company and its customers. The Commission finds the evidence presented by Joint Applicants along with the Staff conditions outlined below satisfy our requirements pursuant to the Act.

The Joint Applicants argued that the replication process of the operation support systems will not diminish service quality nor will it adversely impact Frontier's ability to provide adequate, reliable, efficient, safe and least-cost utility service. The Staff contended that imposing conditions and reporting requirements will ensure that reliable, efficient, safe and least-cost utility service will not be diminished to Illinois customers.

The Commissions inquiry with respect to Section 7-204 must be limited to the Illinois regulated entities – Verizon North and Verizon South. Under the proposed Transaction, it is clear to the Commission that while Frontier will exercise day-to-day operations, the ILECs will continue to be operated by the same management. In addition, the same employees will operate the new corporate entity responsible for the Verizon South exchange.

According to Staff witness Mr. McClerren, both Frontier Illinois operating ILECs and Verizon have, in recent years, had some difficulty meeting the minimum key standards contained in Part 730. Specifically, Staff was concerned with the companies meeting the key Part 730 standards: Toll & Assistance Operator Answer Time, Directory Assistance Operator Answer Time, Repair Office Answer Time, Business Office Answer Time, Service Installations, Out of Service < 24 Hours, and Trouble Reports.

Frontier's total Illinois access lines will be increasing from 97,000 to over 670,000. As such, Mr. McClerren recommended the Commission impose conditions addressing service quality, and operation support systems. The Commission is of the opinion the proposed conditions will assure that Frontier will be able to meet or exceed the minimum key standards of Part 730. The evidence shows there is a significant risk that problems could occur if the conditions are not applied or the transition is made too prematurely so as to create a potential for harm to Illinois customers.

The financial pressure along with more wirelines to handle leads the Commission to conclude that the Conditions are absolutely necessary to assure that service quality will not be diminished.

Joint Applicants contended that the replication process of the operation support systems will be seamless prior to closing. The petitions indicated there would be no adverse effect on services, and that customers would benefit because of Frontier's experience and success in dealing with rural and small urban areas.

We recognize the basis for our Staff's initial misgivings regarding this Transaction. Frontier concedes, as it must, that its financial metrics are not as strong as those of Verizon, from which it is acquiring the properties that are the subject of this Transaction. Further, and of greater (if perhaps more peripheral) concern to the Commission is the experience of former Verizon companies in other jurisdictions which, based upon this record, have resulted in both financial and service degradation experience by the successor companies and their customers. While we find that the Transaction satisfies Section 7-204(b)(1) and (see infra) Section (b)(4), we also find that Staff Conditions 1 and 2 set forth in the attached Conditions Appendix, with Staff's associated reporting requirements – to which the company agrees - are conditions precedent to such approval. The Commission finds Staff conditions require service quality performance at levels more stringent than Part 730 standards. It is vital to the Illinois ILECs that sufficient funds remain available to support service and make capital improvements in Illinois. However, in order to fully ensure that Staff Conditions 1 and 2 have their intended effect, the Commission will modify them as follows:

(1) Staff Condition 1 prohibits transferring Illinois jurisdictional cash from the New Frontier ILECS to Frontier Communications Corporation if a majority of seven specified service standards are not met. That should be a supermajority of 5 out of 7 standards.

(2) Staff Condition 1 requires the measurement of the service standards to recur on an annual basis. This is too long a time period and should be on a semi-annual basis so that any failure to meet the service standards can be more immediately addressed and any transfer of funds halted.

(3) Staff Condition 2 requires the New Frontier ILECS to have at least $50 million available for Illinois operations. As proposed certification of that amount is on an annual basis. However, due to the concerns raised in this proceeding regarding the financial strength of the company, certification should also be done on a semi-annual basis.

We also think that AG/CUB Conditions 1-5 will benefit Staff and the Commission in monitoring Frontier's compliance with Staff Conditions. We are of the opinion that the proposed conditions set forth in the Conditions Appendix, which prevents Frontier ILECs from transferring funds from Illinois operations to its corporate parent if service quality falls below a certain level, are necessary and appropriate to accomplish this end, and the Commission hereby adopts them.

We also note that the question of integrating OSS and billing systems is a significant one. This Commission has ample experience in dealing with the implementation of OSS systems, and knows from such experience that reliable OSS systems and billing systems are vital components of both retail and wholesale service quality. Moreover, the Joint Applicants indicate that the decision to not immediately transition from the existing Verizon systems to Frontier systems constitutes a significant distinction between this transaction and the ill-fated FairPoint transaction. We are inclined to agree that the Joint Applicants have learned valuable lessons from that transaction and have carefully charted their plans for activities in Illinois accordingly.

Nonetheless, in light of the vital nature of billing and OSS systems, we consider proposed Staff Condition 3 set forth above should be imposed in finding that the Transaction satisfies the requirements of Section 7-204(b)(1). We also believe that AG/CUB Conditions 15-18 will assist Staff and the Commission in ensuring that any system transition will be conducted without undue impact on Illinois customers.

B. Section 7-204(b)(2) of the Act provides that "the proposed reorganization will not result in the unjustified subsidization of non-utility activities by the utility or its customers," and

Section 7-204(b)(3) of the Act provides that "costs and facilities are fairly and reasonably allocated between utility and non-utility

activities in such a manner that the Commission may identify those costs and facilities which are properly included by the utility for ratemaking purposes."

1. Position of Joint Applicants

Joint Applicants asserted that the proposed reorganization complies with Section 7-204(b)(2) and (b)(3) of the Act. Section 7-204(b)(2) requires the Commission to find that "the proposed reorganization will not result in the unjustified subsidization of non-utility activities by the utility or its customers," and Section 7-204(b)(3) requires a finding that "costs and facilities are fairly and reasonably allocated between utility and non-utility activities in such a manner that the Commission may identify those costs and facilities which are properly included by the utility for ratemaking purposes."

Joint Applicants contended that the proposed reorganization will not result in the unjustified subsidization of non-utility activities by Frontier or its customers in its current exchanges or in any of the Verizon exchanges.

Joint Applicants testified that, operationally, the reorganization will not trigger any changes in the way costs are allocated. Specifically, the Verizon North exchanges will continue to be operated through the same corporate entity and the Verizon South exchanges will be operated by a new, but virtually identical corporate entity. Therefore, the reorganization will not create any opportunities for unjustified subsidization of non-utility activities by the utility or its customers. In addition, there will be no basis in the reorganization to change how costs and facilities are allocated between utility and non-utility activities.

In addition, nothing about the proposed Transaction will change the ability of Frontier to comply with the Commission's rules and regulations regarding cost allocations and subsidization. Frontier will continue to comply with the Commission's cost allocation methods. Likewise, the management employees of Verizon who are currently responsible for complying with those provisions have expertise in complying with these rules. Frontier expects that the Verizon employees who move over to Frontier as part of this Transaction will, along with Frontier managers, continue to apply their expertise to insuring that their respective operating ILEC companies will comply with the rules and regulations of the Commission. Nothing about this merger will change that.

Staff witness Mike Ostrander proposed and Frontier agreed to Condition 4, which requires Frontier to comply with certain requirements allowing staff access to Frontier's books and to undertake and share with Staff an internal audit to ensure compliance with the subsidization rules. Therefore, the proposed reorganization will not impact the ability of Frontier to fairly and reasonably allocate its costs and facilities between utility and non-utility activities in such a manner that those costs and facilities are appropriately included by Frontier in setting rates for non-competitive telecommunications services. According to the Joint Applicants, this proposed reorganization meets the criteria of Sections 7-204(b)(2) and (b)(3) of the Act.

2. Position of Staff

Mr. Ostrander conducted an analysis of this issue for Staff, determining that the proposed reorganization does not impact the opportunity for the subsidization of non-utility activities of Frontier by utility operations. Mr. Ostrander stated that no change that will occur that affects the opportunity for Frontier to subsidize non-utility activities by the utility operations. Mr. Ostrander observed that, in his direct testimony, Frontier witness Mr. McCarthy testified that the proposed reorganization will not result in the unjustified subsidization of non-utility activities by Frontier or its customers in its current exchanges or in any of the Verizon exchanges.

Mr. Ostrander observed that Frontier is subject to the cost allocation requirements of 83 Ill. Adm. Code 711 ("Part 711"), its cost allocation manual, and FCC cost allocation rules, and that the proposed Transaction will not change the existing cost allocation procedures or accounting methods, as Mr. McCarthy testified. In addition, Frontier agreed to Staff Condition 4, as further evidence of compliance with Section 7-204(b)(2) of the Act.

Frontier did not object to the third condition but, initially proposed that the condition remain in effect for three years after closing of the proposed Transaction. In reply testimony, Mr. Ostrander stated that there is no “clear end date” for Illinois public utilities to be compliant with Sections 7-204(b)(2) and 7-204(b)(3) of the Act. Frontier is not relieved of the obligation to avoid cross-subsidizing its competitive activities with its competitive activities by the passage of time after hypothetical Commission approval of the Transaction, nor is it relieved of the obligation to reasonably allocate the costs of its facilities between utility and non-utility activities in that manner. Mr. Ostrander observed that both of these requirements are embodied in Commission rules that apply independent of approval of the Transaction. In Surrebuttal Testimony, Mr. McCarthy stated that Frontier did not object to filing an annual internal audit report to assure the Commission that Frontier is continuing to properly apply cost allocation principles. However, Frontier did note that should the annual reporting condition become an ongoing and unnecessary burden Frontier may seek to have the annual reporting condition revised.

Mr. Ostrander concurred with Mr. McCarthy that the proposed reorganization does not impact the ability of Frontier to fairly and reasonably allocate costs and facilities between utility and non-utility activities in such a manner that the Commission may identify those costs and facilities which are properly included by the utility for ratemaking purposes. Both agreed that no change will occur that affects the method used by Frontier to reasonably allocate costs between utility and non-utility activities. In direct testimony, Mr. McCarthy testified that the proposed reorganization will not impact the ability of Frontier to fairly allocate its costs and facilities between utility and non-utility activities.

Mr. Ostrander offered that the Commission can be assured that Frontier will reasonably allocate its costs and facilities because Frontier is subject to the cost allocation requirements of Part 711, its cost allocation manual, and FCC cost allocation

rules. Mr. Ostrander stated that the proposed Transaction will not change the existing cost allocation procedures or accounting methods, as testified to by Mr. McCarthy. In addition, Frontier agreed to Staff Condition 4, which serves as further evidence of compliance with Section 7-204(b)(3) of the Act.

3. Commission Analysis and Conclusion

The evidence presented by Joint Applicants and Staff support our findings under Sections 7-204(b)(2) and (b)(3) of the Act. The Commission finds that no change will occur that affects the opportunity for Frontier to subsidize non-utility activities by the utility operations and that the proposed reorganization will not result in the unjustified subsidization of non-utility activities by Frontier or its customers in its current exchanges or in any of the Verizon exchanges. The Commission further finds that the proposed reorganization does not impact the ability of Frontier to fairly and reasonably allocate costs and facilities between utility and non-utility activities in such a manner that the Commission may identify those costs and facilities which are properly included by the utility for ratemaking purposes.

Moreover, insofar as the financial health of Frontier is in any way in question, we believe the financial information to which Staff seeks access, the compliance it seeks, and the associated audit requirements, are vital tools in ensuring that this Transaction does not adversely affect Illinois. Accordingly, while we find that the Transaction satisfies Sections 7-204(b)(2) and (b)(3), we also conclude that Staff Condition 4 set forth in the Conditions Appendix, and agreed to by the company, is a condition precedent to such approval.

C. Section 7-204(b)(4) of the Act provides that "the proposed reorganization will not significantly impair the utility's ability to raise necessary capital on reasonable terms or to maintain a reasonable capital structure."

1. Position of Joint Applicants

Section 7-204(b)(4) of the Act states that in approving a proposed reorganization, the Commission must find that "the proposed reorganization will not significantly impair the utility's ability to raise necessary capital on reasonable terms or to maintain a reasonable capital structure." Frontier testified that it has a strong income statement and balance sheet and is financially capable of operating the acquired properties. Joint Applicants stated that the Transaction will bring about no change in the capital structure of Verizon North or Verizon South, and will not alter the economics of the utilities' regulated operations. Joint Applicants testified that the utilities generate sufficient cash flows to fund their operations, and that they will not require issuance of debt. Accordingly, the utilities internally generate sufficient cash to fund the expenditures necessary to meet service quality standards. Joint Applicants asserted that the Transaction will not change that fact and will not create any need to raise capital. Accordingly, the Joint Applicants argued that the requirements of Section 7-204(b)(4) of the Act are met.

Frontier testified that as a parent it has a strong income statement and balance sheet and is financially capable of operating the acquired properties. Frontier explained that it will continue to be financially strong following the closing of the proposed Transaction. In fact, Joint Applicants argued that its financial position will be improved. By deleveraging its balance sheet and by decreasing both its per-share dividend payout and dividend payout ratio, Frontier will emerge from the Transaction as a stronger, more stable competitor with a financial structure and level of cash flow that will enable it to make investments in the acquired service territories, including in broadband, and to provide even more efficient service in these areas.

Frontier testified that the combined company will be financially stronger than a standalone Frontier in several critical respects. For example, on a pro forma basis for 2008, the combined company would have had free cash flow of over $1.4 billion, as compared to approximately $500 million for Frontier on a stand alone basis. Free cash flow is defined as after-tax cash from operations less cash for capital investments. The Transaction will result in significant free cash flow accretion in the second full year of operation.

Frontier has also revised its dividend policy. At the discretion of its Board of Directors, Frontier currently pays an annual cash dividend of $1.00 per share of Frontier common stock. After the closing of the proposed Transaction, Frontier intends to change its dividend policy to pay an annual cash dividend of $0.75 per share of Frontier common stock, reducing its dividend by 25% – from $1.00 to $0.75 per share – effective with the close of the Transaction. This will result in the ratio of Frontier's dividend payout of its free cash flow decreasing from almost 65% on a standalone basis to approximately 43% on a pro forma basis for 2008. Frontier believes that this dividend policy, and associated reduced dividend payout ratio, affords the combined company the financial flexibility to use the additional free cash flow to invest in the newly acquired Verizon territory, offer new products and services, and increase broadband capability in its markets over the next few years.

According to the Joint Applicants, as a result of the acquisition of Verizon, Frontier's leverage ratio (net debt divided by earnings before interest, taxes, depreciation and amortization, or "EBITDA") is projected to decrease from 3.8 times to 2.6 times, which is substantially better than the leverage ratios of Frontier's peer group. Frontier expects to achieve a credit rating approaching investment grade, which will provide Frontier with improved access to the capital markets, thereby increasing Frontier's flexibility to further manage its balance sheet and/or invest in new products for its customers – although Joint Applicants also made clear that there will be no need to raise any capital for the operations of the VSTO ILECs.

Based on its financial analysis, Frontier projected that following the Transaction Frontier will be able to generate significant free cash flow, and will be able to attract additional capital, if necessary, to provide high quality service and effectively expand broadband deployment that it has planned. Frontier testified that, as a result, Frontier

will have the financial flexibility and resources to make the needed investments in the network and to expand broadband deployment over time.

Through data request responses, entered into the record by Staff, Joint Applicants also demonstrated that the VSTO exchanges generate positive cash flows. Based on Conditions 1 and 2 proposed by Staff witnesses Mr. McClerren and Ms. Phipps, those cash flows will be insulated if there is a reduction of service quality.

Thus, with the inclusion of these conditions, Joint Applicants argued this proposed reorganization meets the criteria of Section 7-204(b)(4) of the Act.

2. Position of Staff

Ms. Phipps offered Staff's analysis and evaluation of the financial implications of the proposed reorganization on Frontier North, Inc. and Frontier Communications of the Carolinas, Inc., respectively the "New Frontier ILECs" under Section 7-204(b)(4) of the Act.

Ms. Phipps recommended that the Commission place two conditions on approval of the proposed reorganization to assure that it will not significantly impair the New Frontier ILECs ability to raise necessary capital on reasonable terms or to maintain a reasonable capital structure for three reasons.

First, Ms. Phipps observed, Frontier is the only source of external capital for the New Frontier ILECs. Therefore, the New Frontier ILECs' ability to raise external capital on reasonable terms depends on Frontier's ability to raise external capital on reasonable terms.

Second, Ms. Phipps noted that Frontier's ability to raise necessary capital on reasonable terms is questionable for the reasons explained hereafter.

Third, in Ms. Phipps' judgment, Frontier's ability to raise necessary capital on reasonable terms is not a required factor for meeting the criteria specified in Section 7-204(b) of the Act because the New Frontier Illinois ILECs generate sufficient cash internally to fund the expenditures necessary to meet service standards. Thus, if the New Frontier Illinois ILECs retain a portion of the cash they generate sufficient for maintaining adequate service, an external source of capital is unnecessary because the New Frontier Illinois ILECs will have "the ability to raise necessary capital" (through the retention of internally generated cash) within the meaning of Section 7-204(b)(4) of the Act. Finally, given that the New Frontier Illinois ILECs are expected to generate internally sufficient cash flow to meet service standards, Ms. Phipps recommended Staff Conditions 1 and 2, to ensure that maintenance of service quality has a higher claim to the New Frontier Illinois ILECs' internally generated cash flow than the financial needs of their affiliates.

Ms. Phipps noted that, pursuant to a Distribution Agreement, Verizon will transfer certain of its ILECs to NCH. NCH, which is referred to as "Spinco" in the Distribution and Merger Agreements, is a newly created subsidiary of Verizon, formed solely for the

proposed reorganization. With respect to the Illinois Verizon properties, Verizon will transfer Verizon South's local exchange operations to New ILEC, a direct subsidiary of NCIH, and an indirect subsidiary of NCH. Verizon will also transfer Verizon North to NCIH. Verizon will distribute NCH stock to Verizon shareholders in exchange for a $3.333 billion payment comprising cash and debt relief.

Ms. Phipps further noted that, immediately following the spin-off of NCH stock to Verizon shareholders, NCH will merge into Frontier, and Verizon shareholders will receive newly issued shares of Frontier valued at approximately $5.247 billion. Pursuant to a Merger Agreement, Frontier will acquire NCH, including Verizon North and NewILEC, and continue to operate those properties as two separate Illinois local exchange companies named Frontier North, Inc. and Frontier Communications of the Carolinas, Inc., respectively (the "New Frontier ILECs").

Ms. Phipps further observed that NCH will issue debt and use the proceeds to pay Verizon an amount that equals the lesser of (x) $3.33 billion and (y) Verizon's estimate of its tax basis in NCH minus the outstanding long-term debt of NCH and its subsidiaries on the distribution date ("Distribution Date Spinco Indebtedness"). This payment from NCH to Verizon is the "Special Payment," and the related debt issued by NCH (which will become Frontier's debt obligation following the merger) is the "Special Payment Financing." If the Special Payment is less than $3.333 billion, then NCH will issue "Spinco Securities" to Verizon, in an amount equal to such difference.

Ms. Phipps observed that Frontier is not obligated to accept the Special Payment Financing nor, if applicable, the Spinco Securities under any of the following circumstances:

- Either the weighted-average life of the financing and the securities, together with Distribution Date Spinco Indebtedness, is less than five years, or any of the Special Payment financing or the Spinco Securities would have a final maturity of earlier than January 1, 2014 (other than bridge financing up to $600 million);

- The financing or the securities or the Distribution Date Spinco Indebtedness would be secured by assets of any operating company;

- The terms or provisions of such financing or securities or Distribution Date Spinco Indebtedness would be prohibited by or result in a default under Frontier's existing credit agreements or indentures;

- The proposed covenants and other terms and conditions (excluding the terms of Spinco Securities set forth in Exhibit G of the Distribution Agreement and the rate, yield or tenor thereof) are not substantially in accordance with prevailing market terms for similarly sized loan bank borrowings or capital issuances by companies similar in size and credit ratings to Frontier and the effect of such covenants and provisions would be materially adverse to post-merger Frontier; or

- The weighted-average annual cash interest rate of the Special Payment Financing, the Spinco Securities and the Distribution Date Spinco Indebtedness exceeds 9.5% (unless Frontier determines a higher rate would not be unduly burdensome).

Ms. Phipps observed that, during cross-examination, Frontier witness Mr. McCarthy testified that Frontier has not secured a financing commitment, but based on "robust interest" expects to obtain 50%-100% of the special payment financing during the first quarter of 2010, which Frontier would hold in an escrow account until the closing of the Transaction, and also testified that the interest rate that would be available to Frontier is approximately 8%.

Ms. Phipps testified that since the Joint Applicants are seeking Commission approval of the proposed reorganization, they should be required to notify the Commission of the exact terms of the Special Payment Financing and Spinco Securities that the Joint Applicants issue in connection with the proposed reorganization. Therefore, Ms. Phipps recommended the Commission adopt the Staff Reporting Requirement 1.

Ms. Phipps testified that the New Frontier Illinois ILECs currently generate more cash than they require for capital expenditures. In the event the New Frontier Illinois ILECs need additional funds to support capital expenditures, Frontier would provide capital to the operating companies through either inter-company loans or capital infusions. Ms. Phipps understood Frontier to assert that it will access capital markets utilizing the issuance of public bonds and bank term loans. As shown on the table below, Verizon's credit ratings are five to six notches higher than Frontier's ratings. As such, Ms. Phipps was of the opinion it will be more challenging for Frontier to raise capital for the New Frontier ILECs than it would be for Verizon. Ms Phipps offered the following table to demonstrate this.

Issuer Ratings and Senior Unsecured Debt Ratings of Verizon, Verizon North and Frontier

	Moody's Investors Service	Standard & Poor's	Fitch Ratings
Verizon	A3 / Negative	A / Negative	A / Stable
Verizon North	A3 / RPD*	A / Negative	A / Negative
Frontier	Ba2 / RPU*	BB / Stable	BB/ Positive

* "RPD" means Review for Possible Downgrade and "RPU" means Review for Possible Upgrade.

Ms. Phipps described her concerns regarding Frontier's financial strength as it pertains to the New Frontier ILECs' ability to provide reasonable and adequate service at reasonable cost. Foremost, Ms. Phipps observed that Frontier has an issuer rating of "Ba2" from Moody's Investors Service ("Moody's"), "BB" from Standard & Poor's ("S&P") and Fitch Ratings. Frontier's current issuer credit ratings are two rating notches below the minimum investment grade credit rating of Baa3/BBB-/BBB-. Ms. Phipps noted that,

according to Moody's: "[o]bligations rated Ba are judged to have speculative elements and are subject to substantial credit risk." Similarly, Ms. Phipps observed that S&P states:

> An obligation rated BB is less vulnerable to nonpayment than other speculative issuers. However, it faces major ongoing uncertainties or exposure to adverse business, financial or economic conditions which could lead to the obligor's inadequate capacity to meet its financial commitment on the obligation.

Ms. Phipps understood Frontier to argue that, "two credit rating agencies (Moody's and Fitch) put Frontier on a positive credit watch the day the proposed Transaction was announced, thereby suggesting Frontier's credit rating may improve following the closing of the Transaction, based upon the projected capital structure." However, Ms. Phipps directed the Commission's attention to a statement by Fitch Ratings that an upgrade may be limited to one notch "due to the ever-present integration risks in large telecom transactions and lower near-term financial flexibility as the company incurs integration costs, invests to expand broadband availability and only begins to realize synergies." Frontier attaining investment grade ratings following the proposed reorganization is questionable. Therefore, in Ms. Phipps' opinion, even after the proposed reorganization, Frontier's financial condition might not be sufficiently strong to eliminate concerns about its capacity to meet its debt servicing obligations during adverse conditions without transferring cash from New Frontier ILECs that is necessary for maintaining the New Frontier ILECs' service quality.

Moreover, Ms. Phipps pointed out that Frontier's management of the integration of the New Frontier ILECs is an important factor in Moody's and S&P's assessments of Frontier's creditworthiness. Ms. Phipps further directed the Commission's attention to statements by Moody's and S&P that Frontier's ability to manage its post-merger capital structure and operations successfully will be key drivers of Frontier's post-merger credit rating. Specifically, Ms. Phipps observed, Moody's notes:

> Moody's review of Frontier's ratings is focused on the final capital structure of the combined entity following the merger, the substantial challenges Frontier faces in integrating a company more than twice its size, the regulatory framework and conditions placed on the merger, and most importantly, progress in the operating systems transition. Moody's will also assess management's commitment and ability to maintain an investment grade credit profile for the combined company in light of the intense competitive challenges confronting the sector and the resulting pressures to achieve the targeted cost savings . . . . Frontier's current Ba2 [rating] reflects the Company's relatively high debt levels for a wireline telecommunications company and the continuing downward pressure on its revenue and cash flow.

Similarly, S&P states:

> Standard & Poor's expects the integration of the Verizon properties will be challenging given the size of the transaction . . . we are concerned that execution missteps or deteriorating operating trends could result in higher leverage in the intermediate term . . . . Potential operating synergies are meaningful at about $500 million . . . but achieving this will require solid execution during the integration and may be impeded by higher access-line losses or a more competitive industry environment.

Given the ratings agencies' concerns regarding Frontier's ability to manage this reorganization successfully, Ms. Phipps recommended that the Commission adopt the Staff Reporting Requirement 2.

Ms. Phipps testified that potential consequences of speculative credit ratings include increasing debt costs and the inability to rollover or refinance existing indebtedness. Ms. Phipps observed that the inability to borrow funds externally reduces cash flows and available liquidity, which could cause credit ratings to spiral downward and possibly cause a company to default on one or more obligations.

To illustrate this, Ms. Phipps pointed to the example of FairPoint, which acquired certain Verizon assets and operations on March 31, 2008, in a transaction very similar to the one proposed by Joint Applicants. Ms. Phipps viewed this transaction as an example of the potential consequences of the nexus of merger integration and speculative credit ratings. Ms. Phipps noted, in seeking Commission approval of the transaction in Docket No. 07-0191, the petitioners stated that transaction would make FairPoint a financially stronger company with an improved capital structure. Moreover, Ms. Phipps observed, S&P expected the transaction to make FairPoint modestly stronger and, consequently, placed FairPoint's "BB-" rating on CreditWatch with positive implications.

Ms. Phipps pointed out that prior to the merger, FairPoint's credit ratings from Moody's, S&P and Fitch Ratings were B1/BB/BB-. In contrast, Ms. Phipps observed, slightly more than two years later, at the time she offered her direct testimony in this proceeding, FairPoint's credit ratings from Moody's, S&P and Fitch Ratings are Caa3/D/C, which signals FairPoint has defaulted or a default is imminent.

Ms. Phipps further heard Frontier to assert that:

> Not only will Frontier continue to be financially strong following the closing of the proposed Verizon transaction, its financial position will be improved. By deleveraging its balance sheet and by decreasing both its per-share dividend payout and dividend payout ratio, Frontier will emerge from this transaction as a stronger, more stable competitor with a financial structure and level of cash flow that will enable it to make investments in the acquired service territories, including in broadband, and to provide even more efficient service in these areas.

Ms. Phipps noted that Frontier prepared revenue, expense, earnings before EBITDA and cash flow projections for the post-merger company through 2014, which assume $500 million savings annually due to synergies, but did not perform any pro forma analysis assuming zero synergies. Ms. Phipps examined the sensitivity of Frontier's financial strength to synergies Frontier assumes will occur with respect to Verizon's Standalone Telephone Operations ("West Standalone").

Specifically, Ms. Phipps testified that she substituted actual 2008 operating expenses and capital expenditures for West Standalone in place of Frontier's projections for West Standalone; she did not adjust the pro forma projections for Standalone Frontier. Ms. Phipps further stated that she calculated the following pro forma financial metrics for the combined entity using Frontier's pro forma analysis and her adjusted pro forma analysis: (1) EBITDA margin; (2) Debt to EBITDA; (3) Free cash flows ("FCF") to debt; (4) Retained cash flows ("RCF") to debt; (5) Funds from operations interest coverage ("FFO Interest Coverage"); and (6) EBITDA less capital expenditures ("Capex") over interest expense. Then, Ms. Phipps noted, she compared Frontier's pro forma and the adjusted pro forma financial metrics to Moody's benchmarks for the global telecommunications industry. Ms. Phipps prepared the following table to illustrate Frontier's financial metrics:

A Comparison of Frontier's Pro Forma Financial Metrics

	Frontier Pro Forma		***Adjusted*** Pro Forma	
		Implied Financial Strength		Implied Financial Strength
EBITDA Margin	48%	Aa	40%	A/Baa
Debt to EBITDA	2.8X	Baa	3.4X	Ba
FCF to Debt	13%	Baa	8%	Ba
RCF to Debt	3%	Caa	-1%	Caa
FFO Interest Coverage	3.9X	Ba	3.5X	Ba
(EBITDA – Capex) / Interest Expense	3.1X	Ba	2.3X	Ba

Ms. Phipps noted that this comparison shows Frontier's pro forma analysis, which assumes synergies totaling $500 million annually, produced investment grade financial metrics for three of the six ratios. In contrast, Ms Phipps' adjustments, which removed identifiable projected synergies and assumed going forward capital expenditures will equal West Standalone's 2008 capital expenditures, produced investment grade financial metrics for only one of the six ratios. Ms. Phipps' analysis demonstrated that Frontier's post-merger financial strength depends on its ability to realize a significant portion of its projected synergies. Therefore, in Ms. Phipps' opinion, Condition 1 and Condition 2 are necessary to protect the public and Frontier.

Ms. Phipps explained that Staff Conditions 1 and 2 would ensure that the New Frontier Illinois ILECs retain sufficient funds to support Illinois operations. Ms. Phipps stated that, should the New Frontier Illinois ILECs fail to pass the service quality test

described in Staff Condition 1, those companies would be prohibited from paying dividends or otherwise transferring Illinois jurisdictional cash balances to Frontier or its affiliates through loans, advances, investments or other means that would divert its moneys, property or other resources to any purpose that is not essentially or directly connected with the provision of non-competitive telecommunication service. Frontier would continue to have access to any funds that the New Frontier Illinois ILECs generate in excess of the amount needed to meet the service quality standards.

Additionally, Staff Condition 2 would require Frontier to reserve funds, exclusively for the Illinois operations of the New Frontier ILECs, in an aggregate amount equal to the higher of $50 million or the currently approved capital expenditure budget of the New Frontier Illinois ILECs. With this condition in place, the proposed reorganization would not significantly impair the New Frontier ILECs' ability to raise *necessary* capital on reasonable terms.

Ms. Phipps noted that Verizon's average annual capital expenditures in Illinois for years 2006 through 2008 equals approximately $50 million. Ms. Phipps understood Frontier to anticipate spending more in capital expenditures on a nationwide basis than the historical amounts Verizon spent on the lines Frontier will acquire. On this basis, the historical amounts that Verizon spent would serve as a minimum threshold to avoid unnecessarily limiting Frontier's investment in the New Frontier Illinois ILECs.

The first part of Section 7-204(b)(4) of the Act requires the Commission to find that the proposed reorganization will not impair the utility's ability to raise necessary capital on reasonable terms. In Ms. Phipps' judgment, under the proposed reorganization, New Frontier Illinois ILECs will have little, if any need to access capital. Foremost, Ms. Phipps observed, the New Frontier Illinois ILECs currently generate sufficient cash to fund their capital expenditures budget. Furthermore, Staff Condition 1 would prevent New Frontier Illinois ILECs from transferring that cash if they fail to meet the service quality standards described in that condition; Staff Condition 2 would require Frontier to maintain a backup source of funding for New Frontier Illinois ILECs' capital expenditures through cash or credit agreements with external financial institutions.

Further, Ms. Phipps noted that Frontier expects its debt ratio to decrease from 91% to 58% following the proposed reorganization. Ms. Phipps testified that, all else equal, a lower debt to capitalization ratio signifies lower financial risk. Ms. Phipps understood Frontier to expect its weighted average cost of capital to fall to 9.13% from 9.91% following the proposed reorganization. Although Frontier and the ratings agencies speculate that the proposed reorganization will enhance Frontier's capital structure, the final capital structure of the merged entity has not yet been finalized. Therefore, Ms. Phipps recommended the Commission adopt Staff Reporting Requirement 3 that will inform the Commission of the capital structure and cost of capital following the proposed reorganization.

While the reduction in the proportion of debt in Frontier's post-merger capital structure, from its current level, should enhance Frontier's ability to raise further capital on reasonable terms should the need arise, Ms. Phipps considered it is unlikely that

Frontier will achieve the degree of financial strength necessary to raise capital on reasonable terms, under most capital market conditions, until it further reduces the proportion of debt in its capital structure.

The second part of Section 7-204(b)(4) of the Act requires the Commission to find that the proposed reorganization "will not impair the utility's ability to maintain a reasonable capital structure." Ms. Phipps interpreted "reasonable capital structure" as one that permits a utility to raise capital under most market conditions and results in a reasonable overall cost of capital. Ms. Phipps noted that the New Frontier ILECs would not independently raise capital. Under that circumstance, observed Ms. Phipps, the Commission typically uses a parent company's capital structure to set rates. Ms. Phipps pointed out that the proposed reorganization would reduce the proportion of debt in Frontier's capital structure, although that reduction in debt is unlikely to be sufficient for it to attain investment grade credit ratings. From this standpoint, the proposed reorganization cannot, in Ms. Phipps' view, be deemed to result in a reasonable capital structure but can be deemed to enhance the ability of Frontier, and through Frontier, the ability of New Frontier ILECs, to achieve a reasonable capital structure.

In summary, Ms. Phipps concluded that, in her opinion, the proposed reorganization will not significantly impair New Frontier Illinois ILECs ability to raise necessary capital on reasonable terms or to maintain a reasonable capital structure, if the New Frontier ILECs comply with the Staff Conditions and Reporting Requirements.

3. Position of IBEW

IBEW argued that Joint Applicants failed to meet the requirements set forth in Section 7-204(b)(4) of the Act, whether the proposed Transaction would "significantly impair the utility's ability to raise necessary capital on reasonable terms or maintain a reasonable capital structure."

IBEW suggested that the Commission evaluate financial soundness based on a comparison of the proposed new owner with the current owner, with a particular focus on the financial impact on the Illinois operating utility. *E.g.*, Illinois Power Company and Ameren Corporation, Docket No. 04-0294. IBEW argued that, in assessing the financial strength of the proposed new owner, there are two relevant questions. First, will the new owner be financially fit by objective criteria? Second, how does the proposed new owner's financial condition compare to the present owner? IBEW argued that Frontier failed both tests. Frontier failed the first test because Frontier does not currently have an investment-grade bond rating and Frontier's revenues and net income have been in a steady state of decline. Frontier failed the second test because Frontier's financial condition is significantly weaker than Verizon's financial condition and because Frontier has regularly paid out dividends in excess of its earnings.

IBEW pointed to a 2007 Montana Public Service Commission ("PSC") decision in which the PSC rejected a proposed merger and acquisition because "In normal utility operations, retained earnings provide a vital source of financial strength for capital investment and as reserves that are available during unexpected financial strains.

Regularly paying out dividends in excess of net earnings by a utility is inappropriate and risky because having insufficient reserves on hand could adversely affect the utility's ability to provide adequate service." *NorthWestern Corp.*, 2007 Mont. PUC LEXIS 54 at ¶ 149 (Mont. PSC July 31, 2007). IBEW stated that the Montana PSC's findings apply equally to Frontier. The IBEW endorsed the reasoning of the Montana PSC and reached the same conclusion about Frontier.

According to IBEW, Frontier only has two or three more years before it will have paid out all of its retained earnings to stockholders, based on its performance in the first half of 2009. IBEW also stated that two Wall Street financial analysts have independently found that Frontier's shareholders' equity is likely to become negative in 2012 or 2013. After that, Frontier's dividend would have to be reduced to no more than its net income – a likely dividend cut of 60% or more. IBEW argued that without this Transaction, Frontier's business model will fail within two or three years. IBEW asserted that Frontier does not plan to change its approach to business. Frontier still plans to pay out more to shareholders than it earns in net income and that there is no scenario where Frontier plans to pay out less in dividends than it earns in net income during the 2010 to 2014 period examined.

IBEW contrasted Frontier's high-risk business model to Verizon. IBEW explained that Verizon has pursued a strategy of reinvesting in its landline business by upgrading to state-of-the-art fiber optic broadband service facilities (FiOS) directly to the home. FiOS has not yet reached Illinois, but IBEW contended that there is no reason to believe that urban/suburban areas of Verizon Illinois would not be in line to have these new facilities deployed. IBEW asserted that Verizon has been spending its cash on new technology and facilities that serve customers. Specifically, VSTO has been reinvesting between 77% and 96% of the cash it receives from depreciation. According to IBEW, this contrasts with Frontier's reinvestment of just 51% to 58% of its depreciation-based cash flows into new capital equipment and facilities. IBEW concluded that Verizon is a financially stronger company than Frontier.

IBEW expressed concern over the uncertainty of Frontier's financing for this Transaction. Frontier is required to issue approximately $3.1 billion to $3.3 billion in new debt in order to provide a cash payment (or debt exchange) to Verizon. However, Frontier has not yet obtained this debt, or even a commitment from a lender to provide the necessary financing. Therefore, the interest rate, debt service requirements, security requirements, restrictions on business operations, and other terms and conditions that Wall Street bankers will require to provide this financing to Frontier are still unknown.

IBEW also argued that the Distribution Agreement between Verizon and Frontier provides that Frontier will receive no working capital from Verizon at closing. Yet, Frontier has not explained how it will provide working capital to operate Verizon's business in Illinois and elsewhere.

IBEW argued that Frontier's assertion that its financial projections demonstrate that the proposed Transaction will improve Frontier's financial condition is questionable.

IBEW argued that Frontier's projections do not show Frontier financial condition improving to the point that the company would achieve even a minimal investment-grade bond rating, let alone a financial condition on par with Verizon's. Further, IBEW argued that Frontier's financial projections are not credible. Frontier bases its projections on overly optimistic assumptions about both revenues and expenses. Moreover, the financial projections Frontier provided in its rebuttal testimony are meaningless. IBEW asserted that Frontier has a spotty track record for projecting the financial effects of a merger.

IBEW argued that Frontier is not now and will not be a financially sound entity. Frontier's financial condition is weak. It is a company built on an unsustainable business model of consistently paying out far more to shareholders than it earns. If this Transaction is allowed to occur, Frontier's management will not change and its high-risk, unsustainable approach to business will not change, nor its desire to enrich shareholders rather than invest in new technologies and services will not change. Therefore, IBEW argued that Frontier is not financially fit to own and operate Verizon Illinois. Frontier does not have the financial wherewithal to acquire operations that would triple its size. In addition, Frontier cannot safely absorb the additional debt burden that would come with the proposed Transaction.

Finally, IBEW argued that none of the conditions proposed by Staff or intervenors and agreed to by the Joint Applicants solves the fundamental problem of Frontier's lack of financial fitness. While the Staff conditions might be a useful part of a restructured transaction, standing on their own they do not cure the problems with Frontier's financial condition. Further, IBEW argued that the proposed conditions do not contain any sanctions if Frontier fails to comply with them. Nor do the proposed conditions address what would happen if Frontier finds itself unable to make the investments it has promised to make. Similarly, proposed Staff Condition 2 requires Frontier to have a line of credit available that is at least equal to the greater of $50 million or the Verizon Illinois annual capital budget. However, this condition does not address the cost of providing this capital to the Illinois operations and most importantly; it does not require Frontier to make any level of capital expenditures in Illinois. Thus, the proposed financial condition does not resolve the serious financial concerns this Transaction presents in this case.

4. Commission Analysis and Conclusion

The evidence presented by Joint Applicants and Staff shows that the proposed reorganization will not significantly impair Frontier's ability to raise the necessary capital on reasonable terms and to maintain a reasonable capital structure, provided the New Frontier ILECs comply with Staff's proposed conditions and reporting requirements, as provided herein, after the reorganization.

As stated in our conclusions on Section 7-204(b)(1) above, we recognize the basis for our Staff's initial misgivings regarding this Transaction. Frontier concedes, as it must, that its financial metrics are not as strong as those of Verizon, from which it is acquiring the properties that are the subject of this Transaction. Again, of greater (if perhaps more peripheral) concern to us is the experience of former Verizon companies

in other jurisdictions which, based upon this record, have resulted in both financial and service degradation experience by the successor companies and their customers. While we find that the Transaction satisfies Section 7-204(b)(1) and (b)(4), we also find that Staff Conditions 1 and 2 set forth in the attached Conditions Appendix, with Staff's associated reporting requirements, with which Staff recommends that we impose and to which the company agrees in any case, are conditions precedent to such approval. It is vital that sufficient funds remain available to support service and make capital improvements in Illinois. We also think that AG/CUB Conditions 1-5 will benefit Staff and the Commission in monitoring Frontier's compliance with Staff Conditions. We are of the opinion that the proposed conditions set forth in Conditions Appendix, which prevent Frontier from transfers of funds from Illinois operations to its corporate parent if service quality or credit ratings fall below a certain level, are necessary and appropriate to accomplish this end, and we hereby adopt them.

D. Section 7-204(b)(5) of the Act provides that "the utility will remain subject to all applicable laws, regulations, rules, decisions and policies governing the regulation."

1. Position of Joint Applicants

Section 7-204(b)(5) of the Act states that, in approving a proposed reorganization, the Commission must find that "the utility will remain subject to all applicable laws, regulations, rules, decisions and policies governing the regulation" of Illinois incumbent local exchange carriers. According to Joint Applicants, no element of this Transaction will impact the applicability of Illinois law to the utilities at issue. The Verizon North exchanges in Illinois will remain the Verizon North exchanges in Illinois, albeit under a different name. The Verizon South exchanges in Illinois, although their assets will be transferred from one corporate entity to another, will remain subject to Illinois law. Likewise, all of the Frontier ILECs will remain subject to all applicable laws, regulations, rules, decisions and policies governing the regulation of telephone service.

Staff witness Dr. Qin Liu testified that Verizon South is technically out of compliance with Section 13-517 of the Act, related to minimum coverage for advanced services (an assertion that Verizon has contested). Dr. Liu proposed the first paragraph of Staff Condition 6 to address that concern. Frontier not only agreed to the first paragraph of Staff Condition 6, but, in order to address concerns about broadband deployment raised by Staff and others, added the commitment included in the second paragraph of Staff Condition 6, committing to roll out a higher level of broadband service on a broader basis than is required by Illinois statute throughout the New Frontier Illinois ILEC territories. Frontier's broadband commitment is further underscored by its agreement to AG/CUB Conditions 6-8, which will give Staff as well as the AG and CUB a voice in the development of a broadband roll out strategy and help them monitor its progress.

In addition, Frontier reached a stipulated settlement agreement with IPTA under which Frontier agreed that the Commission's Final Order, if approved should include a provision that, so long as the Commission's Final Order in Docket 98-0195 (relating to

pricing and services available to pay telephone operators) remains in effect, the Final Order will be binding on Verizon North and NewILEC. Frontier further agreed to support a provision being added to the Commission's Final Order in this Docket stating that the current rates, terms and conditions for local exchange services provided by Verizon North and Verizon South to payphone service providers shall remain in effect in the Verizon North and NewILEC territories for three years after the closing of the proposed Transaction.

Frontier acknowledged the continuing applicability of Illinois law. Thus, according to Joint Applicants the proposed reorganization meets the criteria of Section 7-204(b)(5) of the Act.

2. Position of Staff

Dr. Liu offered testimony regarding Staff's assessment of whether the proposed Transaction satisfies Section 7-204(b)(5) of the Act. The two ILECs involved in the proposed merger, Verizon North and Verizon South, would remain ILECs in their respective service territories. All the applicable laws, rules and regulations governing the two incumbent local exchange companies will not change as a result of the merger, including, but not limited to, Section 251 of the 1996 Telecommunications Act.

Dr. Liu understood Frontier to pledge to "assume and honor all obligations under Verizon's current interconnection agreements, wholesale tariffs, and other existing wholesale arrangements in addition to complying with the statutory obligations applicable to all LECS." Without committing to a specific freeze period, however, Frontier's commitment to assume Verizon's wholesale obligations and provide continuous, uninterrupted service may not, in Dr. Liu's opinion, be meaningful in practice. Therefore, Dr. Liu recommended a specific freeze period to ensure that Frontier provide continuous, uninterrupted services to its wholesale customers after the merger closing.

Dr. Liu recommended a three-year freeze period, which is in line with the practice of mergers in other states. Frontier has since negotiated agreements with Comcast and Level 3, in which different freeze periods were imposed on different classes of wholesale customers. For example, the freeze period for interconnecting customers is 30 months. For wholesale customers that purchase services from Verizon through tariffs (such as special access tariff or intrastate wholesale tariff), the freeze period is 24 months. Dr. Liu ultimately agreed to Frontier's revised proposal of 30 month freeze period for all wholesale customers.

In addition, Dr. Liu noted that the General Assembly has imposed a number of requirements on ILECs, including that of providing advanced telecommunications services to customers in Illinois. Specifically, "[e]very Incumbent Local Exchange Carrier (telecommunications carrier that offers or provides a noncompetitive telecommunications service) shall offer or provide advanced telecommunications services to not less than 80% of its customers by January 1, 2005." Based on information provided in this proceeding, Dr. Liu stated that Verizon South is currently not

in compliance with Section 13-517 of the Act. Dr. Liu recommended that Frontier bring Verizon South into compliance with Section 13-517 of the Act within 24 months of the merger closing date.

3. Commission Analysis and Conclusion

The Commission is unclear how long Verizon South has been in non-compliance with Section 13-517 of the Act, which, as described by Staff witness Dr. Liu requires Illinois local exchange carriers to make "advanced services" available to at least 80% of its customers. Frontier witness Mr. McCarthy asserted that Frontier intends to meet the requirements of Section 13-517 of the Act within 24 months. Mr. McCarthy also committed to roll out a higher level of broadband service on a broader basis than is required by Illinois statute.

Frontier has a track record in deploying broadband at speeds up to 3 Mbps to more rural and less dense areas often using DSL line conditioning equipment to extend the reach of service: it is uncontested that Frontier's current broadband deployment rate of over 90% across its more than two million lines nationwide is *30% higher* than Verizon's deployment in the territories to be transferred based on total households passed. Frontier has made broadband available to 87% of the households in its existing Illinois service territory. Frontier has deployed broadband in over 99% of its central offices and switches across its 24 states and Frontier has deployed broadband in every one of its 138 central offices and switches in Illinois. Thus, Frontier is ready, willing, and able to significantly increase broadband deployment in Illinois.

In contrast, Verizon has made it clear that it would *not* deploy broadband in Illinois beyond its current levels even if it was not leaving the wireline market. Having reviewed the evidence presented, the Commission finds that Joint Applicants meet the requirements of Section 7-204(b)(5) of the Act.

Staff Condition 6 commits the Joint Applicants to deploying 1.5 Mbps DSL to 85% of households of the New Frontier ILECs by December 31, 2013. However, the record is silent as to why the speed of 1.5 Mbps is chosen. Joint Applicant witness Billy Jack Greg notes, "Frontier's basic residential broadband offering significantly exceeds this requirement with download speeds of 3 Mbps. In addition, Frontier is upgrading to faster speeds in some areas in other states where broadband deployment levels are higher. At the same time, as speeds in areas currently served by broadband are increasing" (Joint Applicants Ex. 9.0 at 4). In other states, Joint Applicants appear to be meeting that commitment, IBEW witness Susan Baldwin cites a deposition from Ohio in which Joint Applicants' witness McCarthy states, "the baseline that [Frontier] would like to roll out is a 3 megabit service." He also stated that Frontier would be "upgrading facilities in areas up to max that [it] can get out of the technology" which "could be 9 to 12 megs." (IBEW Ex. 2.0 at 44).

Based on this record, the commitment to 1.5 Mbps DSL service commitment appears to be inadequate. With $40 million committed to broadband deployment per AG/CUB Condition 6, the Commission finds Staff Condition 6 should be modified so that

Joint Applicants commit that by December 31, 2013 they will deploy DSL facilities such that 85% of households served by New Frontier ILECs are able to access broadband service provided by Frontier at up to 3 Mbps download speed.

E. Section 7-204(b)(6) of the Act provides that "the proposed reorganization is not likely to have a significant adverse impact on competition in those markets over which the Commission has jurisdiction."

1. Position of Joint Applicants

Joint Applicants contended that the proposed reorganization also satisfies the requirement of Section 7-204(b)(6) of the Act, which requires a Commission finding that "the proposed reorganization is not likely to have a significant adverse impact on competition in those markets over which the Commission has jurisdiction." According to the Joint Applicants nothing in the proposed reorganization will result in adverse impacts on competition in the Illinois telecommunications markets. First, none of the Verizon North or Verizon South ILEC local exchanges being acquired by Frontier overlap with any of the local exchanges already served by the Frontier ILECs. The Frontier and Verizon ILECs do not currently compete for customers in any of the affected exchanges. While Verizon does have wireless service in the Frontier territories, Verizon will not be transferring its wireless business and will continue to compete with Frontier in both Frontier's existing and its new territories. Similarly, both Verizon and Frontier will compete for the enterprise business customers that Verizon currently serves (many or which it will continue to serve) in the New Frontier Illinois ILEC territories. According to the Joint Applicants, the Transaction will not reduce the number of competitors in Illinois and, in fact, will increase competition.

Further, the proposed Transaction will not have any adverse impacts on wholesale service customers in Illinois. Staff witness Liu proposed in Staff Condition 5 that wholesale rates be capped for a period of time following closing on the proposed Transaction. Frontier agreed to ensure stability for wholesale customers through settlements with Comcast and Level 3, two of its largest and most sophisticated wholesale customers, and through Condition 5.

AG/CUB conditions 15-21 will provide further stability to wholesale customers of the New Frontier Illinois ILECs by assuring that Staff, as well as the AG and CUB are kept apprised of OSS changes within Frontier that could have customer impacts.

2. Position of Staff

Dr. Liu also offered Staff's assessment of whether the proposed Transaction satisfies Section 7-204(b)(6) of the Act.

Dr. Liu stated that merger *generally* reduces the number of competitors in the market. Dr. Liu noted that this would theoretically reduce the degree of competition and raise the retail prices of the goods or services, thus having an adverse impact on

competition. However, observed Dr. Liu, this does not apply in this proposed merger. Dr. Liu pointed out that Frontier currently owns ten local exchange companies in Illinois, nine of which are ILECs. Based on information provided by Joint Applicants, none of the nine ILECs currently operate in any of the local exchanges where Verizon North or Verizon South is currently operating as an ILEC. In addition to the nine ILECs, Frontier also owns Frontier Communications of America, which sought, and was granted, an authority to operate as a facilities-based local exchange carrier within the exchange areas of Frontier's nine ILECs in Docket 07-0233. Frontier's competitive local exchange carrier, Frontier Communications of America, has not filed a local exchange tariff with the Commission as of this date. This means that it has not started offering local exchange services pursuant to authority granted in Docket 07-0233.

Moreover, the approved service territory for Frontier's CLEC is identical to those of its nine ILECs. Thus, Frontier's service territories granted by the Commission currently do not overlap with those of Verizon North and Verizon South. As a result, Frontier is not in direct competition with the Verizon North and Verizon South, the two ILECs involved in the proposed reorganization. Therefore, it was Dr. Liu's opinion that the proposed reorganization will not change the number of competitors for local exchange services in any of the local exchanges involved, and thus would not have a significant adverse impact on competition in the affected local exchanges.

3. Commission Analysis and Conclusion

Section 7-204(b)(6) presents an analysis similar to that required by Section 7-204(b)(5). We are of the opinion that Staff Condition 5 set forth in the Condition Appendix enables us to find that the Transaction satisfies Section 7-204(b)(6). IPTA's proposed condition, to which Frontier has agreed, further supports this finding.

F. Section 7-204(b)(7) of the Act provides that "the proposed reorganization is not likely to result in any adverse rate impacts on retail customers."

1. Position of Joint Applicants

Section 7-204(b)(7) of the Act states that in approving a proposed reorganization, the Commission must find that "the proposed reorganization is not likely to result in any adverse rate impacts on retail customers." Joint Applicants testified that, for the Verizon North exchanges, the very same Verizon tariffs that currently apply to those retail customers before the Transaction will apply after. For the Verizon South exchanges, the same Verizon tariffs that currently apply to those retail customers before the Transaction will be submitted for Frontier Communications of the Carolinas Inc. and will apply to those exchanges after the closing of the proposed Transaction. No existing regulated intrastate service will be discontinued or interrupted as a result of the proposed Transaction. Through proposed Condition 7, Staff witness Karen Chang proposed to ensure that those charges, as applied to non-competitive services, remain capped for at least three years after closing, to which Frontier agreed. As a result of Condition 7, those non-competitive, retail rate caps will stay in place for three years.

Similarly, the AG and CUB proposed conditions 9-14 which Frontier agreed will give further assurances to retail customer that they will not see unjustified rate increases, that the service bundles they are used to will not be abandoned as a result of this Transaction, and services currently deemed non-competitive will not be declared competitive and become subject to market-based price increases.

Frontier, in short, will offer essentially the same regulated intrastate retail services as Verizon's customers receive today. Over time Frontier intends to offer customers new service choices that are currently available to Frontier's existing customers, as well as new products, promotions and services Frontier may make available in the future. Thus, according to the Joint Applicants the proposed reorganization meets the criteria of Section 7-204(b)(7) of the Act.

2. Position of Staff

Karen Y. Chang offered Staff's assessment of whether the Transaction satisfies Section 7-204(b)(7) of the Act. Frontier witness Mr. McCarthy testified that the "very same . . . tariffs that currently apply to . . . retail customers" before the Transaction will apply after the proposed reorganization is closed for all the Verizon North and South exchanges, and Frontier claimed to "ha[ve] no plans to change any of those [regulated intrastate] rates at the time Staff filed its Direct Testimony." Ms. Chang viewed this assurance as inadequate for two reasons. First, Ms. Chang observed that Frontier had not, prior to the Transaction, conducted any analysis to determine whether it could continue to charge Verizon's current rates, or more pointedly, whether any changes to operations resulting from the reorganization would cause Frontier to seek an increase in rates. Second, Ms. Chang noted that, at the closing of this Transaction, Frontier would inherit the books, records and rates of Verizon. Ms. Chang pointed out that Verizon is a rate of return company regulated primarily under Article IX of the Act, and its rates were set in its last rate filing in 1994. These matters, Ms. Chang stated, were of particular concern in light of the fact that, as a result of significant changes in communications technology, law and regulation that have taken place in the intervening fifteen-plus years since Verizon (then General Telephone, or GTE) sought a rate increase, the existing Verizon rate structure may be such as to cause Frontier to seek retail rate increases over the short term. In particular, Ms. Chang cited line losses experienced by Verizon in recent years, as well as the possibility that Frontier will incur costs in merging of billing and operational systems as likely causes for a Frontier decision to seek increased rates.

Based on this, Ms. Chang recommended a freeze in competitive and noncompetitive services for three years after the closing of the Transaction. She also recommended that the Commission require Frontier to present a rate case in order to make any noncompetitive rate increases after the three year freeze.

In response to Ms. Chang's opinion, Frontier witness Mr. McCarthy stated that the company was generally concerned about the three year duration of Ms. Chang's proposed rate freeze. Mr. McCarthy opined that a cap on regulated non-competitive retail rates for one year after closing of the proposed Transaction would be sufficient.

Mr. McCarthy stated that Frontier did not believe it would be in the best interest of its customers to "freeze" rates where continued competition from both CLECs (including cable telephone providers) and wireless companies places downward pressure on all pricing. Mr. McCarthy testified that Frontier also sought acknowledgement in the Commission's Final Order that Frontier could seek relief from this condition if the FCC or Congress takes any action that significantly impacts carrier rate design, for example, through significant changes to intercarrier compensation.

In her Rebuttal Testimony, Ms. Chang continued to advocate a three year cap on all regulated rates. Because first, this would assure that there is no adverse impact on ratepayers as a result of the reorganization. Second, in Ms. Chang's opinion, savings are unlikely to be reflected in Frontier's books until three years have elapsed. Third, Ms. Chang opined that Frontier will most probably spend three years preparing a rate case for the new, larger company to be presented to the Commission.

Ms. Chang recommended that Frontier be allowed to increase its rates only upon a rate case presented by Frontier anytime following the closing. In addition, Ms. Chang testified that she had no objection to Frontier being allowed to seek relief from this condition if the FCC or Congress takes any action that significantly impacts carrier rate design.

In his Surrebuttal Testimony, Mr. McCarthy stated that, if competitive services are excluded from the rate cap, Frontier was prepared to accept the condition as part of an approval. Mr. McCarthy offered as his opinion that competitive services are offered in competition with other carriers, and a cap on these rates could require Verizon to offer them at a rate below cost or below an appropriate return on investment, which could distort the market for such services. Mr. McCarthy stated that Frontier was prepared to cap all regulated noncompetitive retail rates for the former Verizon operating companies for three years from the date of closing of the proposed Transaction. After three years, Mr. McCarthy stated, Frontier would be obliged to present a rate case in order to make any noncompetitive rate increases.

Staff understood that Frontier acceded to, and Staff recommended the Commission impose Staff Condition 7.

3. Commission Analysis and Conclusion

With respect to Section 7-204(b)(7), we observe that Staff Condition 7 set forth in the Conditions Appendix caps non-competitive retail rates for three years. Staff Condition 7 is helpfully supplemented by AG/CUB Conditions 9-14 and the DoD-FEA condition all included in the Conditions Appendix. Based upon and subject to imposition of these conditions, we find that the Transaction satisfies Section 7-204(b)(7).

G. Section 7-204(c) of the Act provides that the Commission shall not approve a proposed reorganization without ruling on: "(i) the allocation of savings from the proposed reorganization; and (ii) whether the company should be allowed to recover any costs

incurred in accomplishing the proposed reorganization and, if so, the amount of costs eligible for recovery and how the costs will be allocated."

1. Position of Joint Applicants

Section 7-204(c) of the Act states that the Commission shall not approve a proposed reorganization without ruling on: "(i) the allocation of savings from the proposed reorganization; and (ii) whether the company should be allowed to recover any costs incurred in accomplishing the proposed reorganization and, if so, the amount of costs eligible for recovery and how the costs will be allocated."

Although Frontier believed there may be future synergies and resulting savings in the future due to the reorganization, savings on an Illinois-specific basis have not been determined and the timing and actual amount of any such savings in Illinois would be speculative. Additionally, any such savings will likely be offset by expenses incurred to achieve them and associated with upgrading the network facilities to be acquired. Frontier currently intends to expand broadband availability over time, and any direction by the Commission requiring Frontier to redirect savings elsewhere would detract from broadband investment in Illinois.

Frontier agreed to not to seek in this proceeding or any other proceeding to recover costs Frontier may incur in accomplishing the proposed reorganization.

2. Position of Staff

Mr. Ostrander presented Staff's analysis regarding Section 7-204(c) of the Act. Mr. Ostrander understood Mr. McCarthy to testify that savings on an Illinois-specific basis have not been determined and that any such savings will likely be offset by expenses incurred to achieve the savings and associated with upgrading the network facilities to be acquired, and to further testify that the Joint Applicants are not seeking in this proceeding, nor will they seek in any other proceeding, to recover any costs Frontier may incur in accomplishing the proposed reorganization. Mr. Ostrander recommended that the Commission determine that: (1) the allocation of any savings resulting from the proposed reorganization would flow through to the costs associated with the regulated intrastate operations for consideration in setting rates by the Commission; and (2) the Joint Applicants will not be allowed to recover any costs incurred in accomplishing the proposed reorganization in future rate proceedings.

Regarding compliance with Section 7-204(c) of the Act, Mr. Ostrander recommended that the Commission rule that:

1) The allocation of any savings resulting from the proposed reorganization would flow through to the costs associated with the regulated intrastate operations for consideration in setting rates by the Commission; and

2) Joint Applicants will not be allowed to recover any costs incurred in accomplishing the proposed reorganization in future rate proceedings.

In his rebuttal testimony, Mr. McCarthy concurred with Staff's position on Section 7-204(c) of the Act, in that Joint Applicants will allocate any savings resulting from the proposed reorganization to the costs associated with the regulated intrastate operations for consideration in setting rates by the Commission, and that Joint Applicants will not be allowed to recover any costs incurred in accomplishing the proposed reorganization in future rate proceedings.

3. Commission Analysis and Conclusion

Under Section 7-204(c) of the Act, before approving a utility reorganization, the Commission must rule on: "(i) the allocation of any savings resulting from the proposed reorganization; and (ii) whether the companies should be allowed to recover any costs incurred in accomplishing the proposed reorganization, and if so, the amount of costs eligible for recovery and how the costs will be allocated."

Regarding compliance with Section 7-204(c) the Commission finds that the allocation of any savings resulting from the proposed reorganization would flow through to the costs associated with the regulated intrastate operations for consideration in setting rates by the Commission in any future rate request. With respect to costs incurred to accomplish the instant reorganization, the Joint Applicants have agreed not to seek cost recovery of such cost. Therefore, the Commission finds that the Joint Applicants shall be prohibited from recovering all such reorganization costs.

V. POSITION OF INTERVENORS: COMCAST, LEVEL 3, IPTA, DOD-FEA AND AG/CUB

Intervenors Comcast, Level 3, IPTA, DoD-FEA and the AG and CUB each reached agreed settlements and/or stipulations with Joint Applicants resolving the concerns or each of these intervenors with the proposed Transaction.

A. Comcast and Level 3

On the basis of the settlement agreements included in the record as Frontier Exhibits 8.1 and 8.2; neither Comcast nor Level 3 had any objection to the Commission approving the proposed Transaction.

B. DoD-FEA

According to DoD-FEA, it reached a resolution of all of its issues with Joint Applicants and, subject only to the inclusion of DoD-FEA's condition in a Final Order in this Docket, DoD-FEA supports the proposed Transaction and urges the Commission to approve the Joint Application in all respects.

The condition proposes that for a minimum period of three years after the close of the Transaction, the New Frontier Illinois ILECs shall cap the rates for Retail Flat and Measured Rate Business Services (1FB and 1MB), and PBX, Centrex, and interstate and intrastate special access services, at their levels in effect at the close of the Transaction. The New Frontier Illinois ILECs may petition the Commission to seek recovery from the impact of exogenous events that materially impact the operations of the New Frontier Illinois ILECs, including but not limited to, orders of the FCC and the Commission (such as a generic intrastate access proceeding); DoD-FEA may file to participate in the Commission's consideration of such a petition by Frontier.

C. AG/CUB

AG/CUB offered the Direct and Rebuttal Testimonies of Lee L. Selwyn. Dr. Selwyn testified that continued availability of high quality, reliable local wireline telephone service is essential for Illinois consumers and for the Illinois economy generally. He expressed concern about the size of the Transaction, Frontier's financial condition and the financial burdens associated with the Transaction, the transition from Verizon to Frontier's operating support systems and its effect on service quality and local operations, and Frontier's ability to expand DSL in the territory it is purchasing.

After the close of evidentiary hearings, AG/CUB submitted a Stipulation with the Joint Applicants containing a group of conditions to resolve all issues among the parties and to expedite the orderly disposition of this proceeding. As stated in the Stipulation, AG/CUB do not oppose the proposed Transaction subject to: (1) the conditions to the Stipulation between AG/CUB and the Joint Applicants: (2) the conditions enumerated in Frontier Corrected Exhibit 8.4.A; and (3) the conditions in Frontier Exhibit 8.1. Based on their settlements or stipulations and/or the inclusion of their conditions, each of these Intervenors do not oppose the proposed Transaction.

D. IPTA

The IPTA submitted the pre-filed Direct and Rebuttal Testimonies of Mark Shmikler. In response to the IPTA's Direct Testimony, Frontier submitted the Rebuttal Testimony of Mr. McCarthy, in which Frontier noted that the IPTA sought assurance that, if the proposed reorganization were approved, Frontier would continue to meet the existing obligations of Verizon North and Verizon South to payphone service providers pursuant to the Commission's existing orders. Frontier witness Mr. McCarthy stated that Frontier would agree to meet Verizon North's and Verizon South's current obligations under the applicable Commission rules for payphones in the current Verizon exchanges. As a result, the IPTA and Frontier entered into discussions resulting in an agreement whereby the parties entered into a joint Stipulation that was submitted with the Surrebuttal Testimony of Mr. McCarthy as Frontier Exhibit 8.3. Pursuant to the Stipulation, the IPTA did not submit its pre-filed testimonies into the record.

The Stipulation provides that the parties agree to the Commission providing in the Final Order provisions that as long as the Commission's Final Order in Docket No. 98-0195 remains in effect, it will be binding on Verizon North and NewILEC in the

provision of local exchange services to payphone service providers in the current Verizon North and Verizon South local exchange territories, and that the current rates, terms and conditions for local exchange services provided by Verizon North and Verizon South shall remain in effect in the Verizon North and NewILEC territories for three years after the closing of the proposed Transaction.

Subject to the inclusion of such provisions in the Final Order, the IPTA has no objection to the Commission's approval of the proposed Transaction.

VI. NEW COMMUNICATIONS OF THE CAROLINA'S AUTHORITY TO PROVIDE 9-1-1 SERVICE UNDER 13-900

A. Staff and Joint Applicant's Position

Stacy Ross presented Staff's assessment of compliance with Section 13-900 of the Act. Staff initially sought assurances that, subsequent to the closing of the Transaction, Frontier will have the appropriate systems, personnel and expertise to maintain and operate the 9-1-1 system in Illinois. Mr. McCarthy stated Frontier understands that the 9-1-1 service and E9-1-1 service that Verizon currently provides in Illinois is a critical safety issue to the people of Illinois and of utmost concern to the Commission. Similarly, Mr. McCarthy stated that Frontier views the seamless transfer of that service from Verizon to Frontier as a critical element of this Transaction. In general, the Joint Applicants' witnesses represented that all of the 9-1-1 services and functions that are currently being performed by Verizon will continue to be performed after the Transaction by Frontier. In addition, the employees who operate and support Verizon's existing 9-1-1 systems will continue to do so after the Transaction as employees of Frontier.

Ms. Ross stated that she was also concerned with the applicability of Section 13-900 of the Act, with regard to Frontier/Verizon North and New Communications of the Carolinas/Verizon South. Section 13-900 of the Act requires 9-1-1 a service provider that was not providing 9-1-1 service on June 30, 2009, to obtain a Certificate of 9-1-1 Service Provider Authority if it plans to provide 9-1-1 network and database services to an authorized 9-1-1 system.

Since Verizon North was providing 9-1-1 network and 9-1-1 database service on the effective date of June 30, 2009, and since Frontier is, under the terms of the agreement, purchasing Verizon North outright, Staff's position is that the Verizon North properties transferred to Frontier should be exempt from the certification requirement under this provision. When the Transaction closes, Verizon North will continue to operate under all of its current certificates of authority with nothing more than a name change to Frontier. Since Verizon North was providing 9-1-1 network and 9-1-1 database service on the effective date of June 30, 2009, it should be exempt from the certification requirement under this provision.

The case is different for Verizon South properties which will be taken over by a newly-formed ILEC named New Communications of the Carolinas, which was not

providing 9-1-1 network and 9-1-1 database service on June 30, 2009. It appears, therefore, that New Communications of the Carolinas is not exempt from the Section 13-900 of the Act certification requirement.

However, as noted above, Joint Applicants' witnesses testified that Verizon employees responsible for the operation of the current Verizon 9-1-1 system in Illinois will be transferred to Frontier at closing. In addition, Frontier intends to open a new 9-1-1 customer care center to serve states, including Illinois, where it is acquiring properties from Verizon. Any necessary additional training of the existing workforce that supports 9-1-1 services in Illinois will be conducted by Verizon prior to closing. Frontier witnesses testified that Frontier has demonstrated that it has the financial capabilities and resources to meet the statutory requirements for a 9-1-1 Certificate and has requested that the Commission grant it a Certificate of 9-1-1 System Provider Authority in this proceeding.

In light of these factors, it was Ms. Ross' opinion that New Communications of the Carolinas will, upon closing of the Transaction, possess the necessary technical and managerial resources and abilities to meet the requirements of Section 13-900(c) of the Act. Staff also agreed that Frontier demonstrated sufficient financial capabilities and resources throughout its testimony in this proceeding. In conclusion, based on representations made by Mr. McCarthy in his rebuttal testimony, New Communications of the Carolinas will, when it comes into existence, possess sufficient technical, financial and managerial resources and abilities to provide network service and database services in a safe, continuous, and uninterrupted manner as required by Section 13-900(c) of the Act. Therefore, Ms. Ross recommended that the Commission grant New Communications of the Carolinas a Certificate of 9-1-1 System Provider Authority.

At the time Ms. Ross filed her testimony, it did not appear that approving the reorganization would negatively impact the delivery of 9-1-1 services in Illinois. Ms. Ross recommended that the following conditions be imposed:

- The post-merger company must inform the Commission prior to the reduction or removal of any 9-1-1 staff which are functional in providing 9-1-1 services in Illinois.

- Any post-merger operational changes that are made in the delivery of 9-1-1 services must be transparent to the 9-1-1 systems, as well as to the 9-1-1 subscribers.

- Any rate increase requested specifically for 9-1-1 network and services should not create additional profits for the post-merged company and shall be submitted to normal Commission review of proposed increases.

Frontier acceded to the imposition of these conditions by the Commission.

B. Commission Conclusion

Based on the analysis submitted by Staff witness Ross and the testimony submitted by Joint Applicants, the Commission concludes that, on the closing of the proposed Transaction, New Communications of the Carolinas Inc. should be granted a Certificate of Authority to serve as a 9-1-1 system provider pursuant to section 13-900 of the Act. We note that Frontier accepts the Staff's position as regards the maintenance of 9-1-1 personnel and resources in this State. We direct this as a condition.

VII. TRANSACTION MEETS THE REQUIREMENTS OF SECTION 6-103 OF THE ACT

A. Joint Applicants' Position

Although Staff contends that Joint Applicants require approval under Section 6-103 of the Act which relates to the merger of two public utilities, Joint Applicants disagree because the merging entities in this Docket are not utilities, but are only utility holding companies. Moreover, Joint Applicants notes that Section 7-204(e) states that "No other Commission approvals shall be required for mergers that are subject to this Section." Nonetheless, Joint Applicants do not object to the Reporting Requirements proposed by Staff witness Phipps or a Commission finding that the transaction complies with Section 6-103 of the Act.

B. Staff Position

Ms. Phipps presented Staff's analysis of this issue. She stated that the capitalization of a public utility formed by a merger or consolidation of two or more corporations is subject to Commission approval under Section 6-103 of the Act. Ms. Phipps recommended the Joint Applicants provide the Commission sufficient information to make a determination regarding the post-merger capitalization, as required under Section 6-103 of the Act. Since the final capital structure of the merged entity has not yet been finalized, Ms. Phipps recommended the Commission adopt Reporting Requirement 3, which will require Frontier to inform the Commission of the capital structure and cost of capital following the proposed reorganization, to which Frontier acceded.

C. Commission Analysis And Conclusion

We concur with Staff that the Joint Applicants should provide the Commission sufficient information to make a determination regarding the post-merger capitalization, as required under Section 6-103 of the Act. Since the final capital structure of the merged entity has not yet been finalized, Staff recommends the Commission adopt Staff Reporting Requirement 3, as set forth in Staff Condition 1 and 2 set forth in the Condition Appendix, which will require Frontier to inform the Commission of the capital structure and cost of capital following the proposed reorganization. We agree that this

should be imposed. We also think that AG/CUB Conditions 2 and 3 will benefit Staff and the Commission in monitoring this Transaction and should be included.

VIII. NEW COMMUNICATIONS OF THE CAROLINA'S COMPLIANCE WITH SECTION 13-405 OF THE ACT

A. Joint Applicants' Position

Due to the structure of the proposed Transaction, Verizon North, Inc. will be transferred to Frontier in its entirety, including with its local exchange certificate. The Illinois operating assets of Verizon South, Inc., however, will be transferred to a new entity, called New Communications of the Carolinas Inc. ("NewILEC"). Verizon South currently operates in the following exchanges: Armstrong, Beason, Bondville, Casey, Cheneyville, Cissna Park, Collison, Congerville, Danforth, Deer Creek, East Lynn, Emden, Fisher, Flatville, Foosland, Gifford, Goodfield, Greenup, Hartsburg, Hoopeston, Ivesdale, Kansas, Ludlow, Milford, Neoga, Ogden, Penfield, Pesotum, Philo, Potomac, Rankin, Rantoul, Royal, Sadorus, Secor, Seymour, Stockland, Thomasboro, Toledo, Tolono, Wellington, Westfield and Woodland (the "Verizon South Exchanges"). Joint Applicants state that NewILEC will be "stepping into the shoes" of Verizon South will receive all of the assets that Verizon South current uses to operate its local exchange operations and that NewILEC will provide the same 9-1-1 services that Verizon South currently provides (9-1-1 discussed in Section VI above). In order to operate those assets, however, NewILEC will require a local exchange certificate. Therefore, NewILEC is seeking authority to provide local exchange service in the Verizon South Exchanges.

According to Section 13-405 of the Act:

> The Commission shall approve an application for a Certificate of Exchange Service Authority only upon a showing by the applicant, and a finding by the Commission, after notice and hearing, that the applicant possesses sufficient technical, financial, and managerial resources and abilities to provide local exchange telecommunications service. Based on its acquisition of the assets currently used by Verizon South and the employees that Verizon South currently employs to operate the Verizon South Exchanges (through Verizon South), NewILEC states that it has sufficient technical, financial, and managerial resources and abilities to provide local exchange telecommunications service in the Verizon South Exchanges.

Upon completion of the sale of assets to NewILEC, Verizon South will no longer provide local exchange services anywhere within Illinois. Verizon South requests that its Section 13-405 Certificate of Exchange Service Authority be cancelled effective upon the closing of the proposed Transaction.

B. Commission Conclusion

Based on the evidence presented in this Docket and the history of service to its current exchanges by Verizon South and the fact that the assets and operations of Verizon South will be transferred to NewILEC, the Commission concludes that NewILEC possesses sufficient technical, financial, and managerial resources and abilities to extend its local exchange telecommunications service to the Verizon South Exchanges. The Commission further concludes that, upon the closing of the proposed Transaction, Verizon South will no longer be providing local exchange service in Illinois and its certificate should be cancelled at that time.

IX. AUTHORITY FOR VERIZON SOUTH TO WITHDRAW FROM NON-COMPETITIVE SERVICE

A. Joint Applicants' Position

Upon the receipt of all necessary regulatory approvals and the closing of the proposed Transaction, Verizon South will no longer be providing non-competitive telecommunications services in the Verizon South Exchanges or anywhere else in Illinois. Verizon South seeks the authority, in accordance with Section 13-406 of the Act, to discontinue the provision of telecommunications services, including the provision of non-competitive telecommunications services in Illinois upon the closing of the proposed Transaction. Section 13-406 provides:

> No telecommunications carrier offering or providing noncompetitive telecommunications service pursuant to a valid Certificate of Service Authority or certificate of public convenience and necessity shall discontinue or abandon such service once initiated until and unless it shall demonstrate, and the Commission finds, after notice and hearing, that such discontinuance or abandonment will not deprive customers of any necessary or essential telecommunications service or access thereto and is not otherwise contrary to the public interest. No telecommunications carrier offering or providing competitive telecommunications service shall discontinue or abandon such service once initiated except upon 30 days notice to the Commission and affected customers. The Commission may, upon its own motion or upon complaint, investigate the proposed discontinuance or abandonment of a competitive telecommunications service and may, after notice and hearing, prohibit such proposed discontinuance or abandonment if the Commission finds that it would be contrary to the public interest.

Joint Applicants testify that, following the closing of the proposed Transaction, NewILEC will continue to provide the same local exchange services that are presently available to customers residing within the Verizon South Exchanges. As a result, Verizon South's discontinuance of the provision of those services will not deprive customers of any

necessary or essential telecommunications service, or access thereto, and is not otherwise contrary to the public interest.

Verizon South in conjunction with NewILEC will provide appropriate notification on behalf of Verizon South to all customers of Verizon South regarding the discontinuance of the provision of non-competitive telecommunications services upon the closing of the proposed transaction.

B. Commission Conclusion

This Order directs Verizon South in conjunction with NewILEC to provide adequate notice to the Commission and its customers of its intent to withdraw from the provision of non-competitive service in the Verizon South Exchanges. After the proposed Transaction closes, NewILEC will provide telecommunications services to subscribers in the Verizon South Exchanges. Accordingly, subscribers will not be deprived of any necessary or essential telecommunications service or access thereto. For that reason, it is not contrary to the public interest to grant Verizon South permission, pursuant to Section 13-406 of the Act, to discontinue providing non-competitive services in the Verizon South Exchanges that NewILEC will acquire at the closing of the proposed transaction.

X. GRANT OF ELIGIBLE TELECOMMUNICATIONS CARRIER STATUS TO NEW COMMUNICATIONS OF THE CAROLINAS FOR THE VERIZON SOUTH EXCHANGES AND CANCELLATION OF VERIZON SOUTH'S STATUS ON CLOSING OF THE TRANSACTION

A. Joint Applicants' Position

In Docket 97-0446, on December 3, 1997, this Commission granted both Verizon North and Verizon South ETC status. Verizon South was granted ETC status for the Verizon South Exchanges listed above.

That Order included temporary waivers of certain ETC requirements. According to the terms of the Order, those waivers expired in the late 1990s. Since the expiration of those waivers, Verizon has provided all of the required ETC services.

Upon closing, NewILEC will become, for the Verizon South Exchanges, a certificated facilities-based incumbent local exchange telecommunications service provider and a common carrier subject to the jurisdiction of this Commission. Also, NewILEC's certificate and the relevant exchange area boundary maps will be on file with the Commission. The NewILEC exchanges will constitute part of its study area and, therefore, its "service area" within the meaning of Section 214(e)(2) of the TA96 and Section 55.201(b) of the FCC's Rules. NewILEC provides and will provide universal service as set forth in the FCC Rules in the Verizon South Exchange, including each of the following services as the FCC defines them throughout its service area:

1) Voice grade access to the public switched network;

2) Local usage;

3) Dual tone multi-frequency (touch tone) or its functional equivalent;

4) Single-party service or its functional equivalent;

5) Access to emergency services;

6) Access to operator services;

7) Access to interexchange services;

8) Access to directory assistance; and

9) Toll limitation for qualifying low-income consumers.

NewILEC will be providing these services in the Verizon South Exchange utilizing the same assets Verizon South currently utilizes.

Frontier testified that NewILEC will comply with the rules for advertising the availability of services designated for support and the charges therefore as required under 83 Ill. Adm. Code 757. NewILEC will also comply with any rules adopted by the Commission related to universal service support for low income consumers. NewILEC will not disconnect Lifeline Service for non-payment of toll charges and will not require a service deposit in order to initiate Lifeline Service if the low income consumer voluntarily elects toll blocking where toll blocking is available.

B. Commission Conclusion

The Commission concludes that, upon closing of the proposed Transaction, NewILEC will be qualified to be an ETC for the Verizon South Exchanges and should be designated as such. Upon that closing, NewILEC will become, for the Verizon South Exchanges, a certificated facilities based incumbent local exchange telecommunications service provider and a common carrier subject to the jurisdiction of this Commission. Also, NewILEC's certificate and the relevant exchange area boundary maps will be on file with the Commission. The former Verizon South exchanges will constitute its study area and, therefore, its "service area" within the meaning of Section 214(e)(2) of the Act and Section 55.201(b) of the FCC's Rules. The Commission also agrees that at the closing of the transaction, Verizon South's status as an ETC should be terminated for its Illinois exchanges.

XI. CONCLUSION

The Commission finds the record clear that the Transaction will result in tangible, significant benefits for Illinois consumers, especially those in rural areas. Frontier has made an enforceable commitment to deploy broadband to 85% of the households in the affected service areas, which are predominately rural, and to expend $40 million on broadband services in Illinois. (Staff Commitment 6 and CUB/AG Condition 6.)[1] This is a 25% increase in the current broadband availability, which equates to more than 100,000 additional unserved and underserved households, and is significantly more than what is required under Illinois law.[2]

As stated herein, Frontier has a track record in deploying broadband to more rural and less dense areas. Again, Verizon has made the decision to exit the local wireline business in this and certain other areas in order to focus on other aspects of its business (such as wireless and global enterprise).

Based on a review of the record, the Commission concludes that the proposed reorganization, along with the recommended conditions approved herein, should be granted.

XII. FINDINGS AND ORDERING PARAGRAPH

The Commission, having considered the entire record herein and being fully advised in the premises, is of the opinion and finds that:

(1) Frontier Communications Corporation, Verizon Communications, Inc., Verizon North, Inc., Verizon South, Inc., and New Communications of the Carolinas are or will be engaged in the business of providing telecommunications services to the public in the State of Illinois and, as such, are each a telecommunications carrier within the meaning of Section 13-202 of the Illinois Public Utilities Act;

(2) the Commission has jurisdiction over the parties and the subject matter of this proceeding pursuant to the Act;

(3) the recitals of fact and conclusions reached in the prefatory portion of this Order are supported by the record and are hereby adopted as findings of fact;

[1] Frontier Corrected Exhibit 8.4.

[2] As discussed in the Order previously, Section 13-517 of the Act requires certain telecommunications carriers "to offer or provide advanced telecommunications services to not less than 80% of its *customers*" (emphasis added). Frontier, however has committed to deploy wireline broadband services to eighty-five (85%) of the *households passed* in the territory it is acquiring. Because of competition, the households passed in the affected areas far exceed the number of customers. Frontier's 85% commitment far exceeds Verizon's current wireline-only deployment rate to households of approximately 60%. Moreover, Frontier will not rely on wireless technology in deploying broadband – it will deploy wireline DSL service. McCarthy Rebuttal Testimony at 56.

(4) for the reasons set forth in the prefatory portion of this Order and in light of the provisions described in the prefatory portion of this Order, the proposed reorganization will not adversely affect Frontier's ability to perform its duties under the Act for the New Frontier Illinois ILECs and the proposed reorganization meets the criteria as set forth in Section 7-204 of the Act in that:

(a) the proposed reorganization will not diminish Frontier's ability to provide adequate, reliable, efficient, safe and least-cost public utility service in the territories served by the New Frontier Illinois ILECs;

(b) the proposed reorganization will not result in the unjustified subsidization of non-utility activities by the New Frontier Illinois ILECs or their respective customers;

(c) costs and facilities are fairly and reasonably allocated between utility and non-utility activities in such a manner that the Commission may identify those costs and facilities, which are purposes;

(d) the proposed reorganization will not significantly impair the New Frontier Illinois ILECs ability to raise necessary capital on reasonable terms or to maintain a reasonable capital structure;

(e) the New Frontier Illinois ILECs will remain subject to all applicable laws, regulations, rules, decisions and policies governing the regulation of Illinois public utilities;

(f) the proposed reorganization is not likely to have a significant adverse effect on competition in those markets served by the New Frontier Illinois ILECs over which the Commission has jurisdiction; and

(g) the proposed reorganization is not likely to result in any adverse rate impacts on retail customers of the New Frontier Illinois ILECs;

(5) the conditions included in the Condition Appendix, attached to this Order and incorporated by this reference, shall apply to the New Frontier Illinois ILECs in connection with the reorganization, subject to the modification to Staff Conditions 1, 2 and 6 and AG/CUB Condition 7 set forth in this order;

(6) subject to the conditions set fort in Condition Appendix, the transaction satisfies Section 6-103 of the Act, and is approved;

(7) as long as the Commission's Order in Docket 98-0195 (relating to pricing and services available to payphone service providers) remains in effect, it will be binding on Verizon North and NewILEC;

(8) the current rates, terms and conditions for local exchange services provided by Verizon North and Verizon South to payphone service providers shall remain in effect in the Verizon North and NewILEC territories for three years after the closing of the proposed transaction;

(9) any savings Frontier attains from the proposed reorganization will flow through to the costs associated with the regulated intrastate operations for consideration in setting rates by the Commission;

(10) the Joint Applicants will not be allowed to recover any costs incurred in accomplishing the proposed reorganization in future rate proceedings;

(11) the proposed reorganization of Frontier is reasonable, subject to the provisions set forth in the prefatory portion of this Order;

(12) the relief requested under Sections 7-204 of the Act should be granted as hereinafter set forth, subject to the provisions imposed by this Order;

(13) the New Frontier ILECs should continue to have the authority under 83 Illinois Administrative Code 250, to maintain the books and records of Frontier outside of the State of Illinois, subject to the requirements of Section 5-106 of the Act, that they promptly reimburse the Commission for the reasonable costs and expenses associated with the audit or inspection of any books, accounts, papers, records, and memoranda kept outside of Illinois;

(14) upon closing of the proposed transactions, New Communications of the Carolinas Inc. will possess sufficient technical, financial, and managerial resources and abilities to provide local exchange telecommunications service;

(15) upon closing of the proposed transaction, the local exchange certificate of Verizon South should be cancelled;

(16) upon closing of the proposed transaction, the Commission finds that, due to the initiation of service by New Communications of the Carolinas Inc., the withdrawal of non-competitive services by Verizon South will not deprive customers of any necessary or essential telecommunications service or access thereto and is not otherwise contrary to the public interest;

(17) upon closing of the proposed transaction, with in the meaning of 47 U.S.C § 214(e), New Communications of the Carolinas Inc. will offer all the services supported by federal universal support, advertise the availability of charges for such services using media of general distribution within their service areas, and make Lifeline services (as defined by 47 C.F.R § 54.401) available to qualifying low-income consumers in their service area;

(18) upon closing of the proposed transaction, New Communications of the Carolinas Inc. will have the technical, financial and managerial resources and abilities to provide the 9-1-1 network and database services in a safe, continuous and uninterrupted manner;

(19) the prayer of the Joint Application may reasonably be granted and the public will be convenienced thereby; and

(20) all motions or objections which have not been ruled upon should be deemed disposed of in a manner consistent with the ultimate conclusions in this Final Order.

IT IS THEREFORE ORDERED by the Illinois Commerce Commission that, pursuant to Section 7-204 and 6-103 of the Act, consent and approval are granted to Frontier Communications Corporation, Verizon Communications Inc., Verizon North Inc., Verizon South Inc., New Communications of the Carolinas Inc. to take all actions necessary to carry out the Merger Agreement between Frontier and Verizon dated May 13, 2009, and to effectuate the transactions described in Section II above and the resulting reorganization of Verizon North, Inc. and Verizon South, Inc.

IT IS FURTHER ORDERED that the Joint Applicants shall comply with the conditions referenced in Finding (5) and enumerated in the Condition Appendix attached to this Order and incorporated herein by reference.

IT IS FURTHER ORDERED that, upon the closing of the proposed transaction, New Communications of the Carolinas Inc. is hereby granted a Certificate of Exchange Service Authority pursuant to Section 13-405 of the Public Utilities Act for the provision of facilities-based local exchange service; said certificate shall read as follows:

CERTIFICATE OF EXCHANGE SERVICE AUTHORITY

IT IS HEREBY CERTIFIED that New Communications of the Carolinas Inc. is authorized, pursuant to Section 13-405 of the Public Utilities Act, to provide facilities-based local exchange telecommunications services within the exchanges of Armstrong, Beason, Bondville, Casey, Cheneyville, Cissna Park, Collison, Congerville, Danforth, Deer Creek, East Lynn, Emden, Fisher, Flatville, Foosland, Gifford, Goodfield, Greenup, Hartsburg, Hoopeston, Ivesdale, Kansas, Ludlow, Milford, Neoga, Ogden, Penfield, Pesotum, Philo, Potomac, Rankin, Rantoul, Royal, Sadorus, Secor, Seymour, Stockland, Thomasboro, Toledo, Tolono, Wellington, Westfield and Woodland.

IT IS FURTHER ORDERED that, upon closing of the proposed Transaction, the Section 13-405 authority of Verizon South, Inc. will be, without further action of this Commission, cancelled.

IT IS FURTHER ORDERED that, upon closing of the proposed transaction, Verizon South shall be allowed to cease offering telecommunications service since a discontinuance or abandonment of service by Verizon South will not deprive customers of any necessary or essential telecommunications service or access thereto and is not otherwise contrary to the public interest.

IT IS FURTHER ORDERED that, upon closing of the proposed transaction, New Communications of the Carolinas Inc. shall be designated as the Eligible Telecommunications Carrier for the Armstrong, Beason, Bondville, Casey, Cheneyville, Cissna Park, Collison, Congerville, Danforth, Deer Creek, East Lynn, Emden, Fisher, Flatville, Foosland, Gifford, Goodfield, Greenup, Hartsburg, Hoopeston, Ivesdale, Kansas, Ludlow, Milford, Neoga, Ogden, Penfield, Pesotum, Philo, Potomac, Rankin, Rantoul, Royal, Sadorus, Secor, Seymour, Stockland, Thomasboro, Toledo, Tolono, Wellington, Westfield and Woodland exchanges under 47 C.F.R. Section 54.201(d), and the Commission shall so notify the Federal Communications Commission so as to cause New Communications of the Carolinas Inc. to receive federal universal service fund support from the date of closing forward.

IT IS FURTHER ORDERED that, upon closing of the proposed transaction, the Eligible Telecommunications Carrier status of Verizon South shall be withdrawn.

IT IS FURTHER ORDERED that any objections, motions, or petitions not yet ruled upon are hereby deemed disposed of in a manner consistent with the ultimate conclusions reached herein.

IT IS FURTHER ORDERED that subject to the provisions of Section 10-113 of the Public Utilities Act and 83 Ill. Adm. Code 200.880, this Order is final; it is not subject to the Administrative Review Law.

By order of the Commission this 21st day of April, 2010.

(SIGNED) MANUEL FLORES

Acting Chairman

CONDITIONS APPENDIX

STAFF CONDITIONS

Condition 1:

(a) Frontier North, Inc. and Frontier Communications of the Carolinas Inc. (the "New Frontier ILECs") will be prohibited from paying dividends or otherwise transferring any Illinois jurisdictional cash balances to Frontier Communications Corporation or its affiliates through loans, advances, investment or other means that would divert [to any purpose] the New Frontier Illinois ILECs' moneys, property or other resources that is not essentially or directly connected with the provision of noncompetitive telecommunications service if the New Frontier Illinois ILECs fail to meet or exceed the standards set forth below for a super-majority (5 of 7) of the following service quality standards of 83 Illinois Administrative Code Part 730, Standards of Service for Local Exchange Telecommunications Carriers:

(i) STANDARDS:

Toll & Assistance Answer Time
(Part 730.510(a)(1)(A)): 4.05 seconds

Information Answer Time
(Part 730.510(a)(1)(B)): 4.31 seconds

Repair Office Answer Time:
(Part 730.510(b)(1)): 34 seconds

Business Office Answer Time
(Part 730.510(b)(1)): 60 seconds

Installation Requests over 5 Business Days
(Part 730.540(a)): 92%

Interruptions of Service over 24 Hours
(Part 730.535(a)): 95%

Trouble Reports per 100 Lines
(Part 730.545(a)): 1.03

In the event of failure, the New Frontier ILECs' dividend payments or otherwise transferring cash to its parent or any affiliate would not be allowed until the next satisfactory report or the end of this condition. Frontier may file an interim service quality report showing updated data for the trailing twelve-month period as soon as six months after an annual report. If Frontier meets a super-majority (5 of 7) of the service quality

standards for this trailing twelve-month period, the dividend payment and cash transfer restrictions above will be lifted. Any such interim service quality report shall include a free cash flow calculation for the twelve months ending the same date as the final month of data reflected in the interim service quality report. Additionally the New Frontier ILECs will provide specific plans to restore service quality levels to previous levels, and identify the incremental monies that will be invested in Illinois as a result of dividend payments and cash transfers being withheld from the parent.

(b) MEASUREMENTS: Measurements shall commence on the date that the merger closes, and recur on a bi-annual calendar year basis.

(c) BI-ANNUAL REPORTS: Each of the New Frontier ILECs shall file a bi-annual report with the Chief Clerk's Office and post such bi-annual report in this docket. The bi-annual report will be filed by February 1 and August 1 of each year for the preceding year. Within the bi-annual report, each of the New Frontier ILECs shall list the standard set by the Commission for each service quality measure and each of the New Frontier Illinois ILECs' actual performance for each annual period. The bi-annual report shall present the actual performance data for every month after the date that the merger closes, with the initial month of data presented being the month in which the merger closes. The bi-annual report shall also include an Illinois jurisdictional free cash flow calculation for the twelve months ending June 1 and December 31 of each year this Condition remains in effect. The Illinois jurisdictional free cash flow calculation shall be in the same format as Joint Applicants' supplemental response to ICC Staff data request RP 3.01 and include Verifications from the financial officers of the New Frontier ILECs.

(d) DURATION OF CONDITION: Condition (1) shall remain continuously in effect until (i) at a minimum Frontier Communication Corporation's issuer credit rating meets two of the following three credit ratings: BBB from Standard & Poor's, Baa2 from Moody's Investors Service or BBB from Fitch Ratings, or (ii) for five years following the closing the proposed transaction, whichever is earlier. Condition (1), i.e., the Service Standards requirement and the prohibition on dividends or other cash transfers, shall be automatically reinstated if at any time Standard & Poor's or Fitch Ratings gives Frontier an issuer credit rating below BB or Moody's Investor Service gives Frontier an issuer credit rating below Ba2.

Condition 2:

Through a combination of available cash and availability under credit agreements with external financial institutions, Frontier Communications Corporation shall keep available exclusively for Illinois operations of Frontier North, Inc. and Frontier Communications of the Carolinas Inc. (the "New Frontier ILECs"), an aggregate amount equal to the higher of $50 million or the currently approved capital expenditure budget for the Illinois operations of the New Frontier ILECs.

Frontier Communications Corporation shall certify annually to the Commission that the required amount is available for Illinois operations of the New Frontier ILECs for the ensuing year. Therefore, on January 15 and July 15 of each year, Frontier Communications Corporation shall file a notice with the Commission certifying that such amount is currently available and the amount of dollar commitment for the New Frontier ILECs' Illinois operations for that year, based on their capital expenditures budget for that year, but in no event less than $50 million. This requirement regarding the availability of funds may be satisfied with one or more Frontier Communications Corporation lines of credit that are available for other purposes provided there is aggregate backup liquidity available to the New Frontier ILECs in an aggregate amount that equals the higher of $50 million or the currently approved capital expenditure budget. The Condition will be in effect whenever Condition 1 is in effect.

Reporting Requirement 1

Frontier North, Inc. and Frontier Communications of the Carolinas Inc. shall file with the Chief Clerk of the Commission copies of all documents relating to the Special Payment Financing and any Spinco Securities issued pursuant to the Distribution Agreement and the Merger Agreement within 10 days after the closing of the proposed transaction. The documents shall be posted in this docket.

Reporting Requirement 2

Following the proposed reorganization, Frontier North, Inc. and Frontier Communications of the Carolinas Inc. shall file with the Chief Clerk of the Commission and the manager of the Finance Department all credit rating reports published by Moody's Investors Service, Standard & Poor's and Fitch Ratings relating to changes in Frontier Communications Corporation's (and any of its affiliates' and subsidiaries') ratings outlooks or credit ratings within 10 days of their publication. Such reports shall be posted in this docket. This condition shall remain in effect until Frontier Communications Corporation's issuer credit rating meets two of the following three credit ratings: BBB from Standard & Poor's, Baa2 from Moody's Investors Service and BBB from Fitch Ratings. Notwithstanding Frontier's ability to obtain the issuer credit ratings to remove this Reporting Requirement, this Reporting Requirement shall be reinstated for so long as any of the following occurs: Standard & Poor's or Fitch Ratings gives Frontier's issuer credit rating at or below BB or Moody's Investor Service gives Frontier's issuer credit rating at or below Ba2.

Reporting Requirement 3

Frontier North, Inc. and Frontier Communications of the Carolinas Inc. shall file with the Chief Clerk of the Commission a statement describing the post-merger

capital structure and overall cost of capital of Frontier North, Inc., Frontier Communications of the Carolinas Inc. and Frontier Communications Corporation. The statement shall be posted in this docket.

Condition 3 (Relating to OSS Changes):

For a period of three years after the date that Frontier Communications Corporation closes this proposed transaction, before any operations support system integration between the current Verizon Illinois and Frontier Illinois territories may occur, Frontier's management must present an operations support system integration plan to the Chief Engineer of the ICC's Telecommunication's Division for review and approval, and Frontier will not proceed with any operations support system integration effort in or for its Illinois operations until it has received the written approval of the Chief Engineer of the ICC's Telecommunication's Division. Frontier's integration plan will describe the operations support system to be replaced, the surviving operations support system, and why the change is being made. The operations support system integration plan will describe any previous experience Frontier has with integrating the operations support systems in other jurisdictions, specifying any problems that occurred in that integration process and what has been done to avert those problems in Illinois. Frontier must specify the impact on personnel levels in Illinois, where the system is currently operated from and will be operated from, as well as the name of any consulting firm assisting in the operations support system integration effort. Frontier's operations support system integration plan will also contain planned actions in the event of a "worst case" scenario, such as having to restore the previous operations support system.

Condition 4 (Relating to Bookkeeping and Audit):

1. Commission Staff will be granted access to all books, accounts, records and personnel of Frontier and all of their utility and non-utility affiliated sister and subsidiary companies, as well as independent auditor's working papers, to the extent permitted by the rules and policies of the independent auditor;

2. Frontier will continue to comply with 83 Ill. Admin. Code 711, Cost Allocation Rules for Large Local Exchange Carriers; and

3. Frontier will conduct an annual internal audit to test compliance with Section 7-204(b)(2) and 7-204(b)(3). The internal audit report will be submitted to the Manager of Accounting of the Commission by April 30th of each year and associated working papers will be available to Commission Staff for review. The first report will be due April 30, 2011 and will cover calendar year 2010.

   The purpose of the internal audit will be to document the procedures performed and conclusions to determine that cost allocations between regulated and non-

regulated activities are in compliance with Frontier's cost allocation manual filed with the Commission and that the cost allocation manual is correct and complete.

Condition 5 (Related to Wholesale Pricing):

1. Frontier will assume or take assignment of all obligations under Verizon's current interconnection agreements, interstate special access tariffs and intrastate tariffs, commercial agreements, line sharing agreements, and other existing arrangements with wholesale customers ("Assumed Agreements"). Frontier shall not terminate or change the rates, terms or conditions of any effective Assumed Agreements during the unexpired term of any Assumed Agreement or for a period of 30 months from the closing of the proposed transaction, whichever occurs later unless requested by the interconnecting party, or required by a change of law.

2. Frontier will allow requesting carriers to extend existing interconnection agreements, whether or not the initial or current term has expired, until at least 30 months from the closing of the proposed transaction, or the date of expiration, whichever is later. This commitment will not affect the scope of Frontier's negotiation rights where a wholesale customer seeks to terminate and renegotiate or arbitrate a new agreement.

3. Rates for tandem transit service, any special access tariffed offerings or any intrastate wholesale tariffed offering, reciprocal compensation and TELRIC 252(c)(2), and (d), rates for 251(c) facilities or arrangements shall not be increased by Frontier for at least 30 months from the closing of the proposed transaction; nor will Frontier create any new rate elements or charges for distinct facilities or functionalities that are currently already provided under existing rates.

Condition 6 (Related Broadband Deployment):

1. Frontier must bring New Communications of the Carolinas Inc. (the former Verizon South) into compliance with Section 13-517 within 24 months following the closing of the merger transaction. Frontier must also file a report with the Commission when New Communications of the Carolinas Inc. meets the 13-517 criteria, a report that would alert the Commission that Frontier has reached the goal and describe in detail how the goal was met.

2. Frontier shall deploy Digital Subscriber Line (DSL) broadband facilities such that by December 31, 2013, 85% of the households within the service territory of the New Frontier Illinois ILECs are able to access broadband service provided by Frontier at speeds of up to 3.0Mbps download speed.

Condition 7 (Related to Retail Pricing):

> Frontier shall cap all regulated noncompetitive retail rates for the former Verizon operating companies for three years from the date of closing of the proposed transaction. After three years, Frontier may propose noncompetitive retail rate increases. However, in doing so, Frontier must present a rate case in order to make any noncompetitive rate increases.

DOD/FEA CONDITION

For a minimum period of three (3) years after the close of the transaction, the New Frontier Illinois ILECs (as that term is defined in the Staff Conditions) shall cap the rates for Retail Flat and Measured Rate Business Services (1FB and 1MB), and PBX, Centrex, and interstate and intrastate special access services, at their levels in effect at the close of the transaction. The New Frontier Illinois ILECs may petition the Commission to seek recovery from the impact of exogenous events that materially impact the operations of the New Frontier Illinois ILECs, including but not limited to, orders of the Federal Communications Commission ("FCC") and this Commission (such as a generic intrastate access proceeding); DoD/FEA may file to participate in the Commission's consideration of such a petition by Frontier.

AG/CUB CONDITIONS

The following commitments are in addition to the commitments already made in Frontier corrected Exhibit 8.4.A as filed with the Commission on January 26, 2010. Consistent with the existing definitions in Exhibit 8.4.A, Frontier Communications Corporation shall be referred to as "Frontier." The post-closing local exchanges currently operated in Illinois by Verizon North, Inc. and Verizon South, Inc. will be referred to as the "New Frontier ILECs" or the "New Frontier Illinois ILECs." All provisions would apply for three years after the closing of the transaction unless otherwise noted:

Financial Conditions

1. Beginning at the date of closing, the New Frontier Illinois ILECs must submit a quarterly report to the Commission on e-Docket in Docket 09-0268 listing the balance of the intercompany receivables and payables showing the beginning balance, the change for the quarter and the ending balance of those accounts. The New Frontier Illinois ILECs must also include in this quarterly report the dividend amount the New Frontier Illinois ILECs paid to Frontier, the parent. This report must also show the dividend payment Frontier, the parent, paid to its shareholders (in total and per share) by quarter. This Condition (1) shall remain continuously in effect until (i) at a minimum Frontier Communication Corporation's issuer credit rating meets two of the following three credit ratings: BBB from Standard & Poor's, Baa2 from Moody's Investors Service or BBB from Fitch Ratings, or (ii) for five years following the closing the proposed transaction,

whichever is earlier. Condition (1), i.e., the Service Standards requirement and the prohibition on dividends or other cash transfers, shall be automatically reinstated if at any time Standard & Poor's or Fitch Ratings gives Frontier an issuer credit rating below BB or Moody's Investor Service gives Frontier an issuer credit rating below Ba2.

2. Within 30 days after the close of the transaction, the New Frontier Illinois ILECs must notify Commission Staff, OAG and CUB of the Frontier post-transaction (a) consolidated Net Debt/EBITDA on a pro forma basis as of closing and (b) the number of shares issued to Verizon shareholders at closing, the price per Frontier share used to determine transaction shares and the calculation of the share price.

3. Frontier shall immediately notify the Commission Staff, OAG and CUB of any material change to the transaction terms and conditions from those set forth in the initial application that: (1) occurs while a Commission order approving the transaction is pending, or (2) occurs before the transaction is closed but after the Commission issues its order approving the transaction.

4. Frontier will provide Commission Staff, OAG and CUB a copy of the opinion of the independent valuation firm provided pursuant to the terms of Section 8.1(k) of the Merger Agreement attesting to the solvency of Frontier on a pro forma basis immediately after the closing of the Transaction and reflecting the financing thereof. This solvency opinion shall be submitted to Commission Staff, OAG and CUB within one business day of its delivery to Frontier.

Service Quality

5. In the event that business answer times reported to the Illinois Commerce Commission under 83 Illinois Administrative Code Section 730.510(b)(1) exceed sixty (60) seconds average for a quarter, the New Frontier Illinois ILECs will provide specific plans to the Commission Staff, OAG and CUB that identifies specific actions to be taken by the New Frontier ILECs to maintain business answer times at less than sixty (60) seconds. The report will be submitted within 30 days following the end of the quarter and will summarize Frontier's plans regarding training, staffing levels and other actions Frontier will take to maintain business answer times at less than sixty (60) seconds. That plan shall also include a budget for the remedial actions to be taken, and Frontier will commit to make the expenditures forecast in that budget and will not use the budgeted funds for any other purpose. This condition will remain in effect for the same duration specified in Frontier Corrected Exhibit 8.4A, Condition 1(d).

DSL/Broadband Deployment

6. As part of its commitment included in Frontier Corrected Exhibit 8.4A, Condition 6 to deploy Digital Subscriber Line (DSL) broadband facilities to 85% of the households with the service territory, the New Frontier Illinois ILECs shall expend no less than $40 million on broadband deployment in the New Frontier Illinois ILECs' territories by December 2013; provided, however, that the New Frontier Illinois ILECs shall meet the broadband deployment commitments in Frontier corrected Exhibit 8.4.A without regard to the amount actually expended.

7. The New Frontier Illinois ILECs shall submit an informational filing for its broadband deployment strategy within 90 days of the transaction closing date. The New Frontier Illinois ILECs will consult with Commission Staff, OAG and CUB regarding the geographic scope of the broadband deployment (including the specific wire centers that will be included) and the timelines for its implementation. The New Frontier Illinois ILECs must file annual progress reports on broadband deployment with the Commission no later than May 1 of each succeeding year following the close of the merger through May 1, 2014. The informational filing and subsequent annual report must contain information on a wire center basis as of December 31of the previous year including:

   - the total number of retail residential and business subscriber lines served by the company;
   - the total number of households in the service territory;
   - the number of broadband-capable subscriber lines by technology (DSL, FTTP and others);
   - the number of broadband subscribers by technology, including both subscribers of standalone broadband services and subscribers of bundles that contain broadband services, and
   - total expenditures associated with new broadband deployment in the previous calendar year by technology.

   In addition, the New Frontier Illinois ILECs will provide Commission Staff, OAG and CUB with periodic updates as broadband is deployed in groups of communities and wire centers throughout the state.

8. The New Frontier Illinois ILECs shall make a stand-alone DSL offering available to consumers and continue to offer stand-alone DSL services at the Verizon ILECs rates, terms and conditions in effect in Illinois at closing for 12 months after the closing of the transaction.

Retail Services Rates

9. The New Frontier Illinois ILECs will not seek to recover from customers any separation, branding, transaction, and/or transition costs associated with this transaction. The types of costs in this category include but are not limited to, transaction costs (accounting, financing, banker, legal advisor, investment banker, and other fees), severance costs, new employees employment costs, increased management costs, and the costs of developing and establishing the brand name. For a period of five years after closing of the proposed transaction, the New Frontier Illinois ILECs will not seek to recover from customers the costs associated with the cutover from the replicated Verizon OSS to Frontier's existing OSS.

10. The New Frontier Illinois ILECs, or their affiliates, shall offer customers of Verizon intrastate long distance services and packages the option to change long distance carriers without incurring a Primary Interexchange Carrier ("PIC") charge for a minimum period of ninety (90) days after the completion of the transaction.

11. The New Frontier Illinois ILECs shall continue to offer and provide bundled regulated telecommunications services as offered by Verizon ILECs in Illinois as of closing for a minimum of twelve (12) months following the close of the transaction.

12. The New Frontier Illinois ILECs will not advocate in any general rate case proceeding for a higher overall cost of capital as compared to what its cost of capital would have been absent the transaction.

13. The New Frontier Illinois ILECs shall cap all regulated noncompetitive retail rates for the former Verizon operating companies for three years from the date of closing of the proposed transaction. During this three-year period, this limitation will continue to apply to services classified as noncompetitive as of the closing of the proposed transaction regardless of whether the noncompetitive service is reclassified as competitive at a later date. The New Frontier Illinois ILECs agree not to file a request for a general increase in rates or for an alternative form of regulation prior to the expiration of the rate cap.

14. Upon execution of this Agreement and until closing or withdrawal of the proposed transaction or notice that the transaction will not close, Verizon North and Verizon South shall not seek to increase rates for stand-alone DSL services, any regulated noncompetitive retail rates, or rates for bundled regulated telecommunications services provided by Verizon ILECs in Illinois, or above the rate levels at the time this Agreement is executed and shall not seek to reclassify a regulated noncompetitive retail service to a competitive service as defined by

the Public Utilities Act. Verizon's execution of this Agreement is limited to this paragraph 14.

Operations Support Systems

15. After the cut-over from the Verizon operating systems to Frontier's operating systems in West Virginia and for a period of one year following the closing of the proposed transaction the New Frontier Illinois ILECs will report to the Staff, the OAG, and CUB on a quarterly basis (a) the service quality measures reported to the Consumer Advocate Division of the West Virginia Public Service Commission and (b) ARMIS service quality data for West Virginia, from the date that the Frontier operating system begins to provide service in West Virginia. If issues or problems arise as a result of the cut-over in West Virginia, the New Frontier Illinois ILECs will identify those issues or problems and what was done to remedy those problems.

16. The New Frontier Illinois ILECs will provide the Staff, the OAG, and CUB a copy of the report documenting the replicated systems' functionality prepared in accordance with Frontier Ex. 8.1, para. I.1.e. during the test period prior to the closing of the transaction. The New Frontier Illinois ILECs will also provide the Staff, the OAG, and CUB the reports concerning any tests of retail service provided to the Oregon, Washington or Ohio Staff as part of the proposed transaction.

17. Frontier shall notify the Staff, the OAG, and CUB when the replicated operating system is put into service in Illinois. Further, Frontier will not proceed with closing of the proposed transaction unless and until it has validated that the operational support systems ("OSS") are fully functioning and operational. Frontier shall provide a report to the Commission, Staff, OAG and CUB confirming that the OSS are operating in accordance with the terms of the merger agreement at least five days prior to close.

18. The New Frontier Illinois ILECs will provide the Staff, the OAG and CUB a detailed OSS integration plan no less than 180 days before the planned implementation of a new customer service and billing OSS to replace the replicated Verizon customer service and billing OSS in Illinois, and the provisions in Frontier Corrected Exhibit 8.4A, Condition 3 will apply for five years after closing of the proposed transaction.

19. Upon execution of this Agreement, OAG and CUB agree to file a notice in the referenced docket, served upon all parties, stating that "OAG/CUB have reached a resolution of all of its issues with Joint Applicants and that OAG/CUB does not oppose the proposed transaction subject to the conditions contained herein and Frontier Corrected Exhibit 8.4a and Frontier Exhibit 8.1." OAG and CUB will not

file a brief, proposed order or any other filings seeking to impose other conditions or opposing the transaction in this proceeding.

20. No party to this agreement waives any right it may have independent of this agreement to seek resolution of any dispute arising from or independent of this agreement before the Illinois Commerce Commission.

21. The New Frontier Illinois ILECs will submit information and data to the Commission Staff, OAG and CUB identified in this Agreement as “public” information to the extent it is filed as “public” with other state commissions where the same information and data are submitted.

22. Within ten (10) days after closing of the proposed transaction, the New Frontier Illinois ILECs will designate a regulatory contact person to work with and communicate with Commission Staff, OAG and CUB regarding fulfillment of the commitments and conditions included in this Agreement after closing of the proposed transaction.