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November 2, 2009

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OREGON PUBLIC UTILITY COMMISSION
ATTENTION: FILING CENTER
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RE: Docket No. UM 1431 – **In the Matter of VERIZON COMMUNICATIONS INC. and FRONTIER COMMUNICATIONS CORPORATION Joint Application for an Order Declining to Assert Jurisdiction Over, or, in the Alternative, Approving the Indirect Transfer of Control of Verizon Northwest Inc.**

Enclosed for electronic filing in the above-captioned docket is the Public Utility Commission Staff's Redacted Direct Testimony.

/s/ Kay Barnes
Kay Barnes
Regulatory Operations Division
Filing on Behalf of Public Utility Commission Staff
(503) 378-5763
Email: kay.barnes@state.or.us

c: UM 1431 Service List (parties)

PUBLIC UTILITY COMMISSION OF OREGON

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UM 1431

STAFF OPENING TESTIMONY OF

Michael Dougherty
Jorge Ordonez
Irina Phillips
Roger White
Wolodymyr Birko
Kay Marinos

In the Matter of VERIZON COMMUNICATIONS INC. and FRONTIER COMMUNICATIONS CORPORATION Joint Application for an Order Declining to Assert Jurisdiction Over, or, in the Alternative, Approving the Indirect Transfer of Control of Verizon Northwest Inc.

REDACTED VERSION

November 2, 2009

CASE: UM 1431
WITNESS: Michael Dougherty

PUBLIC UTILITY COMMISSION
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Administrative Hearing Division

STAFF EXHIBIT 100

Direct Testimony

November 2, 2009

1 **Q. PLEASE STATE YOUR NAME, OCCUPATION, AND BUSINESS**
2 **ADDRESS.**
3 A. My name is Michael Dougherty. I am the Program Manager for the Corporate
4 Analysis and Water Regulation Section of the Public Utility Commission of
5 Oregon (Commission). My business address is 550 Capitol Street NE Suite
6 215, Salem, Oregon 97301-2551.
7 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND WORK**
8 **EXPERIENCE.**
9 A. My Witness Qualification Statement is found in Exhibit Staff/101.
10 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**
11 A. The purpose of my testimony is three-fold. First, I am the lead witness for the
12 Commission Staff (Staff) in this proceeding. Accordingly, I am familiar with
13 Staff sponsored testimony and recommended ordering conditions. Second, I
14 will generally discuss the structure of this transaction, potential risks of the
15 transaction, and mitigation of these risks. Third, I will list Staff's recommended
16 ordering conditions proposed by Staff in this docket.
17 **Q. WHAT IS STAFF'S RECOMMENDATION CONCERNING THIS DOCKET?**
18 A. Staff recommends the Commission deny Verizon Communication Inc.'s
19 (Verizon) and Frontier Communications Corporation's (Frontier) (jointly the
20 Applicants) request to approve this transaction. There are significant risks
21 posed by this transaction which the Applicants have failed to adequately
22 address.
23

1 **Q. ARE THERE ANY CIRCUMSTANCES UNDER WHICH STAFF WOULD**
2 **RECOMMEND THE COMMISSION APPROVE THE TRANSACTION?**
3 A. Yes. The Commission could approve the transaction subject to the Applicants
4 voluntarily offering conditions or commitments that either reduce the numerous
5 risks of the transaction (as outlined later in testimony), or offset the risks.
6 Although Staff believes its recommended conditions (discussed later in
7 testimony) reduce the risks of the transaction, Staff does not believe its
8 conditions will completely mitigate the risks associated with the transaction. As
9 explained later in testimony, the financial risks imposed by the transaction are
10 difficult to address since "ring fencing" (discussed later in testimony) the
11 Oregon operating companies (i.e., the two Frontier subsidiaries that will
12 operate as telecommunications utilities in Oregon) from Frontier is a challenge
13 due to Frontier's proposed organizational structure. This proposed
14 organizational structure does not appear to include such matters as the ability
15 of the Oregon operating companies to issue their own debt, ability to obtain
16 and maintain stand-alone debt ratings, and have an independent director
17 whose vote is necessary to allow for voluntary bankruptcy.
18 **Q. DO YOU FURTHER QUALIFY YOUR RECOMMENDATION?**
19 A. Yes. Because there is only one round of testimony for Staff and Intervenors, I
20 have not been able to review for this testimony any modified or additional
21 conditions submitted by Intervenors. The Intervenors may identify additional
22 exposure to risks such that modification or addition to Staff's recommended
23 ordering conditions is warranted.

Q. PLEASE PROVIDE A LIST OF STAFF WITNESSES, EXHIBIT NUMBERS, AND THE SUBJECTS EACH ADDRESSES.

A. Staff witnesses who are providing direct testimony in this docket are as follows:

Table 1 – Staff Assignments

Witness	Exhibit	Subject(s)
Dougherty	100	Legal Standard; Summary of the Transaction; Verizon Divestitures; Risks and Risk Mitigation; Dividends; Ring Fencing and Other Financial Conditions; Synergy Savings; Records, Access to Books, Ratemaking; Affiliated Interest Issues, and Recommended Approval Conditions
Ordonez	200	Financial Analysis; Financial Leverage; and Credit Ratings Aspects of the Merger
Phillips	300	Revenue and other Operational Issues
White	400	Engineering and Service Assurance; Broadband Issues; and Customer Support and Billing Systems
Birko	500	Service Quality
Marinos	600	Long Distance and Competitive Issues

Q. DID YOU PREPARE EXHIBITS FOR THIS DOCKET?

A. Yes. I prepared Exhibit Staff 102, consisting of 128 separately numbered pages.

Q. HOW IS YOUR TESTIMONY ORGANIZED?

A. My testimony is organized as follows:

Issue 1, Legal Standard 4
Issue 2, Structure of Transaction, Potential Risks of the Transaction, and Mitigation of these Risks 4
Issue 3, Recommended Conditions Proposed by Staff 48

ISSUE 1 - LEGAL STANDARD

1 **Q. WHAT IS THE LEGAL STANDARD THAT THE COMMISSION SHOULD**
2 **APPLY TO THIS TRANSACTION?**
3 A. According to advice given by the Oregon Department of Justice, the
4 Commission should apply an "in the public interest, no harm" standard when
5 considering whether to approve this transaction. This is the standard the
6 Commission used in its Order No. 09-169 involving the merger between
7 CenturyTel and Embarq; and Order No. 95-526 involving a transaction
8 pursuant to ORS 759.375(1)(c) and 759.380 (sale of 23 exchanges). This is a
9 ***lesser*** standard than the "net benefits" standard employed under ORS 757.511
10 for energy utility acquisitions. Additionally, the Commission has used the "in
11 the public interest, no harm" standard for property sales including
12 telecommunication utility property sales (Commission Order No. 08-617
13 (UP 247) and Commission Order No. 02-466 (UP 195)).

14 ## ISSUE 2 - STRUCTURE OF TRANSACTION, POTENTIAL RISKS OF THE
15 ## TRANSACTION, AND MITIGATION OF THESE RISKS

16 **Q. PLEASE PROVIDE A BRIEF CHRONOLOGY OF THIS DOCKET.**
17 A. On May 29, 2009, the Applicants submitted a joint application (Application)
18 requesting a Commission order declining to assert jurisdiction over the
19 transaction, or, in the alternative, approving the indirect transfer of control of
20 Verizon Northwest Inc. (VNW). A Prehearing Conference was held on

1 June 18, 2009, and on June 19, 2009, the Administrative Law Judge (ALJ)
2 issued his Prehearing Conference Report and Ruling. On July 6, 2009,
3 Verizon and Frontier submitted testimony to support their application. On
4 July 17, 2009, the Commission issued an order denying the Applicants' request
5 for the Commission to decline assertion of jurisdiction. On August 24, 2009,
6 the ALJ granted the Citizens Utility Board (CUB) and International Brotherhood
7 of Electrical Workers' (IBEW) motion to amend the procedural schedule. On
8 October 14, 2009, the Commission issued Order No. 09-409 that dismissed
9 IBEW for its improper handling of proprietary information. Settlement
10 conferences were conducted on July 27, 2009, September 24, 2009, and
11 October 15, 2009.

12 **Q. PLEASE SUMMARIZE FRONTIER AND VERIZON'S OPERATIONS.**

13 A. According to the Application, Verizon's telephone operating company
14 subsidiaries serves approximately 35.2 million wireline access lines in
15 25 states and the District of Columbia. VNW is a certified telecommunications
16 utility in Oregon and is the second largest "incumbent local exchange provider"
17 (ILEC) with respect to access lines. VNW provides local exchange services in
18 forty-four exchanges throughout the state. As of December 31, 2008, VNW
19 served approximately 310,000 access lines in Oregon.[1]

20 Frontier is a full-service communications provider that has approximately
21 2.8 million voice and broadband connections, including 2.3 million access lines.
22 Frontier controls incumbent local exchange operations in 24 states, including

[1] Application, dated May 29, 2009, at 4 and 5.

1 its Oregon ILEC, Citizens Telecommunications of Oregon (CTCO). CTCO has
2 approximately 12,000 access lines in Oregon.[2]

3 **Q. PLEASE PROVIDE A BRIEF BACKGROUND OF THE TRANSACTION.**

4 A. The transaction is structured as a Reverse Morris Trust (RMT) transaction.[3]
5 Essentially, Verizon will spin-off VNW, certain long distance customers of
6 Verizon Long Distance, LLC (VLD) and Verizon Enterprise Solutions (VES)
7 from its current operations. To effectuate this transfer, New Communications
8 Holding, Inc. (NCH), New Communications ILEC (NCIH), and NewLD were
9 formed by Verizon. NCH is a direct, wholly-owned subsidiary of Verizon, and
10 NCIH and New LD are direct, wholly-owned subsidiaries of NCH.[4] There are
11 14 states affected by the transaction: Arizona, Idaho, Illinois, Indiana, Michigan,
12 Nevada, North Carolina, Ohio, Oregon, South Carolina, Washington,
13 Wisconsin, and West Virginia as well as a small number of access lines in
14 California bordering Arizona, Nevada, and Oregon.[5] The total number of
15 access lines being transferred to Frontier, through NCH is approximately
16 4.8 million,[6] including the 310,000 lines in Oregon. Thus, the Oregon share of
17 the transaction with respect to access lines is roughly 6.5 percent.

18 As explained in the Application, after a series of intra-corporate stock
19 transfers, the stock of VNW and other affected ILECs will be transferred to

---

[2] Application, dated May 29, 2009, at 4 and 5.
[3] A Reverse Morris Trust (RMT) transaction is a merger and acquisition method that allows a company to complete a sale of a division or divisions without incurring any corporate tax in the transaction. The RMT fall under section 355 of the Internal Revenue Service (IRS). It is analyzed by the Internal Revenue Service, Internal Revenue Bulletin 2003-29. http://www.irs.gov/irb/2003-29_IRB/ar09.html
[4] Application, dated May 29, 2009, at 5.
[5] *Id.* at 5 and 6.
[6] *Id.* at 5.

1 NCH. Similarly, VLD and VES will transfer their accounts receivable and
2 customer relationships related to their long distance operations in Oregon and
3 other affected states to NewLD.[7] In addition to acquiring Verizon's local
4 exchange and long distance business in the affected states, Frontier will also
5 acquire high speed internet, and where provided, wireline video and broadband
6 data (Verizon FiOS).[8] The stock of NCH will then be distributed to Verizon
7 shareholders as a spin-off. Immediately following the spin-off, NCH will be
8 merged into Frontier. Frontier will be the surviving holding company operating
9 under its existing name and corporate structure, but owning all of the stock of
10 NCH's subsidiaries, NCIH, and NewLD.

11 Once the transaction is completed, NCH will no longer exist and VNW will be
12 a wholly-owned, indirect subsidiary of Frontier providing local exchange service
13 in its current service territory.[9] Frontier will also own and control NewLD, which
14 will provide long distance services in Oregon. According to the Application,
15 immediately following the completion of the transaction, VNW will simply
16 change the name on the tariffs.[10]

17 It is important to note that a requirement of a RMT is that shareholders of the
18 seller must receive over 50 percent of the vote and value of the surviving
19 entity[11] (Frontier through NCH). In the case of this transaction, Verizon
20 shareholders will own approximately 68 percent of the post-transaction

---

[7] Application, dated May 29, 2009, at 7.
[8] *Id.*
[9] VNW will be a direct subsidiary of NCIH, which will be a direct subsidiary of Frontier.
[10] Joint Application, dated May 29, 2009, at 7.
[11] Internal Revenue Bulletin 2003-29. http://www.irs.gov/irb/2003-29_IRB/ar09.html

1 Frontier, while current Frontier shareholders will own approximately 32 percent
2 of the post-transaction Frontier. The actual percentage of ownership may vary
3 as the Agreement and Plan of Merger (Merger Agreement) provides for a total
4 of $5.247 billion in equity to be issued to Verizon shareholders excluding any
5 adjustments that may be paid or payable by Verizon to its subsidiaries
6 pursuant to orders or settlements to obtain governmental approvals in the
7 Spinco (NCH) territory that are required in order to complete the merger or
8 spin-off.[12] The actual amount of shares will be determined by the price of
9 Frontier's shares as of the distribution date.[13] Based on an anticipated price of
10 $7.75 per share,[14] 677,032,258 shares would be distributed to Verizon
11 shareholders.[15] Additionally, according to the Merger Agreement, if the price of
12 Frontier's stock drops below $7.00, then the Company average price will equal
13 $7.00. A price of $7.00 would result in 749,571,429 shares being distributed.[16]
14 If the stock price exceeds $8.50, then the Company average price will equal
15 $8.50. A price of $8.50 would result in 617,294,118 shares being distributed.[17]
16 At the close of the market on October 27, 2009, Frontier's stock price was
17 $7.15.
18 In addition to the $5.247 billion in equity, the transaction includes a special
19 cash payment of no greater than $3.3 billion dollars.[18] As a result, Frontier will

[12] Applicants' response to Staff Data Request No. 17. Included in Exhibit Staff 102, page 1.
[13] Agreement and Plan of Merger, Section 1.23, at 6. Included in Exhibit Staff 102, page 2.
[14] Applicants' response to Staff Data Request No. 16. Included in Exhibit Staff 102, page 3.
[15] Staff's calculated number of shares does not include shares reserved for issuance. *See* response to Staff Data Request No. 16.
[16] Applicants' response to Staff Data Request No. 17. Included in Exhibit Staff 102, page 1.
[17] *Id.*
[18] See Staff/200 for discussions on debt.

1 be required to obtain sufficient financing to complete this transaction. As a
2 comparison, the CenturyTel/Embarq transaction (UM 1416) did not include the
3 issuance of any incremental debt.

4 **Q. HAVE THE APPLICANTS FILED A SIMILAR APPLICATION IN OTHER**
5 **STATES?**

6 A. Yes. As a result of being under certain regulatory requirements by federal and
7 state agencies, the Applicants were required to file for approval in several
8 jurisdictions. The table below summarizes the status of jurisdictional approvals
9 as of October 29, 2009 (based on information provided from other states).

10 **Table 2 – Filings with Other Regulatory Agencies**

Regulatory Agency	Current Status if Approval is Pending	Scheduled Hearing Date (if applicable)	Status (Approved, Other)
FCC	Application filed 5/28/09 and 5/29/09, amendment filed 6/8/09		
DOJ	The companies' Hart-Scott-Rodino (HSR) filings filed.[19]		Granted request for early termination of HSR filings
State			
Arizona	Application filed 5/29/09	October 26, 2009	Testimony filed October 19, 2009
California	Application filed 6/04/09	N/A	Approved - October 29, 2009, public meeting

11

[19] The Hart-Scott-Rodino Act established the federal premerger notification program, which provides the FTC and the Department of Justice with information about large mergers and acquisitions before they occur. The parties to certain proposed transactions must submit premerger notification to the FTC and DOJ. http://www.ftc.gov/bc/hsr/index.shtm

Regulatory Agency	Current Status if Approval is Pending	Scheduled Hearing Date (if applicable)	Status (Approved, Other)
Illinois	Application filed 6/04/09	January 19-21, 2010	Testimony filed October 20, 2009
Nevada	Application filed 6/03/09	October 23, 2009	Joint Stipulation of Staff/Joint Applicants approved October 28, 2009
Ohio	Application filed 5/29/09	Three public hearings scheduled, no Commission hearing scheduled	Testimony filed October 8, 2009
South Carolina	Application filed 5/29/09	August 27, 2009	Joint Proposed Order approved
Washington	Application filed 5/29/09	December 15-18, 2009	Testimony to be filed November 3, 2009
West Virginia	Application filed 5/29/09	January 12, 2010	Testimony to be filed November 16, 2009

1

2 **REVERSE MORRIS TRUST AND VERIZON DIVESTITURES**

3 **Q. BECAUSE THE RMT TRANSACTION IS A TAX-FREE TRANSACTION,**
4 **ARE CUSTOMERS OR THE PUBLIC HARMED BY THIS STRUCTURE**
5 **SINCE TAXES WILL NOT BE ASSESSED ON THE DISPOSITION OF THE**
6 **PROPERTIES?**

7 A. The structure of the transaction does not, in itself, pose harm to customers. A
8 RMT transaction is a merger and acquisition method that allows a company to
9 complete a sale of a division or divisions without incurring any corporate tax
10 liability. As previously mentioned, a requirement of a RMT is that shareholders

1 of the seller must receive over 50 percent of the vote and value of the surviving
2 entity (Frontier through NCH). In the case of this transaction, Verizon
3 shareholders will own approximately 68 percent of the post-transaction
4 Frontier, while current Frontier shareholders will own approximately 32 percent
5 of the post-transaction Frontier.

6 **Q. HAS VERIZON PERFORMED ANY RECENT DIVESTITURES INCLUDING**
7 **A RMT TRANSACTION?**

8 a. Yes. Verizon has performed three recent divestitures including a RMT
9 structured transaction to transfer properties. All three of the entities acquiring
10 Verizon properties, (Hawaiian Telcom, Idearc, and FairPoint) have filed for
11 bankruptcy. Hawaiian Telecom was purchased by the Carlyle Group in 2005
12 and filed for bankruptcy on December 1, 2008. Idearc Media LLC was spun-off
13 as a stand-alone company in October 2006 and filed for bankruptcy on March
14 31, 2009. FairPoint, which was structured as a RMT transaction, purchased
15 the assets of Verizon New England Inc., on March 31, 2008, and filed for
16 bankruptcy on October 26, 2009.[20] Prior to filing bankruptcy, FairPoint was
17 experiencing numerous difficulties including credit downgrades, operational
18 and billing system problems, phone service reinstatements, and roll out of new
19 products and services to lure new customers.[21] In addition, a recent article in
20 the Wall Street Journal highlights the revenue and cash flow difficulties that

[20] FairPoint Communications Earnings and Press Releases, dated October 26, 2009. Included in Exhibit Staff 102, pages 4-5.
[21] FairPoint facing serious credit problems; company downgraded; published May 9, 2009. www.timesargus.com. Included in Exhibit Staff 102, pages 6-7.

1 FairPoint and Idearc experienced post-transfer.[22] In the October 26, 2009,
2 press release, FairPoint stated:

3 To facilitate the implementation of the Restructuring Plan, the
4 Company also announced that it and all of its subsidiaries have
5 filed voluntary petitions for reorganization under Chapter 11 of
6 the U.S. Bankruptcy Code in the United States Bankruptcy
7 Court for the Southern District of New York (the "Court"). The
8 Restructuring Plan must be approved by the Court and the
9 Company intends to promptly file a plan of reorganization
10 reflecting the Restructuring Plan with the Court. The Company
11 and its subsidiaries expect to continue to operate their business
12 in the ordinary course throughout the Chapter 11 process under
13 the jurisdiction of the Court while it seeks confirmation of the
14 Restructuring Plan.[23]
15
16 Because of the unfavorable results of previous Verizon's divestitures including
17 the FairPoint RMT transaction, identifying and analyzing the risks of this
18 transaction is not an academic exercise. Staff has reviewed these other
19 transactions and has carefully crafted conditions to address the risks posed by
20 the Application.

21 **Q. BASED ON THE DOCUMENTED DIFFICULTIES CONCERNING THE**
22 **POST-TRANSFER FAIRPOINT, HOW DO THE APPLICANTS PROPOSE**
23 **TO AVOID SIMILAR PROBLEMS?**

24 A. In FTR/100, McCarthy/33-39, Frontier's witness Daniel McCarthy explains
25 reasons why the Frontier transaction will not result in the difficulties of the
26 FairPoint transaction. The reasons include:

27 • Frontier's previous experience in acquisitions that included over
28 300,000 access lines in Minnesota, Illinois, and Nebraska in

[22] http://online.wsj.com/articles/SB124994640773620919.html?mg=com.wsj. Included in Exhibit Staff 102, pages 8-9.
[23] FairPoint Communications Earnings and Press Releases, dated October 26, 2009. Included in Exhibit Staff 102, pages 4-5.

2000; 1.1 million access lines purchased from Global Crossing in 2001; and acquisition of over 320,000 ILEC and 100,000 CLEC from Commonwealth Telephone Company in 2007.[24]

- Successful conversion of customer billing and service system in 2008. According to Frontier, the Company converted and transitioned five different billing systems into one standard customer service and billing system.[25]

- Frontier will not be developing operational, customer support, and financial systems and then cutting over to the new systems to operate in Oregon.[26] Prior to closing, Verizon will replicate and physically separate Verizon's customer support systems from the systems it will continue to use for its own operations after close. These separate systems will be dedicated to Frontier operations.[27] Additionally, Verizon will provide system support for at least a year after close.[28]

- The transaction will significantly deleverage Frontier's balance sheet as the Company's debt-to-EBITDA ratio will drop from 3.8 to 2.6.[29] Additionally, Frontier on a pro forma basis is anticipating a free cash flow of $1.4 billion (compared to $500 million on a stand-alone basis) and a reduced dividend per share of $0.75 (from $1.00), which reduces the dividend payout ratio from approximately 64.6 percent to 43 percent.[30]

However these commitments are either non-specific to Oregon or are not quantified in benchmarks. Although the Applicants highlight the benefits of the transaction, Frontier's S-4 filing with the SEC points out numerous risks associated with the transaction on pages 24-36. These risks include:

- The calculation of the merger consideration will not be adjusted in the event the value of the Spinco business or assets declines before the merger is completed. The value of the Spinco business and assets may have an effect on the value of Frontier

[24] FTR/100, McCarthy/33-34.
[25] FTR/100, McCarthy/35.
[26] FTR/100, McCarthy/36.
[27] FTR/100, McCarthy/40.
[28] FTR/100, McCarthy/41. Please also see Applicant's responses to Comcast Data Requests No. 23 and 24. Included in Exhibit Staff 102, pages 10-11.
[29] FTR/100, McCarthy/36.
[30] FTR/100, McCarthy/27-28.

common stock following completion of the merger. Frontier will also not be permitted to terminate the merger agreement because of any changes in the market price of Frontier common stock.[31]

- Frontier's effort to combine Frontier's business and the Spinco business may not be successful. The acquisition of the Spinco business is the largest and most significant acquisition undertaken by Frontier. Frontier management will be required to devote a significant amount of time and attention to the process of integrating the operations of Frontier's business and the Verizon business, which may decrease the time they will have to serve existing customers, attract new customers, and develop new services strategies. The size and complexity of the Spinco business after the merger, if not managed successfully by Frontier management, may result in interruptions of the business activities of the combined company that could have a material adverse effect on the combined company's business, financial condition and results of operation.[32]

- The combined company may not realize the growth opportunities and cost synergies that are anticipated from the merger. The combined company may be unable to eliminate duplicative costs, or the benefits from the merger may be offset by costs incurred or delays integrating the companies.[33]

- Sales of Frontier common stock may negatively affect its market price. The market price of Frontier common stock could decline as a result of sales of a large number of shares of Frontier common stock in the market after the completion of the merger or the perception that these sales could occur.[34]

- If the assets contributed to Spinco by Verizon are insufficient to operate the Spinco business, it could adversely affect the combined company's business, financial condition and results of operations.[35]

[31] Frontier Communications SEC Form S-4 Registration Statement (filed July 24, 2009), at 24. Included in Exhibit Staff 102, pages 12-24.
[32] *Id.*
[33] *Id.* at 25.
[34] *Id.*
[35] *Id.*

- The combined company's business, financial condition and results of operations may be adversely affected following the merger if it is not able to obtain consents to assign certain Verizon contracts to Spinco. Certain wholesale, large business, Internet service provider, and other customer contracts that are required to be assigned to Spinco by Verizon require the consent of the customer party to the contract to effect this assignment. Verizon and the combined company may be unable to obtain these consents on terms favorable to the combined company or at all, which could have a material adverse impact on the combined company's business, financial condition and results of operations following the merger.[36]

- Regulatory agencies may delay approval of the spin-off and the merger, fail to approve them, or approve them in a manner that may diminish the anticipated benefits of the merger.[37]

- The merger agreement contains provisions that may discourage other companies from trying to acquire Frontier. According to Applicants, the Merger Agreement contains provisions that may discourage a third party from submitting a business combination proposal to Frontier prior to the closing of the merger that might result in greater value to Frontier stockholders than the merger.[38]

- Frontier will be unable to take certain actions after the merger because such actions may jeopardize the tax-free status of the spin-off or merger, and such restrictions can be significant. These restrictions include any transaction involving the acquisition, issuance, repurchase or change of ownership of Frontier capital stock.[39]

- The combined company will likely face further reductions in access lines, switched access minutes of use, long distance revenues, federal and state subsidies and related revenues which could adversely affect it. The businesses that will make up the combined company have experienced declining access lines, switched access minutes of use, long distance revenues, federal and state subsidies and related revenue because of economic conditions, increasing competition, changing consumer behavior (such as wireless displacement of wireline

[36] *Id.* at 26.
[37] *Id.*
[38] *Id.*
[39] *Id. at* 28.

use, e-mail use, instant messaging and increasing use of Voice over Internet Protocol, referred to as VoIP), technology changes and regulatory constraints.[40]

- The combined company will face intense competition. The combined company's competitors will include competitive local exchange carriers and other providers of services, such as Internet service providers (or potential providers) of services, such as Internet service providers, wireless companies, VoIP providers and cable companies.[41]

- Some of the combined company's future competitors will have superior resources, which may place the combined company at a cost and price disadvantage. In addition, some of these future competitors will be able to raise capital at a lower cost than the combined company.[42]

- The combined company may be unable to grow its revenues and cash flows despite the initiatives Frontier has implemented and intends to continue after the merger.[43]

- Weak economic conditions may decrease the demand for the combined company's services. The combined company could be sensitive to the ongoing recession if current economic conditions or their effects continue following the merger.[44]

- Disruptions in the combined company's networks and infrastructure may cause the combined company to lose customers and incur additional expenses.[45]

- The combined company's business will be sensitive to the creditworthiness of its wholesale customers.[46]

- Substantial debt and debt service obligations may adversely affect the combined company. Frontier has a significant amount of indebtedness, which amounted to approximately $4.725 billion as of March 31, 2009. The Spinco business will have indebtedness in the amount of approximately $3.4 billion

[40] *Id.* at 29.
[41] *Id.* at 30.
[42] *Id.*
[43] *Id.* at 31.
[44] *Id.*
[45] *Id.*
[46] *Id.*

at the closing of the merge.[47] The total amount of indebtedness is anticipated to be approximately $8 billion post-transaction.

- The combined company will require substantial capital to upgrade and enhance its operations.[48]

- The combined company will be reliant on support funds provided under federal and state laws.[49]

- If the combined company does not replace or upgrade technology and equipment, it will be unable to compete and meet the needs or expectations of the customers. In addition, rapidly changing technology in the communications industry may influence the combined company's customers to consider other service providers.[50]

While some of these risks will be present regardless of whether the transaction goes forward, many of the risks identified are raised as a result of this transaction and represent potential harms to customers should they not be addressed and mitigated through conditions.

Q. ATHOUGH THERE ARE RISKS, HASN'T FRONTIER POINTED OUT THAT IT HAS A HIGHLY SUCCESSFUL TRACK RECORD OF ACQUIRING, OPERATING, AND INTEGRATING TELECOMMUNICATIONS PROPERTIES ACROSS THE COUNTRY?

A. Yes. Frontier Witness McCarthy in FTR/100, McCarthy/33-34 highlights the acquisitions that Frontier has undertaken since 1993. Based on information provided by Mr. McCarthy in testimony, the major acquisitions of ILEC lines (1.85 million) appear to have occurred between 1993 and 2001.[51] However in

[47] *Id.* at 33.
[48] *Id.* at 34.
[49] *Id. at* 35.
[50] *Id.* at 36.
[51] FTR/100, McCarthy/33-34.

FTR/100, McCarthy/45-47, Mr. McCarthy identifies the executive leadership team that will manage Frontier's operations following the close of the transaction. It is interesting to note that with the exception of Mr. McCarthy and the Chief Accounting Officer, none of the other six executives in the senior management team were employed at Frontier at the time of the major acquisitions. Additionally, Mr. McCarthy and the Chief Accounting Officer are the only two members of the senior management team that appear to have any ILEC experience. This lack of experience in ILEC acquisitions and large ILEC operations may also pose a risk to Oregon. The Company acknowledges this point in its SEC Form S-4 by stating:

> Frontier's effort to combine Frontier's business and the Spinco business may not be successful. The acquisition of the Spinco business is the largest and most significant acquisition undertaken by Frontier. Frontier management will be required to devote a significant amount of time and attention to the process of integrating the operations of Frontier's business and the Verizon business, which may decrease the time they will have to serve existing customers, attract new customers, and develop new services strategies. The size and complexity of the Spinco business after the merger, if not managed successfully by Frontier management, may result in interruptions of the business activities of the combined company that could have a material adverse effect on the combined company's business, financial condition and results of operation.[52]

It is also important to note that none of the previous acquisitions are close to the size and scope of this transaction that will result in acquiring approximately 4.8 million lines. In Oregon alone, Frontier will increase in size approximately 25 times from 12,000 to over 300,000 access lines.

[52] Frontier Communications SEC Form S-4 Registration Statement (filed July 24, 2009), at 24. Included in Exhibit Staff 102.

Q. HOW CAN THE COMMISSION REDUCE THE MANY RISKS ASSOCIATED WITH THE TRANSACTION?

A. Staff has recommended numerous conditions that are designed to protect customers and the public generally. Please note that Staff separated the conditions into general categories. These categories are:

- Records/Rates/Tariffs/Access to Books
- Financial
- Service Quality
- Operational Support Systems
- Long Distance
- Wholesale Services
- OTAP/Lifeline
- Affiliated interests/Non-regulated Operations
- Favored State Commitments/Waivers

Many of the recommended conditions are similar to the conditions ordered in Commission Order No. 09-169 involving the merger between CenturyTel and Embarq. Staff has also prepared numerous additional conditions that address long distance, service quality, Oregon Telephone Assistance Programs, and competitive issues. In some cases, Staff's recommended conditions accept the commitments Frontier offers within its testimony. The recommended conditions also require increased reporting that will allow Staff, parties, and interested parties to monitor the transition of VNW's Oregon operations to Frontier. As previously mentioned, Staff does not believe its conditions will completely mitigate the risks to meet the statutory requirements due to the financial risk posed by the change in ownership and the inability to effectively ring fence the Oregon operating companies from the parent, Frontier, under the proposed organizational structure for the Oregon operating companies.

Q. DID YOU OR OTHER STAFF PERFORM ANY RESEARCH CONCERNING THE RECENT FAIRPOINT RMT TRANSACTION?

A. Yes. Staff Witness Roger White and I engaged in a fact-finding trip to New England to gather a more detailed knowledge of the FairPoint experience, its problems and the effect of these problems on the three New England states (Maine, Vermont, and New Hampshire). The trip included discussions with staff from the state regulatory agencies for these three affected states, discussions with the Maine Office of Public Advocate, discussions with G4 and Comcast (CLECs) personnel, and attending the September 9, 2009, Joint Status Conference concerning the Transfer of Assets to FairPoint Communications, Inc. conducted by the Commissions of these three states. Staff fully realizes that Frontier is a different company than FairPoint; however; Mr. White and I were able to take back with us certain key concepts that reinforce Staff's recommended conditions. These findings are:

- A functional, verified, and tested Operational Support System (OSS) is crucial to the post-transfer Frontier operations. This includes both the Verizon replicated system and the eventual cutover to Frontier's OSS;

- A third-party tester or monitor should be required to ensure an OSS is ready to perform all functions prior to both cutovers. Test cases should include coordination with CLECs;

- The Commission should hold the Applicants to their commitments as stated in both the Application and in testimony. Notably, this includes commitments concerning broadband availability to customers and Frontier's commitment to Verizon employees;

- Conditions are required that are designed to protect Oregon ILECs from potential negative financial impacts created by Frontier or its affiliates (referred to as ring fencing conditions);
- Risks to wholesale service reliability and quality need to be addressed; and
- Enhanced reporting by Frontier post-transaction should be required.

As previously mentioned, Staff realizes that Frontier is not FairPoint. Staff recognizes that Frontier has taken positive actions to mitigate the numerous problems experienced by FairPoint. As Frontier witness McCarthy claims in testimony (FTR/100, McCarthy/33-39), Frontier believes the transaction will not result in the difficulties of the FairPoint transaction because of the Company's experience in acquisitions and actions surrounding the replication of Verizon's OSS. With that said, Staff is charged to critically examine all pertinent positions and facts presented by the Applicants and other parties; ascertain the facts; and make recommendations that assure the "no harm" standard is met and that further the public interest.[53] As such, Staff's recommended conditions are reasonable and prudent to address the risks of this specific transaction.

FRONTIER STOCK PRICES AND DIVIDENDS

Q. HOW HAS FRONTIER'S STOCK PRICE CHANGED RECENTLY?

A. The following table provided by the Applicants shows the average price per share, outstanding shares, and shares reserved for issuances for the years 2007 through 2009; and the anticipated outstanding shares post-transfer at the

[53] PUC Staff Role, dated January 31, 2003. Included in Exhibit Staff 102, page 25.

1 anticipated price of $7.75. At the close of the market on October 27, 2009,

2 Frontier's stock price was $7.15.

3 **Table 2 – Frontier Average Price Per Share**[54]

	Outstanding Shares	Avg. Price Per Share	Reserved for Issuance
2007	327,749,000	$14.38	250,544,000
2008	311,314,000	$10.85	250,544,000
2009	312,364,000	$7.10	250,544,000
Post-transfer	989,364,000	$7.75	To be Determined

4
5 As can be seen from the table, the 2009 price per share is approximately one-
6 half of the 2007 price per share. In terms of equity value (outstanding shares
7 multiplied by stock price), the 2007 equity value of approximately $4.713 billion
8 was two times the 2009 equity value of approximately $2.218 billion. This
9 decrease in the equity value of Frontier is a concern for two reasons.

10 First, while it is true that due to the deep recession many stock prices are
11 lower today than in 2007, with respect to this transaction, a Frontier post-
12 transfer dividend policy of maintaining a $0.75 per share dividend may be
13 problematic. Frontier could potentially place a higher priority on paying
14 dividends to shareholders than maintaining service quality and investing in
15 business operations. Even though Frontier is reducing its post-merger
16 dividend by 25 percent, the reduced dividend, if paid pre-transaction would still
17 be approximately 30 percent greater than Frontier's 2008 earnings per share.
18 Frontier could, based on a dividend of $0.75 per share and 989 million shares

[54] Applicants' response to Staff Data Request No. 16. Included in Exhibit Staff 102, page 3.

outstanding, pay dividends of approximately $742 million to shareholders post-merger at a dividend payout ratio of approximately 52.13 percent.[55]

Secondly, a declining stock price would result in a lower equity value portion of the Company's value resulting in increased debt leverage. To ensure the financial integrity of Frontier and the availability of cash to fund operations, Staff recommends a condition to restrict the availability of dividends to shareholders if Frontier is unable to obtain a "non-consolidation opinion" that affirms effective separation between the Oregon operating companies and Frontier. I discuss ring fencing and the non-consolidation opinion later in testimony.

Q. HAS THE COMMISSION APPROVED RESTRICTION OF DIVIDENDS OR DISTRIBUTIONS IN PREVIOUS MERGER FILINGS?

A. Yes. The Commission has routinely placed restrictions on dividends or distributions in previous merger/financing applications. These dockets/restrictions include:[56]

- UM 814 (PGE/Enron), Commission Order No. 97-196; Condition 6;
- UM 918 (PacifiCorp/ScottishPower), Commission Order No. 99-616, Condition 6;
- UF 4218/UM 1205 (PGE), Commission Order No. 05-1250, Conditions 5 and 11;
- UM 1209 (PacifiCorp/MEHC), Commission Order No. 06-082, Conditions 18 and O18;

[55] In Frontier Presentation, Welcome to the New Frontier, May 13, 2009, page 16, Frontier expects the dividend payout to be 43% after $500 million in synergies are achieved. Staff Exhibit 102, pages 26-27.

[56] Specific Conditions are included in Staff Exhibit 102, pages 28-89.

1 • UM 1283 (Cascade Natural Gas/MDU Resources), Commission Order
2 No. 07-221, Conditions 27, 28, and 29; and
3
4 • UM 1416 (CenturyTel/Embarq), Commission Order No. 09-169,
5 Condition 4.j.
6
7 **Q. IN THOSE DOCKETS THE DIVIDEND RESTRICTIONS TYPICALLY**
8 **REFER TO THE UTILITY'S DIVIDEND TO THE PARENT RATHER THAN**
9 **THE PARENT TO SHAREHOLDERS. WHY DOES STAFF'S CONDITION**
10 **APPLY TO THE LATTER RESTICTION RATHER THAN THE FORMER?**
11 A. In the other transactions, the utility was a well-defined subsidiary that had its
12 own credit rating, access to capital, restrictions on affiliated interest
13 transactions to prevent cross-subsidies, and ability to obtain a "non-
14 consolidation opinion" sufficient to ensure the integrity of the subsidiary as a
15 distinct business from the parent. This is not present in this transaction.
16 Hence in order to preserve cash for the Oregon ILECs, Staff recommended
17 dividend restriction best applies to the parent. If the dividend restriction
18 applied to the Frontier subsidiary, the effect would be to deny cash flowing
19 to the parent when the parent is in financial distress. This could compound
20 the financial difficulties of Frontier to meet its debt obligations. Without
21 sufficient financial separation of Frontier from its subsidiaries, if Frontier
22 were to default on its debt obligations, the default could directly impact its
23 subsidiaries.
24

RING FENCING THE OPERTAING COMPANIES POST-TRANSACTION

Q. PLEASE DEFINE RING FENCING.

A. Ring fencing refers to the conditions imposed in order to protect certain assets or liabilities within a corporation. The purpose of ring fencing is to isolate the utility from negative financial impacts created by its parent company or other affiliates. Ring fencing is used to:

- Ensure the utility maintains a strong credit rating and is able to attract capital;
- Prevent the utility from cross-subsidizing non-regulated utilities; and
- Ensure regulators' access to timely, accurate information.

Standard & Poor's (S&P) has previously commented on ring fencing stating:

> A weak parent has the ability and the incentive to siphon assets out of its financially healthy subsidiary and to burden it with liabilities during times of financial stress. The weak parent might also have an economic incentive to file the subsidiary into bankruptcy - - if the parent itself was forced into bankruptcy - - regardless of the subsidiary's stand-alone strength.[57]

The S&P Commentary also states:

> The difference between entities that saw their ratings fall to "D" and those that were able to maintain investment-grade ratings was due to a combination of factors. These factors (see "Ring-Fencing a Subsidiary," published Oct. 19, 1999) include the:
>
> - "Stand-alone" rating of the subsidiary,
> - Legal and structural inhibitors to a filing of the subsidiary by the parent,
> - Provision of so-called "nonpetition" language by the parent, and
> - Governmental regulatory apparatus affecting the parent and subsidiary.[58]

[57] Protecting Subsidiaries From Parents' Bankruptcies: "Ring-Fencing" as Practiced During the California Power Crisis, February 2, 2001, at 1. Included in Exhibit Staff 102, pages 90-93.
[58] *Id.* at 1.

S&P in a later Commentary states:

> Any action that state regulators take that provides support (whether legal, regulatory, financial or operational) to the utility and/or isolates the utility (most importantly financial obligations) from its parent company will be positive for credit.[59]

Q. BRIEFLY DESCRIBE THE RING FENCING ACTIONS TAKEN BY THE COMMISSION IN PREVIOUS MERGERS, ACQUISITIONS, AND TRANSFERS.

A. The following highlights certain ring fencing actions taken by the Commission in selected previous mergers, acquisitions, and transfers.

Portland General Electric / Enron (UM 814) - Ring fencing conditions included:

- Full access to information requirements and review of inter-corporate transactions involving PGE;
- Maintain separate long-term debt and preferred stock rating;
- Maintain common equity portion of at least 48%;
- PGE was required to notify the Commission of certain dividends and distributions to Enron;
- Prohibition on allocations or direct charges from Enron to PGE without Commission authorization;
- Restrictions on Enron's access to PGE's power, natural gas assets, or excess pipeline capacity;
- PGE was not allowed to seek a higher cost of capital than it would have been authorized absent the merger.

The Commission also approved "The Golden Share" which:

- Resulted in the issuance of a $1.00 Par Junior Preferred Stock;
- Created an "independent director";
- Prevented Enron from forcing PGE to file for bankruptcy; and
- Avoided future downgrades of PGE's bond ratings due to Enron's bankruptcy.

[59] Is State Utility Regulation Coming Back into Vogue – Standard & Poor's, October 4, 2002. Included in Exhibit Staff 102, pages 94-95.

1 PacifiCorp – MEHC (UM 1209) - Ring fencing adopted in UM 1209
2 enhanced the ring fencing from the ScottishPower merger (UM 918)
3 and included:
4
5 • Minimum Equity Percentage increased to 48.25% (Gives 50%
6 weighting to existing preferred stock.);
7 • Independent director – analogous to the Golden Share;
8 • Alternative minimum equity percentage of 35% which includes
9 short-term debt and capital lease obligations;
10 • Non-utility business will not be held by PacifiCorp or its
11 subsidiaries;
12 • Dividend restriction should PacifiCorp's unsecured debt rating is
13 BBB- or lower by two or more ratings agencies; and
14 • Obtaining a non-consolidation opinion.
15
16 Cascade Natural Gas– MDU Resources (UM 1283) – Ring fencing
17 adopted in UM 1209 included:
18
19 • Cascade maintained separate financial statements and other
20 financial books from MDU Resources;
21 • Any diversified holdings and investments of MDU Resources
22 would not be held by Cascade or a subsidiary of Cascade;
23 • Established an independent director;
24 • Cascade's financial securities excluding common equity (e.g.,
25 debt and preferred stock) would be maintained separate from
26 the financial securities of MDU Resources and its affiliates; and
27 • Alternative minimum equity percentage of 35% which includes
28 short-term debt and capital lease obligations; and
29 • Obtaining a non-consolidation opinion.[60]
30
31 A complete list of conditions and more in-depth detail of these conditions are
32 included in Staff Exhibit 102. It is interesting to note S&P stated:

33 Further supporting the ratings separation is the fact that
34 Standard & Poor's views the Oregon Public Utility Commission
35 (OPUC) as being among the most supportive of utility credit
36 quality in the country.[61]
37

[60] Specific Conditions are included in Staff Exhibit 102, pages 28-89.
[61] An Enron Subsidiary is Ring-Fenced, Standard & Poor's Utilities & Perspectives, January 20, 2003, at 15. Included in Exhibit Staff 102, pages 96-97.

1 **Q. PLEASE EXPLAIN A "NON-CONSOLIDATION OPINION."**

2 A. A non-consolidation opinion (NCO) is a legal opinion that is provided by a
3 qualified third-party that there is sufficient separation between a company and
4 an affiliate to ensure the integrity of the subsidiary as a distinct business from
5 the parent. As a result of the sufficient separation, the NCO provides an
6 analysis as to whether a bankruptcy court would cause a substantive
7 consolidation of the assets and liabilities of the parent and affiliate.[62]

8 **Q. HAVE PREVIOUS MERGERS AND ACQUISITIONS APPROVED BY THE**
9 **COMMISSION INCLUDED NCOS?**

10 A. Yes. UM 1209 (PacifiCorp/MEHC), Commission Order No. 06-082; and
11 UM 1283 (Cascade Natural Gas/MDU Resources), Commission Order
12 No. 07-22, both included a requirement for the parent company to obtain a
13 NCO. These conditions were listed as O17 and 30 respectively. Financial and
14 ring fencing conditions applied by the Commission in both the
15 PacifiCorp/MEHC and Cascade/MDU Resources transactions allowed the
16 utilities to obtain a favorable NCO.[63] As previously mentioned, these ring
17 fencing conditions included:

18 • Maintaining separate financial statements and other financial books;
19 • Diversified holdings and investments of the parent not being held by
20 the utility:
21 • Establishment of an independent director; and
22 • Financial securities excluding common equity (e.g., debt and preferred
23 stock) of the utility being maintained separate from the financial
24 securities of the parent and its affiliates.
25

[62] Cascade Natural Gas' non-consolidation opinion at 1. Included in Staff Exhibit 102, pages 98-111.
[63] *Id.*

1 It is important to note that MDU Resources and MEHC were both investment
2 grade when the two acquisitions occurred. The pre-transfer Frontier is
3 presently non-investment grade. The following table highlights the debt ratings
4 of the three companies pre-merger. *See* Staff/200 for more information
5 concerning debt and debt ratings.

6 Table 3 – Pre-merger Debt Ratings

	S&P	Moody's	Fitch
MEHC	BBB-	Baa3	BBB
MDU Resources	BBB+	A3	A-
Frontier	BB	Ba2	BB

7
8 As a result of the current high leverage of Frontier, the current non-investment
9 grade debt ratings of Frontier, and the large amount of debt ($3.3 billion)
10 involved in this transaction, it is reasonable for the Commission to require the
11 Oregon operating companies be ring fenced from Frontier. Additionally as
12 previously mentioned, all three of the recent Verizon divestitures have resulted
13 in a bankruptcy filing by the acquiring entity.

14 **Q. DO YOU BELIEVE THAT THE PROPOSED TRANSACTION WILL**
15 **RESULT IN FRONTIER NORTHWEST HAVING SUFFICIENT**
16 **SEPARATION FROM FRONTIER TO OBTAIN A NCO?**

17 A. No. The Applicants in both the application and testimony have not offered
18 conditions that would sufficiently ring fence Frontier Northwest from Frontier.
19 Unlike previous mergers (UM 814, UM 918, UM 1209 and UM 1283), Frontier's
20 Oregon operating companies will not be well-defined subsidiaries that have
21 their own credit ratings and access to capital. Because there is not enough
22 independence between the Oregon operating companies and the parent, the

1 projected organizational structure is insufficient to protect the Oregon operating
2 companies from any negative financial impacts created by its parent company
3 or other affiliates. It is important to note that in both the MEHC/PacifiCorp
4 (UM 1209) and MDU Resources/Cascade Natural Gas (UM 1283) mergers, the
5 applicants and the parties were able to cooperatively work to structure the
6 transaction in order to receive a NCO.

7 **Q. HOW DO YOU PROPOSE TO ADDRESS THIS ISSUE OF FINANCIAL**
8 **RISK AND RING FENCING FRONTIER NORTHWEST FROM FRONTIER?**

9 A. Although Staff did not place any specific ring fencing conditions on Frontier,
10 Staff recommended condition 14 requires Frontier to obtain a NCO. This
11 approach allows Frontier the opportunity to structure Frontier Northwest and
12 CTCO in a manner that provides distinct integrity and sufficient separation from
13 Frontier. As a result, the Applicants need to propose additional conditions or
14 enhance currently offered conditions.

15 Without a NCO and in order to preserve cash, Staff recommended ordering
16 condition 14 places dividend restrictions on the parent. As previously
17 mentioned, if the dividend restriction applied to Frontier Northwest and CTCO,
18 the effect would be to deny cash flowing to the parent when the parent is in
19 financial distress thus compounding the financial difficulties of Frontier to meet
20 its debt obligations. Without sufficient financial separation of Frontier from its
21 subsidiaries, if Frontier were to default on its debt obligations, the default would
22 directly impact the Company's subsidiaries.

1 Even with a NCO and other financial conditions, all of the financial risk posed
2 by this transaction will not be mitigated. This is because of the difference in
3 financial standing of Verizon as compared to Frontier.

4 **Q. TO CLARIFY, SHOULD RING FENCING INCLUDE CTCO?**

5 A. Yes.

6 **Q. IN ADDITION TO THE NCO RECOMMENDED CONDITION, DOES STAFF**
7 **RECOMMEND ADDITIONAL FINANCIAL CONDITIONS?**

8 A. Yes. Staff recommends three additional conditions which require enhanced
9 reporting Net debt/earnings before interest, tax, depreciation and amortization
10 (EBITDA), restriction of including any acquisition premium in rates, and a
11 restriction of requesting approval from the Commission to encumber the assets
12 of the Operating Companies.

13 **Q. HAS THE COMMISSION APPROVED FINANCIAL CONDITIONS IN**
14 **PREVIOUS MERGER FILINGS?**

15 A. Yes. The Commission has routinely placed numerous financial conditions on
16 previous mergers/financing applications. These financial conditions include:[64]

17
18
19
20
21
22
23
24
25

- UM 814 (PGE/Enron), Commission Order No. 97-196; Conditions 5, 6, 7, 8, and 9;
- UM 918 (PacifiCorp/ScottishPower), Commission Order No. 99-616, Conditions 6 and 7;
- UF 4218/UM 1205 (PGE), Commission Order No. 05-1250, Conditions 4, 5, 6, 7, 8, and 11;

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[64] Included in Staff Exhibit 102, pages 28-89.

- UM 1209 (PacifiCorp/MEHC), Commission Order No. 06-082, Conditions 11, 12, 15, 17, 18, 19, 20, 21, O13, O14, O15, O16, O17, and O18;

- UM 1283 (Cascade Natural Gas/MDU Resources), Commission Order No. 07-221, Conditions 5, 6, 7, 8, 13, 15, 16, 17, 24, 27, 28, and 30; and

- UM 1416 (CenturyTel/Embarq), Commission Order No. 09-169, Conditions 4.j., 4.k., 4.l., and 4.m.

Staff's recommended financial conditions are similar to those previously adopted by the Commission which have succeeded in adequately ring-fencing prior merger applications.[65] These recommended conditions reduce the risks of the transaction and help ensure that the "in the public interest, no harm" standard is achieved.

SYNERGY SAVINGS

Q. DO THE APPLICANTS ADDRESS SYNERGY SAVINGS OF THE TRANSACTION?

A. Yes. According to the Applicants, $500 million in synergies will be achieved as a result of the transaction. These purported synergies will result from consolidations in executive management, legal, information systems, finance and accounting, and increased purchasing power with vendors.[66]

[65] For example, see "Electric Utility Week", July 3, 2006, at 12, which states, "Oregon deemed by many to be the "gold standard" when it comes to ring-fencing, was able to protect Portland General Electric even as parent Enron collapsed." Staff Exhibit 102, page 112.
[66] Frontier Presentation, Welcome to the New Frontier, May 13, 2009, at 18. Included in Exhibit Staff 102, page 113.

Q. ARE THESE SYNERGY SAVINGS SIMILAR TO THE SYNERGY SAVINGS REPORTED IN THE EMBARQ/CENTURYTEL MERGER, DOCKET NO. UM 1416?

A. Yes. However, Frontier's expected synergy savings of $500 million equal approximately 16 percent of the combined company's EBITDA of $3.132 billion (21 percent of Spinco's cash operating expenditures).[67] The Embarq/ CenturyTel synergy savings were approximately 9.5 percent of consolidated EBITDA.[68] As a result, the synergy savings, if achieved, would be significant in comparison to those projected in the Embarq/CenturyTel merger. It should be noted that some of Frontier's post-transfer financial projections take into consideration the synergy savings. As such, if Frontier does not fully achieve the synergy savings, net income and cash flow will be lower than current projections. As previously mentioned, Frontier in its SEC Form S-4 points out that

> The combined company may not realize the growth opportunities and cost synergies that are anticipated from the merger. The combined company may be unable to eliminate duplicative costs, or the benefits from the merger may be offset by costs incurred or delays integrating the companies.[69]

Additionally, absent adoption of related Staff conditions, Frontier has the option to pay Verizon $94 million per year for the operations and maintenance (O&M) of the Verizon replicated operational support system (OSS), if Verizon is contracted to perform these services. If Frontier cannot successfully cutover to

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[67] *Id.* at 14. Staff Exhibit 102, page 114.
[68] Based on data included in Staff's UM 1416 public meeting memo.
[69] Frontier Communications SEC Form S-4 Registration Statement (filed July 24, 2009), at 25. Included in Exhibit Staff 102.

1 its own OSS, Frontier may not be able to fully effectuate the anticipated
2 synergy savings due to potential OSS O&M payments to Verizon or other third-
3 parties. The ability of Frontier to reduce its OSS O&M costs is extremely
4 important in achieving synergy savings. Frontier Witness McCarthy testified at
5 a September 30, 2009, Ohio Public Utilities Commission disposition:

> 6 Frontier will be relying upon Verizon. And I think you're referring
> 7 to, and correct me if I'm wrong, to the maintenance agreement
> 8 for the operational support platform and systems. And that's
> 9 really a five year agreement. We have committed that we would
> 10 be on that agreement for a minimum of one year, ***but it***
> 11 ***certainly -- we will most likely be on that agreement for***
> 12 ***several years.***[70]
> 13

14 In Staff Exhibit Dougherty/102 (Page 116), I present numerous scenarios on
15 the potential decline of Frontier's post-transfer EBITDA (including and
16 excluding synergies) and the effect on the Company's leverage. As can be
17 seen from the Exhibit, if Frontier does not achieve its anticipated synergies, a
18 10 percent annual decline in EBITDA could result in a leverage ratio of greater
19 than 3.8x (current level) in approximately 5 years. A higher leverage ratio
20 could lead to a lower debt rating and subsequent higher cost of debt.

21 **Q. ARE OREGON OPERATIONS INCLUDED IN THE SYNERGY SAVINGS?**

22 A. No, at least not initially. Frontier witness Mr. McCarthy in FTR/100,
23 McCarthy/44-50 addresses VNW's employees, Frontier's proposed
24 organization structure, and integration of VNW's employees into Frontier. Mr.
25 McCarthy states:

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[70] The Public Utilities Commission of Ohio, OHIO PUC CASE NO. 09-454-TP-ACO, The Joint Application of Frontier Communications Corporation, New Communications Holdings Inc. and Verizon Communications Inc., for Consent and Approval of a Change in Control, at 10 (emphasis added). Included in Exhibit Staff 102, page 115.

> "...it is clear that the majority of Verizon company employees who are experienced and dedicated to the provision of local services in Oregon will become part of the Frontier team following the closing of the transaction. Management employees will continue to receive the same levels of compensation and benefits they receive now from Verizon for at least one year after the transaction closes. Frontier has also committed that during the first 18 months after the transaction closes, Frontier will not terminate the employment, other than for cause, of any of the current Verizon employees who are actively employed as installers or technicians or on a leave of absence with a right to reinstatement."[71]

Mr. McCarthy goes on to state on page FTR/100. McCarthy/49-50:

> "The customer service, network and operations functions that are critical to Frontier's success in providing high quality service will continue to work and provide service in Oregon after the transaction is complete."

To ensure that Frontier keeps it promises concerning Oregon personnel, Staff recommended conditions 19 and 20 (set forth later in testimony) require Frontier to fulfill this commitment.

RECORDS/RATES/TARIFFS/ACCESS TO BOOKS

Q. ARE THERE CONCERNS ABOUT FRONTIER'S ABILITY TO PROVIDE ACCESS TO BOOKS AND RECORDS?

A. No. Frontier has previously met all Oregon reporting and tariff requirements. However, because of the significant change in the scale of Frontier's Oregon operations, Staff recommends conditions (listed later in testimony) in order to ensure that:

- Staff has proper access to all books and records of the transaction;

---

[71] Frontier/100, McCarthy 49.

- The two current Oregon operating companies are maintained immediately after completion of the transaction;
- Existing agreements are maintained;
- Existing tariffs are maintained with the exception of adding a service performance guarantee to CTCO;
- The transaction is transparent to customers;
- Customers will not be harmed by higher rates that result from the transaction; and
- The Commission is able to monitor the impacts on Oregon operations and customers.

Q. HAS THE COMMISSION APPROVED RECORDS, ACCESS TO BOOKS, RATES, AND TARIFF CONDITIONS IN PREVIOUS MERGER ORDERS?

A. Yes. The Commission has routinely required records, access to books, rates and tariff conditions in previous merger/financing applications. These dockets include:[72]

- UM 814 (PGE/Enron), Commission Order No. 97-196; Conditions 2, 3, 4, 10, 13, 16;
- UM 918 (PacifiCorp/ScottishPower), Commission Order No. 99-616, Conditions 1, 2, 3, 4, 10, 12, and 19;
- UF 4218/UM 1205 (PGE), Commission Order No. 05-1250, Conditions 3, 7, and 13;
- UM 1209 (PacifiCorp/MEHC), Commission Order No. 06-082, Conditions 3, 4, 5, 6, 8, 16, 17, 21, 23, O9, O11, and O13;
- UM 1283 (Cascade Natural Gas/MDU Resources), Commission Order No. 07-221, Conditions 1, 2, 3, 4, 10, 14, 15, 21, 23, 24, 26, and 33; and
- UM 1416 (CenturyTel/Embarq), Commission Order No. 09-169, Conditions 1, 2, 3, 4.d., 4.e., 4.f, 4.g., 4.h., 4.i., and 4.o.

The Commission should adopt Staff's recommended conditions concerning, records, access to books, rates, and tariffs. These recommended conditions

[72] Included in Staff Exhibit 102, pages 28-89.

1 reduce the risks of the transaction and help ensure that the "in the public
2 interest, no harm" standard is met.

3 **SERVICE QUALITY**

4 **Q. ARE THERE CONCERNS ABOUT FRONTIER'S ABILITY TO PROVIDE**
5 **ADEQUATE LEVELS OF RETAIL SERVICE QUALITY?**

6 A. Yes. Both Staff Witness White (White/400) and Staff Witness Birko (Birko/500)
7 discuss service quality issues and associated concerns resulting from the
8 transfer. Recommended ordering conditions 18 through 27 (listed later in
9 testimony) ensure that adequate service quality is maintained through
10 enhanced service quality and safety reporting.

11 **Q. HAS THE COMMISSION APPROVED SERVICE QUALITY STANDARDS**
12 **IN PREVIOUS MERGER ORDERS?**

13 A. Yes. The Commission has routinely required service quality standards in
14 previous merger/financing applications. These dockets include:[73]

15 • UM 814 (PGE/Enron), Commission Order No. 97-196; Condition 11;
16
17 • UM 918 (PacifiCorp/ScottishPower), Commission Order No. 99-616,
18 Condition 16;
19
20 • UF 4218/UM 1205 (PGE), Commission Order No. 05-1250, Conditions 9
21 and 14;
22
23 • UM 1209 (PacifiCorp/MEHC), Commission Order No. 06-082, Conditions
24 1, 2, 34, 35, 45, and 47;
25
26 • UM 1283 (Cascade Natural Gas/MDU Resources), Commission Order No.
27 07-221, Conditions 22 and 32; and
28

[73] Included in Staff Exhibit 102, pages 28-89. Because of the "net benefit" standard in energy mergers and acquisitions, some of these conditions are "net benefit" conditions.

1 - UM 1416 (CenturyTel/Embarq), Commission Order No. 09-169, Condition
2 4.n.
3
4 The Commission should adopt Staff's recommended service quality standards
5 conditions. These recommended conditions reduce the risks of the transaction
6 and help ensure that the "in the public interest, no harm" standard is met.

7 **OPERATING SUPPORT SYSTEMS**

8 **Q. DOES THE PROPOSED REPLICATION OF VERIZON'S SYSTEMS FULLY**
9 **MITIGATE THE RISKS THAT FAIRPOINT EXPERIENCED WITH ITS**
10 **OPERATING SUPPORT SYSTEM (OSS)?**

11 A. No. Although the Applicants point out that Frontier will eventually own and
12 initially use a replicated version of Verizon's current OSS, it is important to note
13 that FairPoint did not immediately transition or "cut over" to its own system
14 following the purchase of assets. A July 14, 2009, petition by the Vermont
15 Department of Public Service[74] presents a time line that shows the following:

16 2. FairPoint purchased the assets of Verizon New England Inc., d/b/a
17 Verizon Vermont ("Verizon") on March 31, 2008 pursuant to Public
18 Service Board Order of February 15, 2008 in Docket 7270.
19
20 4. On February 1, 2009, FairPoint began operating under its own systems
21 rather than those of Verizon.
22
23 5. Since that date, FairPoint and consequently its Vermont customers
24 have experienced problems due to systems, customer service and
25 billing problems of an unprecedented nature.
26

[74] Petition of the Department of Public Service for an Investigation and for an Order Directing Telephone Operating Company of Vermont LLC, d/b/a FairPoint Communications to Show Cause why its Certificate of Public Good Should not be Revoked, at 1. Included in Exhibit Staff 102, page 117.

1 As evident from the above timeline, there was a ten-month period during which
2 FairPoint used Verizon's system prior to cutting over to its newly developed
3 system. The Maine Public Utility Commission highlights the weakness of the
4 system cutover in a July 24, 2009, filing:

5 We believe that FairPoint's deteriorating financial performance
6 is directly related to its post-cutover failure to restore itself to
7 business as usual. We believe that failure is directly related to
8 the lack of a stable and functional OSS.[75]
9

10 In its August 5, 2009, 10-Q filing with the Securities and Exchange Commission
11 (SEC), FairPoint on page 50 also attributes financial problems with an
12 unsuccessful cutover by stating:

13 Because of cutover issues that have prevented us from
14 executing fully on our operating plan for 2009, our revenue has
15 continued to decline. In addition, cash collections have
16 remained below pre-cutover levels and we have incurred
17 significant incremental costs to operate our Northern New
18 England operations, causing further stress on our liquidity
19 position.[76]
20

21 Frontier will be using the replicated Verizon system for a minimum of one year;
22 however, at some point, it will be transitioning to its own system. Although
23 Frontier may not experience the same problems as FairPoint because it will
24 actually operate the replicated system, the risk of system problems (personnel,
25 technical, data integration, support) still exist for both the transition of the
26 replicated systems and eventual cutover to a Frontier OSS. As both the Maine
27 Public Utility Commission and FairPoint point out, the lack of a stable and

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[75] RE: PUBLIC UTILITIES COMMISSION, Compliance with Commission Order Dated 2/1/08 in Docket No. 2007-67, Docket No. 2008-108 at 2. Included in Exhibit Staff 102, page 118.

[76] FairPoint Communication SEC Form 10-Q dated August 5, 2009, at 54. Included in Exhibit Staff 102, page 119.

1 functional OSS can result in a deteriorating financial performance. Any
2 problems with the system (billing, order entry, etc.) could potentially result in a
3 harm to both retail and wholesale customers.
4 In addition, Frontier may eventually transition from the Verizon replicated
5 systems to its own OSS. Because the transferred Verizon properties are over
6 two times the size of Frontier's current properties, Staff has no means of being
7 assured that Frontier's OSS can handle the increased traffic, both retail and
8 wholesale. Staff Witness White further discusses OSS aspects and risks of
9 this transaction in Staff/400.

10 **Q. DOES STAFF INCLUDE SPECIFIC CONDITIONS TO ADDRESS THE**
11 **SURROUNDING THE REPLICATION OF VERIZON'S OSS AND ITS**
12 **EVENTUAL TRANSITION TO FRONTIER'S OSS?**

13 A. Yes. Staff recommended conditions 28 and 29 (listed later in testimony) to
14 address the OSS transitions. As a result of the inherent risks (personnel,
15 technical, data integration, support) surrounding an unsuccessful cutover to
16 both the Verizon replicated OSS and Frontier's OSS, the Commission should
17 adopt Staff's recommended conditions as necessary to meet the statutory
18 standard for approving the transaction.
19

1 **CAPITAL EXPENDITURES**

2 **Q. DOES STAFF INCLUDE ANY SPECIFIED AMOUNT OF CAPITAL**
3 **EXPENDITURES IN THE RECOMMENDED CONDITIONS?**

4 A. No. Based on the no harm standard, Staff believes that the test of sufficient
5 capital expenditures will be reflected in Frontier's ability to meet its service
6 quality requirements pursuant to Commission statutes and rule
7 (ORS 759.450 – 455; and OAR 860-023-0055). The service quality standards
8 are effectively the performance measurements in place to ensure adequate
9 customer service. Staff Witnesses White and Birko further discuss the service
10 quality aspects of this transaction in Staff/400 and Staff/500. With that said,
11 Staff has concerns about the age of certain Verizon switches and any potential
12 requirement imposed by the Federal Communications Commission (FCC) to
13 expand broadband availability. Staff's recommended Condition 22 was
14 included to partially address these concerns.

15 Certain steps taken by Frontier, if achieved (notably the increased free cash-
16 flow and reduced dividend payout) could allow Frontier to have sufficient funds
17 to meet the Commission's prescribed service standards. However, as
18 described in Staff/400, there could be potentially significant cash requirements
19 to replace outdated switches and increase broadband accessibility. Staff
20 Witness White in Staff/400, White/5-6 highlights the risk that NCIH does not
21 seem to have incorporated the need to update its switches sometime over the
22 next five years as an assumption in its cash flow projections. As Mr. White
23 points out, having to replace all of its switches could result in a $718 million-to-

1 $2.4 billion incremental cash requirement between 2010 and 2014. Having to
2 upgrade the switches could put Frontier at financial risk when it upgrades the
3 switches; and could result in a significant deterioration of service if switches are
4 not replaced in a timely manner. Additionally, Mr. White in Staff/400, White/8,
5 states that Frontier's projected broadband expenditures seem to be very low
6 relative to Frontier's estimate of what it would cost to provide broadband
7 service to its own customers. These two cash requirement factors could add to
8 the financial risks as previously described in this testimony and in Ordonez/200
9 and Phillips/300.

10 Even though the cost of increasing broadband availability could be significant,
11 Frontier's in FTR/100, McCarthy/15 states that Oregon customers will benefit in
12 increased broadband availability. The Company's witness states (emphasis
13 added):

14 *First,* Oregon customers will benefit from greater investment in
15 broadband and its availability over time. Frontier has a proven
16 record of achieving significantly higher broadband availability
17 rates in its service areas, which are even more rural than the
18 areas to be acquired from Verizon. Nationally, Frontier has
19 made broadband available to over 90% of the access lines it
20 serves via network broadband investments made over the last
21 eight (8) years. In Oregon, Frontier has made broadband
22 available to 95% of the households it serves. Once the
23 transaction is completed, ***Frontier's plan is to focus on and***
24 ***invest in broadband over time in the Verizon Oregon***
25 ***exchanges and the other areas it is acquiring so as to***
26 ***approach the levels of broadband availability and***
27 ***subscribership in these areas that more nearly approximate***
28 ***those achieved in Frontier's service territories today.*** In
29 addition, Frontier plans to offer many of the same innovative
30 promotions and service offerings that have focused on the
31 adoption of broadband by consumers.
32

1 Additionally in the Application, the Applicants state on page 15 (emphasis
2 added):

3-15
> The stronger financial structure will allow Frontier to make the greater investments in broadband infrastructure in the rural portions of the acquired Territory over time that are beyond the scope of Verizon's current priorities. Frontier recognizes that broadband is a catalyst for a healthy local economy and job growth, and increasing broadband deployment over time will be a business imperative for Frontier. Indeed, ***broadband is a key component of Frontier's business case for serving the areas it is acquiring from Verizon, both to provide an additional source of revenues and to limit the rate of line losses going forward.*** In its rural areas, Verizon recently has been averaging over 10% access line loss per year.

16
17 In addition, Frontier witness McCarthy emphasized the importance of
18 broadband during the Ohio PUC Disposition, OHIO PUC CASE NO. 09-454-
19 TP-ACO (emphasis added).

20-28
> No. I think the -- in our opinion, the key to competing in Ohio is expanding broadband. ***So you will see us start to expand broadband as quickly as possible post close.*** In our opinion, and Verizon may not necessarily agree with this, but not having broadband in an area is a competitive disadvantage that potentially leads to higher access line losses. We believe that we can change the trends in the business by getting aggressive broadband offers out into the market. And the only way to do that is to invest in the infrastructure.[77]

29
30 Mr. McCarthy goes on to state:

31-33
> Broadband and expanding broadband is our strategy. It's one of our key ways that we're going to change the business as I said before.[78]

34

[77] The Public Utilities Commission of Ohio, OHIO PUC CASE NO. 09-454-TP-ACO, The Joint Application of Frontier Communications Corporation, New Communications Holdings Inc. and Verizon Communications Inc., for Consent and Approval of a Change in Control, at 20. Included in Exhibit Staff 102, page 120.

[78] *Id.*, at 23. Included in Exhibit Staff 102, page 121.

1 The statements by the Frontier are substantiated by data included in its SEC
2 Form S-4. On page 120 of the document, Frontier shows a seven percent
3 decrease in total access lines from March 31, 2008 to March 31, 2009, but an
4 11 percent increase in HSI (high-speed internet) subscribers during the same
5 time period.[79] Revenue from these high capacity Internet and ethernet circuits
6 increased revenue of $3.4 million in 2009, as compared to 2008, primarily due
7 to the growth in the number of these circuits.[80] As a result, total revenue only
8 decreased five percent in 2009, as compared to 2008 for the three month
9 period.[81]

10 It is reasonable for the Commission to expect Frontier to deliver on its
11 promises and to put its promises on reasonable Oregon benchmarks. Because
12 of the threat of line loss and revenue leakage that could potentially result from
13 line loss, and the potential to reduce this line loss (and gain incremental
14 revenue) by broadband availability, recommended condition 22.b. requires
15 Frontier to report on broadband deployment. Staff believes this requirement is
16 consistent with the "in the public interest, no harm" standard.

17 **PATENTS AND LICENSES**

18 **Q. WILL ANY RESTRICTIONS CONCERNING PATENTS AND LICENSE**
19 **AGREEMENTS AFFECT FRONTIER'S ABILITY TO PROVIDE SERVICES**
20 **TO OREGON CUSTOMERS OF VERIZON NORTHWEST?**

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[79] Frontier Communications SEC Form S-4 Registration Statement (filed July 24, 2009), page 120. Included in Exhibit Staff 102, page 122.
[80] *Id.*, at 118. Included in Exhibit Staff 102, page 123.
[81] Frontier Communications SEC Form S-4 Registration Statement (filed July 24, 2009), page 120. Included in Exhibit Staff 102, page 122.

1 A. No, not initially. According to the Applicants in response to Staff Data Request
2 No. 4,[82] Frontier will be able to maintain all current operations performed by
3 Verizon with respect to regulated telecommunications services provided in
4 Oregon. This would include obtaining licenses from third parties or seeking
5 alternate technological or operational changes to continue the provision of
6 telephone services. However, Frontier addresses the potential risk of not
7 obtaining consents and certain Verizon contracts in its SEC Form S-4. As
8 previously mentioned:

> 9 The combined company's business, financial condition and results
> 10 of operations may be adversely affected following the merger if it is
> 11 not able to obtain consents to assign certain Verizon contracts to
> 12 Spinco. Certain wholesale, large business, Internet service
> 13 provider, and other customer contracts that are required to be
> 14 assigned to Spinco by Verizon require the consent of the customer
> 15 party to the contract to effect this assignment. Verizon and the
> 16 combined company may be unable to obtain these consents on
> 17 terms favorable to the combined company or at all, which could
> 18 have a material adverse impact on the combined company's
> 19 business, financial condition and results of operations following the
> 20 merger.[83]

21 **AFFILIATED INTERESTS**

22 **Q. ARE THERE AFFILIATED INTEREST CONCERNS REGARDING THIS**
23 **TRANSACTION?**

24 A. Yes. There are basically two affiliated interest (AI) issues: (1) CTCO has not
25 been required to file AI contracts as a result of the size (less than 50,000
26 access lines) exemption in ORS 759.040; and (2) the current status of
27 numerous AI agreements between VNW and certain Verizon affiliates, most

[82] Included in Staff Exhibit 102, page 124.
[83] Frontier Communications SEC Form S-4 Registration Statement (filed July 24, 2009), at 26. Included in Exhibit Staff 102.

1 notably, Verizon Network Funding (VNF) concerning loans, investments, and
2 financial management services. As of September 2008, VNW had a short-term
3 note balance with VNF of $305,905,551.[84] According to Verizon's response to
4 Staff Data Request No. 33:

5 Frontier will not have any obligation to repay this short-term note.
6 This obligation will be settled by Verizon prior to the closing of the
7 transaction.[85]
8
9 According to the Applicant's response to Staff Data Request No. 34:

10 Frontier will fund ongoing operations and construction programs
11 with cash from operations and/or available borrowings under its
12 credit facilities.[86]
13
14 As previously mentioned, Frontier expects its free cash-flow to be
15 approximately $1.4 billion (compared to $500 million on a stand-alone basis).
16 Concerning other VNW AI agreements, Frontier in its response to Staff Data
17 Request No. 30,[87] expects that VNW will be included in Frontier affiliated
18 service agreements. Additionally, Frontier recognizes that allocation
19 adjustments may be required, and it will continue to comply with all applicable
20 Commission requirements.

21 Concerning CTCO and AI contracts, Staff recommends that CTCO file AI
22 contracts since both Frontier Oregon operating companies will have the same
23 parent. This enhanced review will allow Staff to ensure that both operating
24 companies are paying the same rate for the same services and that there is no
25 cross-subsidization of services occurring. In addition, these filings will allow

[84] Included in Staff Exhibit 102, page 125.
[85] Included in Staff Exhibit 102, page 126.
[86] Included in Staff Exhibit 102, page 127.
[87] Included in Staff Exhibit 102, page 128.

Staff the opportunity to verify allocations to both Oregon operating companies. Staff recommended ordering conditions 51 through 53 address AI issues.

Q. HAS THE COMMISSION APPROVED AI CONDITIONS IN PREVIOUS MERGER FILINGS?

A. Yes. The Commission has routinely placed numerous AI conditions on previous mergers/financing applications. These AI conditions include:[88]

- UM 814 (PGE/Enron), Commission Order No. 97-196; Conditions 1, 2, 3, 12, 13, 14, 16, and 17;
- UM 918 (PacifiCorp/ScottishPower), Commission Order No. 99-616, Conditions 1, 4, 11, 12, 13, 14, 20, and 22;
- UF 4218/UM 1205 (PGE), Commission Order No. 05-1250, Condition 2;
- UM 1209 (PacifiCorp/MEHC), Commission Order No. 06-082, Conditions 4, 5, 6, 7, 8, 9, 13, 14, O3, O4, O6, O10, and O11;
- UM 1283 (Cascade Natural Gas/MDU Resources), Commission Order No. 07-221, Conditions 9, 10, 16; and
- UM 1416 (CenturyTel/Embarq), Commission Order No. 09-169 Conditions 4.p. and 4.q.

The Commission should adopt Staff's recommended AI conditions. These recommended conditions reduce the risks of the transaction and help ensure that the "in the public interest, no harm" standard is achieved.

[88] Included in Staff Exhibit 102, pages 28-89.

COMPETITIVE ISSUES

Q. WOULD THIS TRANSACTION HAVE ANY NEGATIVE EFFECTS ON COMPETITION?

A. Staff Witness Marinos discusses potential problems concerning competition, wholesale customers, and interconnection aspects of this transaction in Staff/600.

ISSUE 3 - RECOMMENDED CONDITIONS PROPOSED BY STAFF

Q. PLEASE SUMMARIZE STAFF'S RECOMMENDED CONDITIONS.

A. A complete listing of the conditions is listed starting on page 51 of this testimony. Unless otherwise specified each condition will remain in place for three years following the close of the proposed transaction. As previously mentioned Staff separated the conditions into general categories. These categories are:

- Records/Rates/Tariffs/Access to Books
- Financial
- Service Quality – Retail
- Operating Support Systems
- Long Distance
- Wholesale Services
- OTAP/Lifeline
- Affiliated interests/Non-regulated Operations
- Favored State Commitments/Waivers

Records/Rates/Tariffs/Access to Books

These conditions are recommended in order to ensure:

- Staff has proper access to all books and records of the transaction;
- The two current Oregon operating companies are maintained immediately after completion of the transaction;

- The transaction is transparent to customers;
- Existing tariffs are maintained with the exception of adding a service performance guarantee to CTCO;
- Customers will not be harmed by higher rates that result from the transaction; and
- The Commission is able to monitor the impacts on Oregon operations and customers.

Financial

These conditions are recommended in order to ensure:

- A non-consolidation opinion is obtained by Frontier or in its place, limitations of dividends to shareholders based on certain financial thresholds;
- Prevention of any acquisition premium going into rates; and
- Enhanced reporting by Frontier.

Service Quality

These conditions are recommended in order to ensure:

- Enhanced service quality and safety reporting;
- Current organizational structure is maintained immediately after completion of the transaction as stated in Frontier testimony;
- Employee integration is undertaken as stated in Frontier testimony;
- A commitment by Frontier to maintain minimum service quality standards as being reported in Verizon's monthly service quality reports; and
- Broadband reporting.

Operating Support Systems

These conditions are recommended in order to ensure:

- Continued use of and proper support for Verizon's operational systems that will be replicated for Frontier;
- Third-party testing to ensure the systems are ready, tested, and verified prior to cutover. The condition also requires CLEC involvement in testing; and
- Replacing an annual fee for OSS maintenance with a time and material basis for a minimum of ten years.

1 **Long Distance**
2
3 These conditions are recommended in order to ensure current customers are
4 afforded current choices concerning long distance service and the opportunity
5 to change providers without paying any change charges for 90 days after
6 close of the transaction.
7
8 **Competitive Issues**
9
10 These conditions are designed to ensure that competitors and their
11 customers are not harmed by the transaction; and that competition continues
12 to be fostered in Oregon.
13
14 **OTAP/Lifeline**
15
16 These conditions require enhanced reporting concerning OTAP/Lifeline
17 programs.
18
19 **Affiliated Interests/Non-regulated Operations**
20
21 These conditions require enhanced affiliated interest reporting and timely
22 filing of affiliated interests contracts that result from the transaction.
23
24 **Favored State Commitments/Waivers**
25
26 This condition requires a favored state commitment that is consistent with the
27 condition included in Commission Order No. 09-169. Additionally, favored
28 state conditions were also included in the UM 1209 (PacifiCorp/MEHC) and
29 UM 1283 (Cascade Natural Gas/MDU Resources) stipulations.
30

STAFF'S RECOMMENDED CONDITIONS

Records/Rates/Tariffs/Access to Books

1. Frontier shall provide the Public Utility Commission of Oregon (Commission) access to all books of account, as well as, all documents, data, and records that pertain to the transfer of the two companies.

2. The Commission reserves the right to review, for reasonableness, all financial aspects of this transaction in any rate proceeding or earnings review under an alternative form of regulation.

3. The Applicants shall immediately notify the Commission of any substantive material changes to the transfer terms and conditions from those set forth in their Application that: (1) are planned to, or in fact do occur while a Commission order approving the transfer is pending, or (2) occur before the transfer is closed, but after the Commission issues its order approving the transfer. The Applicants must also submit a supplemental application for an amended Commission order in this docket if the substantive transfer conditions and terms affecting Oregon change as set forth in this condition.

4. Except as authorized by this Commission, Frontier (referring to the parent company at the conclusion of this transaction) will maintain an organizational structure that includes the two separate ILECs in Oregon (no change from current allocated areas) – Citizens Telecommunications Company of Oregon (CTCO) and Frontier Northwest Inc., (collectively, Operating Companies). Frontier (also referred to as "Company") must file an application with the Commission should it propose to merge or consolidate the operations of the Operating Companies.

5. Subsequent to the transfer, the carrier name on all applicable Verizon Northwest (VNW) retail customer bills will be timely changed to "Frontier". Customer notification will be given to all local exchange and long distance customers per Oregon and FCC rules and regulations.

6. No regulated intrastate service or wholesale service offered to competitive carriers subject to Commission jurisdiction, offered at the time of closing will be discontinued except as approved by the Commission.

7. No changes, except for the change in 7.a. below, will be made by Frontier or its Operating Companies to any rate, rule or regulation currently included in the Operating Companies' access tariff (including special access services), retail tariff or any retail price list without properly filing a rate application.

a. CTCO will offer the same Service Performance Guarantee (SPG) as listed in Verizon Northwest's PUC Oregon No. 18. Section III, Original Sheet 16.

8. An Operating Company 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.

9. Frontier and its Operating Companies will not seek recovery of one-time transfer, branding or transaction costs in Oregon intrastate regulated rate proceedings. Frontier and its Operating Companies will not seek to recover through wholesale service rates one-time transfer, branding or transaction costs.

10. Frontier will hold retail and wholesale customers harmless for increases in overall management costs incurred by the Operating Companies that result from the transaction.

11. All VNW existing agreements with retail customers, and utility operators and licensees[89] for services provided in Oregon including, but not limited to special access discount and/or term plan agreements will be assigned to or assumed by Frontier or its subsidiary and will be honored by the Company for the term of the agreement.

12. Under the current operating structure, financial reporting will remain unchanged with each Operating Company submitting a Form-O and a Form-I.

13. Beginning with the first of the month following 12 months after close of the transaction, and for two subsequent 12-month periods, Frontier shall file with the Commission a report describing:

a. Substantive activities undertaken relating to integrating VNW operations with Frontier, as well as achieving synergies made available as a result of this transaction Frontier synergies will be reported on a Frontier total company basis;

b. Costs and projected savings of each such respective activity on a Frontier total company basis;

c. Organizational and staff force changes in Oregon operations; and

d. Impacts on Oregon operations and customers.

[89] Including, but not limited to, CATV Operators, Special Access Transport, and Facility-Based (FB) CLECs; Joint-Use Agreements and Stipulated Corrective Actions.

The reporting requirement required by Condition 13 shall end with the submission of the third report unless otherwise directed by the Commission.

Financial

14. Frontier commits to obtain a non-consolidation opinion from a qualified entity, subject to customary limitations and qualifications, that if the ring-fencing around the Oregon Operating Companies is maintained and the matter is properly briefed and presented, a bankruptcy court, on its own or upon proper request of a party in interest in a case under the United States Bankruptcy Code commenced against Frontier, would not order the substantive consolidation of the assets and liabilities of the Operating Companies with those of Frontier. Frontier commits to promptly file such opinion with the Commission. If the ring fencing provisions are insufficient to obtain a non-consolidation opinion, Frontier agrees to promptly undertake the following actions:

    a. Notify the Commission of its inability to obtain a non-consolidation opinion.

    b. Propose and implement, subject to Commission approval, such ring fencing provisions that are sufficient to obtain such a non-consolidation opinion.

    c. Obtain such a non-consolidation opinion.

    d. Until Frontier obtains a non-consolidation opinion as described in Condition 14, Frontier shall not make dividend payments to shareholders if:

        i. Frontier's credit rating falls below either Ba2 from Moody's Investor Services, or BB from Standard & Poor's Corporation, or BB from Fitch Ratings for the first two years after close of the transaction; or Frontier's credit rating falls below BBB-/Baa3 after two years following the close of the transaction and thereafter.

        ii. Whenever Frontier's average market value of common stock drops below 33% of the "adjusted capital". As used in this section, "adjusted capital" means the long- term debt (excluding the current portion) and short-term debt plus the average market value of common equity. The average market value of common equity will be calculated using the average

stock price and the average number of fully-diluted shares outstanding during the previous quarter. This paragraph shall be in force until otherwise removed or modified by the Commission.

15. Within 30 days after the close of the transaction, Frontier will notify staff of the post-transfer Net Debt/EBITDA and the price per share used to determine transaction shares.

16. For a period of three years after the closing, Frontier will not seek Commission approval to encumber the assets of the Operating Companies.

17. Frontier agrees that it will not seek to recover in Oregon intrastate regulated retail; or wholesale rates any acquisition premium paid by Frontier for Verizon Northwest.

Service Quality

18. Immediately after the close of this transaction, Citizens Telecommunications Company of Oregon (CTCO) will resume reporting service quality results monthly. Frontier Northwest will continue to report service quality results monthly.

19. Frontier Northwest will implement an organizational structure described in FTR/100, McCarthy/48-49.

20. Frontier Northwest will implement the employee integration described in FTR/100, McCarthy/49-50.

21. Frontier Northwest will maintain no less than current Commission's minimum service quality standards as are currently being reported in the Verizon's monthly service quality reports to the Commission. If Frontier fails to maintain at least the current service quality levels it will be liable for penalties as set forth in ORS 759.450.

22. No later than one year from the close of the transaction, Frontier will provide to the Commission the following:

    a. A multi-year strategic plan that establishes the end-life of each of the base units and remote switches currently being deployed in Verizon's franchise area in Oregon and a proposed replacement for the switch, if any, that ensures Frontier will be able to meet current service standards pursuant to Oregon statutes and rules.

b. In the event the FCC has a merger condition that requires the Company to make additional investment in broadband services, the Company will develop a multi-year strategic plan. This strategic plan will establish the timeline for the deployment of broadband services to each of what are currently Verizon Northwest's 61 wire centers.

c. The planned Oregon capital expenditures concerning the implementation and actions concerning subsections (a) and (b) above. Included in the report will be a comparison of the amount of planned Oregon capital expenditures as a percentage of total system expenditures; and a comparison of the amount of capital expenditure per Oregon access line with the amount of capital expenditure per Frontier Northwest system-wide access lines. .

23. The new company will provide in electronic form the detailed, Form-477 data that Verizon is currently providing to the FCC for its service areas. This will be done annually for five years beginning with the final approval of the new company.

Safety

24. By 30 days prior to the close of the transaction, Verizon will provide a full report of all NESC violations, across the Oregon service territory, as reported by pole owners and Verizon's detailed inspection program. The report will include the proposed schedule to correct all violations and any proposed deferral plans and a list of, and contact information for, the affected parties within those deferral plans.

25. Frontier will acknowledge the Paragraph 30 report and will document and present its full understanding of its obligation to comply with the safety and reliability laws in Oregon per ORS 757.035, OAR 860 Division-024, and OAR 860 Division-028. The Company will provide the primary and secondary safety points of contact within its new organization.

26. Within 7 days after close of the transaction, Frontier agrees to provide the Commission a listing of Frontier's primary and secondary points of contact within its new organization for safety and pole attachment matters.

27. Frontier will honor Verizon Northwest's agreement with Commission safety staff, to place buried facilities on private property at no less than 12 inches below ground level.

Operating Support Systems

28. For a period of not less than three years after the close of the transaction, Frontier will use the Verizon replicated OSS/BSS systems.

    a. During the six-month period before the close of the transaction, Frontier with Verizon's assistance and that of a third party tester will validate that all of the OSS/BSS systems have been completely replicated based on a test plan that has been distributed to all UM 1431 parties for review and comment. The test plan must be distributed at least two weeks prior to the beginning of the tests. A copy of a report detailing the test and results will be promptly provided to the Commission.

    b. During the six-month period before the close of the transaction, Verizon with a third party reviewer will review and correct data errors in all data bases being passed to Frontier and ensure that at least 99 percent of the records have all critical fields correctly populated. Verification results will be promptly provided to the Commission.

    c. At least two weeks prior to the final cut over, CLECs that have current interconnection agreements with either Verizon or Frontier, or both, will be allowed to test the systems using their own data. The replicated wholesale systems will not be used until a majority of the CLECs approve the systems.

29. Prior to the close of the transaction, Frontier and a subsidiary of Verizon shall have entered into an agreement which obligates Verizon to provide system support on a time and material basis for a minimum of ten years. The hourly charge will not exceed the training rate of $125 per hour, adjusted for inflation and will replace the $94 million per year contract currently in place. No fees will be charged for entering into this agreement.

Long Distance

30. For at least 120 days following the close of the proposed transaction, Frontier Northwest will offer substantially the same intrastate toll calling services, at the same rates, as provided by Verizon Northwest immediately prior to closing. This includes the bundled service offerings of local and long distance at the same rates as set forth in the price lists of Verizon Northwest.

31. Frontier will notify each of its Oregon intrastate long distance customers at least 30 days in advance of their transfer to Frontier, consistent with the anti-

slamming requirements in Section 64.1120 of the FCC rules. The notifications will include the requirements set forth in those rules.

32. For 90 days following the customer transfers, Frontier will waive any change charges, e.g., PICs, for any customer choosing to change carriers.

Competition

33. Frontier Northwest will assume or take assignment of all obligations under Verizon Northwest's existing interconnection agreements and other existing arrangements with wholesale carriers ("Assumed Agreements"). Frontier Northwest will not terminate, change the conditions of (with the exception of those governing termination), or increase the rates in, any effective interconnection agreement during the unexpired term of the Agreement, or for a period of three years from the Closing Date, whichever occurs later, unless requested by the interconnecting party, approved by the Commission, or required by a change of law. Furthermore, Frontier Northwest will allow requesting carriers to extend existing Agreements, whether or not the initial or current term has expired, until at least three years from the Closing Date, or the date of expiration, whichever is later. Frontier Northwest will similarly apportion on a pro rata basis any volume thresholds or minimum revenue commitments relating in part to service outside of Oregon.

34. Frontier Northwest will assume or take assignment of all obligations under Verizon Northwest's current intrastate tariffs and price lists for wholesale services. Frontier Northwest will not increase rates for such services or discontinue any such services currently offered for a period of at least three years from the Closing Date.

35. Frontier Northwest will continue to provide transit service subject to the same rates, terms and conditions that are currently provided by Verizon Northwest unless directed otherwise by the Commission.

36. Frontier Northwest will comply with statutory obligations applicable to all incumbent local exchange carriers (ILECs) under 47 U.S.C Section 251 and 252. Frontier Northwest will not seek to avoid any of its obligations on the grounds that it is exempt from any of the obligations pursuant to Section 251(f)(1) or Section 252(f)(2) of the Act.

37. Frontier Northwest will maintain OSS functionality, performance and interfaces (e.g. e-bonding) for wholesale services that is at least equal to that which Verizon currently provides.

38. Frontier Northwest will provide ordering, provisioning and maintenance processes and intervals consistent with those which Verizon currently provides.

39. Frontier Northwest will provide timely resolution of wholesale service problems consistent with Verizon's existing level of performance.

40. Frontier Northwest will provide and maintain on a going-forward basis updated escalation procedures, contact lists and account manager information at least 30 days prior to the transaction close date. The updated contact list shall identify and assign a single point of contact for each wholesale carrier with the authority to address ordering, provisioning, billing and OSS systems maintenance issues of that carrier.

41. Frontier Northwest will continue to make available to each wholesale carrier at no charge to the carriers the types of information and customer communications avenues that Verizon currently makes available concerning wholesale operations support systems and wholesale business practices.

42. Frontier Northwest will ensure that the Wholesale and CLEC support centers are sufficiently staffed by adequately trained personnel so as to provide a level of service that is comparable to that currently provided by Verizon.

43. The Applicants will submit to the Commission the Joint Partial Settlement Agreement wholesale data for Verizon's Oregon ILEC for the year leading up to the transaction closing date.

44. After closing, Frontier will continue to provide the same types of monthly reports of wholesale performance metrics that Verizon currently provides to wholesale customers and will also submit these metrics to Commission Staff.

45. Within 60 days after the closing date, Frontier will participate in a docket to be opened by the Commission to examine the need for establishing a wholesale service performance plan for Frontier in Oregon.

OTAP/Lifeline

46. Frontier will process weekly electronic Oregon Telephone Assistance Program/Lifeline/Link-Up America "Approved/Modified" reports submitted by the Commission.

47. Frontier will process monthly electronic Oregon Telephone Assistance Program/Lifeline "Termination" reports.

48. After processing the weekly electronic Oregon Telephone Assistance Program/Lifeline "Approved/Modified" reports, Frontier will submit to the Commission a weekly "No Match" report that lists any Commission-approved customers the company was unable to include as eligible for the Oregon Telephone Assistance/Lifeline credit and provide the reasons for such omission (e.g. the customer's name not being on the telephone bill).

49. When Frontier submits its monthly OTAP reimbursement report electronically, the company will also submit a monthly electronic report containing all active Oregon Telephone Assistance Program/Lifeline customers including their corresponding telephone number and address.

50. Frontier will submit a monthly electronic "Order Activity" report that lists Oregon Telephone Assistance Program/Lifeline customers by name, in addition to their telephone number and address, who have permanently disconnected service, were disconnected as a non-pay disconnect, or were disconnected per PUC request. Frontier must include in the monthly electronic "Order Activity" report customers who have changed their telephone number or address and provide their new telephone number or address.

Affiliated Interests/Non-regulated Operations

51. Frontier agrees that its Operating Companies will comply with all applicable Commission statutes and regulations regarding affiliated interest transactions, including timely filings of applications and reports. To the extent affiliated interest changes do occur, the Company or its Operating Companies will make the appropriate affiliated interest filings pursuant to ORS 759.390.

52. Within 90 days after the close of this transaction, Frontier will file with the Commission affiliated interest agreements including an updated Cost Allocation Manual for services that reflect as charges and credits to operating accounts in CTCO's and Frontier Northwest's Form O.

53. The certificates of all Frontier and Verizon entities certified as Competitive Providers in Oregon will remain in effect and unchanged as of the date of close of the transaction. Thereafter, Frontier and Verizon will report any changes affecting those certificates in compliance with applicable Commission statutes and regulations.

Most Favored State Commitments

54. Frontier agrees that the Conditions may be expanded or modified as a result of regulatory decisions in other states, including decisions based upon settlements, that impose conditions or commitments related to this transfer proposal. Frontier agrees that the Commission may adopt any commitments or conditions from other states that are adopted after the final order in UM 1431 is issued that are related to addressing harms of this transaction if:

    a. The commitment or condition does not result in the combined company being required to provide a "net benefit" and either

        i. The Commission or Staff had not previously identified the harm to Oregon ratepayers; or

        ii. The commitments or conditions in a final order of another state are more effective at preventing a harm previously identified by the Commission or Staff.

    Should new commitments or conditions meeting the requirements of subsections a.i. or a.ii. of this paragraph occur, Frontier will commit to the following process to facilitate a prompt decision from the Commission under this section:

    b. Within fifteen (15) calendar days after a final order adopting a new condition or stipulation with new or amended commitments by a commission in another state jurisdiction, Frontier will send a copy of the stipulation and commitment to Oregon Commission staff and to all parties in UM 1431.

    c. Frontier will notify the Commission that they have received the last such final order from other states adopting new conditions, stipulations or commitments (the "Final Filing") within fifteen (15) calendar days of receipt and send it to Staff and all UM 1431 parties.

    d. Within ten calendar days after the last such filing from the other states ("Final Filing"), any party to this proceeding may file with the Commission its response, including its position as to whether any of the covenants, commitments and conditions from the other jurisdictions (without modification of the language thereof except such non-substantive changes as are necessary to make the commitment or condition applicable to Oregon), meets the three requirements set forth above, and should be adopted in Oregon. Any party filing such a response should serve it upon the UM 1431 parties.

e. Within five calendar days after any such response filing, the Applicants may file a reply with the Commission. If the 5th calendar day falls on Saturday, Sunday, or a holiday, the next business day will be considered as the 5th day. The Applicants shall serve any such reply upon the UM 1431 parties.

Q. DO YOU BELIEVE THAT THESE CONDITIONS ARE SUFFICIENT TO FULLY MITIGATE THE RISKS TO THIS TRANSACTION?

A. No. As previously mentioned, although Staff' believes its recommended conditions reduce the risks of the transaction, Staff does not believe its conditions will completely mitigate the risks to meet the statutory requirements due to the change in financial risk and the inability to effectively ring fence the Oregon operating companies from the parent, Frontier under the proposed organizational structure. With that said, many of these conditions were accepted by the Commission in the CenturyTel/Embarq merger approved in docket UM 1416.

Q. ALTHOUGH YOU LIST NUMEROUS RECOMMENDED CONDITIONS, WEREN'T CONDITIONS IMPOSED BY THE MAINE, NEW HAMPSHIRE, AND VERMONT COMMISSIONS CONCERNING THE FAIRPOINT - VERIZON TRANSACTION?

A. Yes. The following is a partial summary of conditions imposed by the New England commissions on FairPoint.

- A 35 percent reduction in dividends following the merger for up to 10 years;
- Restriction on the ability to pay dividends if certain financial ratios are not met;

- Restriction that the cumulative amount of our dividend does not exceed the cumulative adjusted free cash flow;

- By December 31, 2011, if the ratio of total indebtedness to adjusted EBITDA is 3.6 or higher it will be reduced by $150 million the following year. If this doesn't happen, dividends will be suspended until the 2.03 billion credit facility is refinanced;

- Verizon was required to contribute $316.2 million to working capital;

- Required annual capital expenditures in states by year as follows:

    - Maine: $48 million, $48 million, $47 million;
    - New Hampshire: $52 million, $52 million, $52 million; $49 million, $49 million plus an addition $50 million; and
    - Vermont: Average $41 million for the first year, average $40 million for the three years.

- Vermont required the Verizon group to contribute $31.7 million for service quality and broadband build out; and

- Pay annually the greater of 90 percent of free cash flow or $45 million to pay down the new credit facility.

As the above indicates, even with extensive conditions imposed on the FairPoint – Verizon transaction, FairPoint still encountered numerous financial and service problems; and filed for bankruptcy on October 26, 2009. As previously mentioned, the Maine Public Utility Commission attributes the problems primarily to the unsuccessful cutover from the Verizon to the FairPoint systems. As a result, Staff believes that the recommended conditions should be accepted by the Commission in whole.

Q. DOES THIS CONCLUDE YOUR REPLY TESTIMONY?

A. Yes.

CASE: UM 1431
WITNESS: Michael Dougherty

PUBLIC UTILITY COMMISSION OF OREGON

STAFF EXHIBIT 101

Witness Qualification Statement

November 2, 2009

WITNESS QUALIFICATION STATEMENT

NAME:	MICHAEL DOUGHERTY
EMPLOYER:	PUBLIC UTILITY COMMISSION OF OREGON
TITLE:	PROGRAM MANAGER, CORPORATE ANALYSIS AND WATER REGULATION
ADDRESS:	550 CAPITOL ST. NE, SALEM, OR 97308-2148
EDUCATION:	Master of Science, Transportation Management, Naval Postgraduate School, Monterey CA (1987) Bachelor of Science, Biology and Physical Anthropology, City College of New York (1980)
EXPERIENCE:	Employed with the Oregon Public Utility Commission from June 2002 to present, currently serving as the Program Manager, Corporate Analysis and Water Regulation. Also serve as Lead Auditor for the Commission's Audit Program. Performed a five-month job rotation as Deputy Director, Department of Geology and Mineral Industries, March through August 2004. Employed by the Oregon Employment Department as Manager - Budget, Communications, and Public Affairs from September 2000 to June 2002. Employed by Sony Disc Manufacturing, Springfield, Oregon, as Manager - Manufacturing, Manager - Quality Assurance, and Supervisor - Mastering and Manufacturing from April 1995 to September 2000. Retired as a Lieutenant Commander, United States Navy. Qualified naval engineer. Member, National Association of Regulatory Commissioners Staff Sub-Committee on Accounting and Finance. Team Member in UE 1206, PGE Issuances of Securities; Team Member in UM 1209, MEHC acquisition of PacifiCorp; Team Member in UM 1283, MDU Resources acquisition of Cascade Natural Gas Corporation; and Team Leader in UM 1416, Merger of CenturyTel and Embarq.

CASE: UM 1431
WITNESS: Michael Dougherty

PUBLIC UTILITY COMMISSION OF OREGON

STAFF EXHIBIT 102

Exhibits in Support Of Direct Testimony

November 2, 2009

Docket No. UM-1431
Verizon and Frontier Responses to STAFF Data Requests Nos. 1-46
June 25, 2009

DATA REQUEST NO. 17:

Based on Article III of the Agreement and Plan of Merger, please provide the amount of shares that will be transferred if the Company Average Price is $7.00, $7.50, $8.00, and $8.50.

Frontier Response:

Without limitation of its other General Objections, please see, in particular, General Objections Nos. 3 and 12. Subject to and without waiver of its general and specific objections, Frontier responds as follows:

The Merger Agreement provides for a total of $5,247,000,000 in equity to be issued to Verizon shareholders (excluding any adjustments that may be paid or payable by Verizon or its subsidiaries pursuant to orders or settlements to obtain governmental approvals in the Spinco territory that are required in order to complete the merger or the spin-off). The number of shares to be issued based on the identified Company Average Price per share are as follows (before giving effect to any adjustments that may be made as described in the preceding sentence):

$7.00	749,571,429
$7.50	699,600,000
$8.00	655,875,000
$8.50	617,294,118

Prepared By: Cassandra Guinness
Date: June 25, 2009

1.23 "Company Average Price" means the average of the volume weighted averages of the trading prices of the Company Common Stock, as such prices are reported on the NYSE Composite Transactions Tape (as reported by Bloomberg Financial Markets or such other source as the parties shall agree in writing), for the 30 consecutive trading days ending on the third trading day immediately preceding the Effective Time; provided, however, that (x) if an ex-dividend date is set for the Company Common Stock during this 30-day period, then the trading price for a share of Company Common Stock for each day during the portion of such period that precedes such ex-dividend date shall be reduced by the amount of the dividend payable on a share of Company Common Stock, (y) if such average of the volume weighted averages of the trading prices of the Company Common Stock exceeds $8.50, then the Company Average Price shall equal $8.50 and (z) if such average of the volume weighted averages of the trading prices of the Company Common Stock is less than $7.00, then the Company Average Price shall equal $7.00.

1.24 "Company Benefit Agreements" has the meaning set forth in Section 6.12(a).

1.25 "Company Benefit Plans" has the meaning set forth in Section 6.12(a).

1.26 "Company Board Recommendation" has the meaning set forth in Section 7.4(b).

1.27 "Company Common Stock" means the common stock, par value $0.25 per share, of the Company.

1.28 "Company Credit Agreements" means (i) the Credit Agreement, dated as of March 10, 2008, among the Company, CoBank, ACB, as the administrative agent, the lead arranger and a lender, and the other lenders party thereto, (ii) the Credit Agreement, dated as of May 18, 2007, among the Company, the lenders party thereto and Deutsche Bank AG New York Branch, as the administrative agent, (iii) the Credit Agreement, dated as of December 6, 2006, among the Company, CoBank, ACB, as the administrative agent, the lead arranger and a lender, and the other lenders party thereto and (iv) the Loan Agreement, dated as of October 24, 2001, by and between the Company and Rural Telephone Finance Cooperative, as amended, in each case as such agreement may be amended, supplemented or otherwise modified from time to time.

1.29 "Company Disclosure Letter" has the meaning set forth in the first paragraph of Article VI.

Docket No. UM-1431
Verizon and Frontier Responses to STAFF Data Requests Nos. 1-46
June 25, 2009

DATA REQUEST NO. 16:

In the following table format, please provide the amount of Frontier outstanding common stock.

	Outstanding Shares	Avg. Price per Share	Reserved for Issuance
2007			
2008			
2009			
Post-transfer (based on anticipated price)			

Frontier Response:

Without limitation of its other General Objections, please see, in particular, General Objections Nos. 3 and 12. Subject to and without waiver of its general and specific objections, Frontier responds as follows:

	Outstanding Shares	Avg. Price per Share	Reserved for Issuance
2007	327,749,000	$14.38	250,544,000
2008	311,314,000	$10.85	250,544,000
2009	312,364,000	$7.10	250,544,000
Post-transfer (based on price of 7.75)	989,364,000	$7.75	To be Determined

Prepared By: Cassandra Guinness
Date: June 25, 2009

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FairPoint Reaches Agreement with Bank Lenders -Initiates Voluntary Chapter 11 Proceeding

Chapter 11 Filing Will Not Impact the Company's Operations or Customers and Will Reduce Debt by $1.7 billion

CHARLOTTE, N.C., Oct. 26 /PRNewswire-FirstCall/ -- FairPoint Communications, Inc. (NYSE: FRP) (the "Company"), a leading provider of a full range of communications services, today announced it has reached agreement on a comprehensive financial restructuring plan (the "Restructuring Plan") with lenders (the "Supporting Lenders") holding more than 50 percent of the outstanding debt under its secured credit facility. The Restructuring Plan is expected to reduce the Company's debt by $1.7 billion thereby providing a long-term solution for the Company's balance sheet.

To facilitate the implementation of the Restructuring Plan, the Company also announced that it and all of its subsidiaries have filed voluntary petitions for reorganization under Chapter 11 of the U.S. Bankruptcy Code in the United States Bankruptcy Court for the Southern District of New York (the "Court"). The Restructuring Plan must be approved by the Court and the Company intends to promptly file a plan of reorganization reflecting the Restructuring Plan with the Court. The Company and its subsidiaries expect to continue to operate their business in the ordinary course throughout the Chapter 11 process under the jurisdiction of the Court while it seeks confirmation of the Restructuring Plan.

"The day-to-day operations of our business will not be impacted by today's actions," said David Hauser, Chairman and CEO of FairPoint. "We want to assure our customers, employees and vendors that we remain committed to continuing to provide reliable, uninterrupted service to all of our customers. Today's actions represent a critical and positive step in our efforts to reduce our indebtedness, strengthen our financial condition and position FairPoint to compete more effectively in a dynamic marketplace," concluded Hauser.

In connection with the Restructuring Plan, the Company has received commitments from certain of the Supporting Lenders for a $75 million debtor-in-possession revolving credit facility (the "DIP Facility") to ensure sufficient liquidity during the Chapter 11 process. The Company currently has approximately $46 million of cash on hand and expects to continue to generate positive operating cash flow. In total, including the DIP Facility, the Company will have available liquidity of approximately $121 million. In addition, under the terms of the Restructuring Plan, the Company does not expect to pay interest or principal on its prepetition debt while in Chapter 11.

Upon emergence from Chapter 11, subject to certain conditions, the DIP Facility will convert into a $75.0 million five-year revolving credit facility. Pursuant to the Restructuring Plan, the Company's total debt would be reduced to approximately $1.0 billion from its current level of nearly $2.7 billion which includes accrued interest and amounts owed under its interest rate swap agreements. In addition, annual interest costs would be reduced from more than $200 million to approximately $65 million. In accordance with the Restructuring Plan, approximately $1.1 billion of debt under the credit facility would be converted into equity, transferring 98%, and in certain circumstances, 100% of the equity ownership of the Company to the secured lenders under the credit facility, subject to future dilution for issuances under an equity incentive plan and for warrants issued under the Restructuring Plan.

The Restructuring Plan also provides for a new $1.0 billion secured term loan. This new term loan will (i) bear interest at LIBOR plus 4.5%, with a 2.0% LIBOR floor, (ii) have a five-year term and (iii) require mandatory amortization of $10.0 million in each of the first two years and $50.0 million in the third year following emergence from Chapter 11, with increasing annual amortization amounts thereafter through maturity.

Other terms of the Restructuring Plan are still being negotiated, but the Restructuring Plan provides that all of the Company's outstanding senior notes due 2018, aggregating approximately $570 million (including accrued interest), as well as other unsecured creditors will be converted into equity ownership of the Company equal to approximately 2% and will be issued warrants to purchase up to 5% of the ownership interest in the Company assuming such class accepts the Restructuring Plan.

"We are extremely pleased with the terms of the agreement reached with our secured lenders," stated Alfred Giammarino, Executive Vice President and CFO of FairPoint. "This plan will provide FairPoint with significantly greater financial flexibility through the reduction of nearly $170 million in minimum annual debt service requirements. This enhanced flexibility will enable

us to continue to invest in new technologies and provide advanced services to customers throughout our service territories," concluded Giammarino.

The Company also filed certain first day motions with the Court to enable it to continue to conduct business without interruption. These include motions providing for employees to continue to receive compensation and benefits as usual and to maintain customer programs. During the reorganization process, suppliers and contractors should expect to be paid for post-petition purchases of goods and services in the ordinary course of business.

In addition, the Company requested the Court to impose certain restrictions on trading in its common stock in order to preserve valuable tax assets. Such trading restrictions, if imposed, would apply immediately to investors beneficially owning at least 4 million shares, or 4.4 percent, of the outstanding common stock of the Company. For these purposes, beneficial ownership of stock will be measured in accordance with special U.S. tax rules that, among other things, apply constructive ownership concepts and take into account indirect holdings.

Rothschild Inc. is acting as financial advisor for the Company; AlixPartners, LLP as the restructuring advisor; and Paul, Hastings, Janofsky & Walker LLP is the Company's counsel.

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Dougherty/6

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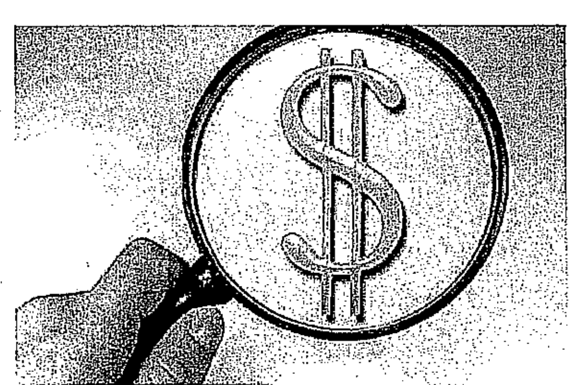
FairPoint facing serious credit problems; company downgraded



By CLARKE CANFIELD The Associated Press - Published: May 9, 2009

PORTLAND, Maine — FairPoint Communications' credit rating has been downgraded by three ratings agencies after the company revealed it's considering hiring a financial adviser to explore a possible restructuring of its debt.

In a regulatory filing this week, North Carolina-based FairPoint said an adviser would evaluate the company's financial situation. The company also said any cash flow disruptions could put a strain on its ability to meet its financial obligations.

In response, Fitch Ratings, Moody's Investor Services and Standard & Poor's Ratings Services all downgraded the company's credit ratings. Fitch went so far as to say the possibility of bankruptcy was a concern.

"Hiring an adviser sometimes leads to a bankruptcy or a restructuring," John Culver, senior director of Fitch's telecommunications group, said in a telephone interview.

FairPoint last year bought Verizon Communications' landline telephone and Internet business in Maine, New Hampshire and Vermont for $2.3 billion. During the process leading up to the acquisition, regulators and opponents of the deal questioned FairPoint's financial ability to take on Verizon's

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operations in the region.

Since the acquisition, the company has struggled with the poor economy and operational problems that have increased expenses and caused it to delay pushing out new products and services to lure new customers.

In its quarterly earnings report filed this week, FairPoint said it is "at risk" of not being able to meet all its debt obligations as soon as the end of June. If a default occurs, lenders could call in loans, foreclose upon collateral securing those loans or end their commitments to lend the company money, company officials said.

The company on Friday said it had no comment on the credit downgrades.

Credit ratings are important because they indicate a company's financial soundness and its ability to repay its debts. A poor credit rating indicates a high risk of defaulting on a loan and leads to higher interest rates.

Wayne Jortner, general counsel with the Maine Public Advocate, the state's utility watchdog agency, said some people hear the word "bankruptcy" when the idea of debt restructuring is brought up.

"But restructuring might mean nothing more than asking some of the creditors to extend a payment deadline or restructure the payments in some way," he said.

Still, Jortner said he hasn't been able to get FairPoint to turn over detailed information he is seeking on the company's finances, its customer losses and its customer service problems. FairPoint has filed a letter with the PUC seeking protection from those questions, he said.

Jortner said FairPoint has said it wants to focus its resources on fixing its operational problems, not answering questions.

"That doesn't really inspire confidence when you're the dominant telephone utility in Maine — not to mention two other states — and you're saying you can't operate the utility and answer some questions at the same time," Jortner said. "That's not something I want to hear from the dominant telephone company in the state."

Bike Ride draws nude riders, lookers-on

Professor linked to white pride

Too many schools, too few students, says ed chief

Health care for all

The best he can be: Spaulding graduate is the definition of success

CitiFinancial® Loans
Choose the Personal Loan Provider With 93% Customer Satisfaction.
Loans.CitiFinancial.com

Free 2009 Credit Report
View your Latest Credit Reports & Scores from all 3 bureaus for $0.
FreeCreditReportsInstantly.com

See Your Credit Rating
A Good Credit Score = 700 or Above. See Yours In 2 Easy Steps for $0!
www.FreeCreditReport.com

Finance Companies
Access Company Profiles And Get Sales Leads For Finance Businesses!
www.selectory.com

READER COMMENTS

I would think that Fairpoint would be smart enough to relize that if a big company like verizon is willing to sell all of there landline customers in this area that they are prolly not very profitable here. I can see a big company with big assests buying a smaller company, though having the smaller company try to buy out the big company is usally counter productive.
Verizon prolly sold the customers to Fair Point knowing they wouldnt be able to handle the volume of data transmittion, knowing they wouldnt be able to service the customers and would have to take serious losses. Now Verizon will prolly end up getting there customers back at half the price.
Fairpoint doesnt have the resources that Verizon does, I think they are now figuring that out. Telephone customers dont like interrupted services. Anyhow I just go with AT&T and dont really worry about having a landline. What do I need it for anyways?
– Posted by **ok then** on Sun, May 10, 2009, 4:48 pm EST
report this comment

This, and many other reasons, is why I switched yesterday from Fairpoint to an Internet based phone service and saved 66%. If you have high speed Internet, save yourself the hassle of dealing with Fairpoint. I find their operators and service people rude and uninformed.
– Posted by **keepthechange2012** on Sat, May 9, 2009, 11:09 am EST
report this comment

---

test
– Posted by **keepthechange2012** on Sat, May 9, 2009, 11:07 am EST
report this comment

Pretty amazing the PSB approved the sale. People were screaming very loudly that Fair Point couldn't handle taking on Verizon's land lines. Didn't take long to find out they were right.
– Posted by **news reader** on Sat, May 9, 2009, 7:06 am EST
report this comment

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THE WALL STREET JOURNAL.
WSJ.com

THE GAME | AUGUST 11, 2009

The Two Sides of Verizon's Deal Making

By DENNIS K. BERMAN

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

Today, three of Verizon's most significant divestitures are either in bankruptcy or near it. As they say on Wall Street, it all depends on what side of the trade you're on.

Verizon's former yellow-pages unit, which goes by the ungainly name of Idearc, sought court refuge from creditors in May; Verizon's former Hawaiian telecom franchise, purchased by Carlyle Group, filed for bankruptcy in December, and FairPoint Communications, which absorbed landlines from Verizon in a complicated divestment, is close to going under, the company said in a July securities filing. In all, these companies have lost upward of $13 billion in value and counting.

This should make Mr. Seidenberg a hero to Verizon investors. Not only did he bail out of the assets at the right moment, he extracted prices that literally sucked the life out of the buyers.

If only it were that simple. In the case of Idearc and FairPoint, their buyers happened to include Verizon shareholders themselves. They received controlling interests in the newly formed companies.

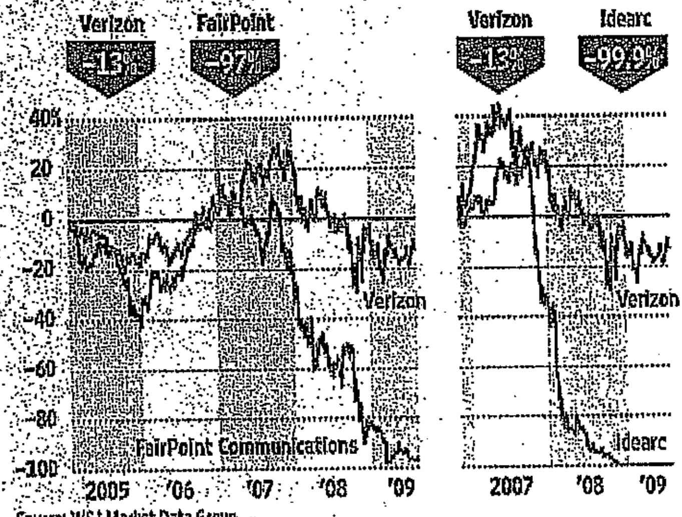
That is a good thing for those who sold out early. Those who didn't are now sitting on Idearc and FairPoint stock trading at three cents and 54 cents a share, down from around $28 and $10, respectively, when the spinoffs began.

How did Idearc go from birth to bankruptcy in under 900 days? Back in 2006, private-equity firms were scrambling to buy directories companies, reasoning that their steady cash flows could support very high levels of debt.

Verizon's tax-free spinoff was in essence a do-it-yourself leveraged buyout, with the company's own shareholders the buyers o: a highly indebted company, eagerly financed by banks and high-yield bond buyers. Verizon was taking what the market gave it.

It took too much. The incursions of Internet advertising and the decaying U.S. economy soon overwhelmed Idearc, whose

Staff/102
Dougherty/9



revenue fell nearly 9% over the past year. Once worth $5 billion in equity and $9.2 billion in debt, its bankruptcy advisers now peg its value at around $3 billion.

"It was a victim of a time when people's perception of risk and reward were shaped by the environment," said one person who worked on the original transaction.

Verizon officials say they are proud of their deals. "These asset sales made sense for the acquiring companies at the time they were bought and have proven to add significant value for Verizon shareholders since then," said Verizon spokesman Peter Thonis.

There are nonetheless consequences for a deal-making machine like Verizon -- with at least 18 transactions in the past seven years -- to leave a string of busted companies in its wake.

These things matter greatly to how state and federal regulators perceive the company. Maine, New Hampshire, Vermont and Hawaii each are in an uproar over the FairPoint divestiture, with much of the ire directed at Verizon. "It was a great deal for Verizon," said New Hampshire's public consumer advocate, Meredith Hatfield. "Whether it was a great deal for New Hampshire consumers is a different question."

It matters to market perceptions, too. "Could you be the next FairPoint?" barked CNBC's Jim Cramer in an interview with the chief executive of Frontier Communications Inc., which bought five million rural landlines from Verizon in May.

But perhaps being a good deal maker means not worrying about the past. Mr. Seidenberg is today focused on Verizon's fiber-optic service FiOS, which was funded in part by the three divestitures. He hasn't uttered the word "Idearc" in public in two and a half years.

Write to Dennis K. Berman at dennis.berman@wsj.com

Printed in The Wall Street Journal, page C1

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DATA REQUEST NO. 23:

Please describe all efforts Verizon will take to test, measure, and ensure that the Verizon Northwest Inc. operations support systems ("OSS") functionality, performance, and electronic bonding will be seamlessly migrated to Frontier and will remain at least at the same level of quality as Verizon Northwest Inc. currently provides them. Please include in your response (a) the extent to which any independent third parties will be used to oversee testing and certification to ensure that replicated OSS systems are working properly prior to close; and (b) whether current billing account numbers, login IDs or passwords used in Verizon territories will change in any way.

Response:

Without limitation of its other General Objections, please see, in particular, Applicants' General Objection Nos. 1, 3, 5, 5, 7, 8, and 12. Subject to and without waiver of its general and specific objections, Applicants respond as follows:

Verizon will take numerous steps to confirm that the Verizon Northwest Inc. operations support systems ("OSS") functionality, performance, and electronic bonding will be migrated to Frontier and will remain at least at the same level of quality as Verizon Northwest Inc. currently provides them. Frontier will also have the opportunity to confirm that such systems are in operation prior to closing.

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

No independent third parties will be used to oversee testing and certification to ensure that replicated OSS systems are working properly prior to close. This is not necessary because the separate instance developed for Frontier is not the creation of a new system or processes. Rather, it is the equivalent of basically cloning the existing proven systems which eliminates new system debugging issues.

Current end-user billing account numbers will remain the same. However, for security reasons certain, in consultation with Frontier, login IDs and passwords to access the systems may be changed.

Prepared By: James Miggans
Date: July 31, 2009

DATA REQUEST NO. 24:

Will Frontier integrate its current operations support systems ("OSS") with the Verizon Northwest Inc. OSS after the Transactions closes? If not, please explain why not. If so, please explain how and over what period of time such integration will take place,

Response:

Without limitation of its other General Objections, please see, in particular, Applicants' General Objection Nos. 1, 3, 4, 6, 7, and 10. Subject to and without waiver of its general and specific objections, Applicants respond as follows:

Following closing, Citizens Telecommunications Company of Oregon and Verizon Northwest will remain as separate legal entities with different customer record and billing systems. At this specific time plans have not been developed to integrate the OSS for wholesale/interconnection services.

Prepared By: Cassandra Guinness
Date: July 31, 2009

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RISK FACTORS

You should carefully consider the following risks, together with the other information contained in this proxy statement/prospectus and the annexes hereto. The risks described below are not the only risks facing Frontier and the combined company. Additional risks and uncertainties not currently known or that are currently deemed to be immaterial may also materially and adversely affect the combined company's business operations or the price of the combined company's common stock following completion of the merger.

Risks Relating to the Spin-Off and the Merger

The calculation of the merger consideration will not be adjusted in the event the value of the Spinco business or assets declines before the merger is completed. As a result, at the time Frontier stockholders vote on the merger, they will not know the value of the Spinco business or assets which will be acquired in the merger. The value of the Spinco business and assets may have an effect on the value of Frontier common stock following completion of the merger.

The calculation of the number of shares of Frontier common stock to be issued to Verizon stockholders pursuant to the merger agreement will not be adjusted in the event the value of the Spinco business declines, including as a result of the loss of access lines. If the value of the Spinco business declines after Frontier stockholders approve the merger proposals, the market price of the common stock of the combined company following completion of the merger may be less than Frontier stockholders anticipated when they voted to approve the merger proposals. Conversely, any decline in the Frontier average price as a result of a decrease in the price of Frontier common stock during the Frontier average price calculation period will, subject to the collar, increase the aggregate number of shares of Frontier common stock to be issued pursuant to the merger agreement. Further, any amounts paid, payable or forgone by Verizon pursuant to orders or settlements that are issued or entered into in order to obtain governmental approvals in the Spinco territory that are required to complete the merger or the spin-off will increase the aggregate number of shares of Frontier common stock to be issued pursuant to the merger agreement, all as described in "The Transactions—Calculation of Merger Consideration." While Frontier will not be required to consummate the merger upon the occurrence of any event or circumstance that has, or would reasonably be expected to have, individually or in the aggregate, a material adverse effect on Spinco or the Spinco business, neither Verizon nor Frontier will be permitted to terminate the merger agreement because of any changes in the value of the Spinco business or because of an increase in the number of shares of Frontier common stock to be issued to Verizon stockholders due to amounts paid, payable or forgone in connection with government approvals as described above, in each case that do not rise to the level of a material adverse effect on Spinco or the Spinco business. Frontier will also not be permitted to terminate the merger agreement because of any changes in the market price of Frontier common stock.

Frontier's effort to combine Frontier's business and the Spinco business may not be successful.

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

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will be required to devote a significant amount of time and attention before completion of the merger to the process of migrating the systems and processes supporting the operations of the Spinco business in West Virginia from systems owned and operated by Verizon to those owned and operated by Frontier. The size, complexity and timing of this migration, if not managed successfully by Frontier management, may result in interruptions of Frontier's business activities.

The combined company may not realize the growth opportunities and cost synergies that are anticipated from the merger.

The success of the merger will depend, in part, on the ability of the combined company to realize anticipated growth opportunities and cost synergies. The combined company's success in realizing these growth opportunities and cost synergies, and the timing of this realization, depends on the successful integration of Frontier's business and operations and the Spinco business and operations. Even if the combined company is able to integrate the Frontier and Spinco businesses and operations successfully, this integration may not result in the realization of the full benefits of the growth opportunities and cost synergies that Frontier currently expects from this integration within the anticipated time frame or at all. For example, the combined company may be unable to eliminate duplicative costs, or the benefits from the merger may be offset by costs incurred or delays in integrating the companies.

After the close of the transaction, sales of Frontier common stock may negatively affect its market price.

The market price of Frontier common stock could decline as a result of sales of a large number of shares of Frontier common stock in the market after the completion of the merger or the perception that these sales could occur. To the extent permitted under the tax sharing agreement, any effort by the combined company to obtain additional capital by selling equity securities in the future will be made more difficult by such sales, or the possibility that such sales may occur. See "The Transaction Agreements—Additional Agreements Between Frontier, Verizon and their Affiliates—The Tax Sharing Agreement."

Depending on the trading prices of Frontier common stock prior to the closing of the merger and before accounting for the elimination of fractional shares and any number of shares that may be issued as a result of amounts paid, payable or forgone by Verizon pursuant to orders or settlements that are issued or entered into in order to obtain governmental approvals in the Spinco territory that are required to complete the merger or the spin-off, Verizon stockholders will collectively own between approximately 66% and 71% of the combined company's outstanding equity immediately following the closing of the merger. Certain Verizon stockholders (such as certain index funds and institutional investors with specific investment guidelines that do not cover Frontier common stock) who receive shares of Frontier common stock pursuant to the merger agreement may be required to sell their shares of Frontier common stock immediately after the merger, which may negatively affect the price of the combined company's common stock.

If the assets contributed to Spinco by Verizon are insufficient to operate the Spinco business, it could adversely affect the combined company's business, financial condition and results of operations.

Pursuant to the distribution agreement, Verizon will contribute to Spinco defined assets and liabilities of its local exchange business and related landline activities in the Spinco territory, including Internet access and long distance services and broadband video provided to designated customers in the Spinco territory. The merger agreement provides that all the contributions will be made so that the Spinco business (other than the portion conducted in West Virginia) is segregated from Verizon's other businesses at least 60 days prior to the closing of the spin-off and merger. See "The Transaction Agreements—The Distribution Agreement—Preliminary Transactions." However, the contributed assets may not be sufficient to operate all aspects of the Spinco business and the combined company may have to use assets or resources from Frontier's existing business or acquire additional assets in order to operate the Spinco business, which could adversely affect the combined company's business, financial condition and results of operations.

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Pursuant to the distribution agreement, the combined company has certain rights to cause Verizon to transfer to it any assets required to be contributed to Spinco under that agreement that were not contributed as required. If Verizon were unable or unwilling to transfer those assets to the combined company, or if Verizon and the combined company were to disagree about whether those assets were required to be contributed to Spinco under the distribution agreement, the combined company might not be able to obtain those assets or similar assets from others without significant costs or at all.

The combined company's business, financial condition and results of operations may be adversely affected following the merger if it is not able to obtain consents to assign certain Verizon contracts to Spinco.

Certain wholesale, large business, Internet service provider and other customer contracts that are required to be assigned to Spinco by Verizon require the consent of the customer party to the contract to effect this assignment.

Verizon and the combined company may be unable to obtain these consents on terms favorable to the combined company or at all, which could have a material adverse impact on the combined company's business, financial condition and results of operations following the merger.

Regulatory agencies may delay approval of the spin-off and the merger, fail to approve them, or approve them in a manner that may diminish the anticipated benefits of the merger.

Completion of the spin-off and the merger is conditioned upon the receipt of certain government consents, approvals, orders and authorizations. See "The Transaction Agreements—The Merger Agreement—Conditions to the Completion of the Merger." While Frontier and Verizon intend to pursue vigorously all required governmental approvals and do not know of any reason why they would not be able to obtain the necessary approvals in a timely manner, the requirement to receive these approvals before the spin-off and merger could delay the completion of the spin-off and merger, possibly for a significant period of time after Frontier stockholders have approved the merger proposals. Any delay in the completion of the spin-off and the merger could diminish the anticipated benefits of the spin-off and the merger or result in additional transaction costs, loss of revenues or other effects associated with uncertainty about the transaction. Any uncertainty over the ability of the companies to complete the spin-off and the merger could make it more difficult for Frontier to maintain or to pursue particular business strategies. In addition, until the spin-off and the merger are completed, the attention of Frontier management may be diverted from ongoing business concerns and regular business responsibilities to the extent management is focused on obtaining regulatory approvals.

Further, governmental agencies may decline to grant required approvals, or they may impose conditions on their approval of the spin-off and the merger that could have an adverse effect on the combined company's business, financial condition and results of operations. Any amounts paid, payable or forgone by Verizon pursuant to orders or settlements that are issued or entered into in order to obtain governmental approvals in the Spinco territory that are required to complete the merger or the spin-off will increase the aggregate number of shares of Frontier common stock to be issued pursuant to the merger agreement, and any such increase could be significant, all as described in "The Transactions—Calculation of Merger Consideration."

The merger agreement contains provisions that may discourage other companies from trying to acquire Frontier.

The merger agreement contains provisions that may discourage a third party from submitting a business combination proposal to Frontier prior to the closing of the merger that might result in greater value to Frontier stockholders than the merger. The merger agreement generally prohibits Frontier from soliciting any acquisition proposal, and Frontier may not terminate the merger agreement in order to accept an alternative business combination proposal that might result in greater value to Frontier stockholders than the merger. Further, even if the Frontier board withdraws or modifies its recommendation of the merger, it will still be required to submit the

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merger to a vote of its stockholders. In addition, before the Frontier board may withdraw or modify its recommendation, Verizon has the opportunity to offer to modify the terms of the merger in response to any competing acquisition proposals that may be made. If the merger agreement is terminated by Frontier or Verizon in certain circumstances, Frontier may be obligated to pay a termination fee of $80 million to Verizon, which would represent an additional cost for a potential third party seeking a business combination with Frontier.

Failure to complete the merger could adversely affect the market price of Frontier common stock as well as Frontier's business, financial condition and results of operations.

If the merger is not completed for any reason, the price of Frontier common stock may decline to the extent that the market price of Frontier common stock reflects positive market assumptions that the merger will be completed and the related benefits will be realized. Frontier may also be subject to additional risks if the merger is not completed, including:

- the requirement in the merger agreement that, under certain circumstances, Frontier pay Verizon a termination fee of $80 million;
- substantial costs related to the merger, such as legal, accounting, filing, financial advisory and financial printing fees, which must be paid regardless of whether the merger is completed; and
- potential disruption to the business of Frontier and distraction of its workforce and management team.

If the spin-off does not qualify as a tax-free spin-off under Section 355 of the Internal Revenue Code, referred to as the Code, including as a result of subsequent acquisitions of stock of Verizon or Frontier, then Verizon or Verizon stockholders may be required to pay substantial U.S. federal income taxes, and Frontier may be obligated to indemnify Verizon for such taxes imposed on Verizon.

The spin-off and merger are conditioned upon Verizon's receipt of a private letter ruling from the IRS to the effect that the spin-off and certain related transactions will qualify as tax-free to Verizon, Spinco and the Verizon stockholders for U.S. federal income tax purposes, referred to as the IRS ruling. A private letter ruling from the IRS generally is binding on the IRS. However, the IRS ruling will not rule that the spin-off satisfies every requirement for a tax-free spin-off, and the parties will rely solely on the opinion of counsel described below for comfort that such additional requirements are satisfied.

The spin-off and merger are also conditioned upon Verizon's receipt of an opinion of Debevoise & Plimpton LLP, referred to as Debevoise, counsel to Verizon, to the effect that the spin-off and certain related transactions will qualify as tax-free to Verizon, Spinco and the stockholders of Verizon. The opinion will rely on the IRS ruling as to matters covered by it.

Both the IRS ruling and the opinion of counsel will be based on, among other things, certain representations and assumptions as to factual matters made by Verizon, Spinco and Frontier. The failure of any factual representation or assumption to be true, correct and complete in all material respects could adversely affect the validity of the IRS ruling or the opinion of counsel. An opinion of counsel represents counsel's best legal judgment, is not binding on the IRS or the courts, and the IRS or the courts may not agree with the opinion. In addition, the IRS ruling and the opinion will be based on current law, and cannot be relied upon if current law changes with retroactive effect.

The spin-off will be taxable to Verizon pursuant to Section 355(e) of the Code if there is a 50% or more change in ownership of either Verizon or Spinco, directly or indirectly, as part of a plan or series of related transactions that include the spin-off. Because Verizon stockholders will collectively own more than 50% of the Frontier common stock following the merger, the merger alone will not cause the spin-off to be taxable to Verizon under Section 355(e). However, Section 355(e) might apply if other acquisitions of stock of Verizon before or after the merger, or of Frontier after the merger, are considered to be part of a plan or series of related transactions that include the spin-off. If Section 355(e) applied, Verizon might recognize a very substantial amount of taxable gain.

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Under the tax sharing agreement, in certain circumstances, and subject to certain limitations, Frontier is required to indemnify Verizon against taxes on the spin-off that arise as a result of actions or failures to act by Frontier, or as a result of changes in ownership of the stock of Frontier after the merger. See "Risk Factors—Risks Relating to the Spin-Off and the Merger—Frontier will be unable to take certain actions after the merger because such actions could jeopardize the tax-free status of the spin-off or the merger, and such restrictions could be significant" and "The Transaction Agreements—Additional Agreements Between Frontier, Verizon and Their Affiliates—The Tax Sharing Agreement." In some cases, however, Verizon might recognize gain on the spin-off without being entitled to an indemnification payment under the tax sharing agreement.

See "Material United States Federal Income Tax Consequences of the Spin-Off and the Merger."

If the merger does not qualify as a tax-free reorganization under Section 368 of the Code, Frontier and the stockholders of Verizon may be required to pay substantial U.S. federal income taxes.

The obligations of Verizon and Frontier to consummate the merger are conditioned, respectively, on Verizon's receipt of an opinion of Debevoise, counsel to Verizon, and Frontier's receipt of an opinion of Cravath, Swaine & Moore LLP, referred to as Cravath, counsel to Frontier, in each case to the effect that the merger will qualify as a tax-free reorganization under Section 368(a) of the Code, and that no gain or loss will be recognized as a result of the merger by Spinco or by Spinco stockholders (except for cash in lieu of fractional shares). These opinions will be based upon, among other things, certain representations and assumptions as to factual matters made by Verizon, Spinco and Frontier. The failure of any factual representation or assumption to be true, correct and complete in all material respects could adversely affect the validity of the opinions. An opinion of counsel represents counsel's best legal judgment, is not binding on the IRS or the courts, and the IRS or the courts may not agree with the opinion. In addition, the opinions will be based on current law, and cannot be relied upon if current law changes with retroactive effect. If the merger were taxable, Spinco stockholders would recognize taxable gain or loss on their receipt of Frontier stock in the merger, and Spinco would be considered to have made a taxable sale of its assets to Frontier.

Frontier will be unable to take certain actions after the merger because such actions could jeopardize the tax-free status of the spin-off or the merger, and such restrictions could be significant.

The tax sharing agreement prohibits Frontier from taking actions that could reasonably be expected to cause the spin-off to be taxable or to jeopardize the conclusions of the IRS ruling or opinions of counsel received by Verizon or Frontier. In particular, for two years after the spin-off, Frontier may not:

- enter into any agreement, understanding or arrangement or engage in any substantial negotiations with respect to any transaction involving the acquisition, issuance, repurchase or change of ownership of Frontier capital stock, or options or other rights in respect of Frontier capital stock, subject to certain exceptions relating to employee compensation arrangements, stock splits, open market stock repurchases and stockholder rights plans;
- permit certain wholly owned subsidiaries owned by Spinco at the time of the spin-off to cease the active conduct of the Spinco business to the extent it was conducted immediately prior to the spin-off; or
- voluntarily dissolve, liquidate, merge or consolidate with any other person, unless Frontier survives and the transaction otherwise complies with the restrictions in the tax sharing agreement.

The tax sharing agreement further restricts Frontier from prepaying, or modifying the terms of, the Spinco debt securities, if any.

Nevertheless, Frontier is permitted to take any of the actions described above if it obtains Verizon's consent, or if it obtains a supplemental IRS private letter ruling (or an opinion of counsel that is reasonably acceptable to Verizon) to the effect that the action will not affect the tax-free status of the spin-off or the merger. However, the

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receipt by Frontier of any such consent, opinion or ruling does not relieve Frontier of any obligation it has to indemnify Verizon for an action it takes that causes the spin-off to be taxable to Verizon.

Because of these restrictions, for two years after the merger, Frontier may be limited in the amount of capital stock that it can issue to make acquisitions or to raise additional capital. Also, Frontier's indemnity obligation to Verizon may discourage, delay or prevent a third party from acquiring control of Frontier during this two-year period in a transaction that stockholders of Frontier might consider favorable. See "The Transaction Agreements—The Merger Agreement," "The Transaction Agreements—Additional Agreements Between Frontier, Verizon and Their Affiliates—The Tax Sharing Agreement" and "Material United States Federal Income Tax Consequences of the Spin-Off and the Merger."

Investors holding shares of Frontier common stock immediately prior to the merger will, in the aggregate, have a significantly reduced ownership and voting interest after the merger and will exercise less influence over management.

After the merger's completion, Frontier stockholders will, in the aggregate, own a significantly smaller percentage of the combined company than they will collectively own of Frontier immediately prior to the merger. Depending on the trading prices of Frontier common stock prior to the closing of the merger and before accounting for the elimination of fractional shares and adjustments for any amounts paid, payable or forgone by Verizon pursuant to orders or settlements that are issued or entered into in order to obtain governmental approvals in the Spinco territory that are required to complete the merger and the spin-off, Frontier stockholders will collectively own between approximately 29% and 34% of the combined company's outstanding equity immediately following the closing of the merger. Consequently, Frontier stockholders, collectively, will be able to exercise less influence over the management and policies of the combined company than they would be able to exercise over the management and policies of Frontier immediately prior to the merger. Moreover, the number of shares of Frontier common stock to be issued to Verizon stockholders pursuant to the merger agreement is subject to increase by any amounts paid, payable or forgone by Verizon pursuant to orders or settlements that are issued or entered into in order to obtain government approvals in the Spinco territory that are required to complete the merger or the spin-off, and any such increase may be significant. In addition, Verizon will have the right to initially designate three of the twelve members of the board of directors of the combined company.

The pendency of the merger could adversely affect the business and operations of Frontier and the Spinco business.

In connection with the pending merger, some customers of each of Frontier and the Spinco business may delay or defer decisions or may end their relationships with the relevant company, which could negatively affect the revenues, earnings and cash flows of Frontier and the Spinco business, regardless of whether the merger is completed. Similarly, current and prospective employees of Frontier and the Spinco business may experience uncertainty about their future roles with the combined company following the merger, which may materially adversely affect the ability of each of Frontier and the Spinco business to attract and retain key personnel during the pendency of the merger.

Risks Related to the Combined Company's Business Following the Merger

The combined company will likely face further reductions in access lines, switched access minutes of use, long distance revenues and federal and state subsidy revenues, which could adversely affect it.

The businesses that will make up the combined company have experienced declining access lines, switched access minutes of use, long distance revenues, federal and state subsidies and related revenues because of economic conditions, increasing competition, changing consumer behavior (such as wireless displacement of wireline use, e-mail use, instant messaging and increasing use of Voice over Internet Protocol, referred to as VoIP), technology changes and regulatory constraints. For example, Frontier's access lines declined 7% in 2008,

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and 6% in 2007 (excluding the access lines added through Frontier's acquisitions of Commonwealth and GVN). In addition, Frontier's switched access minutes of use declined 9% in 2008 and 8% in 2007 (excluding the switched access minutes added through Frontier's acquisitions of Commonwealth and GVN). The Spinco business's access lines declined 10% in 2008, and 8% in 2007. In addition, the Spinco business's switched access minutes of use declined 11% in 2008 and 11% in 2007. These factors, among others, are likely to cause the combined company's local network service, switched network access, long distance and subsidy revenues to continue to decline, and these factors may cause the combined company's cash generated by operations to decrease.

The combined company will face intense competition, which could adversely affect it.

The communications industry is extremely competitive and competition is increasing. The traditional dividing lines between local, long distance, wireless, cable and Internet service providers are becoming increasingly blurred. Through mergers and various service expansion strategies, service providers are striving to provide integrated solutions both within and across geographic markets. The combined company's competitors will include competitive local exchange carriers and other providers (or potential providers) of services, such as Internet service providers, wireless companies, VoIP providers and cable companies that may provide services competitive with the services that the combined company will offer or will intend to introduce. Competition will continue to be intense following the merger, and Frontier cannot assure you that the combined company will be able to compete effectively. Frontier also believes that wireless and cable telephony providers have increased their penetration of various services in Frontier's and Spinco's markets. Frontier expects the combined company to continue to lose access lines at least in the near term and that competition with respect to all the products and services of the combined company will increase.

Frontier expects competition to intensify as a result of the entrance of new competitors, penetration of existing competitors into new markets, changing consumer behavior and the development of new technologies, products and services that can be used in substitution for the combined company's products and services. Frontier cannot predict which of the many possible future technologies, products or services will be important in order to maintain the combined company's competitive position or what expenditures will be required to develop and provide these technologies, products or services. The combined company's ability to compete successfully will depend on the success and cost of capital expenditure investments in the Spinco territory as well as the cost of marketing efforts and on the combined company's ability to anticipate and respond to various competitive factors affecting the industry, including a changing regulatory environment that may affect the combined company and its competitors differently, new services that may be introduced (including wireless broadband offerings), changes in consumer preferences, demographic trends, economic conditions and pricing strategies by competitors. Increasing competition may reduce the combined company's revenues and increase the combined company's marketing and other costs as well as require the combined company to increase its capital expenditures and thereby decrease its cash flow.

Some of the combined company's future competitors will have superior resources, which may place the combined company at a cost and price disadvantage.

Some of the companies that will be competitors of the combined company will have market presence, engineering, technical and marketing capabilities and financial, personnel and other resources substantially greater than those of the combined company. In addition, some of these future competitors will be able to raise capital at a lower cost than the combined company. Consequently, some of these competitors may be able to develop and expand their communications and network infrastructures more quickly, adapt more swiftly to new or emerging technologies and changes in customer requirements, take advantage of acquisition and other opportunities more readily and devote greater resources to the marketing and sale of their products and services than the combined company. Additionally, the greater brand name recognition of some future competitors may require the combined company to price its services at lower levels in order to retain or obtain customers. Finally, the cost advantages of some of these competitors may give them the ability to reduce the prices for an extended period of time if they so choose.

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The combined company may be unable to grow its revenues and cash flows despite the initiatives Frontier has implemented and intends to continue after the merger.

The combined company must produce adequate revenues and cash flows that, when combined with funds available under Frontier's revolving credit facility, which will continue to be the combined company's revolving credit facility (subject to any permitted refinancing or replacement thereof by Frontier), will be sufficient to service the combined company's debt, fund its capital expenditures, pay its taxes, fund its pension and other employee benefit obligations and pay dividends pursuant to its dividend policy. Frontier has implemented and will continue to implement several growth initiatives that will affect the combined company, including increasing marketing promotions and related expenditures and launching new products and services with a focus on areas that are growing or demonstrate meaningful demand such as wireline and wireless high-speed Internet, referred to as HSI, satellite video products and the "Frontier Peace of Mind" suite of products, including computer technical support. Frontier cannot assure you that these initiatives will improve the combined company's financial position or its results of operations.

Weak economic conditions may decrease demand for the combined company's services.

The combined company could be sensitive to the ongoing recession if current economic conditions or their effects continue following the merger. Downturns in the economy and competition in the combined company's markets could cause some of the combined company's customers to reduce or eliminate their purchases of the combined company's basic and enhanced services, HSI and video services and make it difficult for the combined company to obtain new customers. In addition, if current economic conditions continue, they could cause the combined company's customers to delay or discontinue payment for its services.

Disruption in the combined company's networks and infrastructure may cause the combined company to lose customers and incur additional expenses.

To attract and retain customers, the combined company will need to provide customers with reliable service over its networks. Some of the risks to the combined company's networks and infrastructure include physical damage to access lines, security breaches, capacity limitations, power surges or outages, software defects and disruptions beyond its control, such as natural disasters and acts of terrorism. From time to time in the ordinary course of business, the combined company could experience short disruptions in its service due to factors such as cable damage, inclement weather and service failures of the combined company's third-party service providers. The combined company could experience more significant disruptions in the future. The combined company could also face disruptions due to capacity limitations if changes in the combined company's customers' usage patterns for its HSI services result in a significant increase in capacity utilization, such as through increased usage of video or peer-to-peer file sharing applications. Disruptions may cause interruptions in service or reduced capacity for customers, either of which could cause the combined company to lose customers and incur additional expenses, and thereby adversely affect its business, revenues and cash flows.

The combined company's business will be sensitive to the creditworthiness of its wholesale customers.

The combined company will have substantial business relationships with other telecommunications carriers for whom it will provide service. While bankruptcies of these carriers have not had a material adverse effect on Frontier or the Spinco business in recent years, future bankruptcies in their industry could result in the loss of significant customers by the combined company, as well as more price competition and uncollectible accounts receivable. Such bankruptcies may be more likely in the future if current economic conditions continue into 2010 or beyond. As a result, the combined company's revenues and results of operations could be materially and adversely affected.

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A significant portion of the combined company's workforce will be represented by labor unions and will therefore be subject to collective bargaining agreements, and if the combined company is unable to enter into new agreements or renew existing agreements before they expire, the combined company workers subject to collective bargaining agreements could engage in strikes or other labor actions that could materially disrupt the combined company's ability to provide services to its customers.

As of March 31, 2009, Frontier had approximately 5,650 active employees. Approximately 2,875, or 51%, of these employees were represented by unions and were therefore subject to collective bargaining agreements. Of the union-represented employees, approximately 1,350, or 47%, were subject to collective bargaining agreements that expire in 2009 and approximately 950, or 33%, were subject to collective bargaining agreements that expire in 2010.

As of December 31, 2008, assuming the contribution had taken place as of that date, Spinco would have had approximately 11,000 active employees. Approximately 8,100, or 74%, of these employees were represented by unions and were therefore subject to collective bargaining agreements. Of the union-represented employees, approximately 300, or less than 4%, were subject to collective bargaining agreements that expire in 2009 and approximately 3,500, or 43%, were subject to collective bargaining agreements that expire in 2010.

Frontier cannot predict the outcome of negotiations for the collective bargaining agreements of the combined company. If the combined company is unable to reach new agreements or renew existing agreements, employees subject to collective bargaining agreements may engage in strikes, work slowdowns or other labor actions, which could materially disrupt the combined company's ability to provide services. New labor agreements or the renewal of existing agreements may impose significant new costs on the combined company, which could adversely affect its financial condition and results of operations in the future.

The combined company may complete a significant strategic transaction that may not achieve intended results or could increase the number of its outstanding shares or amount of outstanding debt or result in a change of control.

The combined company will evaluate and may in the future enter into additional strategic transactions. Any such transaction could happen at any time following the closing of the merger, could be material to the combined company's business and could take any number of forms, including, for example, an acquisition, merger or a sale of all or substantially all of the combined company's assets.

Evaluating potential transactions and integrating completed ones may divert the attention of the combined company's management from ordinary operating matters. The success of these potential transactions will depend, in part, on the combined company's ability to realize the anticipated growth opportunities and cost synergies through the successful integration of the businesses the combined company acquires with its existing business. Even if the combined company is successful in integrating the acquired businesses, Frontier cannot assure you that these integrations will result in the realization of the full benefit of any anticipated growth opportunities or cost synergies or that these benefits will be realized within the expected time frames. In addition, acquired businesses may have unanticipated liabilities or contingencies.

If the combined company completes an acquisition, investment or other strategic transaction, the combined company may require additional financing that could result in an increase in the number of its outstanding shares or the aggregate amount of its debt, although there are restrictions on the ability of the combined company to issue additional shares of stock for these purposes for two years after the merger. See "Risk Factors—Risks Relating to the Spin-Off and the Merger—Frontier will be unable to take certain actions after the merger because such actions could jeopardize the tax-free status of the spin-off or the merger, and such restrictions could be significant" and "The Transaction Agreements—Additional Agreements Between Frontier, Verizon and Their Affiliates—Tax Sharing Agreement." The number of shares of the combined company's common stock or the aggregate principal amount of its debt that it may issue may be significant. A strategic transaction may result in a change in control of the combined company or otherwise materially and adversely affect its business.

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Risks Related to Liquidity, Financial Resources and Capitalization

If the recent severe contraction in the global financial markets and current economic conditions continue into 2010, this economic scenario may have an impact on the combined company's business and financial condition.

If the diminished availability of credit and liquidity due to the recent severe contraction in the global financial markets and current economic conditions continues into 2010, this economic scenario may affect the financial health of the combined company's customers, vendors and partners, which in turn may negatively affect the combined company's revenues, operating expenses and cash flows. In addition, although Frontier believes, based on information available to Frontier, that the financial institutions that have outstanding commitments under Frontier's revolving credit facility (which will continue to be the revolving credit facility of the combined company, subject to any permitted refinancing or replacement thereof by Frontier) will be able to fulfill their commitments to the combined company, if the current economic environment and the recent severe contraction in the global financial markets continue until 2010, this could change in the future.

The combined company will have significant debt maturities in 2011, when approximately $1.1 billion of the combined company's debt, representing a portion of Frontier's debt outstanding prior to the merger, will mature. Historically, Frontier has refinanced its debt obligations well in advance of scheduled maturities. Given the current credit environment, the combined company's ability to access the capital markets may be restricted and its cost of borrowing may be materially higher than Frontier's financing costs have been historically.

As a result of negative investment returns arising from a contraction in the global financial markets and ongoing payment of benefits, Frontier's pension plan assets have declined from $822.2 million at December 31, 2007, to $546.3 million at March 31, 2009, a decrease of $275.9 million, or 34%. This decrease consisted of a decline in asset value of $191.0 million, or 23%, and benefits paid of $84.9 million, or 11%. As a result of the continued accrual of pension benefits under the applicable pension plan and the continued negative investment returns arising from the continued contraction of the global financial markets, Frontier expects that Frontier's pension expenses will increase in 2009. Frontier will be required to make a cash contribution to its pension plan beginning in 2011, although pension asset volatility could require Frontier to make a cash contribution no earlier than 2010. Once the merger is consummated, the combined company will maintain Frontier's pension plan and will be responsible for contributions to fund the plan's liabilities, and may be required to continue making these cash contributions in respect of liabilities under Frontier's pension plan. The combined company will also, upon consummation of the merger, maintain pension plans that assume the Spinco business's pension plan liabilities for active employees. The applicable Verizon pension plans will transfer assets to the pension plans of the combined company pursuant to applicable law and the terms of the employee matters agreement entered into among Verizon, Spinco and Frontier, referred to as the employee matters agreement. Following the merger, the combined company will be responsible for making any required contributions to the new pension plans to fund liabilities of the plans, and the ongoing pension expenses of the Spinco business may require the combined company to make cash contributions in respect of the Spinco business's pension plan liabilities.

Substantial debt and debt service obligations may adversely affect the combined company.

Frontier has a significant amount of indebtedness, which amounted to approximately $4.725 billion as of March 31, 2009. The Spinco business will have indebtedness in the amount of approximately $3.4 billion at the closing of the merger. After the merger, the combined company may also obtain additional long-term debt and working capital lines of credit to meet future financing needs, subject to certain restrictions under the terms of Frontier's existing indebtedness, which would increase its total debt.

The potential significant negative consequences on the combined company's financial condition and results of operations that could result from its substantial debt include:

- limitations on the combined company's ability to obtain additional debt or equity financing;

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- instances in which the combined company is unable to meet the financial covenants contained in its debt agreements or to generate cash sufficient to make required debt payments, which circumstances would have the potential of accelerating the maturity of some or all of the combined company's outstanding indebtedness;
- the allocation of a substantial portion of the combined company's cash flow from operations to service the combined company's debt, thus reducing the amount of the combined company's cash flow available for other purposes, including operating costs, capital expenditures and dividends that could improve the combined company's competitive position, results of operations or stock price;
- requiring the combined company to sell debt or equity securities or to sell some of its core assets, possibly on unfavorable terms, to meet payment obligations;
- compromising the combined company's flexibility to plan for, or react to, competitive challenges in its business and the communications industry; and
- the possibility of the combined company being put at a competitive disadvantage with competitors who do not have as much debt as the combined company, and competitors who may be in a more favorable position to access additional capital resources.

The combined company will require substantial capital to upgrade and enhance its operations.

Verizon's historical capital expenditures in connection with the Spinco business have been significantly lower than Frontier's level of capital expenditures. Replacing or upgrading the combined company's infrastructure will require significant capital expenditures, including any expected or unexpected expenditures necessary to make replacements or upgrades to the existing infrastructure of the Spinco business. If this capital is not available when needed, the combined company's business will be adversely affected. Responding to increases in competition, offering new services, and improving the capabilities of, or reducing the maintenance costs associated with, the combined company's plant may cause the combined company's capital expenditures to increase in the future. In addition, the combined company's anticipated annual dividend of $0.75 per share will utilize a significant portion of the combined company's cash generated by operations and therefore could limit the combined company's ability to increase capital expenditures significantly. While Frontier believes that the combined company's anticipated cash flows will be adequate to maintain this dividend policy while allowing for capital spending and other purposes, any material reduction in cash generated by operations and any increases in capital expenditures, interest expense or cash taxes would reduce the amount of cash available for further capital expenditures and payment of dividends. Accelerated losses of access lines, the effects of increased competition, lower subsidy and access revenues and the other factors described above may reduce the combined company's cash generated by operations and may require the combined company to increase capital expenditures.

Risks Related to Regulation

Changes in federal or state regulations may reduce the access charge revenues the combined company will receive.

A significant portion of Frontier's revenues (approximately $285 million, or 13%, in 2008) and a significant portion of Verizon's Separate Telephone Operations' revenues (approximately $212 million, or 5%, in 2008) are derived from access charges paid by other carriers for services Frontier and the Spinco business provide in originating and terminating intrastate and interstate long distance traffic. As a result, Frontier expects a significant portion of the combined company's revenues to continue to be derived from access charges paid by these carriers for services that the combined company will provide in originating and terminating this traffic. The amount of access charge revenues that Frontier and the Spinco business receive (and, after the closing, the combined company will receive) for these services is regulated by the Federal Communications Commission, referred to as the FCC, and state regulatory agencies.

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The FCC is considering proposals that may significantly change interstate, intrastate and local intercarrier compensation. When and how these proposed changes will be addressed are unknown and, accordingly, Frontier cannot predict the impact of future changes on the combined company's results of operations. However, future reductions in the combined company's access revenues will directly affect the combined company's profitability and cash flows as those regulatory revenues do not have substantial associated variable expenses.

Certain states also have open proceedings to address reform to access charges and other intercarrier compensation. Frontier cannot predict when or how these matters will be decided or the effect on the combined company's subsidy or access revenues. In addition, Frontier has been approached by, and is currently involved in formal state proceedings with, various carriers seeking reductions in intrastate access rates in certain states. Certain of those claims have led to formal complaints to the applicable state regulatory agencies. A material reduction in the access revenues the combined company will receive would adversely affect its financial results.

The combined company will be reliant on support funds provided under federal and state laws.

A portion of Frontier's revenues (approximately $120 million in the aggregate, or 5.4%, in 2008) and a portion of Verizon's Separate Telephone Operations' revenues (approximately $235 million in the aggregate, or 5.4%, in 2008) are derived from federal and state subsidies for rural and high cost support, commonly referred to as universal service fund subsidies, including the Federal High Cost Loop Fund, federal interstate access support, federal interstate common line support, federal local switching support fund, various state funds and surcharges billed to customers. The FCC and state regulatory agencies are currently considering a number of proposals for changing the manner in which eligibility for federal and state subsidies is determined as well as the amounts of such subsidies. Although the FCC issued an order on May 1, 2008 to cap the amounts that competitive eligible telecommunications carriers, referred to as CETCs, may receive from the high cost Federal Universal Service Fund, referred to as the USF, this CETC cap may only remain in place until the FCC takes additional steps. In November 2008, the FCC issued a Further Notice of Proposed Rulemaking seeking comment on several different alternatives, some of which could significantly reduce the amount of federal high cost universal service support that the combined company would receive. Frontier cannot predict if or when the FCC will take additional actions or the effect of any such actions on the combined company's subsidy revenues.

Federal subsidies representing interstate access support, rural high cost loop support and local switching support represented approximately $74 million, or 3%, of Frontier's revenues in 2008 and approximately $125 million, or 3%, of Verizon's Separate Telephone Operations' revenues in 2008. Frontier currently expects that as a result of both an increase in the national average cost per loop and a decrease in Frontier's and the Spinco business's cost structure, there will be a decrease in the subsidy revenues Frontier and the Spinco business will earn in 2009 through the Federal High Cost Loop Fund. The amount of federal interstate access support funds received may also decline as that fund is also subject to a national cap and the amounts allocated among carriers within that cap can vary from year to year. State subsidies represented approximately $9 million, or less than 1%, of Frontier's revenues in 2008 and approximately $25 million, or less than 1%, of Verizon's Separate Telephone Operations' revenues in 2008. Approximately $37 million, or 2%, of Frontier's 2008 revenues, and approximately $85 million, or 2%, of Verizon's Separate Telephone Operations' 2008 revenues, represents a surcharge to customers (local, long distance and interconnection) to recover universal service fund contribution fees which are remitted to the FCC and recorded as an expense in "other operating expenses."

The combined company and its industry will likely remain highly regulated, and the combined company will likely incur substantial compliance costs that could constrain its ability to compete in its target markets.

As an incumbent local exchange carrier, the combined company will be subject to significant regulation from federal, state and local authorities. This regulation will restrict the combined company's ability to change its rates, especially on its basic services and its access rates, and will impose substantial compliance costs on the

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combined company. Regulation will constrain the combined company's ability to compete and, in some jurisdictions, it may restrict how the combined company is able to expand its service offerings. In addition, changes to the regulations that govern the combined company may have an adverse effect upon its business by reducing the allowable fees that it may charge, imposing additional compliance costs or otherwise changing the nature of its operations and the competition in its industry.

Pending FCC rulemakings and state regulatory proceedings, including those relating to intercarrier compensation and universal service, could have a substantial adverse impact on the combined company's operations.

Risks Related to Technology

In the future, as competition intensifies within the combined company's markets, the combined company may be unable to meet the technological needs or expectations of its customers, and may lose customers as a result.

The communications industry is subject to significant changes in technology. If the combined company does not replace or upgrade technology and equipment, it will be unable to compete effectively because it will not be able to meet the needs or expectations of its customers. Replacing or upgrading the combined infrastructure could result in significant capital expenditures.

In addition, rapidly changing technology in the communications industry may influence the combined company's customers to consider other service providers. For example, the combined company may be unable to retain customers who decide to replace their wireline telephone service with wireless telephone service. In addition, VoIP technology, which operates on broadband technology, now provides the combined company's competitors with a low-cost alternative to provide voice services to the combined company's customers, and wireless broadband technologies may permit the combined company's competitors to offer broadband data services to the combined company's customers throughout most or all of its service areas.

PUC Staff Role

The role of the Commission Staff must be viewed in context of the statutory responsibilities of the Public Utility Commission of Oregon.[1]

Charge to the Commission

The Public Utility Commission is chartered as a consumer protection and advocacy body. As directed by state law (ORS 756.040), the Commission represents the customers of any public utility or telecommunications utility and the public generally in all controversies respecting rates, valuations, service, and all matters of which the Commission has jurisdiction.

The Commission's responsibility is to protect such customers, and the public generally, from unjust and unreasonable exactions and practices, and to obtain for them adequate service at fair and reasonable rates.

The Commission shall balance the interests of the utility investor and the consumer in establishing fair and reasonable rates. In carrying out its duty to protect customers of utilities and the public generally, the Commission has broad discretion in setting rates, so long as rates provide revenue for prudently incurred operating expenses and capital costs of the public utility or telecommunications utility.

Rates set by the Commission shall provide a return to the equity holder that is commensurate with the return on investment in other enterprises having corresponding risks; and sufficient to ensure confidence in the financial integrity of the utility, allowing the utility to maintain its credit and attract capital.

Role of the Commission Staff

The role of the Commission Staff is to assist the Commission in fulfilling its statutory mandates, as described above. In both public meetings and contested case proceedings, Staff assists in building a complete public record by providing independent, expert analysis and recommendations on issues before the Commission.

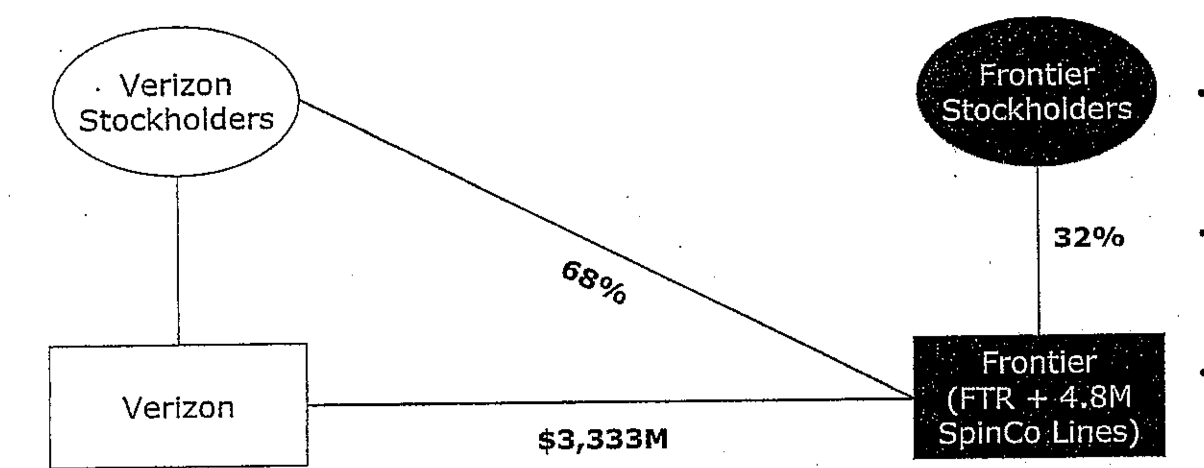
In developing recommendations, Commission Staff shall:

1. Critically examine all pertinent positions and facts presented by the involved utility and other parties,
2. Ascertain the facts and identify policy and legal considerations, and
3. Make recommendations that further the public's interest.

In carrying out its responsibilities, while considering case precedent, Staff should not anticipate future Commission actions. Staff must discharge its responsibilities consistent with the Commission's obligation to conduct fair proceedings. Staff's responsibilities do not change regardless of whether there are any intervenors, funded or unfunded, in a case representing consumer interests.

[1] This document replaces the section of the "Internal Operating Policy Guidelines" entitled "Responsibilities of Utility Program Staff."

Transaction Summary



- SpinCo pays Verizon $3,333M in cash or debt relief
- Verizon distributes 100% of SpinCo to Verizon shareholders
- SpinCo merges with Frontier; Frontier is the surviving entity
- Share price collar of $7.00 – $8.50 per share; 617 – 750M shares (66-71%) Verizon stockholder ownership

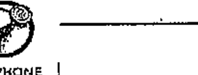
Parameter	Frontier (a)	SpinCo	Total
Price/Share	$ 7.75	$ 7.75	$ 7.75
Shares Outstanding	312	677	989
Equity Value	$ 2,421	$ 5,247	$ 7,668
Net Debt	4,547	3,333	8,005 (b)
Firm Value	$ 6,968	$ 8,580	$ 15,673
2008 EBITDA (c)	$ 1,214	$ 1,918	$ 3,132
FV/'08 EBITDA	5.7x	4.5x	5.0x
Net Debt/'08 EBITDA	3.8x	1.7x	2.6x

(a) As of 3/31/09
(b) Includes $125 million of financing for integration costs
(c) FY 2008 Pro forma EBITDA, excludes synergies

Key Financial Characteristics

2008 Statistics	Frontier	SpinCo (b)	Sub-Total	Synergies	Total
Revenue	**$2,237**	**$4,287**	**$6,524**	---	**$6,524**
EBITDA	**1,214**(a)	**1,918**	**3,132**	**$500**	**3,632**
% EBITDA Margin	54.3%	44.7%	48.0%		55.7%
Bridge to Free Cash Flow:					
Interest Expense	(363)	(290)	(653)	0	(653)
Cash Taxes	(79)	(285)	(364)	(190)	(554)
Capital Expenditures	(288)	(413)	(701)	0	(701)
Other	9	0	9	0	9
Free Cash Flow	**$493**	**$930**	**$1,423**	**$310**	**$1,733**
FCF/Share	$1.58	$1.37	$1.44	N/A	$1.75 (c)
Net Debt / EBITDA	3.8x	1.7x	2.6x		2.2x
Dividends ($0.75 / share)	---	---		---	$742 (c)
Dividend Payout Ratio	---	---		---	**43%** (c)

(a) Adjusted to exclude Severance and Early Retirement Costs and Legal Settlement Costs.
(b) 2008 audited financial statements adjusted for certain matters
(c) Assuming Frontier issues share at the mid-point of the collar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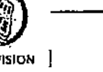
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WIRELESS DATA

WHEREFORE, the Settlement Parties stipulate and agree as follows:

CONDITIONS

The Settlement Parties agree that the following conditions shall be incorporated in a final Commission order approving the Application:

1. To determine the reasonableness of allocation factors used by Enron to assign costs to PGE and amounts subject to allocation or direct charges, the Commission or its agents may audit the accounts of Enron and its unregulated subsidiaries which are the bases for charges to PGE. Enron agrees to cooperate fully with such Commission audits.

2. Enron and PGE shall provide the Commission access to all books of account, as well as all documents, data and records of their affiliated interests, which pertain to transactions between PGE and all its affiliated interests.

3. PGE shall maintain its own accounting system, separate from Enron's accounting system. All PGE financial books and records shall be kept in Portland, Oregon.

4. Enron and PGE shall exclude all costs of the merger, including merger transition costs, from PGE's utility accounts. Within 90 days following the merger completion, Enron will provide a preliminary accounting of these costs. Further, Enron agrees to provide the Commission a final accounting of these costs, within 30 days following the accounting close of the merger.

5. PGE shall maintain separate debt and, if outstanding, preferred stock ratings.

6. PGE shall not make any distribution to Enron that would cause PGE's equity capital to fall below 48 percent of the total PGE capital without Commission approval. The Commission Staff, PGE and Enron may re-examine this minimum common equity percentage as financial conditions change, and may request that it be adjusted.

7. Enron, PGE and Commission Staff agree that the allowed return on common equity and other costs of capital will not rise as a result of the merger. These capital costs refer to the costs of capital used for purposes of rate setting, avoided cost calculations, affiliated interest transactions, least cost planning, and other regulatory purposes.

8. Enron and PGE shall provide the Commission unrestricted access to all written information provided to common stock, bond, or bond rating analysts, which directly or indirectly pertains to PGE or any affiliate that exercises influence or control over PGE. Such information includes, but is not limited to, reports provided to, and presentations made to, common stock analysts and bond rating analysts. For purposes of this condition, "written" information includes but is not limited to any written and printed

material, audio and video tapes, computer disks and electronically-stored information. Nothing in this condition shall be deemed to be a waiver of Enron's or PGE's right to seek protection of the information.

9. Unless such a disclosure is unlawful, Enron shall notify the Commission of:

   a. Its intention to transfer more than 5 percent of PGE's retained earnings to Enron over a six-month period, at least 60 days before such a transfer begins.

   b. Its intention to declare a special cash dividend from PGE, at least 30 days before declaring each such dividend.

   c. Its most recent quarterly common stock cash dividend payment from PGE within 30 days after declaring each such dividend.

10. Enron guarantees that the customers of PGE shall be held harmless if the merger between Enron and PGC results in a higher revenue requirement for PGE than if the merger had not occurred.

11. PGE shall stipulate to, adopt, and implement service quality performance measures, as fully described in Commission Staff's Proposed Stipulations for Service Quality Measures, to ensure that its current levels of service quality are maintained or improved. The P1 and P2 measures for 1997 shall be:

	P1	P2
C1	.10	.13
R1	1.5	1.7
R2	1.2	1.4
R3	NA	NA

2. PGE and Enron agree to comply with all Commission requirements regarding affiliated interest (AI) transactions, including timely filing of applications and reports. For 1997, 1998, and 1999, PGE will file semi-annual AI reports, as otherwise required by OAR 860-27-200. The AI report due dates shall be April 1, 1998, for the second half of 1997 and October 1, 1998, and June 1, 1999, respectively, for the 1998 semiannual reports. For 1999, the semiannual AI report due dates shall be October 1, 1999 and June 1, 2000.

13. Within 45 days of the end of each calendar quarter for 1997, 1998, and 1999, beginning with the first full quarter following completion of the merger, PGE shall file detailed quarterly reports with the Commission regarding: (a) employee transfers, permanent and temporary, between PGE and Enron; and (b) consulting and training activities conducted by both PGE and Enron personnel for the other entity.

14. Enron shall not subsidize its activities by allocating to or directly charging PGE expenses not authorized by the Commission to be so allocated or directly charged.

15. PGE shall not give its affiliates preferential access through any prearranged, formal or informal, agreement with any of its affiliates regarding PGE's excess pipeline capacity and related capacity assets. PGE's capacity releases will be posted on the appropriate interstate pipeline Electronic Bulletin Board ("EBB").

PGE shall not give its affiliates preferential access through any prearranged, formal or informal, agreement with any of its affiliates regarding PGE's power or natural gas assets.

If PGE and an affiliate engage in a blind (i.e. arm's length) exchange transaction (e.g. NYMEX, EBBs and similar exchanges), the Commission will presume that the transaction meets the Commission's affiliated interest transfer pricing policy requirements.

16. PGE shall file detailed quarterly reports with the Commission regarding transactions between PGE and Enron involving: (a) gas commodity sales and pipeline capacity releases, and (b) electric power exchanges and sales, and (c) competitive ancillary electric services sales. Commission Staff, Enron, and PGE will promptly develop a report acceptable to the Commission. Such quarterly reports shall be filed for 1997, 1998, and 1999, within 45 days of the end of the quarter, beginning with the first full quarter after completion of the merger.

17. PGE shall not provide to any marketing personnel of any of PGE's affiliates or to any other person not affiliated with PGE, data or information regarding any individual PGE franchise retail customer unless the customer grants written permission, which may be by electronic means. PGE shall provide information developed by it on end-use customer opinions, end-use customer usage, end-use customer characteristics, or similar aggregated retail customer market information to all entities, on the same terms and conditions, as stated below:

a. All entities including PGE affiliates shall provide PGE a written request for information, with a copy to the Commission. PGE shall maintain, at its headquarters, a list of all requests within the last 12 months, and shall make it available to any person requesting it.

b. If the identical information has been previously provided to the marketing personnel of any of PGE's affiliates or to any other entity not affiliated with PGE, PGE must provide the information within 10 business days of receiving the request.

c. If the identical information has not been previously provided to the marketing personnel of any of PGE's affiliates or to any other entity not affiliated with PGE, PGE must, within ten business days, either (1) provide the requested information; (2) provide an estimate of the date by which it can provide the information and an explanation of why more than ten business days is necessary; or (3) deny the request with an explanation of the reason for denial.

d. If PGE denies a request for information by an entity not affiliated with PGE, it shall not make the information available in response to a request from the marketing personnel of any of PGE's affiliates for three months.

e. Any requesting person may file a complaint under ORS 756.500 with the Commission.

f. PGE shall be entitled to collect, in advance of providing the requested information, reasonable compensation for the cost of providing it.

18. The Commission understands that PGE and Enron will abide by the agreements reflected in the Memorandum of Understanding (MOU), entered into in January 1997 between PGC, Enron, Natural Resources Defense Council, Northwest Conservation Act Coalition, The Nature Conservancy of Oregon, Northwest Environmental Advocates, Renewable Northwest Project, Oregon Citizen's Utility Board, Oregon Trout, Trout Unlimited, Native Fish Society, American Rivers, Oregon Energy Coordinator's Association, Community Action Directors of Oregon, and Oregon HEAT.

The Commission acknowledges the MOU and the commitments made therein. However, such acknowledgment by the Commission does not include acceptance or denial of 1) any of the costs or benefits contained within the MOU, for which PGE may desire to seek inclusion in rates, or 2) any filings that PGE may make to the Commission in accordance with the terms of the MOU. The parties maintain whatever enforcement rights exist in other forums.

19. Enron and PGE commit to provide guaranteed merger related cost of service reductions of $9 million per year for 4 years for a total of $36 million. PGE will establish a balancing account and credit that account with $9 million per year beginning on the anniversary of the merger completion date and the three subsequent anniversary dates. The balancing account will accrue interest on the unamortized balance at the then current PGE approved rate of return. Customers will receive the benefit of these cost of service reductions through a tariff that shall reduce the unamortized account balance. The customer credit will remain in effect for a total of 4 years, or until the effective date of new tariffs following a general rate case, whichever occurs first.

Residual balances in the balancing account, if any, whether debit or credit, will be disposed of only at the discretion of the Commission.

In the event that the actual savings are less than the guaranteed amount of $9 million per year, when determining the new tariffs, PGE will adjust its cost of service to reflect a total merger related cost of service reduction of $9 million in such new tariffs for a period not to extend beyond five years after merger completion. In the event that the new tariffs are a result of PGE disaggregation or divestiture, occurring prior to 5 years after merger completion, the disposition of the $9 million per year for the remainder of the 5 years will be decided in such proceeding.

20.

A. Payment

Enron and PGE are obligated to provide PGE's customers $105 million upon merger completion, which represents full payment for any entitlement PGE's customers may have to value that relates to:

1) use of PGE's name, reputation, business relationships, expertise, goodwill or other intangibles;

2) wholesale and non-franchise retail activities that PGE has undertaken that will not take place within PGE after the merger (this includes but is not limited to PGE's discontinued term wholesale trading and risk management activities), and wholesale and non-franchise retail activities that PGE might have undertaken had the merger with Enron not occurred; and,

3) added value of the merged entity that is achievable because of the combination or because of the association with PGE.

This payment obligation also shall constitute full payment to PGE's customers for any entitlement to the revenues, value or other benefits arising from the business activities of the merged entity, other than the regulated business activities conducted by PGE. The term "regulated business activities" shall mean the assets and services of PGE which are subject to economic regulation under Oregon or federal law.

B. Exclusions

This payment does not include:

1) revenues from current and future long-term power sales, if any, made by PGE using PGE resources, the cost of which is included in PGE's revenue requirement;

2) revenues from future short-term power sales, if any, made by PGE, using PGE resources, the cost of which is included in PGE's revenue requirement, but only in the event that PGE has surplus resources at the time it enters into such sales; or

3) any benefit resulting from purchases by PGE of Bonneville Power Administration (BPA) power that BPA has allocated to PGE for the benefit of PGE's retail customers.

C. Accounting

1) The $105 million described in this Condition 20 shall be recorded immediately upon completion of the merger. PGE will record a receivable from Enron and an equal obligation to reflect the payment owed to PGE customers. PGE shall amortize the balance in the customer credit account based on the actual amounts refunded.

2) The customer credit account is established for customers within PGE's service territory, and the amount of the credit shall not be affected by a customer's decision to purchase electricity from third parties pursuant to a direct access or retail wheeling tariff. If functional or corporate disaggregation occurs, or if divestiture occurs, the remaining unamortized balance of the customer credit at that time will be attributed entirely to the distribution function of PGE. The customer credit will stop when the unamortized balance reaches zero.

3) Interest on the unamortized balance shall be accrued at the then-current PGE approved rate of return and added to the customer credit account.

4) Customers will receive the benefit of this credit through a tariff that shall reduce the unamortized balance of the customer credit. The tariff will be canceled when the customer credit has been fully amortized to customers. Residual balances, if any, whether debit or credit, will be disposed of only at the discretion of the Commission.

D. **Implementation**

1) Customer credits will be determined based on an eight-year amortization period for the customer credit account. The Commission may change the amortization period in future rate proceedings, provided that the total amortization period does not exceed ten (10) years.

2) The customer credits will be apportioned among customer classes in the following manner:

   a) 27 percent of the customer credits will be apportioned on an equal-percent-of-revenues basis among all customer classes, including retail power customers served under special contracts but excluding lighting maintenance and ownership charges under lighting Schedules 14, 15 and 91. The maximum credit available to any special contract customers under this subsection shall not exceed the average percentage credit available to all customers under this subsection.

   b) The remaining 73 percent of the customer credits will be apportioned on an equal-percent-of-revenues basis among all customer classes excluding lighting maintenance and ownership charges under lighting Schedules 14, 15 and 91, provided that customers purchasing under Schedule 99 shall receive a benefit only to the extent that they would be credited under the terms of their contracts.

   The Commission may change this apportionment in future rate proceedings.

3) PGE will file tariffs to ensure that credits to all customers as set forth herein will begin no later than 45 days after the merger completion date.

E. **Compensation For Use of Employees**

Enron shall compensate PGE for the use of PGE employees spending time on Enron matters at the higher of cost or market. PGE shall access Enron employees at a rate equivalent to the lower of cost or market.

:1. If PGE or Enron violates any of the conditions 1-20, except for conditions 11 and 18, the Commission may impose in an Order, without first acquiring an order of the Circuit Court, a sum as prescribed in ORS 756.990, subject to the following:

a. For failure to file any notice or report required by these conditions, the Commission must give PGE and Enron written notice of the violation. If such notice or report is provided to the Commission within 10 business days of receipt of the written notice, there will be no penalty assessment. PGE or Enron may request permission for extensions of the 10 business day period for cause, which permission the Commission shall not unreasonably withhold.

b. For any violation of conditions 2, 3, 5, 6, 9a, 9b, 15, and 17, Staff must give PGE and Enron notice of the violation, and the date or dates on which the violation occurred.

c. For any alleged violation other than those covered in a. and b. above,[1] Staff must give PGE and Enron written notice of the violation. If such failure is corrected within 5 business days of receipt of the written notice, there will be no penalty assessment. PGE or Enron may request permission for extensions of the 5 business day period for cause, which permission the Commission shall not unreasonably withhold.

d. Notice of any failure of a., b. or c. shall be delivered to both Enron and PGE.

e. If Enron and/or PGE remain in violation following the periods specified by sections a. and c. above, Staff shall propose imposition of the penalty to the Commission. However, the Commission will impose a penalty on only one of either Enron or PGE for the same violation.

f. Penalties imposed under this condition shall not go to the General Fund. PGE penalties shall be included in a deferred account established under ORS 757.259. Enron penalties require a cash payment to PGE, whereupon the cash payment amount would be included in a deferred account established under ORS 757.259.

g. Enron and PGE shall have the right to appeal an order imposing any sums pursuant to this condition under ORS 756.580.

!. On or before 60 days after the closing of the merger, PGE shall file a plan with the Commission which includes the following components:

a. proposed terms and conditions on which all customer classes will have the opportunity to choose their electricity provider;

b. proposed separation of competitive from monopoly businesses of PGE; and

[1] Condition Nos. 1, 7, 8, 10, 14, 19, 20 and insofar as the they do not deal with the filing a report, Conditions Nos. 4 and 12.

c. the proposed resolution and recovery of stranded costs.

OTHER PROVISIONS

In order to support the incorporation of the above agreements into a final order of the Commission on the Application, the Settlement Parties further agree as follows:

1. Settlement Parties agree that the conditions and commitments made in this Stipulation constitute benefits of the proposed merger to PGE customers and that completion of the merger will serve PGE's customers in the public interest. Settlement Parties recommend that the Commission adopt this Stipulation in its entirety and approve the proposed merger. The parties have negotiated this Stipulation as an integrated document. Accordingly, if the Commission rejects all or any material part of this Stipulation, or adds elements to any final order which are not contemplated by this Stipulation, each party reserves the right to withdraw from this Stipulation upon written notice to the Commission and Settlement Parties within five (5) business days of service of the final order rejecting or changing this Stipulation.

2. This Stipulation and all pleadings, data requests, responses to data requests, depositions, transcripts, testimony and written comments shall be entered into the record as evidence. With respect to the issues covered by this Stipulation, the Settlement Parties agree to waive cross examination of one another at any hearing held in this docket. The Settlement Parties agree to support approval of this Stipulation throughout this proceeding.

3. Settlement Parties have executed this Stipulation to resolve identified issues in this proceeding. With respect to the dollar amounts referenced in this Stipulation, no Settlement Party shall be deemed to have accepted or consented to the principles, methods or theories, employed in arriving at such amounts referenced in this Stipulation.

UM 918
SCOTTISHPOWER/PACIFICORP MERGER CONDITIONS

Staff/102
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1. ScottishPower and PacifiCorp shall provide the Commission access to all books of account, as well as all documents, data and records of their affiliated interests, which pertain to transactions between PacifiCorp and all its affiliated interests.

2. PacifiCorp shall maintain its own accounting system, separate from ScottishPower's accounting system. All PacifiCorp financial books and records shall be kept at PacifiCorp headquarters in Portland, Oregon.

3. ScottishPower and PacifiCorp shall exclude all costs of completing the merger from PacifiCorp's utility accounts. Within 90 days following the merger completion, ScottishPower will provide a preliminary accounting of these costs. Further, ScottishPower agrees to provide the Commission a final accounting of these costs, within thirty days following the accounting close of the merger.

4. The Commission or its agents may audit the accounting records of ScottishPower and its unregulated subsidiaries that are the bases for charges to PacifiCorp, to determine the reasonableness of allocation factors used by ScottishPower to assign costs to PacifiCorp and amounts subject to allocation or direct charges. ScottishPower agrees to cooperate fully with such Commission audits.

5. PacifiCorp shall maintain its own debt and, if outstanding, preferred stock ratings.

6. PacifiCorp shall not make any distribution to ScottishPower that will reduce PacifiCorp's common equity capital below the corresponding threshold percent of PacifiCorp's total capital without Commission approval, as detailed in the following table. PacifiCorp's total capital is defined as common equity, preferred equity and long-term debt. Long-term debt is defined as debt with a term of one year or more.

Year	Threshold Common Equity Percent
After December 31, 1999	35%
After December 31, 2000	36%
After December 31, 2001	37%
After December 31, 2002	38%
After December 31, 2003	39%

After December 31, 2004, PacifiCorp shall not make any distribution to ScottishPower that will reduce PacifiCorp's common equity capital below 40 percent of total PacifiCorp capital without Commission approval. The Commission Staff and PacifiCorp may reexamine this minimum common equity percentage as financial conditions or accounting standards change, and may request that it be adjusted.

7. ScottishPower and PacifiCorp agree that in future Commission proceedings, they will not seek a higher cost of capital than that which PacifiCorp would have been authorized on its own. Specifically, no capital financing costs (either debt or equity) should increase by virtue of the fact that PacifiCorp was merged with ScottishPower.

8. ScottishPower and PacifiCorp agree to the following provisions with respect to information requests and resolution of disputes related to information requests:

   a. PacifiCorp and ScottishPower shall provide Staff, upon request, access to books and records of PacifiCorp and ScottishPower that are reasonably calculated to lead to information relating to PacifiCorp, including without limitation, Board of Directors'

Minutes. Nothing in this condition shall be deemed to be a waiver either of ScottishPower's or PacifiCorp's right to seek protection of the information pursuant to a protective order issued by the Commission or a waiver of ScottishPower's or PacifiCorp's right to object to production of information on the grounds that the request is overbroad, unduly burdensome or outside the scope of the Commission's regulatory jurisdiction.

b. In the event of a dispute between Staff and ScottishPower regarding a Staff request for books and records or minutes, the parties agree that an Administrative Law Judge (ALJ) of the Commission shall resolve the dispute. The ALJ shall review the requested documents in camera and shall hear the arguments of Staff and ScottishPower as to the obligation to provide access. In resolving the dispute, the ALJ shall decide whether the requested documents are reasonably calculated to lead to the discovery of admissible evidence. The ALJ shall use this standard whether or not Staff is making the request in connection with an open docket. When ScottishPower submits any document for an in camera inspection, it may request that the Commission treat the documents as exempt from disclosure under Oregon's Public Records Law. If ScottishPower makes such request, it shall specify to the ALJ the provisions of the Public Records Law that apply. If the ALJ, on behalf of the Commission, determines that the documents are exempt from disclosure, then the Commission shall, in the event it receives a request for documents under the Public Records Law, assert the appropriate provision(s) as a basis for not disclosing the documents.

9. Unless such a disclosure is unlawful, ScottishPower shall notify the Commission:

a. Its intention to transfer more than 5 percent of PacifiCorp's retained earnings to ScottishPower over a six-month period, at least thirty days before such a transfer is effected.

b. Its intention to declare a special cash dividend from PacifiCorp, at least thirty days before declaring such dividend.

c. Its most recent quarterly stock cash dividend payment from PacifiCorp, within thirty days after declaring such dividend.

10. ScottishPower/PacifiCorp guarantee that the customers of PacifiCorp shall be held harmless if the merger between ScottishPower and PacifiCorp results in a higher revenue requirement for PacifiCorp than if the merger had not occurred. This includes, but is not limited to, costs associated with currency exchange agreements not otherwise authorized by the Commission. However, this hold harmless provision shall not apply to incremental costs associated with cost-effective investments in renewables and conservation subsequently approved by the Commission.

11. ScottishPower shall not subsidize its activities by allocating to or directly charging PacifiCorp expenses not authorized by the Commission to be so allocated or directly charged.

12. On June 18, 1999, ScottishPower/PacifiCorp filed a proposed cost allocation methodology for the allocation of corporate and affiliate investments, expenses, and overheads. On or about October 1999, PacifiCorp/ScottishPower shall schedule a conference/meeting with state and other interested regulators to discuss the proposed corporate and affiliate cost allocation methodology. The final methodology will comply with the following principles:

a. ScottishPower shall establish and maintain an accounting process for directly assigning or allocating costs incurred by ScottishPower to PacifiCorp's operations. The cost categories subject to allocation to PacifiCorp from ScottishPower shall be limited to common corporate functions and ScottishPower must demonstrate a basis for recovery of the costs.

b. Costs will be directly assigned to specific subsidiaries whenever possible and shared or indirect costs shall be allocated based upon primary cost-causation factors.

c. ScottishPower shall have in place a time profile system adequate to support the allocation of executives' costs to significant projects. These time profiles will be reviewed, at a minimum, on a semi-annual basis or when significant changes occur.

d. An audit trail shall be maintained such that all costs subject to allocation and the basis for application of the allocation methodology can be specifically identified, particularly with respect to their origin. In addition, the audit trail must be adequately supported by appropriate documentation.

e. Any corporate cost allocation methodology used for rate setting in Oregon, and subsequent changes thereto, must be approved by the Oregon Commission.

f. PacifiCorp's total corporate costs will not rise as a result of the merger. Through December 31, 2004, ScottishPower/PacifiCorp agree that the corporate costs allocated to PacifiCorp (in U.S. dollars) will not be greater than 1999 costs for comparable PacifiCorp functions escalated for inflation using the GDP-PI.

13. Except as modified by Commission rule or order, if PacifiCorp subsequently has affiliates that provide wholesale energy services within the WSCC as currently defined, PacifiCorp shall file detailed semi-annual reports with the Commission regarding transactions between PacifiCorp and any of its affiliates involving: a.) Electric power exchanges and sales, and b.) Competitive ancillary electric services sales. Commission staff, ScottishPower and PacifiCorp will promptly develop a report acceptable to the Commission. The reports shall be filed semi-annually, within 45 days of the close of each six-month period, beginning with the first year after closing of the merger.

14. If PacifiCorp, either directly or through an affiliate, intends to market generation services or ancillary services to retail customers within PacifiCorp's Oregon service territory in competition with other providers, PacifiCorp shall notify the Commission prior to marketing such services for the purpose of establishing conditions to preclude anti-competitive behavior. Such conditions shall be similar to those set forth in the UM 814, Order No. 97-196, except as modified by the Commission.

15. Within 45 days of the end of each calendar six-month period for 2000, 2001, and 2002, beginning with the first full six months after completion of the merger, PacifiCorp shall file detailed semi-annual reports with the Commission regarding: a.) Employee transfers, permanent and temporary, between PacifiCorp and ScottishPower; and b.) Consulting and training activities conducted by both PacifiCorp and ScottishPower personnel for the other entity. Temporary is defined as more than three months but less than one year for purposes of this condition, and less than 50 percent of time in aggregate over any two-year period.

16. ScottishPower and PacifiCorp shall adopt and implement Network Performance Standards, Customer Service Performance Standards and Customer Guarantees, as fully described in the executed June 15, 1999, Stipulation Relating to Performance Standards and Customer Guarantees (Exhibit Staff/801, Thornton-Riordan/1-8) and those included in the Appendix to this document, to ensure that PacifiCorp's current levels of service quality are maintained or improved. The customer guarantee payments and any service quality penalties, shall not be reflected in company results of operations and/or any rate review. In addition, any company customer guarantee payment shall include a statement that acceptance of the payment does not waive any rights or claims against PacifiCorp.

17. ScottishPower and PacifiCorp shall adopt and implement all commitments contained in the "Stipulation Relating to Conservation Programs", as executed on July 7, 1999 (Exhibit Staff/801, Thornton-Riordan/34-41).

18. ScottishPower and PacifiCorp commit to provide a guaranteed annual merger credit to Oregon customers for four years. The amount of the credit shall be $9 million for years 2001, 2002 and 2003 and $12 million for 2004. ScottishPower and PacifiCorp also commit to provide an additional credit of $3 million per year for the same four year period to reflect the revenue requirement impact of the investments necessary to implement the service performance standards and customer guarantees referenced in Conditions 16 and 23. In years 2003 and 2004, the $3 million credit will be assigned to PacifiCorp's distribution function. The total credit in years 2001-2003 will be $12 million and the total credit in 2004 will be $15 million. Payments to customers associated with the merger credit shall not be reflected in company results of operations and/or any rate review.

For years 2001 and 2002, ScottishPower and PacifiCorp must provide the full $12 million credit, irrespective of whether actual merger related cost savings are reflected in rates or whether disaggregation occurs. In years 2003 and 2004, respectively, ScottishPower and PacifiCorp may reduce or offset the $9 million and $12 million merger credit to the extent that cost reductions related to the merger are reflected in rates. The $3 million credit in years 2003 and 2004 may not be offset or reduced in this manner. The Commission shall determine the allocation of the merger credit among customers at the time of the implementation of the credit. The dates set forth above assume that the transaction will close in 1999. If closing is delayed, ScottishPower and PacifiCorp may request the Commission to adjust the dates so that the merger credit begins on the one-year anniversary date of the actual closing date.

PacifiCorp shall establish a balancing account and credit that account with the appropriate per year credit, consistent with this provision, beginning on January 1, 2001, and each subsequent January 1, through 2004. The balancing account will accrue interest on the unamortized balance at PacifiCorp's authorized rate of return. Customers will receive the benefit of these monies through a rate credit described above and such credits shall reduce the unamortized account balance.

19. ScottishPower and PacifiCorp agree to make a general rate filing by March 1, 2004, for rates effective January 1, 2005, if the Commission requests on or before December 31, 2003, that PacifiCorp make such a filing. The Commission will not make such a request unless PacifiCorp's earnings fall outside a zone of reasonableness.

20. PacifiCorp and ScottishPower shall agree to comply with all Commission requirements regarding affiliated interest (AI) transactions, including timely filing of applications and reports. In particular for 2000, 2001, and 2002 PacifiCorp shall file semiannual AI reports on any new affiliated interest transactions between ScottishPower and PacifiCorp, in the form required by OAR 860-027-0100. The semi-annual AI report due date shall be October 1.

21. ScottishPower shall file its Merger Transition Plan (the Plan) with the Commission no later than six months after the closing date of the merger. The Plan shall include all items described in Exhibit ScottishPower/34.

22. ScottishPower and PacifiCorp agree not to assert in any future proceedings that neither the provisions of the PUHCA nor Ohio v. FERC shall preempt the Commission's jurisdiction over affiliated interest transactions. ScottishPower and PacifiCorp will explicitly waive any such defense in any proceeding.

23. ScottishPower and PacifiCorp agree to abide by all commitments and conditions in the Appendix, which lists commitments and conditions included in the UM 918 application, and also the accompanying testimony and exhibits that are not amended or superseded by or included in this list of conditions or one of the ScottishPower/PacifiCorp Stipulations.

24. If the Commission believes that ScottishPower and/or PacifiCorp has violated any of the conditions set forth above, then the Commission shall give ScottishPower and PacifiCorp written notice of the violation:

a. If the violation is for failure to file any notice or report required by the conditions, and if ScottishPower and/or PacifiCorp provides the notice or report to the Commission within ten business days of the receipt of the written notice, then the Commission shall take no action. ScottishPower or PacifiCorp may request, for cause, permission for extension of the ten-day period. For any other violation of these conditions, the Commission must give PacifiCorp and ScottishPower written notice of the violation. If such failure is corrected within five business days of the written notice, then the Commission shall take no action. ScottishPower or PacifiCorp may request, for cause, permission for extension of the five-day period.

b. If ScottishPower and/or PacifiCorp fail to file a notice or report within the time permitted in a) above, or if ScottishPower and/or PacifiCorp fail to cure within the time permitted above a violation that does not relate to the filing of a notice or report, then the Commission may open an investigation to determine the number and seriousness of the violations. If the Commission determines that ScottishPower and/or PacifiCorp violated one or more conditions, then the Commission shall state the level of penalty it will seek under ORS 756.990 in an action filed in circuit court. If the Commission issues an order that recommends an ORS 756.990 penalty against ScottishPower and/or PacifiCorp, then ScottishPower and/or PacifiCorp may appeal such order under ORS 756.580. If the Commission's order is upheld on appeal, then the Commission may file a complaint in circuit court seeking penalties under ORS 756.990, and ScottishPower and PacifiCorp shall file a responsive pleading agreeing to pay the penalties. The Commission shall seek a penalty on only one of ScottishPower or PacifiCorp for the same violation.

Enron until the date of the issuance of the New PGE Common Stock, at which time they will terminate; provided that the obligations of PGE and Enron under conditions 7 and 10 of the Stipulation in UM 814 shall not be enforced against Enron but may be enforced, if at all, only against PGE; and (2) the Conditions set forth in this Stipulation shall apply from and after, but not before, the date of the issuance of the New PGE Common Stock, except that Condition 11 shall apply from and after the date the Commission approves the Application and Condition 6(c) of this Stipulation shall apply from and after the date the Commission approves the Application until such Condition is terminated in accordance with Condition 6(d) of this Stipulation. PGE agrees to assume full legal and financial responsibility of Enron's obligations associated with conditions 7 and 10 of the UM 814 Stipulation to the extent required by Conditions 6(a)(i) and 6(b) of this Stipulation.

Terms used in this Stipulation but not defined herein shall have the meanings given to them in the Application.

Conditions

1. There will be no direct charges or allocations to PGE from the Reserve.

2. PGE shall provide the Commission access to all books of account, as well as all documents, data and records of their affiliated interests, which pertain to transactions between PGE and all its affiliated interests. The Reserve shall provide the Commission access to all books of account, as well as all documents, data and records pertaining to PGE. Nothing in this Condition shall be deemed a waiver of PGE's or the Reserve's right to seek a protective order to maintain the confidentiality of the information described above.

3. All PGE financial books and records shall be kept in Portland, Oregon.

4. PGE shall exclude from PGE's utility accounts all non-recurring costs of PGE's

transition from a privately held corporation to a publicly traded corporation, including but not limited to the costs of the issuance of the New PGE Common Stock, the initial listing of such stock on a national stock exchange, and the release of any such stock held by the Reserve to Holders of Allowed Claims. Beginning within 90 days following the date of issuance of the New PGE Common Stock, PGE will provide annual reports of these costs.

5. PGE shall not make any distribution to shareholders that would cause PGE's common equity capital to fall below 48% of the total PGE capital without Commission approval. This 48% minimum common equity capital percentage shall be reduced to a 45% minimum common equity capital percentage at such time that the Reserve holds 20% or more but less than 40% of the issued and outstanding common stock of PGE. There shall be no minimum common equity capital percentage during the time that the Reserve holds less than 20% of the issued and outstanding common stock of PGE. PGE may seek, through a filing and Commission order, adjustment of the minimum common equity capital percentage. The other Settlement Parties may take any position they deem appropriate if PGE seeks adjustment of the minimum common equity capital percentage.

6. (a) PGE agrees not to seek recovery of increases in the allowed return on common equity and other costs of capital (i) due to Enron's ownership of PGE or (ii) caused by the ownership by the Reserve of 25% or more of PGE's issued and outstanding common stock. These capital costs refer to the costs of capital used for purposes of rate setting, avoided cost calculations, affiliated interest transactions, least cost planning, and other regulatory purposes.

(b) PGE agrees not to seek recovery of increases in PGE's revenue requirement that result from Enron's ownership of PGE.

(c) In connection with Conditions 6(a)(i) and 6(b), PGE shall not make any

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distribution to shareholders that would cause PGE's common equity capital to fall below the level specified in Condition 5 plus $40 million. PGE has agreed to maintain this additional $40 million during the pendency of PGE's next general rate case to assure PGE's financial capacity to absorb adjustment(s), if any, in PGE's revenue requirement resulting from Conditions 6(a)(i) and/or 6(b).

(d) Condition 6(c) shall expire thirty (30) days after the PGE tariffs approved in PGE's next general rate case become effective, without regard to any appeal of the Commission's order approving such tariffs.

7. PGE and the Reserve shall provide the Commission unrestricted access to all written information provided to common stock and bond analysts, or rating agencies, which directly or indirectly pertains to PGE or any affiliate that exercises influence or control over PGE. Such information includes, but is not limited to, reports provided to, and presentations made to, common stock and bond analysts and rating agencies. For purposes of this Condition, 'written' information includes but is not limited to any written and printed material, audio and video tapes, computer disks and electronically-stored information. Nothing in this Condition shall be deemed to be a waiver of PGE's or the Reserve's right to seek a protective order to maintain the confidentiality of the information.

8. During the time that the Reserve holds 25% or more of the issued and outstanding common stock of PGE, PGE shall provide the Commission written notice of any dividend declared by the board of directors of PGE at the same time that PGE discloses this information to the public.

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9. PGE agrees to extend the Service Quality Measures Stipulation as adopted in UM 814 in OPUC Order 97-196, dated June 4, 1997, as recorded in the Stipulation made but not adopted in UM 1121 and included in Order 05-114, Appendix B, for a ten (10) year period including calendar years 2007 through 2016. In addition, PGE agrees to work with ICNU to evaluate and, if necessary, develop additional service quality standards related to service to industrial customers with a focus on high tech companies.

10. Conditions #2 and #7 shall no longer apply to the Reserve at such time as the Commission finds that the Reserve holds less than 25% of PGE's issued and outstanding common stock.

11. From the date the Commission approves the Application to the date of the issuance of the New PGE Common Stock, PGE shall not make any distribution to Enron unless PGE has a senior secured debt rating of not lower than BBB+ from Standard & Poor's and can reasonably expect to maintain that rating after the distribution.

12. (a) For five (5) years beginning with 2006, PGE commits that up to two (2) representatives from each customer group precertified to receive intervenor funding from electric companies pursuant to OAR 860-012-0100 will be invited to at least one meeting of the PGE Board of Directors per year to address the Board. During 2010, PGE will consult with these customer groups regarding whether this standing appearance is useful and should continue. For so long as this Condition is in place, PGE will consider making a similar opportunity available to non-profit interest groups representing interests relevant to energy policy and PGE's service to customers.

(b) For five (5) years beginning with 2006, PGE commits to provide a process by which representatives of organizations representing customer, environmental or low-income

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interests may meet with PGE officers on a periodic basis to discuss matters of policy and utility operations. PGE commits to the availability of management for the purposes of these meetings on a quarterly basis, contingent on the organizations requesting such meetings. During 2010, PGE will consult with the organizations with whom it has interacted under this Condition regarding the usefulness of the process and whether it should continue.

13. PGE agrees not to propose in its next general rate case a decoupling mechanism that would apply to Schedule 83. PGE further agrees to oppose a decoupling mechanism for Schedule 83 if any other party makes such a proposal in its next general rate case.

14. PGE agrees to work in good faith with Staff and other interested parties to develop and present to the Commission a billing accuracy service quality measure ("SQM"). Within 180 days of a Commission order approving the Application, PGE will file with the Commission a billing accuracy SQM. In general, the SQM would apply to systematic errors (such as programming and input errors, failure to follow tariff provisions and failure to implement rates correctly) and would be reasonably consistent with billing accuracy SQMs that apply to other energy utilities in Oregon. The SQM could exclude billing errors resulting from such sources as meter reads, customer meter reads, crossed meters, customer-caused errors, force majeure, estimates due to access issues, or inaccuracies that do not affect the calculation of the bill or prevent the bill from reaching the customer, but would not necessarily exclude Commission-required notices. In addition, PGE can also request exclusions or reductions in remedy amounts where there are mitigating circumstances. The SQM could include the ability for PGE to request a targeted and time-limited exclusion category for the introduction of a new metering or billing program or new tariff offering. Each bill affected by a systematic error would be considered an incident in the month the bill is issued, except that

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multiple bills to the same customer that contain the same type of error would count as one incident in that month. PGE would provide the Commission notice within 10 days after becoming aware of a specific billing error incident and after a certain level of errors per month. A written report would follow within a certain number of days. PGE would also prepare an annual report on billing for the Commission, to include such information as the number of estimated bills and bills excluded from this SQM under one of the approved categories. The SQM would include a per-incident remedy for errors beyond an agreed level, and a monthly or quarterly and annual maximum remedy. No bill counted as an error for purposes of this SQM would also be the basis of an At-Fault complaint for purposes of the C-1 SQM in PGE's Service Quality Program. The SQM would include a trial period before remedies applied. The parties also agree to review the costs of implementing and operating this SQM program prior to presenting it to the Commission. The Settlement Parties other than PGE may take any position they deem appropriate regarding the filings made under this Condition.

15. (a) PGE shall propose for OPUC approval to offer customers with aggregate load larger than 1 aMW (each point of delivery of at least 250 kW) a three-year and a five-year option to opt out of the cost of service rate with a fixed transition amount under similar terms as current Schedule 483 (effective September 1, 2004). Subject to OPUC approval, the Schedule 483 offer will be made each September for a 30-day period at least through 2010. For the 2005 and 2006 windows (for service beginning in 2006 and 2007 respectively), PGE will propose transition amounts that do not include long-term resources (5 years or longer) identified in its 2004 IRP Action Plan. Beginning with the 2007 window, transition amounts

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proposed will include long-term resources identified in its 2004 IRP Action Plan. ICNU agrees not to oppose and will consider supporting future proposals, if any, of PGE during the offering of Schedule 483 that would allow PGE to provide 3 to 5 year market-based pricing options to Schedule 483-eligible customers in a manner similar to its current one and three month market-based options under Schedule 83.

(b) PGE in consultation with customers eligible for direct access and electricity service suppliers shall develop the following proposals, which shall be included in its next general rate case filing:

(i) For customers with aggregate load larger than 1 aMW (each point of delivery of at least 250 kW) an opportunity to elect direct access for the remainder of the year with a two business day decision window (concluding at 5:00 pm of the next business day after posting) at least once each month. PGE may, at its option, propose an alternative that provides more frequent opportunities to elect direct access under which an eligible customer may request the calculation of a transition amount at any time.

(ii) For customers with aggregate load larger than 10 aMW (each point of delivery of at least 250 kW) the option to purchase flat blocks of energy from energy service suppliers not to exceed 50% of their load while purchasing the balance of the load and load shaping and other necessary services from PGE. In order to qualify for this option, the customer would have to exhibit an aggregated average monthly load factor of at least 60% over the most recent 12-month period.

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(c) ICNU agrees that the above conditions eliminate the need for a new resource opt-out as discussed in Commission Order No. 05-133 for PGE's 2004 IRP Action Plan and will support a PGE filing that requests a waiver of that requirement. ICNU may take any position it wishes on opt-out options applicable to new resources not identified in the 2004 IRP Action Plan.

(d) The Settlement Parties other than PGE and ICNU may take any position they deem appropriate regarding the filings made under this Condition.

16. Enron agrees to provide PGE the tax indemnification and employee benefits indemnification as described in Article III of the Separation Agreement (Application Exhibit 17), except that, as provided in footnotes 1 and 2 to that Article, the indemnifications may be modified or deleted if settlements are reached in the respective matters prior to the issuance of the New PGE Common Stock.

17. If the Commission believes that PGE and/or the Reserve have violated any of the Conditions set forth herein, or any conditions imposed by the Commission in its final order approving the Application (for purposes of this condition 17, collectively the "Conditions"), then the Commission shall give PGE and the Reserve written notice of the violation.

(a) If the violation is for failure to file any notice or report required by the Conditions, and if PGE and/or the Reserve provide the notice or report to the Commission within ten business days of the receipt of the written notice of violation, then the Commission shall take no action. PGE or the Reserve may request, for cause, permission for extension of the ten-day period. For any other violation of the Conditions, if such violation is corrected within five business days of the written notice of violation, then the Commission shall take no action. PGE or the Reserve may request, for cause, permission for extension of the five-day period.

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(b) If PGE and/or the Reserve fail to file a notice or written report within the time permitted in subparagraph (a) above, or if PGE and/or the Reserve fail to cure, within the time permitted above, a violation that does not relate to the filing of a notice or report, then the Commission may open an investigation, with an opportunity for PGE and/or the Reserve to request a hearing, to determine the number and seriousness of the violations. If the Commission determines after the investigation and hearing (if requested) that PGE and/or the Reserve violated one or more of the Conditions, then the Commission shall issue an order stating the penalty. PGE and/or the Reserve, as appropriate, may appeal such an order to the appropriate court. If no party appeals the order stating the penalty within the time allowed, or if the Commission's order is upheld on appeal, and the order imposes penalties under a statute that requires the Commission to file a complaint in court, then the Commission may file a complaint in the appropriate court seeking the penalty specified in the order, and PGE and/or the Reserve shall file a responsive pleading agreeing to such penalty. The Commission shall seek to impose a penalty on only one of PGE or the Reserve for the same violation.

(c) The Commission shall not be bound by subsection (a) in the event the Commission determines PGE and/or the Reserve has violated any of the material Conditions, contained herein, more than two times within a rolling 24-month period.

(d) PGE and/or the Reserve shall have the opportunity to demonstrate to the Commission that subsection (c) should not apply on a case-by-case basis.

General Terms and Conditions

1. The Settlement Parties agree that this Stipulation and its terms and Conditions are in the public interest.

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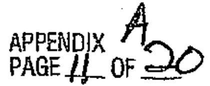

MEHC Acquisition of PacifiCorp
Oregon Docket No. UM-1209

Consolidated List of Commitments

Commitments Applicable to All States:

1) MEHC and PacifiCorp affirm the continuation (through March 31, 2008) of the existing customer service guarantees and performance standards in each jurisdiction. MEHC and PacifiCorp will not propose modifications to the guarantees and standards prior to March 31, 2008. Refer to Commitment 45 for the extension of this commitment through 2011.

2) Penalties for noncompliance with performance standards and customer guarantees shall be paid as designated by the Commission and shall be excluded from results of operations. PacifiCorp will abide by the Commission's decision regarding payments.

3) PacifiCorp will maintain its own accounting system, separate from MEHC's accounting system. All PacifiCorp financial books and records will be kept in Portland, Oregon. PacifiCorp's financial books and records and state and federal utility regulatory filings and documents will continue to be available to the Commission, upon request, at PacifiCorp's offices in Portland, Oregon, Salt Lake City, Utah, and elsewhere in accordance with current practice.

4) MEHC and PacifiCorp will provide the Commission access to all books of account, as well as all documents, data, and records of their affiliated interests, which pertain to transactions between PacifiCorp and its affiliated interests or which are otherwise relevant to the business of PacifiCorp. This commitment is also applicable to the books and records of Berkshire Hathaway, which shall retain its books and records relevant to the business of PacifiCorp consistent with the manner and time periods of the Federal Energy Regulatory Commission's record retention requirements that are applicable to PacifiCorp's books and records.

5) MEHC, PacifiCorp and all affiliates will make their employees, officers, directors, and agents available to testify before the Commission to provide information relevant to matters within the jurisdiction of the Commission.

6) The Commission or its agents may audit the accounting records of MEHC and its subsidiaries that are the bases for charges to PacifiCorp, to determine the reasonableness of allocation factors used by MEHC to assign costs to PacifiCorp and amounts subject to allocation or direct charges. MEHC agrees to cooperate fully with such Commission audits.

7) MEHC and PacifiCorp will comply with all applicable Commission statutes and regulations regarding affiliated interest transactions, including timely filing of applications and reports.

8) PacifiCorp will file on an annual basis an affiliated interest report including an organization chart, narrative description of each affiliate, revenue for each affiliate and transactions with each affiliate.

9) PacifiCorp and MEHC will not cross-subsidize between the regulated and non-regulated businesses or between any regulated businesses, and shall comply with the Commission's applicable orders and rules with respect to such matters.

10) Due to PUHCA repeal, neither Berkshire Hathaway nor MEHC will be registered public utility holding companies under PUHCA. Thus, no waiver by Berkshire Hathaway or MEHC of any defenses to which they may be entitled under *Ohio Power Co. v. FERC*, 954 F.2d 779 (D.C. Cir.), *cert. denied sub nom. Arcadia v. Ohio Power Co.*, 506 U.S. 981 (1992) (*"Ohio Power")*, is necessary to maintain the Commission's regulation of MEHC and PacifiCorp. However, while PUHCA is in effect, Berkshire Hathaway and MEHC waive such defenses.

11) a) Any diversified holdings and investments (e.g., non-utility business or foreign utilities) of MEHC following approval of the transaction will not be held by PacifiCorp or a subsidiary of PacifiCorp. This condition will not prohibit MEHC or its affiliates other than PacifiCorp from holding diversified businesses.

b) Ring-fencing provisions for PPW Holdings LLC will include the provisions in Appendix 1. These provisions have been derived from those in effect for NNGC Acquisition, LLC as of December 1, 2005.

12) PacifiCorp or MEHC will notify the Commission subsequent to MEHC's board approval and as soon as practicable following any public announcement of: (1) any acquisition of a regulated or unregulated business representing 5 percent or more of the capitalization of MEHC; or (2) the change in effective control or acquisition of any material part or all of PacifiCorp by any other firm, whether by merger, combination, transfer of stock or assets.

13) The Inter-company Administrative Services Agreement (IASA) will include the corporate and affiliate cost allocation methodologies. The IASA will be filed with the Commission as soon as practicable after the closing of the transaction. Approval of the IASA will be requested if required by law or rule, but approval for ratemaking purposes will not be requested in such filing. Refer to Commitment 14 (f). Amendments to the IASA will also be filed with the Commission.

14) Any proposed cost allocation methodology for the allocation of corporate and affiliate investments, expenses, and overheads, required by law or rule to be

submitted to the Commission for approval, will comply with the following principles:

a) For services rendered to PacifiCorp or each cost category subject to allocation to PacifiCorp by MEHC or any of its affiliates, MEHC must be able to demonstrate that such service or cost category is necessary to PacifiCorp for the performance of its regulated operations, is not duplicative of services already being performed within PacifiCorp, and is reasonable and prudent.

b) Cost allocations to PacifiCorp and its subsidiaries will be based on generally accepted accounting standards; that is, in general, direct costs will be charged to specific subsidiaries whenever possible and shared or indirect costs will be allocated based upon the primary cost-driving factors.

c) MEHC and its subsidiaries will have in place positive time reporting systems adequate to support the allocation and assignment of costs of executives and other relevant personnel to PacifiCorp.

d) An audit trail will be maintained such that all costs subject to allocation can be specifically identified, particularly with respect to their origin. In addition, the audit trail must be adequately supported. Failure to adequately support any allocated cost may result in denial of its recovery in rates.

e) Costs which would have been denied recovery in rates had they been incurred by PacifiCorp regulated operations will likewise be denied recovery whether they are allocated directly or indirectly through subsidiaries in the MEHC group.

f) Any corporate cost allocation methodology used for rate setting, and subsequent changes thereto, will be submitted to the Commission for approval if required by law or rule.

15) MEHC and PacifiCorp commit that PacifiCorp will maintain separate debt and preferred stock, if any. PacifiCorp will maintain its own corporate credit rating, as well as ratings for long-term debt and preferred stock, from Moody's and S&P or their successor rating agencies.

16) MEHC and PacifiCorp will exclude all costs of the transaction from PacifiCorp's utility accounts. Within 90 days following completion of the transaction, MEHC will provide a preliminary accounting of these costs. Further, MEHC will provide the Commission with a final accounting of these costs within 30 days of the accounting close.

17) MEHC and PacifiCorp will provide the Commission with unrestricted access to all written information provided by and to credit rating agencies that pertains to PacifiCorp or MEHC. Berkshire Hathaway and MEHC will also provide the

Commission with unrestricted access to all written information provided by and to credit rating agencies that pertains to MEHC's subsidiaries to the extent such information may potentially impact PacifiCorp.

18) a) MEHC and PacifiCorp commit that PacifiCorp will not make any dividends to PPW Holdings LLC or MEHC that will reduce PacifiCorp's common equity capital below the following percentages of its Total Capital without Commission approval:

48.25% from the date of the close of the transaction through December 31, 2008;
47.25% from January 1, 2009, through December 31, 2009;
46.25% from January 1, 2010 through December 31, 2010;
45.25% from January 1, 2011 through December 31, 2011;
44.00% after December 31, 2011.

b) PacifiCorp's Total Capital is defined as common equity, preferred equity and long-term debt. Long-term debt is defined as debt with a term of more than one year. For purposes of calculating the numerator of the percentage, common equity will be increased by 50% of the remaining balance of preferred stock that was in existence prior to the acquisition of PacifiCorp by MEHC. PacifiCorp and MEHC will work with Commission staff to determine a percentage of common equity credit to apply to preferred stock issued by PacifiCorp after the acquisition of PacifiCorp by MEHC. In the absence of such an agreement between Commission staff and the Companies, MEHC and PacifiCorp agree to treat new issuances of preferred stock as 100% debt, unless a Commission order approves a different percentage.

c) MEHC and PacifiCorp commit that PacifiCorp will not make any dividends to PPW Holdings LLC or MEHC that will reduce PacifiCorp's common equity capital below 35% of its Total Adjusted Capital without Commission approval. For purposes of calculating the numerator of the percentage, common equity will not include any portion of PacifiCorp preferred stock issued and outstanding. PacifiCorp's Total Adjusted Capital is defined as common equity, preferred equity, long-term debt, short-term debt and capitalized lease obligations.

d) The Commission, on its own motion or at the request of any party, may reexamine the minimum common equity percentages as financial conditions or accounting standards warrant.

19) The capital requirements of PacifiCorp, as determined to be necessary to meet its obligation to serve the public, will be given a high priority by the Board of Directors of MEHC and PacifiCorp.

20) MEHC and PacifiCorp commit that neither PacifiCorp nor its subsidiaries will, without the approval of the Commission, make loans or transfer funds (other than

dividends and payments pursuant to the IASA) to MEHC, Berkshire Hathaway or their respective subsidiaries, or assume any obligation or liability as guarantor, endorser, surety or otherwise for MEHC, Berkshire Hathaway or their respective subsidiaries; provided that this condition will not prevent PacifiCorp, to the extent allowed by law, from making loans or transferring funds to a subsidiary of PacifiCorp or assuming any obligation or liability on behalf of a subsidiary of PacifiCorp. MEHC and Berkshire Hathaway will not pledge any of the assets of the business of PacifiCorp as backing for any securities which MEHC, Berkshire Hathaway or their respective subsidiaries, but excluding PacifiCorp and its subsidiaries, may issue.

21) MEHC and PacifiCorp will not advocate for a higher cost of capital as compared to what PacifiCorp's cost of capital would have been, using Commission standards, absent MEHC's ownership.

22) [This Commitment number has intentionally been left blank. Commitment 22 is not available if a state selects Oregon-specific Commitment O 12.]

23) PacifiCorp will continue a Blue Sky tariff offering in all states. PacifiCorp will continue to support this offering through innovative marketing, by modifying the tariff to reflect the developing green power market and by monitoring national certification standards.

24) PacifiCorp will continue its commitment to gather outside input on environmental matters, such as through the Environmental Forum.

25) PacifiCorp will continue to have environmental management systems in place that are self-certified to ISO 14001 standards at all PacifiCorp operated thermal generation plants.

26) MEHC will maintain at least the existing level of PacifiCorp's community-related contributions, both in terms of monetary and in-kind contributions. The distribution of PacifiCorp's community-related contributions among the states will be done in a manner that is fair and equitable to each state.

27) MEHC will continue to consult with regional advisory boards to ensure local perspectives are heard regarding community issues.

28) MEHC will honor PacifiCorp's existing labor contracts.

29) After the closing of the transaction, MEHC and PacifiCorp will make no unilateral changes to employee benefit plans prior to May 23, 2007 that would result in the reduction of employee benefits.

30) PacifiCorp will continue to produce Integrated Resource Plans according to the then current schedule and the then current Commission rules and orders.

31) When acquiring new generation resources in excess of 100 MW and with a dependable life of 10 or more years, PacifiCorp and MEHC will issue Requests for Proposals (RFPs) or otherwise comply with state laws, regulations and orders that pertain to procurement of new generation resources for PacifiCorp.

32) Nothing in these acquisition commitments shall be interpreted as a waiver of PacifiCorp's or MEHC's rights to request confidential treatment for information that is the subject of any commitments.

33) [This Commitment number has intentionally been left blank. Oregon-specific Commitment O 1 substitutes for this Commitment 33.]

34) MEHC and PacifiCorp have identified transmission projects that MEHC and PacifiCorp believe will enhance reliability, facilitate the receipt of renewable resources, or enable further system optimization. Subject to permitting and the availability of materials, equipment and rights-of-way, MEHC and PacifiCorp commit to use their best efforts to achieve the following transmission system infrastructure improvements[1]:

a) Path C Upgrade (~$78 million) – Increase Path C capacity by 300 MW (from S.E. Idaho to Northern Utah). The target completion date for this project is 2010. MEHC and PacifiCorp assert that this project:
   - enhances reliability because it increases transfer capability between the east and west control areas,
   - facilitates the delivery of power from wind projects in Idaho, and
   - provides PacifiCorp with greater flexibility and the opportunity to consider additional options regarding planned generation capacity additions.

b) Mona - Oquirrh (~$196 million) – Increase the import capability from Mona into the Wasatch Front (from Wasatch Front South to Wasatch Front North). This project would enhance the ability to import power from new resources delivered at or to Mona, and to import from Southern California by "wheeling" over the Adelanto DC tie. The target completion date for this project is 2011. MEHC and PacifiCorp assert that this project:
   - enhances reliability by enabling the import of power from Southern California entities during emergency situations,
   - facilitates the acceptance of renewable resources, and
   - enhances further system optimization since it enables the further purchase or exchange of seasonal resources from parties capable of delivering to Mona.

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[1] It is possible that upon further review a particular investment might not be cost-effective, optimal for customers or able to be completed by the target date. If that should occur, MEHC pledges to propose an alternative to the Commission with a comparable benefit.

c) Walla Walla - Yakima or Mid-C (~$88 million) – Establish a link between the "Walla Walla bubble" and the "Yakima bubble" and/or reinforce the link between the "Walla Walla bubble" and the Mid-Columbia (at Vantage). MEHC and PacifiCorp assert that either of these projects presents opportunities to enhance PacifiCorp's ability to accept the output from wind generators and balance the system cost effectively in a regional environment. The target completion date for this project is 2010.

35) MEHC and PacifiCorp make the following commitments to improve system reliability:

a) investment in the Asset Risk Program of $75 million over the three years, 2007-2009,

b) investment in local transmission risk projects across all states of $69 million over eight years after the close of the transaction,

c) O & M expense for the Accelerated Distribution Circuit Fusing Program across all states will be increased by $1.5 million per year for five years after the close of the transaction, and

d) extension of the O&M investment across all states for the Saving SAIDI Initiative for three additional years at an estimated cost of $2 million per year.

e) MEHC and PacifiCorp will support the Bonneville Power Administration in its development of short-term products such as conditional firm. No less than three months following the close of the transaction, PacifiCorp will initiate a process to collaboratively design similar short-term transmission products and will include stakeholders in this process. PacifiCorp will make every reasonable effort to complete a product by the end of 2008.

f) PacifiCorp will continue to offer its Partial Interim Service product, and will make commercially reasonable efforts to offer transmission customers as much firm service as the Company's transmission studies show is available, including weeks within a month. PacifiCorp will also continue its OATT tariff provision that allows transmission customers to alter pre-scheduled transactions up to 20 minutes before the hour as long as such provision is consistent with established scheduling practices and does not jeopardize system reliability. PacifiCorp will notify parties to this proceeding if it proposes changes to these two elements of its OATT.

36) MEHC recognizes that it can and should have a role in addressing the critical importance of transmission infrastructure to the states in which PacifiCorp serves. MEHC also recognizes that some transmission projects, while highly desirable, may not be appropriate investments for PacifiCorp and its regulated customers.

Therefore, MEHC commits its resources and leadership to assist PacifiCorp states in the development of transmission projects upon which the states can agree. Examples of such projects would be RMATS and the proposed Frontier transmission line.

37) [This Commitment number has intentionally been left blank. Commitment 37 is not available if a state selects Oregon-specific Commitment O 14.]

38) [This Commitment number has intentionally been left blank. Commitment 38 is not available if a state selects Oregon-specific Commitments O 9 and O 11.]

39) In Commitment 31, MEHC and PacifiCorp adopt a commitment to source future PacifiCorp generation resources consistent with the then current rules and regulations of each state. In addition to that commitment, for the next ten years, MEHC and PacifiCorp commit that they will submit as part of any commission approved RFPs for resources with a dependable life greater than 10 years and greater than 100 MW, --including renewable energy RFPs -- a 100 MW or more utility "own/operate" alternative for the particular resource. It is not the intent or objective that such alternatives be favored over other options. Rather, the option for PacifiCorp to own and operate the resource which is the subject of the RFP will enable comparison and evaluation of that option against other viable alternatives. In addition to providing regulators and interested parties with an additional viable option for assessment, it can be expected that this commitment will enhance PacifiCorp's ability to increase the proportion of cost-effective renewable energy in its generation portfolio, based upon the actual experience of MEC and the "Renewable Energy" commitment offered below.

40) MEHC reaffirms PacifiCorp's commitment to acquire 1400 MW of new cost-effective renewable resources, representing approximately 7% of PacifiCorp's load. MEHC and PacifiCorp commit to work with developers and bidders to bring at least 100 MW of cost-effective wind resources in service within one year of the close of the transaction.

MEHC and PacifiCorp expect that the commitment to build the Walla-Walla and Path C transmission lines will facilitate up to 400 MW of renewable resource projects with an expected in-service date of 2010. MEHC and PacifiCorp commit to actively work with developers to identify other transmission improvements that can facilitate the delivery of cost-effective wind energy in PacifiCorp's service area.

In addition, MEHC and PacifiCorp commit to work constructively with states to implement renewable energy action plans so as to enable PacifiCorp to achieve at least 1400 MW of cost-effective renewable energy resources by 2015. Such renewable energy resources are not limited to wind energy resources.

41) MEHC supports and affirms PacifiCorp's commitment to consider utilization of advanced coal-fuel technology such as super-critical or IGCC technology when adding coal-fueled generation.

42) a) MEHC and PacifiCorp commit to participate in the Environmental Protection Agency's SF_6 Emission Reduction Partnership for Electric Power Systems. Sulfur hexafluoride (SF_6) is a highly potent greenhouse gas used in the electric industry for insulation and current interruption in electric transmission and distribution equipment. MEHC and PacifiCorp represent that over a 100-year period, SF_6 is 23,900 times more effective at trapping infrared radiation than an equivalent amount of CO_2, making it the most highly potent, known greenhouse gas. SF_6 is also a very stable chemical, with an atmospheric lifetime of 3,200 years. As the gas is emitted, it accumulates in the atmosphere in an essentially un-degraded state for many centuries. Thus, a relatively small amount of SF_6 can have a significant impact on global climate change. Through its participation in the SF_6 partnership, PacifiCorp will commit to an appropriate SF_6 emissions reduction goal and annually report its estimated SF_6 emissions. MEHC and PacifiCorp represent that this not only reduces greenhouse gas emissions, it saves money and improves grid reliability. Since 1999, EPA's SF_6 partner companies have saved $2.5 million from the avoided gas loss alone. Use of improved SF_6 equipment and management practices helps protect system reliability and efficiency.

b) Within six months after close of the transaction, MEHC and PacifiCorp commit that PacifiCorp will establish a global warming working group composed of representatives of the regulatory, consumer, educational and environmental communities in the six states that PacifiCorp serves, as well as representatives of PacifiCorp and MEHC. PacifiCorp will work with the global warming working group to identify cost-effective measures to reduce PacifiCorp's greenhouse emissions. PacifiCorp will develop and file with the Commission its strategy, which MEHC supports, for reducing its greenhouse gas emissions.

43) Working with the affected generation plant joint owners and with regulators to obtain required approvals, MEHC and PacifiCorp commit to install, to the extent cost effective, the equipment likely to be necessary under future emissions control scenarios at a cost of approximately $812 million. Concurrent with any application for an air permit, MEHC and PacifiCorp will discuss its plans regarding this commitment with interested parties and solicit input. While additional expenditures may ultimately be required as future emission reduction requirements become better defined, MEHC believes these investments in emission control equipment are reasonable and environmentally beneficial. The execution of an emissions reduction plan for the existing PacifiCorp coal-fueled facilities, combined with the use of reduced-emissions coal technology for new coal-fueled generation, is expected to result in a significant decrease in the emissions rate of PacifiCorp's coal-fueled generation fleet. MEHC represents that the investments to which MEHC is committing are expected to result in a decrease in the SO_2 emissions rates of more than 50%, a decrease in the NO_x

emissions rates of more than 40%, a reduction in the mercury emissions rates of almost 40%, and no increase expected in the CO_2 emissions rate.

44) a) MEHC and PacifiCorp commit to conducting a company-defined third-party market potential study of additional DSM and energy efficiency opportunities within PacifiCorp's service areas. The objective of the study will be to identify opportunities not yet identified by the company and, if and where possible, to recommend programs or actions to pursue those opportunities found to be cost-effective. The study will focus on opportunities for deliverable DSM and energy efficiency resources rather than technical potentials that may not be attainable through DSM and energy efficiency efforts. On-site solar and combined heat and power programs may be considered in the study. During the three-month period following the close of the transaction, MEHC and PacifiCorp will consult with DSM advisory groups and other interested parties to define the proper scope of the study. The findings of the study will be reported back to DSM advisory groups, commission staffs, and other interested stakeholders and will be used by the Company in helping to direct ongoing DSM and energy efficiency efforts. The study will be completed within fifteen months after the closing on the transaction, and MEHC shareholders will absorb the first $1 million of the costs of the study.

b) PacifiCorp further commits to meeting its portion of the NWPPC's energy efficiency targets for Oregon, Washington and Idaho, as long as the targets can be achieved in a manner deemed cost-effective by the affected states.

c) In addition, MEHC and PacifiCorp commit that PacifiCorp and MEC will annually collaborate to identify any incremental programs that might be cost-effective for PacifiCorp customers. The Commission will be notified of any additional cost-effective programs that are identified.

45) MEHC and PacifiCorp commit to continue customer service guarantees and performance standards as established in each jurisdiction, provided that MEHC and PacifiCorp reserve the right to request modifications of the guarantees and standards after March 31, 2008, and the right to request termination (as well as modification) of one or more guarantees or standards after 2011. The guarantees and standards will not be eliminated or modified without Commission approval.

46) MEHC has significant experience in assisting its communities with economic development efforts. MEHC plans to continue PacifiCorp's existing economic development practices and use MEHC's experience to maximize the effectiveness of these efforts.

47) MEHC understands that having adequate staffing and representation in each state is not optional. MEHC understands its importance to customers, to regulators and to states. MEHC and PacifiCorp commit to maintaining adequate staffing and

presence in each state, consistent with the provision of safe and reliable service and cost-effective operations.

48) PacifiCorp will provide public notice and an invitation to encourage stakeholders to participate in the Integrated Resource Plan (IRP) process. The IRP process will be used to consider Commitments 34, 39, 40, 41, 44, 52 and 53. PacifiCorp will hold IRP meetings at locations or using communications technologies that encourage broad participation.

49) By June 1, 2007 and each June 1 thereafter through June 1, 2011, PacifiCorp will file a report with the Commission regarding the implementation of the Commitments. The report will, at a minimum, provide a description of the performance of each of the commitments that have quantifiable results. If any of the commitments is not being met, relative to the specific terms of the commitment, the report shall provide proposed corrective measures and target dates for completion of such measures. PacifiCorp will make publicly available at the Commission non-confidential portions of the report.

50) PacifiCorp will maintain its current pension funding policy, as described in the 2005 Actuarial Report, for a period of two years following the close of the transaction.

51) Subject to, and in consideration for, dismissal of all existing proceedings and no commencement of any future state regulatory proceeding against PacifiCorp involving or arising from the SEC PUHCA Audit Report of Scottish Power dated May 11, 2004, MEHC will contribute to PacifiCorp, at no cost to PacifiCorp, MEHC's stock ownership in the Intermountain Geothermal Company and the associated steam rights (approximately 70% of the total rights) to the steam resources serving PacifiCorp's Blundell geothermal plant and terminate MEHC's and Intermountain Geothermal Company's rights and obligations under the contracts. MEHC will assist PacifiCorp in determining the cost-effectiveness of acquiring the remaining 30% of the rights. No more than six months after the close of the transaction, MEHC will provide parties a clear and complete disclosure statement that details any potential liabilities and risks, identified by or for MEHC, associated with the ownership rights of MEHC in Intermountain Geothermal. MEHC also commits that PacifiCorp customers will not be harmed from the contribution to PacifiCorp of the Intermountain Geothermal steam resources and stock.

52) Upon closing, MEHC and PacifiCorp commit to immediately evaluate increasing the generation capacity of the Blundell geothermal facility by the amount determined to be cost-effective. Such evaluation shall be summarized in a report and filed with the Commission concurrent with the filing of PacifiCorp's next IRP. This incremental amount is expected to be at least 11 MW and may be as much as 100 MW. All cost effective increases in Blundell capacity, completed before January 1, 2015, should be counted toward satisfaction of PacifiCorp's

1400 MW renewable energy goal, in an amount equal to the capacity of geothermal energy actually added at the plant.

53) MEHC or PacifiCorp commit to commence as soon as practical after close of the transaction a system impact study to examine the feasibility of constructing transmission facilities from the Jim Bridger generating facilities to Miners, Wyoming. Upon receipt of the results of the system impact study, MEHC or PacifiCorp will review and discuss with stakeholders the desirability and economic feasibility of performing a subsequent facilities study for the Bridger to Miners 500 kV transmission project.

Oregon-Specific Commitments:

O 1.a) If the Commission believes that MEHC and/or PacifiCorp have violated any of the commitments of the stipulation, or any conditions imposed by the Commission in its final order approving the Application (collectively, the "Conditions"), then the Commission shall give MEHC and PacifiCorp written notice of the violation.

i) If the violation is for failure to file any notice or report required by the Conditions, and if MEHC or PacifiCorp, or both provide the notice or report to the Commission within ten business days of the receipt of the written notice, then the Commission shall take no action. MEHC or PacifiCorp may request, for cause, permission for extension of the ten-day period. For any other violation of the Conditions, the Commission must give MEHC and PacifiCorp written notice of the violation. If such failure is corrected within five business days of the written notice, then the Commission shall take no action. MEHC or PacifiCorp may request, for cause, permission for extension of the five-day period.

ii) If MEHC or PacifiCorp, or both, fail to file a notice or written report within the time permitted in subparagraph a. above, or if MEHC or PacifiCorp, or both, fail to cure, within the time permitted above, a violation that does not relate to the filing of a notice or report, then the Commission may open an investigation, with an opportunity for MEHC or PacifiCorp, or both, to request a hearing, to determine the number and seriousness of the violations. If the Commission determines after the investigation and hearing (if requested) that MEHC or PacifiCorp, or both, violated one or more of the Conditions, then the Commission shall issue an Order stating the level of penalty it will seek. MEHC or PacifiCorp, or both, as appropriate, may appeal such an order under ORS 756.580. If the Commission's order is upheld on appeal, and the order imposes penalties under a statute that further requires the Commission to file a complaint in court, then the Commission may file a complaint in the appropriate court seeking the penalties specified in the order, and MEHC or PacifiCorp, or both, shall file a responsive pleading agreeing to

pay the penalties. The Commission shall seek a penalty on only one of MEHC or PacifiCorp for the same violation.

iii) The Commission shall not be bound by the process provided in paragraph ii in the event the Commission determines PacifiCorp has violated any of the material conditions more than two times within a rolling 24-month period.

iv) PacifiCorp or MEHC, or both, shall have the opportunity to demonstrate to the Commission that the process provided in paragraph ii should not apply on a case-by-case basis.

b) In the event of a dispute between Commission Staff and MEHC or PacifiCorp regarding a Commission Staff request made pursuant to acquisition conditions or commitments (including Berkshire Hathaway records requested pursuant to Commitment 4 or other applicable commitment), the parties agree that an Administrative Law Judge (ALJ) shall resolve the dispute as follows: (i) within ten (10) business days MEHC or PacifiCorp shall deliver to the ALJ the books and records responsive to Staff's request and shall indicate the basis for the objection, including whether the request is overbroad, unduly burdensome or outside the scope of the Commission's jurisdiction; (ii) Staff may respond in writing and MEHC or PacifiCorp, or both, may reply; (iii) the ALJ shall review the documents in private; and (iv) the ALJ shall issue a ruling determining whether the documents are, directly or indirectly, relevant to PacifiCorp or reasonably calculated to lead to the discovery of admissible evidence directly or indirectly relevant to PacifiCorp. The ALJ shall use this standard whether or not Staff is making the request in connection with an open docket. Nothing in this provision shall affect the right of MEHC or PacifiCorp to request that the Commission treat the documents as exempt from disclosure to third parties under applicable law.

O 2.a) The corporate headquarters of PacifiCorp will remain in Oregon. MEHC commits to maintaining a balance of corporate and senior management positions between Oregon and Utah. To achieve such balance, MEHC may decide as appropriate to locate a few corporate and senior management positions, and associated staff, in Utah, if cost effective. By September 1, 2007, MEHC and PacifiCorp will file a plan with the Commission that explicitly sets forth: (1) corporate and senior management positions (and associated corporate personnel positions) that have been identified for location in Oregon and Utah; (2) the timeframe for implementing different stages of the plan; and (3) an economic analysis supporting the cost effectiveness of the plan. MEHC will promptly implement the plan pursuant to the timeframe. If corporate or senior managers, and related staff, are relocated from Oregon to Utah under the Plan, the costs of relocation will not be included in Oregon rates.

b) PacifiCorp and MEHC will ensure that senior management personnel located in Oregon continue to have authority to make decisions on behalf of PacifiCorp

pertaining to (1) local Oregon retail customer service issues related to tariff interpretation, line extensions, service additions, DSM program implementation and (2) customer service matters related to adequate investment in and maintenance of the Oregon sub-transmission and distribution network and outage response. Such decisions will be subject to normal and prompt corporate approval procedures, senior executive approval and board approval, as appropriate. MEHC and PacifiCorp will include a description of the implementation of this commitment in the filing required in paragraph a).

O 3. MEHC and PacifiCorp commit that they will interpret Oregon Revised Statutes Sections 757.015 and 757.495 to require Commission approval of any contract between PacifiCorp and (i) any affiliate of MEHC or (ii) any affiliate of Berkshire Hathaway. This shall include the IASA. MEHC and PacifiCorp intend that by obtaining Commission approval of the IASA, PacifiCorp will avoid the need to seek individual approval of affiliate transactions which are subject to that agreement. The IASA is expected to address the provision of electric service to affiliates of MEHC or Berkshire Hathaway under tariffs approved by state or federal authorities.

O 4. MEHC and PacifiCorp commit that they will interpret Oregon Revised Statutes Sections 757.480 to require Commission approval of any transaction which results in a merger of PacifiCorp with another public utility, without regard to whether that public utility provides service in Oregon.

O 5. Berkshire Hathaway acknowledges the Commitments made by MEHC and PacifiCorp and will not impede satisfaction of the Commitments. Berkshire Hathaway acknowledges that it is bound by Commitments 4, 5 and 17 and that it is subject to Commitments that are applicable to the affiliates of PacifiCorp and MEHC; provided, however, that Berkshire Hathaway does not guarantee or agree to be responsible for performance of Commitments made by MEHC and PacifiCorp.

O 6. MEHC and PacifiCorp will request Commission approval, for cost allocation and affiliate transaction purposes, of the IASA and any amendments filed pursuant to Commitment 13.

O 7. MEHC and PacifiCorp commit to $142.5 million (total company amount) of offsetable rate credits as reflected in Appendix 2 and as described in the following Commitments O 8 through O 12. These rate credits will be reflected in rates on the effective date of new rates as determined by the Commission in a general rate case. The rate credits will terminate on December 31, 2010, to the extent not previously offset, unless otherwise noted. The rate credits in Commitments O 8 and O 12 are subject to deferred accounting as specified therein. Where total company values are referenced, the amount allocated to Oregon will equal the Oregon-allocated amount using Commission-adopted allocation factors.

O 8.a) MEHC and PacifiCorp commit to reduce the annual non-fuel costs to PacifiCorp customers of the West Valley lease by $0.417 million per month (total company) or an expected $3.7 million in 2006 (assuming a March 31, 2006 transaction closing), $5 million in 2007 and $2.1 million in 2008 (the lease terminates May 31, 2008), which shall be the amounts of the total company rate credit. Beginning with the first month after the close of the transaction to purchase PacifiCorp, Oregon's share of the monthly rate credit will be deferred for the benefit of customers and accrue interest at PacifiCorp's authorized rate of return. (This commitment is reflected in Row 1 of Appendix 2.)

b) This commitment is offsetable, on a prospective basis, to the extent PacifiCorp demonstrates to the Commission's satisfaction, in the context of a general rate case, that such West Valley non-fuel cost savings:
   i) are reflected in PacifiCorp's rates; and,
   ii) there are no offsetting actions or agreements by MEHC or PacifiCorp for which value is obtained by PPM or an affiliated company, which, directly or indirectly, increases the costs PacifiCorp would otherwise incur.

O 9.a) MEHC and PacifiCorp will hold customers harmless for increases in costs retained by PacifiCorp that were previously assigned to affiliates relating to management fees. The total company amount assigned to PacifiCorp's affiliates is $1.5 million per year, which is the amount of the total company rate credit. This commitment expires on December 31, 2010. This Commitment is in lieu of Commitment 38, and a state must choose between this Commitment O 9 and Commitment 38. (The commitment is reflected in Row 2 of Appendix 2).

b) This commitment is offsetable to the extent PacifiCorp demonstrates to the Commission's satisfaction, in the context of a general rate case the following:
   i) Corporate allocations from MEHC to PacifiCorp included in PacifiCorp's rates are less than $7.3 million;
   ii) Costs associated with functions previously carried out by parents to PacifiCorp and previously included in rates have not been shifted to PacifiCorp or otherwise included in PacifiCorp's rates; and
   iii) Costs have not been shifted to operational and maintenance accounts (FERC accounts 500-598), customer accounts (FERC accounts 901-905), customer service and informational accounts (FERC accounts 907-910), sales accounts (FERC accounts 911-916), capital accounts, deferred debit accounts, deferred credit accounts, or other regulatory accounts.

O 10.a) MEHC commits to use an existing, or form a new, captive insurance company to provide insurance coverage for PacifiCorp's operations. The costs of forming such captive will not be reflected in PacifiCorp's regulated accounts, nor allocated directly or indirectly to PacifiCorp. Such captive shall be comparable in costs and services to that previously provided through ScottishPower's captive insurance company Dornoch. MEHC further commits that insurance costs incurred by PacifiCorp from the captive insurance company for equivalent coverage for

calendar years 2006 through 2010, inclusive, will be no more than $7.4 million (total company). Oregon Commission Staff has valued the potential increase in PacifiCorp's total company revenue requirement from the loss of ScottishPower's captive insurance affiliate as $4.3 million annually, which shall be the amount of the total company rate credit. This commitment expires on December 31, 2010.

b) This commitment is offsetable if PacifiCorp demonstrates to the Commission's satisfaction, in the context of a general rate case, the costs included in PacifiCorp's rates for such insurance coverage is not more than $7.4 million (total company). (This commitment is reflected in Row 3 in Appendix 2.)

O 11.a) MEHC and PacifiCorp will hold customers harmless for increases in costs resulting from PacifiCorp corporate costs previously billed to PPM and other former affiliates of PacifiCorp. Oregon Commission Staff has valued the potential increase in total company revenue requirement if these costs are not eliminated as $7.9 million annually (total company) through December 31, 2010 and $6.4 million annually (total company) from January 1, 2011 through December 31, 2015, which shall be the amounts of the total company rate credit. This commitment shall expire on the earlier of December 31, 2015 or when PacifiCorp demonstrates to the Commission's satisfaction, in the context of a general rate case, that corporate costs previously billed to PPM and other former affiliates have not been included in PacifiCorp's rates. This Commitment is in lieu of Utah Commitment 38, and a state must choose between this Commitment O 11 and Commitment 38.

b) This commitment is offsetable to the extent PacifiCorp demonstrates to the Commission's satisfaction, in the context of a general rate case, that corporate costs previously billed to PPM and other former affiliates have not been included in PacifiCorp's rates. (The commitment is reflected in Row 4 of Appendix 2.)

O 12.a) MEHC and PacifiCorp commit that PacifiCorp's total company A&G costs will be reduced by $6 million annually based on the A&G categories, assumptions, and values contained in Appendix 3 titled, "UM 1209 A & G Stretch". The amount of the total company rate credit is $6 million per year. This commitment expires December 31, 2010. Beginning with the first month after the close of the transaction, Oregon's share of the $0.5 million monthly rate credit will be deferred for the benefit of customers and accrue interest at PacifiCorp's authorized rate of return. This Commitment is in lieu of Commitments 22 and U 23 from the Utah settlement, and a state must choose between this Commitment O 12 and Commitments 22 and U 23.

b) The credit will be offsetable, on a prospective basis, by the amount that PacifiCorp demonstrates to the Commission's satisfaction, in a general rate case, that total company A&G expenses included in PacifiCorp's rates are lower than the benchmark and have not been shifted to other regulatory accounts. The 2006 benchmark will be $228.8 million. Subsequent benchmarks shall equal the 2006

benchmark multiplied by the ratio of the Global Insight's Utility Cost Information Service (UCIS)-Administrative and General – Total Operations and Maintenance Index (INDEX CODE Series JEADGOMMS), for the test period divided by the 2006 index value. If another index is adopted in a future PacifiCorp case, that index will replace the aforementioned index and will be used on a prospective basis only. If this occurs, the benchmark for future years will equal the benchmark from the rate case in which a new index was adopted multiplied by the ratio of the new index for the test period divided by the index value for the first year that the index is adopted.

O 13. The premium paid by MEHC for PacifiCorp (Acquisition Premium) will be excluded from the utility accounts of PacifiCorp. Further, MEHC and PacifiCorp commit that they will not propose to recover the Acquisition Premium in Oregon retail rates, or include the Acquisition Premium in PacifiCorp's results of operations, unless this commitment is modified by the Commission, pursuant to a filing under ORS 756.568, to allow for the recovery of the Acquisition Premium. MEHC and PacifiCorp will not request or support a motion to modify this commitment to allow recovery of the Acquisition Premium unless a party in a proceeding before the Commission proposes an adjustment to PacifiCorp's revenue requirement that MEHC and PacifiCorp assert violates the regulatory theory of the matching principle. If PacifiCorp seeks recovery of the Acquisition Premium, then other Parties are free to oppose such recovery, including the validity of the matching principle.

O 14.a) In the event of a ratings downgrade by two or more rating agencies of PacifiCorp's senior long-term debt that occurs within 12 months after the Commission approves the Transaction or issues an order adopting acquisition commitments from other PacifiCorp states, whichever, comes later (the "Baseline Date"), and at least one such agency identifies issues related to MEHC's acquisition of PacifiCorp as a cause of the ratings downgrade, the assumed yield for any incremental debt issued by PacifiCorp after the downgrade will be reduced by 10 basis points for each notch that PacifiCorp is downgraded below PacifiCorp's rating on the Baseline Date. Such adjustment will continue until the debt is no longer outstanding. In the case where one rating agency issues a rating downgrade, but not two or more rating agencies, denoted as a split rating, the adjustment shall be 5 basis points for each notch. The adjustment imposed by this commitment will be eliminated for debt issuances following the ratings upgrade of PacifiCorp equal to the rating on the Baseline Date. This Commitment is in lieu of Commitment 37, and a state must choose between this Commitment O 14 and Commitment 37.

b) In the event that debt issued by PacifiCorp within 12 months after the Baseline Date is recalled and refinanced, PacifiCorp agrees to hold customers harmless, for the term of the debt, as compared to the revenue requirements pursuant to subparagraph a) and its basis point reductions, of the originally financed debt.

O 15.a) MEHC commits that immediately following the closing of the transaction, the acquiring company (PPW Holdings LLC) will have no debt in its capital structure. MEHC and PacifiCorp commit that the consolidated capital structure of PPW Holdings LLC will not contain common equity capital below the following percentages of its Total Capital as defined in Commitment 18b:

48.25% from the date of the close of the transaction through December 31, 2008;
47.25% from January 1, 2009 through December 31, 2009;
46.25% from January 1, 2010 through December 31, 2010;
45.25% from January 1, 2011 through December 31, 2011;
44.00% after December 31, 2011.

b) MEHC and PacifiCorp commit that the consolidated capital structure of PPW Holdings LLC will not contain common equity capital below 35% of its Total Adjusted Capital as defined in Commitment 18c.

c) MEHC will provide the Commission 30 days prior notice if PPW Holdings LLC intends to issue debt. MEHC and PacifiCorp acknowledge that if PPW Holdings LLC does issue debt, the Commission has the authority pursuant to a re-opener under ORS 757.568 limited to the consideration of additional ring-fencing provisions that may be appropriate.

O 16. MEHC commits that no amendments, revisions or modifications will be made to the ring-fencing provisions of Commitment 11 b) without prior Commission approval pursuant to a limited re-opener under ORS 757.568 for the sole purpose of addressing the ring-fencing provisions.

O 17. Within three months of closing of the transaction, MEHC commits to obtain a non-consolidation opinion that demonstrates that the ring fencing around PPW Holdings LLC is sufficient to prevent PPW Holdings LLC and PacifiCorp from being pulled into an MEHC bankruptcy. MEHC commits to promptly file such opinion with the Commission. If the ring-fencing provisions of this agreement are insufficient to obtain a non-consolidation opinion, MEHC agrees to promptly undertake the following actions:

a) Notify the Commission of this inability to obtain a non-consolidation opinion.

b) Propose and implement, upon Commission approval, such ring-fencing provisions that are sufficient to prevent PPW Holdings LLC from being pulled into an MEHC bankruptcy.

c) Obtain a non-consolidation opinion.

O 18. MEHC and PacifiCorp commit that PacifiCorp will not make any dividends to PPW Holdings LLC or MEHC if PacifiCorp's unsecured debt rating is BBB- or

lower by S & P or Fitch (or Baa3 or lower by Moody's), as indicated by two of the three rating agencies.

O 19. MEHC and PacifiCorp commit to support renewal of the 3% public purpose charge under ORS 757.612 beyond 2011, provided that the Commission supports the renewal, the report to the legislature required under ORS 757.617 concludes that the Energy Trust continues to operate in a reasonable manner, and the legislation renewing the 3% public purpose charge is not included in a bill that MEHC and PacifiCorp otherwise deem objectionable. Additionally, with respect to potential modifications to the 3% public purpose charge arising from the 2007 report to the legislature required under ORS 757.617, MEHC and PacifiCorp agree to oppose any modifications that reduce the public purpose charge to less than 3% annually. In addition, provided the report to the legislature concludes the Energy Trust has operated in a reasonable manner and the Commission renews its contract with the Energy Trust, MEHC and PacifiCorp will support the Energy Trust.

O 20. MEHC and PacifiCorp acknowledge that the $10 million low-income bill payment assistance under ORS 757.612 does not expire in 2011. MEHC and PacifiCorp will oppose any reduction in the current amount of the fund.

O 21. MEHC commits to provide shareholder funding to hire a consultant to study and design for possible implementation of an arrearage management project for low-income customers that could be made applicable to Oregon and other states that PacifiCorp serves. PacifiCorp will provide a resource for facilitation of a working group to oversee the project. The study shall commence no later than 180 days after close of the transaction and be completed, through the issuance of a formal report to the Commission, no later than 365 days after close of the transaction. MEHC recognizes that such a program may have to be tailored to best fit the unique low-income environment of each individual state. The project will be developed by PacifiCorp in conjunction with the relevant regulatory and governmental agencies, low-income advocates, and other interested parties in each state that is interested in participating. The goals for the project will include reducing service terminations, reducing referral of delinquent customers to third party collection agencies, reducing collection litigation and reducing arrearages and increasing voluntary customer payments of arrearages. The costs of this study will be at least $66,000 on a total company basis paid for by shareholders. If less than six states participate, the amount of the shareholder funds will be reduced proportionally.

O 22. MEHC and PacifiCorp commit to a total contribution level for Oregon low-income bill payment assistance in the amount of $400,000 annually, for a five-year period beginning July 1, 2006. The contributions may be comprised of contributions from corporate, employee, other sources, and customer donations. The corporate contribution will be recorded in non-utility accounts. Before the

end of the five-year period, MEHC and PacifiCorp commit to work with low-income advocates and customer groups to evaluate additional contributions.

O 23. MEHC and PacifiCorp agree to include representatives of both Community Action Directors of Oregon and Oregon Energy Coordinators Association in the list of interested parties participating in the DSM study under Commitment 44.

O 24. MEHC and PacifiCorp acknowledge current city franchise authority including but not limited to a city's authority to control the use of its rights of way and collect charges for the use of the city's rights of way, as set forth and authorized by applicable Oregon law. Before any efforts to seek a legislative or regulatory change, MEHC and PacifiCorp will enter into discussions with the League of Oregon Cities regarding said modifications.

O 25. To the extent available, MEHC and PacifiCorp commit to have 400 MW of cost effective new renewable resources in PacifiCorp's generation portfolio by December 31, 2007. The 400 MW will include Wolverine Creek (64.5 MW) and Cove Fort (42 MW). MEHC and PacifiCorp will analyze the projects consistent with applicable regulatory rules and orders in effect at the time and as informed by the IRP. Resource identification shall be performed using an RFP procedure. If PacifiCorp fails to meet this 400 MW target it will disclose to signatories (excluding any bidders and affiliates of bidders) the cost-effectiveness analysis it used when rejecting the lowest cost projects. PacifiCorp shall file a report, on the status of meeting this target, with the Commission no later than six months after close of the transaction. In evaluating acquisition of renewable energy, all other things being equal, MEHC and PacifiCorp will not prefer ownership of facilities.

O 26.a) Concurrent with its next IRP filing, PacifiCorp commits to file a ten-year plan for achieving the 1400 MW renewables target, including specific milestones over the ten years when resources will be added. The filing will include a ten-year plan for installing transmission that will facilitate the delivery of renewable energy and the achievement of its 2015 goal of at least 1400 MW of cost-effective renewable energy. Within six (6) months after the close of the transaction, MEHC and PacifiCorp will file with the Commission a preliminary plan for achieving the 1400 MW renewable target.

b) PacifiCorp commits to address as part of its next IRP the appropriate role of incremental hydropower projects in meeting the 1400 MW renewables target.

O 27. MEHC and PacifiCorp will support cost effective and safe community renewable energy projects in Oregon using PURPA contracts implemented under avoided cost tariffs approved by the Commission. If PURPA is no longer in effect in Oregon before an alternate market for community renewable energy is developed, PacifiCorp will work with Oregon stakeholders and the Commission to develop replacement procedures for new contracts. For the purpose of this Commitment, community renewable energy projects are defined as: Locally owned renewable

energy projects. normally 1-10 MW standard contract PURPA projects and industrial co-gen type projects above 10 MW that use negotiated PURPA contracts. Projects can be: 1. Private ownership (example - several farmers in a wind project); 2. Municipal ownership (irrigation district small-hydro or local school; wind turbine); or 3. Combined municipal/private ownership projects (local community partnered with landowners).

O 28. To the extent consistent with the interests of PacifiCorp's retail customers, MEHC and PacifiCorp will support through action and policy the emerging community renewable energy market in Oregon. PacifiCorp will also consult with community renewable energy representatives if PacifiCorp is contemplating changes to system operations that would adversely affect community renewable energy projects.

O 29. MEHC and PacifiCorp agree that once a FERC license is issued and (a) PacifiCorp either (i) affirmatively accepts the license, or (ii) is deemed to have accepted the license pursuant to the terms of the license and FERC rules and procedures, and (b) the license's conditions are not subject to further appeals, PacifiCorp shall have the ability to fund implementation of all final license conditions. This provision is generally applicable, but also specifically applies to the following PacifiCorp hydropower projects: Klamath, Lewis River, and Prospect.

O 30. MEHC and PacifiCorp renew PacifiCorp's commitment to implement the Condit (FERC No. 2342, settlement signed Sept. 22, 1999, amended Feb. 28th, 2005), Lewis (FERC Nos. 935, 2071, 2111, 2213, settlement signed November 30, 2004) and Powerdale (FERC No. 2659, settlement signed June 26, 2003), settlement agreements. As circumstances evolve, PacifiCorp will continue to approach the agreements in a spirit of cooperation with other stakeholders and to attempt through constructive dialog with the parties to find ways to accomplish the goals identified in the agreements. MEHC and PacifiCorp agree to make reasonable attempts to accomplish the objectives of those agreements even in the face of changing circumstances, to the extent it is consistent with customer interests.

O 31. MEHC and PacifiCorp commit to form an IGCC Working Group, sponsored by PacifiCorp to discuss various policy and technology issues associated with IGCC, carbon capture, and sequestration. Working Group members would include representatives from major stakeholder and regulatory groups, PacifiCorp and MEHC officials, and others as appropriate. The Working Group will include Oregon stakeholders as well. Some issues and challenges to development that would be considered by the Working Group would include:

- the status of development of carbon sequestration policy and methods, including requirements for monitoring and verifying sequestration options;
- information sharing, so that, to the extent possible, all parties develop a shared understanding of expected IGCC technology benefits, expected capital and O&M costs, and potential risks;

- information sharing to understand such terms and associated requirements with concepts such as "carbon capture ready" and "permanent sequestration";
- issues related to technology of and permitting for IGCC air emissions, waste disposal, water use and site usage;
- commercial terms and conditions associated with IGCC plant development, construction, and maintenance; and
- implications of Utah SB 26 on development of IGCC plants given the implications of long development lead times, development costs, project risk, and cost uncertainty.
- the allocation of risk between shareholders and ratepayers of additional carbon dioxide emissions in the event PacifiCorp proceeds with a coal unit that is not able to capture and store carbon emissions.

The IGCC Working Group would meet periodically to discuss the above issues and identify possible solutions, and to stay abreast of the evolving technology and commercial environment.

O 32. MEHC and PacifiCorp commit to the following:

a) MEHC and PacifiCorp commit to study the economics and viability of an IGCC option and will present the results of this study as a resource alternative to inform the resource selection and RFP process under consideration in Docket 05-035-47. PacifiCorp will also file the results of this study and the draft RFP with the OPUC for review and public comment. PacifiCorp will suggest procedural schedules that will facilitate this commitment. As soon as practical, but not later than three months after the closing of the transaction, PacifiCorp will provide to the parties estimated cost and timeline ranges for completion of an IGCC project, as well as potential resource alternatives if an IGCC design is not reasonably achievable in time to economically meet the resource need presently identified in 2012 from a customer and shareholder perspective.

b) PacifiCorp will perform initial conceptual and siting studies, general feasibility studies, and, where appropriate, other more detailed studies and engineering work, for an IGCC plant for the 2014 resource need identified in the October 2005 IRP Update. The studies will include an evaluation of the expected cost and performance impacts of constructing a plant to be carbon capture ready. These studies will be performed in parallel with similar studies to evaluate other generation technologies. Such studies will be completed within the next IRP cycle.

c) PacifiCorp will include a utility self-build option of an IGCC unit in any RFPs for the 2014 and later non-renewable resource needs, whether or not the IGCC option is found to be PacifiCorp's preferred cost-based alternative, and present PacifiCorp's evaluation of the IGCC option against another self-build alternative(s) as part of the Utah SB 26 process. This will include an

evaluation of the cost and performance impacts of the IGCC resource being constructed to be carbon capture ready.

O 33 Prior to January 1, 2016, MEHC and PacifiCorp will not support Oregon legislation to eliminate or impair retail access as defined by SB 1149 and relevant Commission rules.

O 34. MEHC and PacifiCorp acknowledge that the Commitments are being made by MEHC and PacifiCorp and are binding only upon them (and their affiliates where noted). MEHC and PacifiCorp are not requesting in this proceeding a determination of the prudence, just and reasonable character, rate or ratemaking treatment, or public interest of the investments, expenditures or actions referenced in the Commitments, and the Parties in appropriate proceedings may take such positions regarding the prudence, just and reasonable character, rate or ratemaking treatment, or public interest of the investments, expenditures or actions as they deem appropriate.

MDU Resources Acquisition of Cascade Natural Gas Corporation

In support of the Application, MDU Resources and Cascade make the following commitments:

1) Cascade will maintain its own accounting documentation, and financial data will be accessible in Cascade's Washington office. Cascade's financial books and records and state and federal utility regulatory filings and documents will continue to be maintained in Cascade's Washington office consistent with current practice and be available to the Commission, upon request.

2) Financial statements and other financial books and records for Cascade shall be maintained separate from the books and records of MDU Resources. The assets of Cascade and its subsidiaries will be accounted for separately from the assets of MDU Resources and its other subsidiaries, divisions and affiliates. This condition shall not prevent the maintenance of books and records for Cascade, MDU Resources or their affiliates on or through a common accounting platform or system. This condition shall also not prevent, for non-Oregon regulatory purposes, the consolidated treatment or reporting of financial statements, financial results, and other financial books and records of Cascade, MDU Resources or their subsidiaries and affiliates for financial reporting, tax or other purposes.

3) MDU Resources and Cascade will provide the Commission access to all books of account, as well as all documents, data, and records of their affiliated interests, which pertain to transactions between Cascade and its affiliated interests or which are otherwise reasonably calculated to lead to discoverable information regarding Cascade. Upon request and subject to execution of a confidentiality agreement that incorporates the terms of the Commission's standard protective order, MDU and Cascade will provide copies of relevant documents subject to this commitment to consumer parties to this docket.

4) In accordance with Oregon law or regulation, the Commission or its agents may audit the accounting records of MDU Resources and its subsidiaries or divisions that are the basis for charges to Cascade. MDU Resources agrees to cooperate fully with such Commission audits.

5) Any diversified holdings and investments (*e.g.*, non-utility related business or foreign utilities) of MDU Resources will not be held by Cascade or a subsidiary of Cascade. This condition will not prohibit MDU Resources or its affiliates other than Cascade from holding diversified businesses.

6) Cascade will operate as an indirect wholly owned subsidiary of MDU Resources. Cascade will not issue debt for the acquisition of Cascade's stock by MDU Resources. Cascade agrees to hold its Oregon customers

harmless from any financial risk exposures of MDU Resources' other affiliates including Centennial Energy Holdings, Inc. (Centennial) and any associated costs resulting from such financial risk exposure. No credit facilities at Cascade will contain cross-default provisions with respect to credit facilities at MDU Resources or Centennial or their subsidiaries, and no credit facility signed by Cascade will allow any creditor of MDU Resources, Centennial or their subsidiaries (other than Cascade and its subsidiaries) to have recourse against Cascade or its subsidiaries in the event of bankruptcy of MDU Resources or Centennial or their subsidiaries (other than Cascade and its subsidiaries). No credit facilities at MDU Resources or Centennial or their subsidiaries (other than Cascade and its subsidiaries) will contain cross-default provisions with respect to credit facilities at Cascade, and no credit facility signed by MDU Resources or Centennial or their subsidiaries will allow any creditor of Cascade or its subsidiaries to have recourse against MDU Resources or Centennial or their subsidiaries (other than Cascade and its subsidiaries) .

7) At least one director of Equico, the intermediate holding company that will own Cascade's stock, will be an Independent Director who is not a member, stockholder, director (except as such Independent Director of Equico), officer, employee, partner, attorney, creditor, supplier, customer other than a consumer, or supplier of MDU Resources or its affiliates. The organizational documents for Equico will not permit Equico, without the unanimous consent of all its directors including the Independent Director, to merge, liquidate or sell substantially all of Equico's assets or to consent to the institution of bankruptcy proceedings or the inclusion of Equico in bankruptcy proceedings.

8) Cascade or MDU Resources will notify the Commission subsequent to MDU Resources' board approval and as soon as practicable following any public announcement of: (1) any acquisition of a regulated or unregulated business representing 5 percent or more of the capitalization of MDU Resources; or (2) the change in effective control or acquisition of any material part or all of Cascade by any other firm, whether by merger, combination, transfer of stock or assets; or (3) any acquisition of a business with a substantial business presence in Cascade's service area that has a value in excess of $100 million or requires notification of the United States Securities and Exchange Commission.

9) MDU Resources and Cascade shall comply with all Commission statutes, rules, and ordering conditions concerning affiliated interests filings. This shall include the Inter-company Administrative Services Agreement (IASA). Cascade intends that by obtaining Commission approval of the IASA, Cascade will avoid the need to seek individual approval of affiliate transactions which are subject to that agreement. The IASA will include the corporate and affiliate cost allocation methodologies described in condition 12. The IASA will be filed with the Commission as soon as practicable after

the closing of the transaction by which Cascade becomes an indirect subsidiary of MDU Resources (the "Transaction"). Approval for ratemaking purposes will not be requested in such filing. Amendments to the IASA will also be filed with the Commission.

10) Cascade commits for Oregon regulatory purposes, that commencing with closing of the Transaction and through December 31, 2012, the allocated shared corporate costs, as well as its allocated and assigned utility division costs, will not exceed the costs the Cascade customers would otherwise have paid absent the acquisition, as adjusted for changes in the Consumer Price Index. Compliance with this condition shall be determined as follows:

a. For purposes of this condition, Cascade's Oregon-allocated A&G costs will be based on the A&G categories, assumptions, and values contained in Appendix 1 titled, "UM 1283 900 Accounts Stretch– Oregon-allocated" using the 2005 Accounts 901 through 935 labor and non-labor costs, but excluding Account 904 (uncollectible accounts) costs (the "2005 Benchmark"). The 2005 Benchmark will be set at $6,848,545. The benchmark for each subsequent year shall equal the prior year's benchmark multiplied by the increase in the Consumer Price Index for All Urban Consumers: All Items: Index 1982-84=100 (Series CUUR0000SA) in the previous twelve months. Cascade may propose, when using future test years, to use a forecast of the consumer price index. Except as provided in Condition 11, Cascade commits that during the period of this condition, Cascade's A&G costs, excluding Account 904 costs, for rate making, revenue sharing and regulatory reporting purposes shall be the lesser of its actual 900 Accounts costs, excluding Account 904 costs, or the benchmark for the applicable year. Because public purpose funding in Account 908 did not commence until after 2005, such costs shall also be excluded from the condition and calculations of this paragraph, but shall be included for ratemaking, revenue sharing, and regulatory reporting purposes.

b. Cascade will not shift A&G costs to operational and maintenance accounts (FERC accounts 700-894), capital accounts, deferred debit accounts, deferred credit accounts, or other regulatory accounts that are a basis for ratemaking.

c. Cascade may request that the Commission include in the benchmark A&G costs that are incurred or increased as a direct consequence of a change in a statute or rule, or as a result of an order or directive of the Commission, effective after the date of this condition. The intent of this condition is to protect Cascade from unforeseen mandated circumstances that could increase A&G costs.

11) MDU Resources and Cascade further commit that beginning at the same time as the fall 2008 PGA rate adjustment (estimated to be around November

1, 2008) and continuing through December 31, 2012, Cascade will provide annual rate credits of $200,000 to Oregon customers distributed on an equal margin basis unless otherwise ordered by the Commission. The rate credits in this paragraph will not be off-settable for the first three years, and thereafter will be fully off-settable, on a prospective basis, by the amount that Cascade demonstrates to the Commission's satisfaction in any general rate case that the Oregon-allocated A&G expenses included in Cascade's rates are lower than the benchmark set in condition 10 and have not been shifted to operational and maintenance accounts (FERC accounts 700-894), capital accounts, deferred debit accounts, deferred credit accounts, or other regulatory accounts that are a basis for ratemaking. The rate credits shall be provided as bill credits for each month that this condition is in effect, pro-rated based upon estimated volumes and subject to true-up on an annual basis in a manner to be approved by the Commission. Rate credits shall be excluded from Cascade's regulatory accounts and shall be paid for out of shareholder funds.

12)Any corporate cost allocation used for rate setting, and subsequent changes thereto, will be submitted to the Commission for review. Any proposed cost allocation methodology for the allocation of corporate and affiliate investments, expenses, and overheads, required by law or rule to be submitted to the Commission for review or approval, will comply with the following principles:

a. For services rendered to Cascade or each cost category subject to allocation to Cascade by MDU Resources or any of its affiliates, Cascade must be able to demonstrate that such service or cost category is necessary to Cascade for the performance of its regulated operations, is not duplicative of services already being performed within Cascade, and is reasonable and prudent.

b. Cost allocations to Cascade and its subsidiaries will be based on generally accepted accounting standards; that is, in general, direct costs will be charged to Cascade and its subsidiaries whenever possible and shared or indirect costs will be allocated based upon the primary cost-driving factors.

c. MDU Resources and its divisions will have in place an allocation or reporting system adequate to support the allocation and assignment of costs of executives and other relevant personnel to Cascade.

d. An audit trail will be maintained such that all costs subject to allocation can be specifically identified, particularly with respect to their origin. In addition, the audit trail must be adequately supported. Failure to adequately support any allocated cost may result in denial of its recovery in rates.

e. Costs which would have been denied recovery in rates had they been incurred by Cascade regulated operations will likewise be denied recovery

whether they are allocated directly or indirectly through MDU Resources. Cascade shall include in any rate case filing a confirmation of this provision or a proposed implementing ratemaking adjustment if necessary.

13)Cascade's financial securities excluding common equity (e.g., debt and preferred stock) will be maintained separate from the financial securities of MDU Resources and its affiliates. Cascade will maintain its own corporate credit rating separate from that of MDU Resources and its affiliates.

14)Cascade will exclude all costs of the Transaction, including integration costs, from Cascade's utility accounts for ratemaking purposes (e.g., earnings reviews, PGA filings, etc.) Within 90 days following completion of the Transaction, Cascade will provide a preliminary accounting of transaction costs. Further, Cascade will provide the Commission with a final accounting of these costs within 60 days of the close of accounting for the Transaction. For purposes of this condition, "integration costs" include costs associated with determining how Cascade will operate effectively as an indirect subsidiary of MDU Resources after the Transaction closes. Integration costs include but are not limited to senior executive officers costs as a result of employment agreement change of control provisions. Integration costs will not include any costs that Cascade would have reasonably incurred absent the Transaction or costs incurred to combine Cascade's operating systems with those of MDU Resources for improved efficiencies or for other beneficial purposes. Transition costs are costs that are neither transaction nor integration costs and are incurred to improve efficiencies. If Cascade includes any transition costs for ratemaking purposes, it must provide to the Commission's satisfaction a demonstration of the net benefit for customers. Cascade commits that it will not seek to defer, pursuant to ORS 757.259, any transition costs.

15)MDU Resources and Cascade will provide the Commission, upon request, with unrestricted access to all written information provided by and to credit rating agencies that is reasonably calculated to lead to discoverable information relating to Cascade. Upon request and subject to execution of a confidentiality agreement that incorporates the terms of the Commission's standard protective order, MDU Resources and Cascade will provide consumer parties to this docket with access to written information provided by and to credit rating agencies that pertains to Cascade.

16)MDU Resources and Cascade commit that neither Cascade nor its subsidiaries will, without the approval of the Commission, make loans to MDU Resources or its respective subsidiaries, or assume any obligation or liability as guarantor, endorser, surety or otherwise for MDU Resources or its respective subsidiaries; provided that this condition will not prevent Cascade, to the extent allowed by law, from making loans or transferring funds to a subsidiary of Cascade or assuming any obligation or liability on behalf of a

subsidiary of Cascade. MDU Resources and Cascade will not pledge any of the assets of the business of Cascade as backing for any securities which MDU Resources or its respective subsidiaries, but excluding Cascade and its subsidiaries, may issue.

17)Cascade will not advocate for a higher cost of debt or equity capital as compared to what Cascade's cost of debt or equity capital would have been, absent MDU Resources' ownership.

18)Nothing in these acquisition conditions shall be interpreted as a waiver of Cascade's or MDU Resources' rights to request confidential treatment for information that is the subject of any conditions.

19)Nothing in these acquisition conditions shall be interpreted to limit the Commission's authority under its statutes and rules.

20)If the Commission believes that MDU Resources or Cascade have violated any of these commitments, or any conditions imposed by the Commission in its final order approving the Application (collectively, the "Conditions"), then the Commission shall give MDU Resources and Cascade written notice of the violation.

a. If the violation is for failure to file any notice or report required by the Conditions, and if MDU Resources or Cascade, as applicable, provides the notice or report to the Commission within ten business days of the receipt of the written notice, then the Commission shall take no action. MDU Resources or Cascade may request, for cause, an extension of the ten-day period. For any other violation of the Conditions, if such failure is corrected within five business days of the written notice, then the Commission shall take no action. MDU Resources or Cascade may request, for cause, an extension of the five-day period.

b. If MDU Resources or Cascade, or both, fail to file a notice or written report or fail to cure any other violation within the time periods permitted in subparagraph a. above, then the Commission may open an investigation, with an opportunity for MDU Resources or Cascade, as applicable, to request a hearing, to determine the number and seriousness of the violations. If the Commission determines after the investigation and hearing (if requested) that MDU Resources or Cascade, or both, violated one or more of the Conditions, then the Commission shall issue an order stating the level of penalty it will seek. MDU Resources or Cascade, or both, as appropriate, may appeal such an order under ORS 756.610. If no party appeals the order stating the penalty, or if the Commission's order is upheld on appeal, and the order imposes penalties under a statute that further requires the Commission to file a complaint in court, then the Commission may file a complaint in the appropriate court seeking the penalties specified in the order, and MDU Resources or Cascade, as applicable, shall file a

responsive pleading agreeing to pay the penalties. The Commission shall seek penalties only against MDU Resources for violations by only MDU Resources and only against Cascade for violations by only Cascade, but may seek penalties against both MDU Resources and Cascade when both have violated a commitment or condition.

c. The Commission shall not be bound by the process provided in paragraph 19a in the event the Commission determines Cascade has violated any of the material conditions more than two times within a rolling 24-month period.

d. Cascade or MDU Resources, or both, shall have the opportunity to demonstrate to the Commission that the process provided in paragraph 20(b) should not apply on a case-by-case basis.

21)In the event of a dispute between Commission Staff and Cascade or MDU Resources regarding a Commission Staff request for books, documents, or records made pursuant to acquisition conditions or commitments, the parties agree that an Administrative Law Judge (ALJ) shall resolve the dispute as follows: (i) within ten (10) business days MDU Resources or Cascade shall deliver to the ALJ the books and records responsive to Staff's request and shall indicate the basis for the objection, including whether the request is overbroad, unduly burdensome or outside the scope of the Commission's jurisdiction; (ii) Staff may respond in writing and MDU Resources or Cascade, may reply; (iii) the ALJ shall review the documents in camera; and (iv) the ALJ shall issue a ruling determining whether the books, documents, or records are, directly or indirectly, relevant to Cascade or reasonably calculated to lead to the discovery of admissible evidence relevant to Cascade or to MDU Resources' adherence with the acquisition conditions or commitments. The ALJ shall use this standard whether or not Staff is making the request in connection with an open docket. Nothing in this provision shall affect the right of MDU Resources or Cascade to request that the Commission treat the documents as exempt from disclosure to third parties under applicable law or regulation. Cascade shall have the right to request that the ALJ's ruling be certified to the Commission. However, Cascade or MDU Resources must make the request to certify the ALJ's ruling to the Commission within 5 business days of receipt of the ruling. Should Cascade or MDU Resources make such a request, it must also request an expedited ruling.

22)MDU Resources and Cascade commit that Cascade will maintain adequate staffing and presence in each state in which it operates, consistent with the provision of safe and reliable service and cost-effective operations.

23)Within twelve months of the closing of the Transaction and annually thereafter through 2012, Cascade will file a report with the Commission regarding the implementation of the Conditions. The report will, at a minimum, provide a description of the performance of each of the Conditions that have quantifiable results. If any Condition is not being met, relative to the specific

terms of the Condition, the report shall provide proposed corrective measures and target dates for completion of such measures. Cascade will make publicly available at the Commission non-confidential portions of the report. Upon request and subject to execution of a confidentiality agreement that incorporates the terms of the Commission's standard protective order, MDU and Cascade will provide confidential portions of the report to consumer parties to this docket.

24)The premium paid by MDU Resources for Cascade (Goodwill or Acquisition Premium) will be excluded from the utility accounts of Cascade. Further, MDU Resources and Cascade commit that they will not propose rate recovery of the Acquisition Premium in Oregon rates or include the Acquisition Premium in Cascade's Oregon results of operations unless this condition is modified by the Commission, pursuant to a filing under ORS 756.568, to allow for the recovery of the Acquisition Premium.

25)Cascade and/or the MDU Resources Foundation will maintain at least Cascade's current level of charitable contributions in Oregon and Washington. Some of those contributions may be made directly by Cascade in support of local organizations. In addition, qualified tax-exempt 501(c)(3) entities will be eligible to apply for grants from MDU Resources Foundation.

26)MDU Resources and Cascade will provide the Commission access to those portions of corporate minutes including Board of Directors' minutes, all committee and subcommittee minutes, along with any related reports and source documents that may lead to relevant information regarding Cascade's business and associated risk analysis. Upon request and subject to execution of a confidentiality agreement that incorporates the terms of the Commission's standard protective order, MDU and Cascade will provide copies of relevant documents subject to this commitment that pertain to Cascade to consumer parties to this docket.

27)Cascade will not declare or make any dividend to MDU Resources or any other person that owns or holds an equity interest in Cascade, unless, on the date of such dividend, either:

a. at the time and as a result of such dividend, Cascade's Interest Coverage Ratio is equal to or greater than 3:1; or

b. at such time, Cascade's unsecured debt rating is at least investment grade (BBB- or its then equivalent with Standard & Poor's Ratings Group and Baa3 or its then equivalent with Moody's Investors Service, Inc).

"Interest Coverage Ratio" means, with respect to Cascade on any Measurement Date, the ratio of (i) the aggregate amount of EBITDA of Cascade for the four fiscal quarters for which financial information in respect thereof is available

immediately prior to such Measurement Date to (ii) the aggregate Interest Expense during such four fiscal quarters.

28)a. Cascade commits that Cascade will not make any dividends that will reduce Cascade's common equity capital below the following percentages of Cascade's Total Capital without Commission approval (Cascade's Total Capital is defined as common equity, preferred equity and long-term debt):

41% from the date of the close of the transaction through December 31, 2008;
42% from January 1, 2009, through December 31, 2009;
43% from January 1, 2010 through December 31, 2010;
44% from January 1, 2011 through December 31, 2011;
45% after December 31, 2011.

b. Cascade commits that Cascade will not make any dividends that will reduce Cascade's common equity capital below 38% of Cascade's Total Adjusted Capital without Commission approval, subject to the exception stated herein. Cascade's Total Adjusted Capital is defined as common equity, preferred equity, long-term debt, short-term debt and capitalized lease obligations. If Cascade's common equity capital is below 38%, but above 35% of Cascade's Total Adjusted Capital, Cascade may make a dividend upon notice to the Commission. Cascade may use this exception only once each calendar year. If Cascade uses this exception, it shall make a presentation to the Commission regarding the financial health of Cascade including Cascade's plans to increase the percentage of common equity capital. Cascade shall also provide written reports to the Commission regarding the financial health of Cascade and progress on Cascade's plans to increase the percentage of common equity capital for four quarters following Cascade's use of this exception, unless this requirement is waived by the Commission.

c. Cascade commits that Cascade will not make any dividends that will reduce Cascade's common equity capital below 35% of Cascade's Total Adjusted Consolidated Capital (using a purchased accounting approach) without Commission approval. Cascade's Total Adjusted Consolidated Capital is defined as the common equity, preferred equity, long-term debt, short-term debt and capitalized lease obligations of both Cascade and Cascade's intermediate holding companies viewed on a consolidated basis.

d. The Commission, on its own motion or at the request of any party, may reexamine the minimum common equity percentages under this condition as financial conditions or accounting standards warrant. The common equity percentages set forth in subparagraph 28(a) shall be reviewed if the Commission adopts a capital structure for Cascade for ratemaking or revenue

sharing purposes with a level of common equity capital below the applicable percentage set forth in subparagraph 28(a).

29) Through December 31, 2016, Cascade will provide notice to the Commission, and to other parties to this Docket upon request, when the dividend payment increases by 10% or more than the dividends paid over the previous quarter.

30) Within three months of closing of the Transaction, Cascade commits to obtain a non-consolidation opinion , subject to customary limitations and qualifications, that if the ring-fencing around Cascade is maintained and the matter is properly briefed and presented, a bankruptcy court, on its own or upon proper request of a party in interest in a case under the United States Bankruptcy Code commenced against MDU Resources, would not order the substantive consolidation of the assets and liabilities of Cascade with those of MDU Resources. Cascade commits to promptly file such opinion with the Commission. If the ring-fencing provisions of this agreement are insufficient to obtain a non-consolidation opinion, MDU Resources agrees to promptly undertake the following actions:

a. Notify the Commission of this inability to obtain a non-consolidation opinion.

b. Propose and implement, upon consultation with Commission Staff and parties to this stipulation and Commission approval, such ring-fencing provisions that are sufficient to obtain such a non-consolidation opinion.

c. Obtain such a non-consolidation opinion.

31) The Applicants agree that the Commission shall have an opportunity and the authority to consider and adopt in Oregon any commitments or conditions to which the Applicants agree or with which the Applicants are required to comply in other jurisdictions, even if such commitments and conditions are agreed to after the Commission enters its order in this docket provided, however, that any financial commitments, or commitments having a financial impact, shall be proportionate to Cascade's corresponding business function in Oregon in relation to its corresponding total company business function. To facilitate the Commission's consideration and adoption of the commitments and conditions from other jurisdictions, the Parties urge the Commission to issue an order accepting this Stipulation as soon as practical, but to reserve in such order the explicit right to re-open to add commitments and conditions accepted or ordered in another state jurisdiction.

32) MDU Resources and Cascade affirm that they understand the commitments made by Cascade in Docket UG 167 regarding Service Quality Measures backed by revenue requirement reductions and the agreement to contribute certain revenues for public purposes, including conservation and assistance

to low-income customers for bill-paying and weatherization as established in that Docket. Further, MDU Resources and Cascade understand that revenue requirement reductions for noncompliance with performance standards and customer guarantees shall be paid as designated by the Commission and shall be excluded from Cascade's regulatory accounts and results of operations. Cascade supplements Cascade's previous commitments as follows:

a. The decoupling mechanism, as set forth in the Conservation Alliance Plan tariff sheets, shall continue until September 30, 2012, subject to any necessary modifications to the Conservation Alliance Plan recommended by independent evaluation required by Section 8 of the UG 167 Stipulation or any other modification required by the Commission.

b. Public purposes funding, at no less than the level specified in Section 10 of the UG 167 Stipulation, shall continue until September 30, 2012. Such funds shall continue to be distributed to the Energy Trust of Oregon and community services agencies in the manner prescribed in Section 10 of the UG 167 Stipulation or any other manner required by the Commission. This commitment is conditioned upon such funding being included as a cost of service for ratemaking and revenue sharing purposes.

c. Cascade agrees that an Earnings Sharing Mechanism as established in Order No. 04-203 in Docket UM 903 and as modified in the Docket UG 167 Stipulation shall continue until September 30, 2012, unless otherwise modified by the Commission; Provided, however, that the Parties agree that the earnings band shall be increased to 215 basis points and the baseline return on equity shall be 10.1 percent as detailed in the UG 173 settlement document.

33) Cascade shall file revised tariff sheets for its Oregon transportation customers to eliminate the existing 50,000 therm restriction and replace it with provisions requiring transporters to keep their nominations and deliveries within the same monthly tolerance band as Northwest Pipeline.

34) Commencing January 1, 2008 and continuing through December 31, 2012, Cascade shall provide not less than $12,500 per year for funding of low-income client education programs at the four Oregon community action agencies that deliver the current Cascade low-income public purposes program. Such funding shall not come from Cascade's customers.

35) Cascade agrees to join the Intervenor Funding Program that was established in Commission Order No. 03-388, beginning in calendar year 2007, under the same terms and conditions as other utilities participating in the program, with the exception that Cascade will make available $30,000 in each of the three

accounts specified in Attachment B of that Order. Cascade also agrees to support an extension of the Intervenor Funding Program beyond 2007.

FINAL PROPOSED CONDITIONS

1. CenturyTel shall provide the Commission access to all books of account, as well as, all documents, data, and records that pertain to the merger of the two companies.

2. The Commission reserves the right to review, for reasonableness, all financial aspects of this transaction in any rate proceeding or earnings review under an alternative form of regulation.

3. The Applicants shall immediately notify the Commission of any substantive changes to the merger terms and conditions from those set forth in their application that: (1) are planned to, or in fact do occur while a Commission order approving the merger is pending, or (2) occur before the merger is closed, but after the Commission issues its order approving the merger. The Applicants must also submit a supplemental application for an amended Commission order in this docket if the merger conditions and terms change as set forth in this condition.

4. CenturyTel shall commit to the following and submit any necessary filings to effect such changes at the appropriate time:

    a. Post-Merger, CenturyTel will maintain an organizational structure that includes the three regulated ILECs in Oregon (no change from current certification) - United Telephone Company of the Northwest (UTNW) dba Embarq, CenturyTel of Oregon, Inc., and CenturyTel of Eastern Oregon, Inc., both dba CenturyTel (Operating Companies). Any change in certification will require the proper Commission filings.

    b. The merger will be transparent to the Operating Companies' Oregon regulated retail customers. Immediately after the merger, the carrier name on all applicable retail customer bills will remain unchanged.

    c. The Company will keep Staff apprised of organizational structure changes as they occur.

    d. No changes will be made by CenturyTel or its Operating Companies to any rate, rule or regulation currently included in the Operating Companies' access tariff, retail tariff or any retail price list without properly filing a rate application.

    e. If an Operating Company files a general rate proceeding in Oregon, it will file based upon its own individual regulated telecommunications utility rate base, earnings requirement, rates, etc.

f. An Operating Company will not advocate in any general rate case proceeding for a higher cost of capital as compared to its cost of capital would have been, using appropriate financial analysis absent the merger.

g. CenturyTel will not seek recovery of one-time merger, branding or transaction costs in Oregon intrastate regulated rate proceedings.

h. All existing agreements with other carriers and customers will continue in force and will be honored by the Company.

i. Under the current operating structure, financial reporting will remain unchanged, i.e., two Form-Os for the CenturyTel, Inc. ILECs, one Form-O for the Embarq ILEC, one Form-I for the CenturyTel, Inc. ILECs, and one Form-I for the Embarq ILEC.

j. At any time when the condition in subsection 4j(i) exists, the Operating Companies of the merged company will limit payments of dividends on common equity distributed to any company (including affiliates and subsidiaries of Century Tel) holding shares of the operating companies in any year to an amount not more than 50% of net income in the preceding fiscal year. The Operating Companies will limit payment of dividends on common equity in any quarter, if dividends are distributed quarterly, to not more than one-fourth of the annual limitation amount.
   (i) The average market value of CenturyTel's common equity is less than 50 percent of the book value of CenturyTel's net debt. The average market value of CenturyTel's common equity will be calculated using the average stock price and the average number of fully-diluted shares outstanding during the preceding 120 calendar days. As used in this section, "net debt" means total long-term debt less cash. This test will be calculated prior to the determination of each declaration of dividend, whether quarterly, special, or other.

k. Neither CenturyTel nor the Operating Companies of the merged company will pledge the assets of the Operating Companies to secure any borrowing undertaken by CenturyTel (including affiliates and subsidiaries other than the operating companies) without approval of the Commission.

l. The acquisition premium paid by CenturyTel Inc. for Embarq Corporation will be excluded from the utility accounts of the operating companies. Further, CenturyTel commits that it will not propose to recover the acquisition premium in Oregon intrastate regulated retail and access rates.

m. CenturyTel will notify the Commission if goodwill impairment (fair value less than book value) exceeds 20 percent in any annual testing year.

n. Service Quality reporting for the Operating Companies, both content and frequency, will remain unchanged. However, pursuant to Commission Order No. 08-205, the Commission continues to reserve the right to revoke CenturyTel's current reporting exemption should a Staff investigation reveal poor CenturyTel network performance.

o. CenturyTel will hold customers harmless for increases in management costs incurred by the operating companies that result from the merger.

p. The Operating Companies will comply with all applicable Commission statutes and regulations regarding affiliated interest transactions, including timely filings of applications and reports. To the extent affiliated interest changes do occur, the Company will make the appropriate affiliated interest filings pursuant to ORS 759.390.

q. The certificates of all CenturyTel entities certified as Competitive Providers in Oregon will remain in effect and unchanged as of the date the merger is effective. Thereafter, CenturyTel will report any changes affecting those certificates in compliance with applicable Commission statutes and regulations.

r. The Conditions may be expanded or modified as a result of regulatory decisions in other states, including decisions based upon settlements, that impose conditions or commitments related to this merger proposal. CenturyTel agrees that the Commission may adopt any commitments or conditions from other states that are adopted after the final order in UM 1416 is issued that are related to addressing harms of this transaction if:

   1. The commitment or condition does not result in the combined company being required to provide a "net benefit" and either
      a. The Commission or Staff had not previously identified the harm to Oregon ratepayers; or
      b. The commitments or conditions in a final order of another state are more effective at preventing a harm previously identified by the Commission or Staff.

   Should new commitments or conditions meeting the requirements of subsections 1a or 1b of this paragraph occur, CenturyTel will commit to the following process to facilitate a prompt decision from the Commission under this section:

   - Within fifteen (15) calendar days after a final order adopting a new condition or stipulation with new or amended commitments by a commission in another state jurisdiction, CenturyTel and Embarq Corporation will send a copy of the stipulation and commitment to Oregon Commission staff and to all parties in UM 1416.

- CenturyTel and Embarq will notify the Commission that they have received the last such final order from other states adopting new conditions, stipulations or commitments (the "Final Filing") within fifteen (15) calendar days of receipt and send it to Staff and all UM 1416 parties.
- Within ten calendar days after the last such filing from the other states ("Final Filing"), any party to this proceeding may file with the Commission its response, including its position as to whether any of the covenants, commitments and conditions from the other jurisdictions (without modification of the language thereof except such non-substantive changes as are necessary to make the commitment or condition applicable to Oregon), meets the three requirements set forth above, and should be adopted in Oregon. Any party filing such a response should serve it upon the UM 1416 parties.
- Within five calendar days after any such response filing, the Applicants may file a reply with the Commission. If the 5th calendar day falls on Saturday, Sunday, or a holiday, the next business day will be considered as the 5th day. The Applicants shall serve any such reply upon the UM 1416 parties.

s. CenturyTel may seek a waiver of Conditions (f), (g), (m), (o), and (j) such that any or all of these conditions are no longer in force subsequent to five years from the date of this order.

t. Beginning with the first of the month following twelve months after close of the transaction, and for three subsequent twelve-month periods, CenturyTel shall file with this commission a report describing:
   1. substantive activities undertaken relating to integrating CenturyTel operations with Embarq, as well as achieving synergies made available as a result of this transaction;
   2. costs and projected savings of each such respective activity;
   3. organizational and staff force changes in Oregon operations; and,
   4. impacts on Oregon operations and customers.

   This reporting requirement shall end with the submission of the fourth report unless otherwise directed by the Commission.

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Commentary

Protecting Subsidiaries From Parents' Bankruptcies: 'Ring-Fencing' as Practiced During the California Power Crisis

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Parent and Subsidiary Linkage

PG&E Corp. and Edison International Family Structures

The Ring-Fencing Process

Blossoming Liabilities Create Economic Disincentives

Stand-Alone Credit Strength Underlies Rating

Ring-Fencing Is Not a Cure for All

Prior to the California power crisis, Pacific Gas & Electric Co. (PG&E), Southern California Edison Co. (SoCalEd), and their respective holding companies, PG&E Corp. and Edison International, held ratings in the 'A' category. But, as the magnitude of the problems of the California energy sector grew larger, the credit positions of these companies began to decline rapidly. This past January, the utilities and their holding companies defaulted on their rated obligations.

Typically, when a corporate parent defaults on its debt, the ratings of the parent's subsidiaries will fall in step. Indeed, certain subsidiaries of Edison International and PG&E Corp. saw ratings downgrades as a consequence of their parents' credit deterioration. Yet, the rule is not universal: while Standard & Poor's lowered its ratings on some subsidiaries of Edison International and PG&E Corp., the respective parents' downgrades did not take those subsidiaries out of investment grade.

The difference between the entities that saw their ratings fall to 'D' and those that were able to maintain investment-grade ratings was due to a combination of factors. These factors (see "Ring-Fencing a Subsidiary," published Oct. 19, 1999) include the:

- "Stand-alone" rating of the subsidiary,
- Legal and structural inhibitors to a filing of the subsidiary by the parent,
- Provision of so-called "nonpetition" language by the parent, and
- Governmental regulatory apparatus affecting the parent and subsidiary.

These factors, which are all "positive" criteria, allow a subsidiary's rating to slightly exceed the rating of the parent.

In the case of Edison International and PG&E Corp., however, novel circumstances permitted an extensive rating differential for specific subsidiaries. Standard & Poor's concluded that these circumstances create a powerful financial disincentive for the parent or its creditors to file the subsidiary; it is the existence of these so-called "negative" criteria that allow specific subsidiaries of the defaulted PG&E Corp. and Edison International to maintain investment-grade ratings.

Parent and Subsidiary Linkage

In general, the rating of a weaker parent will constrain the rating of an otherwise financially healthy, wholly owned subsidiary. A weak parent has the ability and the incentive to siphon assets out of its financially healthy subsidiary and to burden it with liabilities during times of financial stress. The weak parent might also have an economic incentive to file the subsidiary into bankruptcy--if the parent itself was forced into bankruptcy--regardless of the subsidiary's stand-alone strength. Experience suggests that insolvent corporations will often jointly file with their subsidiaries--even those subsidiaries not themselves experiencing financial difficulty.

Nonetheless, depending on the subsidiary's stand-alone strength, a package of enhancements may be effective in raising the subsidiary's rating a full rating category over the credit quality of the consolidated entity. If the subsidiary has multiple owners, one or more of which is capable of defending the subsidiary from the acts of an insolvent parent, an even wider rating differential may be merited. Such a package can result in the wider rating differential because it may reduce the parent's means--as well as the incentive--to shift assets from and liabilities to the subsidiary, or to file it into bankruptcy. (That the subsidiary has an operating business distinguishes this approach from true securitizations in which three or more rating category differentials are possible.)

PG&E Corp. and Edison International Family Structures

Besides owning a California utility (PG&E), PG&E Corp. indirectly holds, under its wholly owned National Energy Group (NEG) subsidiary, three indirect subsidiaries: Gas Transmission Northwest, PG&E Generating LLC, and PG&E Energy Trading Holdings LLC. Gas Transmission Northwest owns the PGT Pipeline and PG&E Generating owns various independent power projects and an energy trading subsidiary. Through its subsidiaries, PG&E Energy Trading Holdings enters into various hedging arrangements

In addition to Edison International's utility subsidiary SoCalEd, it owns The Mission Group, a holding company for Edison Mission Energy (EME). EME owns some 57 independent power projects and generation subsidiaries worldwide, as well as Edison Mission Marketing & Trading (EMMT).

The Ring-Fencing Process

As the California power crisis was unfolding, Edison International and PG&E Corp. attempted to protect certain subsidiaries from consequences of their credit downgrade or insolvency with "ring-fencing" strategies. Edison International sought to ring-fence EME, leaving SoCalEd susceptible to rating downgrades if an Edison International downgrade occurred. PG&E Corp. sought to ring-fence NEG and its subsidiaries.

Edison International and PG&E Corp. achieved the ring-fencing by:

- Making certain subsidiaries into special-purpose entities (SPE) or "limited-purpose operating entities" similar to an SPE;
- Providing a nonconsolidation opinion between subsidiary and parent;
- Securing legal comfort that the ring-fencing did not contradict any law, regulation order, or contract; and
- Securing other legal comfort that the ring-fencing would not invoke any of the "recharacterization" provisions of the Federal Bankruptcy Code.

The limited-purpose operating entity provisions adopted by EME included restrictions on its objects and powers, limitations on additional indebtedness, and the installation of an "independent director" on its board. The nonconsolidation opinion provides that upon the insolvency of the parent, the assets of the subsidiary would not be consolidated with the parent's. The principles of corporate separateness, in other words, would be respected through a bankruptcy of the parent. EME also limited its ability to declare dividends, being required to pass certain financial or rating tests, or both. The dividend restriction should protect EME's financial position and its ability to meet its obligations.

PG&E Corp.'s path to ring-fencing was more complex. The rating on PG&E Energy Trading Holdings benefited from PG&E Corp.'s rating due to a PG&E Corp. guarantee. The first step of the ring-fencing, therefore, was to protect

the stand-alone credit quality of PG&E Energy Trading Holdings by replacing the PG&E Corp. guarantee with a cross-guarantee from Gas Transmission Northwest. The second step was to protect Gas Transmission Northwest and PG&E Energy Trading Holdings from a parent insolvency.

In both cases, PG&E Corp. inserted a new SPE between NEG and the company to be protected and rendered a nonconsolidation opinion between the new SPEs and NEG, its parent. For PG&E Energy Trading Holdings, adopting SPE criteria was straightforward because it was already a shell company. The nonconsolidation opinion was then rendered between NEG, as parent, and PG&E Energy Trading Holdings.

NEG remained unfenced and subject to a potential downgrade in the event of a PG&E Corp. downgrade or bankruptcy. The ring-fencing protected only Gas Transmission Northwest and PG&E Energy Trading Holdings from downgrade. PG&E Generating, another unfenced subsidiary of NEG, was equally exposed. PG&E Corp. later addressed the exposures by additional ring-fencing. A new SPE was inserted between PG&E Corp. and NEG, with a nonconsolidation opinion being rendered between PG&E Corp. and the new SPE. NEG also adopted the SPE requirements. At the conclusion of this second step, NEG and its subsidiaries were ring-fenced from a PG&E Corp. insolvency.

Blossoming Liabilities Create Economic Disincentives

Typically, Standard & Poor's will not rate even ring-fenced subsidiaries much higher than the rating of the consolidated entity. Nonetheless, certain circumstances can lead to exceptions to the weak-parent/strong-subsidiary linkage, such as independent finance subsidiaries and regulated entities. Even in such instances, however, there typically remains some linkage. This linkage usually constrains the rating of an otherwise advantaged subsidiary to one full rating category (three "notches") above the credit quality of the consolidated entity. In the Edison International and PG&E Corp. cases, of course, the differential is much wider.

As a requirement for the separation Edison International and PG&E Corp. had to demonstrate significant economic disincentives to filing their ring-fenced subsidiaries into bankruptcy. In the case of PG&E Corp., a noninvestment-grade rating on PG&E Energy Trading Holdings would likely trigger termination clauses in hundreds of commodity hedges to which PG&E Energy Trading Holdings' trading subsidiaries are party. These termination provisions require payment of termination fees to defray costs of finding and entering into replacement hedges. Such termination costs could be considerable indeed. EME similarly would incur material incremental liabilities from a bankruptcy filing that would materially reduce its value to Edison International creditors. These liabilities could include substantial, and unavoidable, liquidated damages due to breach of energy trading and marketing obligations, such as swap terminations, incurred by EME's subsidiary, EMMT. In addition, a bankruptcy filing of EME would trigger other nonrejectable liabilities, including equity commitment guarantees, debt service reserve replenishment obligations, and lease guarantee obligations of certain EME assets. The potential loss of value of the going concern and the fact that senior liens at the project level generally encumber all of EME's assets should further dissuade Edison International or its creditors from attempting to file EME. Moreover, general reorganizational costs under bankruptcy could run into the hundreds of millions of dollars, to say nothing of the years it would take to reorganize. Standard & Poor's concluded that if an otherwise financially sound EME, or NEG, filed for bankruptcy, the adverse financial and contractual consequences of such a filing would likely outweigh any perceived advantages to either parent's creditors.

Stand-Alone Credit Strength Underlies Rating

The credit ratings of the ring-fenced entities must be justified by their stand-alone financial and business strength without support from the parent company. Historically, the subsidiary ratings benefited from implied credit support from their respective parents, Edison International or PG&E Corp. However, with the unresolved California power crisis, it is unlikely that Edison International or PG&E Corp. will, for the foreseeable future, be in a financial position to support their respective subsidiaries. Standard & Poor's analyses of the quality and flow of dividends from the many project investments supporting the ring-fenced entities indicate that EME and NEG have stand-alone investment-grade characteristics.

Ring-Fencing Is Not a Cure for All

Edison International and PG&E Corp. were able to take advantage of a unique set of facts and circumstances that allowed for the creation of ring-fenced subsidiaries while they were on the brink of bankruptcy. In general, ring-fencing will only create a marginal rating differential between subsidiary and its parent entity. In many cases, a distressed parent, or its creditors, will perceive that significant economic incentives exist to file a solvent subsidiary into bankruptcy. Those incentives may well give rise to strategies that can trump the legal structures that may be in place. Surprise outcomes are not unheard of in the bankruptcy context. Despite the economic and legal arguments that support rating levels of the ring-fenced entities well above those of Edison International and PG&E Corp., Standard & Poor's cautions that each ring-fencing exercise must be viewed on its own merits.

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UTILITIES

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Is State Utility Regulation Coming Back Into Vogue?

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Recent inquiries by regulators suggest U.S. state utility commissions are starting to pay more attention to the relationship between a utility holding company's regulated and nonregulated businesses, likely because of problems experienced by certain diversified energy companies. Coupled with vociferous opposition from western and southern states over FERC transmission initiatives, it appears that utility regulation may be moving to the forefront, which could be beneficial for credit quality at the operating company level.

Talk of isolating a utility from the parent company's unregulated activities could be signaling a trend that greater regulation of utilities is back in vogue, which is quite the opposite of one of the reasons--less regulation--why electric restructuring was instituted. Standard & Poor's Ratings Services has long-held a view of a lack of regulatory insulation from nonregulated operations and diminishing regulatory support for utility credit quality, which has caused many ratings downgrades over the past few years. Therefore, any action that state regulators take that provides support (whether legal, regulatory, financial, or operational) to the utility and/or isolates the utility (most importantly financial obligations) from its parent company will be positive for credit.

Although not all regulated utilities have been affected by the troubles at their affiliate companies, in view of the harsh consequences inflicted on utilities in certain cases, Standard & Poor's believes it is quite likely that state regulators will be placing even greater emphasis on "protecting" the utilities they regulate. For instance, in the ongoing probe of Westar Energy Inc, members of the Kansas Corporation Commission are considering some form of break-up of the company's unregulated and utility operations to protect ratepayers. In Minnesota, during hearings to examine the possible spillover of NRG Energy Inc.'s financial problems onto utility ratepayers, state regulators said they are considering drafting measures at establishing a stronger financial barrier between parent company Xcel Energy Inc.'s regulated and unregulated businesses. Both cases represent a desire by state regulators to protect ratepayers by ensuring the utility is run prudently.

Standard & Poor's view of what constitutes sufficient regulatory insulation has evolved given the ongoing business mix shift by utility holding companies toward nonregulated investments throughout the 1990s. Importantly, ratings are based on the qualitative and quantitative fundamentals of the consolidated entity, not just any one individual subsidiary. Thus, credit ratings of regulated utility companies are affected by the parent company's nonregulated businesses. Only when sufficient regulatory insulations exists will the corporate credit rating (risk of default) of an operating company be separated from that of the holding company.

In Standard & Poor's view, insulation brought about by legislative statues is a great deal more certain than state utility commission rulemaking and will ultimately provide for greater ratings separation. Notably, most state regulators maintain their state or

commission has explicit laws or regulations in place that provide sufficient [illegible] prevent the financial condition of the utility from being adversely affected by the activities of nonregulated affiliates. However, from a credit perspective, Standard & Poor's believes most of these laws and regulations to be reactive measures; they do not prevent the diversified businesses from weakening the regulated business. These rules typically enable state regulators to take action only after the damage has occurred. Examples of active regulation include measures that meaningfully and timely restrict the flow of the utility's cash to its parent company, such as overhead allocation, loan and dividend restrictions, and stringent equity-maintenance requirements.

State utility commissions are also drawing battle lines against the FERC's effort for some standard market design for the nation's transmission infrastructure. In a Standard & Poor's survey, most state regulators, as expected, feel that the states have the proper jurisdiction over retail transmission, and not the FERC, claiming state oversight provides the best way to oversee transmission issues, including transmission siting. The most important issues confronting state regulation of utilities revolve around transmission--reliability and adequacy, siting, and general regulatory issues. The reliability and transmission adequacy problems experienced by California, Massachusetts, and Illinois, all of which were at the forefront of electric deregulation, have made not just regulators, but also politicians and ratepayers, highly sensitized on how to assure electric reliability in a restructured industry.

Although Standard & Poor's views the future rating trend of the electric industry to be decidedly negative, with insufficient regulated authorized returns and expanding nonregulated investments providing the most downward pressure, the credit quality of electric utilities on a stand-alone basis could show signs of stabilization if they are increasingly sheltered by state regulators. Elevated scrutiny of the general well being of a utility company, specifically its exposure within an energy holding company, indicates a gradual return to stronger utility regulation and could calm the deterioration in credit quality experienced in the industry. This attitude from state regulators, which is quite different from their earlier thinking that a parent's nonregulated activities had little or no impact on the utility company, is absolutely more reasonable. Today, the average power industry credit rating is approximately 'BBB+' versus 'A'/'A-' five years ago, with slightly less than one-half of the industry now carrying a 'BBB' category rating.

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Setting The Standard.

An Enron Subsidiary Is "Ring-Fenced"

On Nov. 25, 2002, Standard & Poor's affirmed Portland General Electric Co.'s (PGE) 'BBB+' corporate credit rating following the implementation of ring-fencing structures designed to insulate the credit quality of PGE from that of its parent Enron Corp. (D/—/—). As a result, PGE is the only Enron subsidiary to be rated on its own credit merits.

In October 2001, Northwest Natural Gas Co. (Northwest; A/Stable/A-1) had agreed to buy PGE from Enron. Subsequently, Standard & Poor's lowered its ratings on Enron Corp. following that company's bankruptcy. PGE's ratings were not lowered, reflecting Standard & Poor's expectation that PGE would be sold to Northwest under the above-mentioned contract of sale that had been executed prior to Enron's bankruptcy. Following the mutual termination of the sale agreement between Enron and Northwest, Enron's management committed to establish, and subsequently implemented, mechanisms to isolate, or "ring-fence," the credit quality of PGE from that of Enron. This ring-fencing enabled PGE to maintain ratings that were more indicative of its stand-alone credit quality.

The PGE Ring-Fencing

In the days following the termination of the sale agreement with Northwest, Enron's management assured Standard & Poor's in writing that it had no intention of bringing PGE into its bankruptcy, a fact that was key to the maintenance of PGE's rating. In addition, Enron commenced an auction for 12 of its operating businesses, including PGE, indicating management's intent to keep PGE out of the Enron bankruptcy and further bolstering the case for rating PGE on a stand-alone basis.

However, these developments were not, by themselves, sufficient to enable PGE to maintain investment-grade ratings. Transwestern Gas Pipeline Co., another 100%-owned subsidiary of Enron involved in the auction process, is rated BB/Watch Pos/—. These ratings are not based on the stand-alone credit quality of Transwestern because Transwestern could still remain a part of a reorganized holding company, of uncertain credit quality, that emerges from bankruptcy.

Ring-Fencing and Economic Disincentives

In general, the rating of a weaker parent constrains the rating of an otherwise financially healthy, wholly owned subsidiary. A weak parent has the ability and may have the incentive to siphon assets out of its financially healthy subsidiary and to burden it with liabilities during times of financial stress. The weak parent might also have an economic incentive to file the subsidiary into bankruptcy if the parent itself were forced into bankruptcy, regardless of the subsidiary's stand-alone strength.

Ring-fencing may allow for an exception to this rule. In appropriate circumstances, a package of enhancements, including legal and structural inhibitors to a filing of the subsidiary by the parent and provision of so-called "nonpetition" language by the parent, along with other considerations such as regulatory insulation, may allow a subsidiary's rating to be elevated over the credit quality of the consolidated entity (assuming the stand-alone rating of the subsidiary merits the same). Typically, Standard & Poor's will not rate even ring-fenced subsidiaries more than three "notches" above the credit quality of the consolidated entity. However, in the case of Enron and PGE, the establishment of powerful financial disincentives for Enron and its creditors to file PGE into bankruptcy enabled a much greater ratings separation.

Legal and Structural Mechanisms

In addition to providing a "nonconsolidation" legal opinion (to the effect that a bankruptcy court would not consolidate PGE with Enron), PGE has established a special class of junior preferred stock (or "golden share") that requires the vote of the junior preferred holder before PGE could voluntarily file for bankruptcy. The stock is held by an entity that is independent of PGE and its affiliates. On Sept. 30, 2002, the junior preferred stock was issued to Global Securitization Services LLC, a limited liability company specializing in the ownership and administration of special-purpose vehicles established in connection with structured finance transactions.

In Standard & Poor's judgment, the issuance of the junior preferred stock is a useful mitigatant to the risk of a voluntary bankruptcy filing. The requirement that the holder of the golden share consider the interest of creditors may also weigh in favor of the conclusion that PGE should not easily be voluntarily filed into bankruptcy for the benefit of Enron's creditors and in a manner detrimental to PGE's bondholders.

Regulatory Insulation

Further supporting the ratings separation is the fact that Standard & Poor's views the Oregon Public Utilities Commission (OPUC) as being among the most supportive of utility credit quality in the country. Indicative of this support are the several restrictive conditions imposed on Enron when Enron acquired PGE in 1997 that served to largely insulate PGE from Enron's subsequent woes. Among the important restrictions were the maintenance of a 48% equity level at

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PGE and advance notification of special or large dividends to Enron. In addition, PGE is required to maintain its own accounting system, separate from Enron's.

The effectiveness of OPUC's rules can be gauged from the fact that Transwestern Pipeline and Northern Natural Gas, FERC-regulated gas pipelines that are both Enron subsidiaries, pledged their assets as collateral for loans in November 2001, and then passed the funds to Enron through promissory notes just weeks before Enron's collapse. Transwestern's $550 million worth of loans to Enron has been written off by the pipeline and Northern Natural is still liable for $450 million. Although the merits of these transactions are currently under litigation, Enron was unable to similarly borrow money from PGE, illustrating the effectiveness of regulatory insulation.

Economic Disincentives

PGE's corporate credit rating is significantly higher than would be expected from the ring-fencing criteria because of the perceived economic disincentives for Enron or its creditors to file PGE into bankruptcy. In Standard & Poor's view, PGE's value as a going concern is greater than if it were part of a consolidated bankruptcy filing. Standard & Poor's has concluded that if an otherwise healthy PGE were filed into bankruptcy, the adverse financial and contractual consequences of such a filing would outweigh any advantages. A bankruptcy filing by PGE would likely result in defaults under PGE's portfolio of power purchase and sale agreements. Standard & Poor's has been advised that the nature of these agreements is such that a default would trigger termination payments by the company for net out-of-the-money positions. A downgrade of ratings to below investment-grade status could require the company to post additional collateral. Standard & Poor's further understands that these contracts constitute "safe-harbor" contracts for purposes of sections 556 and 560 of the bankruptcy code and that the defaults would not be affected by the "automatic stay" provision of the federal bankruptcy code. Standard & Poor's believes that the financial penalty that would be suffered by PGE in the event of a downgrade to noninvestment-grade status, or, a priori, a PGE bankruptcy, is a material disincentive for Enron's creditors to file PGE.

Currently, if Standard & Poor's cut PGE's ratings to below investment grade, counterparties have the right to demand about $117 million in collateral. In addition, counterparties could demand upfront cash payments for all purchases by PGE of its gas and power requirements. These requirements are substantial because PGE is short on generation capacity.

Where Does PGE Go From Here?

PGE is currently rated 'BBB+' with a developing outlook. The ring-fencing mechanisms implemented thus far are sufficient, in Standard & Poor's opinion, to insulate PGE's credit quality from that of Enron. Still, as the developing outlook indicates, there is uncertainty about where PGE's rating will ultimately go. This will depend on PGE's prospective buyer or on the nature of the company that eventually emerges from the Enron bankruptcy if PGE is not sold to a third party. ■

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August 28, 2007

Oregon Public Utility Commission
550 Capitol Street N.E., Suite 215
Salem, Oregon 97301-2551

Re: **OPUC Docket UM 1283**
In the Matter of MDU Resources Group, Inc. Application for Authorization to Acquire Cascade Natural Gas Corporation

Nonconsolidation opinion regarding MDU Resources Group, Inc. and Cascade Natural Gas Corporation

Commissioners and Staff:

We have acted as special counsel to Cascade Natural Gas Corporation, a Washington corporation (*"Cascade"*), for the purpose of providing this opinion to you in connection with the acquisition of Cascade by MDU Resources Group, Inc., a Delaware corporation (*"MDU Resources"*).

OPINION

Based upon the facts on the date hereof, and the assumptions, legal considerations and reasoning set forth herein, it is our opinion that based on existing statutory and case law, in a competently argued and properly presented case with a correctly reasoned judicial decision in conformity with existing statutory and case law, and over the competently argued objection of creditors of Cascade or any other party in interest, the bankruptcy court would not, in a case under the Bankruptcy Code (as defined below) in which MDU Resources is a debtor, cause a substantive consolidation of the assets and liabilities of Cascade with those of MDU Resources and treat such assets and liabilities as though Cascade and MDU Resources were one entity.

BACKGROUND

Cascade is wholly owned by Prairie Cascade Energy Holdings, LLC ("Prairie Cascade"), a Delaware limited liability company. Prairie Cascade is wholly owned by MDU Energy Capital, LLC, a Delaware limited liability company ("MDU Energy Capital"). MDU Energy Capital is wholly owned by MDU Resources. MDU Resources, Prairie Cascade and MDU Energy Capital are hereinafter collectively referred to as the *"Upstream Affiliates."*

GENERAL QUALIFICATIONS AND ASSUMPTIONS

For purposes of this opinion we have only examined Order No. 07-221 entered on June 5, 2007 and amended July 25, 2007 by the Oregon Public Utility Commission in Docket UM 1283 (the

"*Order*") and the certificates attached hereto as Exhibit A (the "*Factual Certificates*"), and have assumed the accuracy thereof in all respects material to the our opinion. We have assumed in all respects material to our opinion that: (i) each of MDU Resources and Cascade is duly organized, validly existing and in good standing under the laws of the jurisdiction of its organization; and (ii) creditors of Cascade have reasonably relied on the separateness of Cascade from MDU Resources and would suffer prejudice from, or would be harmed by, a consolidation of Cascade with MDU Resources We have conducted no independent factual investigation of our own, but rather have relied solely upon the Factual Certificates and the assumptions set forth herein, all of which we assume to be true, complete and accurate in all material respects.

The law covered by our opinion is limited to the Bankruptcy Reform Act of 1978 as amended and codified in Title 11 of the United States Code (the "*Bankruptcy Code*"). We have not reviewed, nor is our opinion in any way predicated upon an examination of, any other law.

We express no opinion as to any matter not specifically set forth herein, including, without limitation, the effect of substantive consolidation of any other entities or persons other than as expressly set forth herein. We note that the question of whether the assets and the liabilities of Cascade will be substantively consolidated with those of MDU Resources is inherently fact-specific. Other than as specifically provided herein, we cannot opine as to what action a court will take in the future when reviewing actions that have not occurred as of the date hereof. We express no opinion as to the substantive consolidation of the assets and the liabilities of Cascade with those of MDU Resources, if such consolidation is done in a manner that is not prejudicial to Cascade's creditors. Finally, we assume that any case involving the issues that are the subject of this opinion is properly presented and competently argued, and the applicable law is correctly applied.

ADDITIONAL FACTUAL ASSUMPTIONS

A. Cascade.

1. To the extent material to its separateness, Cascade at all times will comply with the ring-fencing provisions of the Order.

2. Cascade is, and intends in the future to remain, solvent; provided, however, that our opinion is not based on any assumption as to Cascade's future solvency.

3. Cascade maintains, and intends in the future to maintain, adequate capital in light of its contemplated business operations; provided, however, that our opinion is not based on any assumption as to Cascade's future adequate capitalization.

4. Cascade will not engage in any type of fraudulent activity material to its separateness.

B. Upstream Affiliates.

1. To the extent material to Cascade's separateness, each Upstream Affiliate has caused, and at all times hereafter will cause, Cascade to be operated and managed in compliance with the ring-fencing provisions of the Order.

2. No Upstream Affiliate will engage in any type of fraudulent activity material to Cascade's separateness.

LEGAL ANALYSIS

A. Discussion of Law. The following discussion summarizes our analysis in reaching our opinion and does not constitute an independent opinion as to any element of the analysis.

1. Introduction

In a bankruptcy case in which MDU Resources is a debtor, creditors may want to bring Cascade's assets into MDU Resources' bankruptcy estate to enhance their ultimate recovery. The method by which this may be accomplished is known as substantive consolidation.[1] The Bankruptcy Code does not provide explicit statutory authority for substantive consolidation. Rather, courts have relied on the broad grant of power codified in Section 105(a) of the Bankruptcy Code which provides that "[t]he court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." But see In re Stone & Webster, Inc., 286 B.R. 532, 540-541 (Bankr. D. Del. 2002) (finding "clear statutory authority in the Bankruptcy Code for substantive consolidation" pursuant to Section 1123(a)(5)(C) of the Bankruptcy Code); In re Affiliated Foods, Inc., 249 B.R. 770, 775 (Bankr. W.D. Mo. 2000) (stating that Section 1123(a)(5)(C) of the Bankruptcy Code "indicates Congress' intent that a Chapter 11 debtor be free to merge or consolidate with another entity as part of the reorganization process") (quoting In re Gaming of Amer., Inc., 228 B.R. 275, 287 (Bankr. N.D. Okla. 1998)).

There is a split of authority as to whether or not the bankruptcy court has either subject matter jurisdiction or personal jurisdiction over a non-debtor. Some courts have held that substantive consolidation may be achieved even though one of the subject entities is not a debtor in bankruptcy proceedings. See Sampsell v. Imperial Paper & Color Corp., 313 U.S. 215 (1941); see also Soviero v. Franklin Nat. Bank, 328 F.2d 446 (2d Cir. 1964); In re Munford, Inc., 115 B.R. 390 (Bankr. N.D. Ga. 1990); In re Tureaud, 45 B.R. 658 (Bankr. N.D. Okla. 1985), aff'd, 59 B.R. 973 (N.D. Okla. 1986); In re Crabtree, 39 B.R. 718 (Bankr. E.D. Tenn. 1984); In re 1438 Meridian Place, N.W., Inc., 15 B.R. 89 (Bankr. D. C. 1981).

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[1] "Substantive Consolidation" should be distinguished from joint administration or procedural consolidation, which permit unitary administration of the estates of two or more related debtors in bankruptcy in the same court. See Fed. R. Bank. P. 1015.

Some courts have refused to take jurisdiction under the equitable powers of Section 105 of the Bankruptcy Code. See Matter of Fesco Plastics Corp., 996 F.2d 152 (7th Cir. 1993); In re Schwinn Bicycle Co., 210 B.R. 747, 761 (Bankr. N.D. Ill. 1997); In re Deltacorp, Inc., 111 B.R. 419, 420 (Bankr. S.D.N.Y. 1990). These courts reason that on its face Section 105(a) does not broaden the bankruptcy court's jurisdiction and thus a bankruptcy court cannot use Section 105 to add something to the Bankruptcy Code or to achieve a result inconsistent with the Bankruptcy Code. Section 105 is viewed merely as an aid to the exercise of jurisdiction. To substantively consolidate a non-debtor with a debtor would effectively force a non-debtor into bankruptcy without Section 303 Bankruptcy Code protections for involuntary petitions and thus, would arguably be contrary to the express Bankruptcy Code limitations for involuntary petitions. In re Circle Land and Cattle Corp., 213 B.R. 870 (Bankr. D. Kan. 1997).[2]

Substantive consolidation of affiliated entities closely resembles a corporate merger in which the rights of shareholders and creditors of the merging entities are affected. Accordingly, "substantive consolidation usually results in, inter alia, pooling the assets of, and claims against, the two entities; satisfying liabilities from the resulting common fund; eliminating inter-company claims; and combining the creditors of the two companies for purposes of voting on reorganization plans." In re Augie/Restivo Baking Co., 860 F.2d 515, 518 (2d Cir. 1988); accord In re American Way Service Corp., 229 B.R. 496, 526 (Bankr. S.D. Fla. 1999); In re Steury, 94 B.R. 553, 554 (Bankr. N.D. Ind. 1988).

However, substantive consolidation is not merely a procedural device, but rather a measure that affects substantive rights. Certain creditors may face a harsh economic result associated with an involuntary combination of their debtor's estate with less solvent estates. For example:

> It must be recognized and affirmatively stated that substantive consolidation, in almost all instances, threatens to prejudice the rights of creditors. This is so because separate debtors will almost always have different ratios of assets to liabilities. Thus, creditors of a debtor whose asset-to-liability ratio is higher than that of its affiliated debtor must lose to the extent that the asset-to-liability ratio of the merged estates will be lower.

In re Snider Bros., 18 B.R. 230, 234 (Bankr. D. Mass. 1982) (citation omitted). For this reason, the Second Circuit noted that "[t]he power to consolidate should be used sparingly . . . ." Chem. Bank New York Trust Co. v. Kheel, 369 F.2d 845, 847 (2d Cir. 1966). See also In re Ltd. Gaming of Am., Inc., 228 B.R. 275, 286-87 (Bankr. N.D. Okla. 1998).

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[2] The opinion set forth herein does not depend on Cascade being a non-debtor at the time substantive consolidation with MDU Resources is sought.

The need to protect interests of creditors affected by substantive consolidation was underscored in the case In re Augie/Restivo Baking Co., 860 F.2d at 518-19, in which the court stated:

> The sole purpose of substantive consolidation is to ensure the equitable treatment of all creditors.
>
> ***
>
> [C]reditors who make a Loan on the basis of the financial status of a separate entity expect to be able to look to the assets of their particular borrower for satisfaction of that loan. Such lenders structure their Loan according to their expectations regarding that borrower and do not anticipate either having the assets of a more sound company available in case of insolvency or having the creditors of a less sound debtor compete for the borrower's assets.

The Third Circuit was even more emphatic in In re Owens Corning, 419 F.3d 195, 210 (3d Cir. 2005) stating:

> If an objecting creditor relied on the separateness of the entities, consolidation cannot be justified *vis-à-vis* the claims of that creditor.

These concerns are no less applicable where investors purchase the securities of one entity that may be related to another independent entity. In re Flora Mir Candy Corp., 432 F.2d 1060 (2d Cir. 1970).

Recently, attempts to substantively consolidate two or more related entities have increased as a result of the pervasiveness of complex corporate structures. According to one court:

> There is, however, a 'modern' or 'liberal' trend toward allowing substantive consolidation, which has its genesis in the increased judicial recognition of the widespread use of interrelated corporate structures by subsidiary corporations operating under a parent entity's corporate umbrella for tax and business purposes.

Eastgroup Properties v. Southern Motel Assoc., Ltd., 935 F.2d 245, 248-49 (11th Cir. 1991) (citations omitted). However, the Third Circuit expressly disagreed in In re Owens Corning that such a "liberal trend" exists.[3]

A variety of judicially created standards have been developed over the years to determine whether substantive consolidation should be granted in any given case. The fluidity and uncertainty associated with such standards have been noted by several courts, but are best typified by the comment "[t]hat as to substantive consolidation, precedents are of little value, thereby making each analysis on a

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[3] In re Owens Corning, 419 F.3d at 209, n.15.

case by case basis." In re Crown Mach. & Welding Inc., 100 B.R. 25, 27-28 (Bankr. D. Mont. 1989). This ad hoc approach is largely responsible for the unsettled nature of the appropriate standards, relevant factors, the weight to be attached to such factors and the significance of competing considerations offered by objectors to substantive consolidation. Accordingly, this opinion, as well as any other analysis of whether there is a substantial risk of substantive consolidation, is subject to the general qualification that there can be no guaranty as to whether substantive consolidation will be granted by a court exercising its discretionary equitable authority in any given instance.

2. Analysis Employed

There are essentially two principal tests for determining whether two or more related entities should be substantially consolidated. The traditional test examines widely cited substantive consolidation factors or elements, which are based on common law alter ego or veil piercing doctrines. The second "balancing" test gives greater weight to the impact of substantive consolidation on creditors and uses certain factors to aid in the determination of whether there is substantial identity between the entities to be consolidated and whether consolidation is necessary to avoid some harm or realize a certain benefit for all creditors.

a. Traditional Common Law Theories

Because there is no explicit statutory authority for this extraordinary relief, a number of cases decided shortly after the enactment of the Bankruptcy Code relied principally on the presence or absence of certain "elements" similar to factors relevant to the traditional common law doctrines of "piercing the corporate veil" and "alter ego" theories. See, e.g., In re Vecco Constr. Indus., 4 B.R. 407 (Bankr. E.D. Va. 1980); In re Gulfco Inv. Corp., 593 F.2d 921 (10th Cir. 1979); In re Food Fair Inc., 10 B.R. 123 (Bankr. S.D.N.Y. 1981); In re Tureaud, 45 B.R. 658; In re 1438 Meridian Place, N.W., Inc., 15 B.R. 89; In re Stop & Go of Am., Inc., 49 B.R. 743 (Bankr. D. Mass. 1985); In re Baker & Getty Fin. Serv., 78 B.R. 139 (Bankr. N.D. Ohio 1987); see also In re S.I. Acquisition, Inc., 58 B.R. 454, 460 n.3 (Bankr. W.D Tex. 1986), rev'd on other grounds, 817 F.2d 1142 (5th Cir. 1987).

Two sets of substantive consolidation elements are often cited. In the cases that depend primarily on the "alter ego" theory, the following factors are cited as relevant to the issue of whether substantive consolidation is justified:

(1) parent corporation owns all or a majority of the capital stock of the subsidiary;

(2) parent and subsidiary have common officers and directors;

(3) parent finances subsidiary;

(4) parent is responsible for incorporation of subsidiary;

(5) subsidiary has grossly inadequate capital;

(6) parent pays salaries, expenses or losses of subsidiary;

(7) subsidiary has substantially no business except with parent;

(8) subsidiary has essentially no assets except for those conveyed by parent;

(9) parent refers to subsidiary as department or division of parent;

(10) directors or officers of subsidiary do not act in interests of subsidiary, but take directions from parent; and

(11) formal legal requirements of the subsidiary as a separate and independent corporation are not observed.

Fish v. East, 114 F.2d 177 (10th Cir. 1940); In re Tureaud, 45 B.R. at 662; In re Gulfco Inv. Corp., 593 F.2d 921 (10th Cir. 1979); Eastgroup Properties, 935 F.2d at 250 (11th Cir. 1991).

Under the "alter ego" approach, courts did not generally permit consolidation without a showing that organization of the subsidiary resulted in some blatant abuse, even in cases where one or more of the above factors was present. As noted by one court:

> Few questions of law are better settled than that a corporation is ordinarily a wholly separate entity from its stockholders, whether they be one or more .... But notwithstanding such situation and such intimacy of relation, the corporation will be regarded as a legal entity, as a general rule, and the courts will ignore the fiction of corporate entity only with caution, and when the circumstances justify it, and when it is used as a subterfuge to defeat public convenience, justify wrong, or perpetuate a fraud.

Commerce Trust Co. v. Woodbury, 77 F.2d 478, 487 (8th Cir. 1935) (citations omitted). Thus, it was observed that "The reported cases have generally been easily decided because the courts could point to blatant abuses of the separate corporate entities in the enterprise structure . . . ." Landers, A Unified Approach to Parent, Subsidiary, and Affiliate Questions in Bankruptcy, 42 U. Chi. L. Rev. 589, 635 (1975). It has been noted that "[i]n the older cases, the application of substantive consolidation was limited to extreme cases involving fraud or neglect of corporate formalities and accounting procedures." In re Standard Brands Paint Co., 154 B.R. 563, 568 (Bankr. C.D. Cal. 1993).

Beginning with In re Vecco Constr. Indus., 4 B.R. at 407, 410, the courts have focused on a revised series of substantive consolidation "elements" to be considered in determining whether to substantively consolidate affiliated debtor corporations:

(1) the degree of difficulty in segregating and ascertaining individual assets and liabilities;

(2) the presence or absence of consolidated financial statements;

(3) the profitability of consolidation at a single physical location;

(4) the commingling of assets and business functions;

(5) the unity of interests and ownership between the various corporate entities;

(6) the existence of parent and inter-corporate guarantees of the loan; and

(7) the transfer of assets without formal observance of corporate formalities.

While courts have considered the various factors listed above, some courts have stated that the existence of these factors is not dispositive. "Rather, they should be evaluated within the larger context of balancing the prejudice resulting from the proposed order of consolidation with the prejudice movant alleges it suffers from debtor's separateness." In re DRW Property Co. 82, 54 B.R. 489, 495 (Bankr. N.D. Tex. 1985) (citing In re Donut Queen, 41 B.R. 706, 709-10 (Bankr. E.D.N.Y. 1984)). In weighing the relative costs and benefits, the courts have considered the costs of identifying separate assets where the books and records of the two identities are mixed (e.g., DRW Property, 54 B.R. at 495-96); the reliance, or lack thereof, by creditors of one corporation on the assets of the related entity, (e.g. In re Stop & Go of Am., Inc., 49 B.R. 743, 748-49 (Bankr. D. Mass. 1985); Donut Queen, 41 B.R. at 710-11; In re Baker & Getty Fin. Services, 78 B.R. 139, 142-43 (Bankr. N.D. Ohio 1987)); and whether creditors who dealt with one corporation knew of its relationships with the affiliated entity, In re Snider Brothers, 18 B.R. 230, 235-36 (Bankr. D. Mass. 1982). The courts recognized, however, that "[t]here is no one set of elements which, if established, will mandate consolidation in every instance." Snider Bros., 18 B.R. at 234. As a result, courts have tended to focus on other "equitable" factors discussed below.

b. The Balancing Tests

In addition to evaluating the above-enumerated factors, most courts also have engaged in an analysis involving a "balance of the equities" – *i.e.*, whether the benefits of consolidation outweigh potential harm to creditors. According to the Second Circuit:

> Resort to consolidation in such circumstances [involving commingling of assets and business functions], however, should not be Pavlovian. Rather, substantive consolidation should be used only after it has been determined that all creditors will benefit because untangling is either impossible or so costly as to consume the assets .... Commingling, therefore, can justify substantive consolidation only where "the time and expense necessary even to attempt to unscramble them [is] so substantial as to threaten the realization of any net assets for all the creditors," or where no accurate identification and allocation of assets is possible. In such circumstances, all creditors are better off with substantive consolidation.

In re Augie/Restivo Baking Co., 860 F.2d at 519 (citations omitted); accord In re Mortgage Inv. Co., 111 B.R. 604, 609 (Bankr. W.D. Tex. 1990); Holywell Corp. v. Bank of New York, 59 B.R. 340, 347 (S.D. Fla. 1986), appeal dismissed, 838 F.2d 1547 (11th Cir.), cert. denied, 488 U.S. 823 (1988); In re Richton Int'l Corp., 12 B.R. 555, 558 (Bankr. S.D.N.Y. 1981). The Second Circuit reduced the laundry list of traditional factors to two critical factors, "whether creditors dealt with the entities as a single economic unit and, 'did not rely on their separate entity in extending credit,' . . . [or] whether the affairs

of the debtors are so entangled that consolidation will benefit all creditors." In re Augie/Restivo Baking Co., 860 F.2d at 518 (citations omitted).

Similarly, another court has stated:

> A review of the case law reveals that equity has provided the remedy of consolidation in those instances where it has been shown that the possibility of economic prejudice which would result from continued corporate separateness outweighed the minimal prejudice that consolidation would cause. While several courts have recently attempted to delineate what might be called "the elements of consolidation," I find that the only real criterion is that which I have referred to, namely the economic prejudice of continued debtor separateness versus the economic prejudice of consolidation. There is no one set of elements which, if established, will mandate consolidation in every instance. Moreover, the fact that corporate formalities may have been ignored, or that different debtors are associated in business in some way, does not by itself lead inevitably to the conclusion that it would be equitable to merge otherwise separate estates.

In re Snider Bros., 18 B.R. at 234 (citations omitted). The court further stated that "the evidence in support of an application to consolidate must do more than show a unity of interest or an intermingling of funds." Id. at 238.

Certain guidelines have been adopted in some decisions for allocating the burden of proof. The proponent seeking consolidation has the ultimate burden of proof that substantive consolidation should be granted in a particular case. "[I]t must be clearly shown that not only are the 'elements of consolidation' present in a given bankruptcy setting, but that the court's action is necessary to prevent harm or prejudice, or to effect a benefit generally." Id. In addition, in the face of an affirmative showing that consolidation is warranted, an objecting creditor has the burden of proving that it relied solely on the credit of one of the entities and that consolidation will therefore result in more than minimal harm. Id.; In re Drexel Burnham Lambert Group Inc., 138 B.R. 723, 766 (Bankr. S.D.N.Y. 1992).

The Eleventh Circuit has adopted a similar analysis stating:

> the proponent of substantive consolidation must show that (1) there is substantial identity between the entities to be consolidated; and (2) consolidation is necessary to avoid some harm or to realize some benefit. When this showing is made, a presumption arises "that creditors have not relied solely on the credit of one of the entities involved." Once the proponent has made this prima facie case for consolidation, the burden shifts to an objecting creditor to show that (1) it has relied on the separate credit of one of the entities to be consolidated; and (2) it will be prejudiced by substantive consolidation. Finally, if an objecting creditor has made this showing, "the

> court may order consolidation only if it determines that the demonstrated benefits of consolidation 'heavily' outweigh the harm . . . ."

Eastgroup Properties, 935 F.2d at 249 (citations omitted); In re Optical Technologies, Inc., 221 B.R. 909, 912 (Bankr. M.D. Fla. 1998). The Eleventh Circuit drew this test from the decision in In re Auto-Train Corp., 810 F.2d 270 (D.C. Cir. 1987). The Eighth Circuit has adopted a three factor variant of the Eleventh Circuit Eastgroup Properties test whereby Courts examine the following three factors in their substantive consolidation analysis: (1) the necessity of consolidation due to the interrelationship among the entities; (2) whether the benefits of consolidation outweigh the harm; and (3) the prejudice resulting from refusal to consolidate. In re Giller, 962 F.2d 796, 799 (8th Cir. 1992) (finding substantive consolidation appropriate where sole majority shareholder ignored corporate form and fraudulently transferred assets). See also In re Huntco, Inc., 302 B.R. 35, 39 (Bankr. E.D. Mo. 2003) (the three factors are "only illustrative of the type of fact specific analysis the court must conduct") (citing In re Affiliated Foods, 249 B.R. 770, 777 (Bankr. W.D. Mo. 2000)).

In the bankruptcy case of In re Bonham, 229 F.3d 750, 763 (9th Cir. 2000), the Ninth Circuit Court of Appeals affirmed a bankruptcy court's *nunc pro tunc* substantive consolidation of two non-debtor corporations with an individual debtor's chapter 7 bankruptcy case. The court held that the "bankruptcy court's power of substantive consolidation has been considered part of the bankruptcy court's general equitable powers since the passage of the Bankruptcy Act of 1898." Id. (citing In re Reider, 31 F.3d at 1105; Sampsell v. Imperial Paper & Color Corp., 313 U.S. 215, 219 (1941)). Although the Ninth Circuit explicitly adopted the Second Circuit's test, the Court seemed to analyze the facts more with reference to the two guiding principles of substantive consolidation enumerated by the Eleventh Circuit in Eastgroup Properties – entanglement and disregard of corporate formalities, and balancing of harms – rather than strictly within the framework of its newly adopted rule. Id. at 766-67. After reciting six relevant factors in a footnote[4], the court recited multiple facts illustrating that the debtor had commingled its assets with those of non-debtors, used the names of non-debtor entities interchangeably, lacked separate financial statements and tax returns, and the debtor made all decisions for each of the non-debtor entities, all to the point where "the exercise of disentangling the affairs of [the debtor and non-debtor entities] would be needlessly expensive and possibly futile." Id. Further, the Bonham Court took pains to address the effect of substantive consolidation on creditors, which is relevant to both elements of the Second Circuit's Augie/Restivo test. The Court expressly found that substantive consolidation would impose no unfair harm on third parties and that the only "harm" was to early investors who had been paid at the expense of other investors, in that all investors would share losses equally under substantive consolidation.

In In re Owens Corning, 419 F.3d 195 (3d Cir. 2005), *cert. denied*, 126 S. Ct. 1910 (2006), the Third Circuit presented a comprehensive analysis of substantive consolidation and found that the following principles underlie this remedy:[5] (i) limiting the cross-creep of liability by respecting entity

[4] See In re Bonham, 229 F.3d 750, 766 n. 10 (9th Cir. 2000).

[5] In re Owens Corning, 419 F.3d at 211.

separateness is a fundamental ground rule; (ii) the harms to be addressed by substantive consolidation are nearly always those caused by debtors who disregard separateness; (iii) mere benefit to administration of the case is not sufficient to invoke the remedy of substantive consolidation; (iv) substantive consolidation is extreme and imprecise and should be rarely used; (v) substantive consolidation may not be used for the primary purpose of tactically disadvantaging a group of creditors in the plan process. The Court concluded:

> In our Court what must be proven (absent consent) concerning the entities for whom substantive consolidation is sought is that (i) prepetition they disregarded separateness so significantly their creditors relied on the breakdown of entity borders and treated them as one legal entity or (ii) postpetition their assets and liabilities are so scrambled that separating them is prohibitive and hurts all creditors.[6]

Because substantive consolidation is an equitable doctrine, its application has been tailored to the facts of the case. In re Standard Brands Paint Co., 154 B.R. 563, 573 (Bankr. C.D. Cal. 1993). However explained or applied, some variant of the balancing test has been employed by the vast majority of courts. For example, in the Third Circuit, the In re GC Cos., Inc. Bankruptcy Court examined and applied the Second Circuit Augie/Restivo test and the Eleventh Circuit Eastgroup Properties test side by side in allowing substantive consolidation. In re GC Cos., Inc., 274 B.R. 663 (Bankr. D. Del. 2002), *aff'd in part by, remanded by*, 298 B.R. 226 (D. Del. 2003). On appeal, the United States District Court for the District of Delaware concluded that the Bankruptcy Court had not abused its discretion by weighing the equities of a request for substantive consolidation, which was essentially an Eastgroup Properties influenced standard. Id. at 231-232 (while the District Court likened its approach to the bankruptcy court's approach in Eastgroup Properties, it declined to expressly adopt that rule).

Under any variant of the balancing test, the laundry list of consolidation factors enumerated earlier remains relevant, but not necessarily dispositive, as to whether substantive consolidation should be granted. Some courts look to the consolidation factors as evidence in support of proving a *prima facie* case for consolidation. See, e.g., Eastgroup Properties, 935 F.2d at 249-50; In re Augie/Restivo Baking Co., 860 F.2d at 518-20. Other courts have employed a hybrid approach which looks to the traditional factors independently of the question as to whether the equities of the case warrant consolidation. See e.g., In re Luth, 28 B.R. 564, 566-68 (Bankr. D. Idaho 1986); In re Richton Int'l. Corp., 12 B.R. at 557-59.

In applying any of the analysis discussed above, most courts tend to examine similar factors. In general, if creditors did not rely on the financial strength of related entities, courts will not order substantive consolidation merely because two related entities are affiliated in business or because two related entities' assets to some extent have been commingled or because a wholly-owned subsidiary has failed to observe certain corporate formalities. See In re Owens Corning, 419 F.3d 195 (3d Cir. 2005);

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[6] Id.

In re Augie/Restivo Baking Co., 860 F.2d 515; Eastgroup Properties, 935 F.2d 245; In re Snider Bros., 18 B.R. 230; In re 599 Consumer Electronics, Inc., 195 B.R. 244 (Bankr. S.D.N.Y. 1996).

On the other hand, courts also will order substantive consolidation where creditors did not distinguish between affiliated entities and relied on the assets of both entities. See In re Mortgage Inv. Co., 111 B.R. at 604.

Similarly, when the combination of affiliates' assets, liabilities and business affairs are so "hopelessly entangled" such that segregation is either prohibitively expensive or impossible, courts are prone to grant substantive consolidation. See Chem. Bank New York Trust Co. v. Kheel, 369 F.2d 845 (2d Cir. 1966). Even in this scenario, protection of creditors whose interests would be adversely and unfairly affected by consolidation may predominate over financial entanglement concerns. See In re Flora Mir Candy Corp., 432 F.2d at 1063 (unlikely that any showing of accounting difficulties would justify consolidation when claims of debenture holder of formerly independent entity, whose stock was subsequently transferred, would be extinguished or diluted; no evidence of accounting difficulties when financial statements for each debtor had been prepared by accountants).

Additionally, the failure to consistently observe corporate formalities is typically given some evidentiary weight in cases, but usually is not dispositive unless such elements, together with other evidence, support a finding of fraudulent or inequitable conduct by the debtors or their principals. See In re Baker & Getty Fin. Serv., 78 B.R. at 142 (substantive consolidation ordered when corporate funds were commingled and used for principal's personal purposes, inadequate records of transfers were made, and corporate entities were alter ego of principal who admitted having engaged in Ponzi scheme to defraud investors); In re Tureaud, 45 B.R. at 661 (alter ego finding based on majority of "elements" and fraud supported substantive consolidation of nondebtor entities in face of "hopeless" commingling of personal and corporate assets, numerous undocumented inter-corporate transfers, lack of distinction between inter-company transactions despite separateness of books and records, and impossibility of accurately tracing all transfers).

To temper the inequities of consolidation, the bankruptcy court may order limited, conditional or qualified consolidation, thus protecting or accommodating the interests of creditors who may be harmed by consolidation, but one cannot be assured of such protection. In re Creditors Serv. Corp., 195 B.R. 680, 690 (Bankr. S.D. Ohio 1996).

In expressing our opinion, we note the following considerations presented by the facts of this case:

(1) The financial and business affairs of Cascade and MDU Resources are readily distinguishable from each other.

(2) Cascade will be operated as a separate entity from MDU Resources and the respective assets and liabilities of Cascade and MDU Resources are ascertainable in a bankruptcy or otherwise so as to preclude valid support for substantive consolidation under the standards discussed above.

(3) Cascade will maintain its assets in such a manner that it is not costly or difficult to segregate, identify or ascertain such assets. As a result, it would be difficult for any third party to persuade a bankruptcy court that substantive consolidation of Cascade with MDU Resources is warranted under the balancing test or the substantive consolidation "elements" approach, because of the lack of any actual prejudice to creditors' interests associated with the recognition of separate entities.

(4) Cascade will not assume any obligation or liability as guarantor, endorser, surety or otherwise for MDU Resources, nor pledge any of its assets as backing for any securities of MDU Resources.

(5) Cascade's creditors have reasonably relied upon Cascade's separateness from MDU Resources and would suffer prejudice from, or would be harmed by, substantive consolidation.

(6) Each of Cascade and MDU Resources was established for a legitimate business purpose and not for the purpose of perpetuating a fraud or circumventing public policy.

(7) Cascade's capitalization as of the date hereof provides it with adequate capital to conduct its respective business, so the continued recognition of Cascade and MDU Resources as entities distinct from one another would not circumvent public policy.

In reaching our conclusion herein, we have relied upon concepts from the cases discussed herein that involve general principles regarding the doctrine of substantive consolidation. While we believe that the general principles applicable in the context of analysis of substantive consolidation should be applied to reach the result that substantive consolidation of Cascade with MDU Resources would not be ordered, we caution that a court addressing the issue of substantive consolidation would rule on the issue of substantive consolidation based upon the particular facts and circumstances before it, and might, therefore, reach a different result based on those facts. Therefore our opinion is a reasoned opinion based upon an analysis of case law decided under the laws of various jurisdictions that we believe would be applicable by analogy to the factual patterns set forth herein. Thus, our opinion is not a guaranty as to what a particular bankruptcy court actually would hold, but an opinion as to the decision a bankruptcy court would reach assuming that the issues were properly presented and assuming that the bankruptcy court correctly followed existing precedent as to legal and equitable principles applicable in bankruptcy cases.

In this regard, we further note that legal opinions on matters involving bankruptcy law unavoidably have inherent limitations that generally do not exist in respect of other issues on which opinions of third parties typically are provided. These inherent limitations exist primarily because of (i) the pervasive equity powers of the bankruptcy court, (ii) the overriding goal of reorganization to which other legal rights and policies may be subordinated, (iii) the potential relevance of the exercise of judicial discretion, as evidenced by the fact that courts have accorded different degrees of significance to a variety of factual elements, (iv) facts and circumstances arising in the future which are different from those assumed herein, and (v) the nature of the bankruptcy process in general.

Accordingly, the conclusions reached herein must be considered in light of these broad statutory and equitable powers of the bankruptcy court over the debtor's property, estate, creditors, and equity security holders. Consequently, we render no opinion as to the availability or effect of a preliminary injunction, temporary restraining order, or other such temporary relief, or equitable remedies other than substantive consolidation and except as set forth expressly herein.

This opinion is rendered for the sole benefit of the addressee hereof and no other person or entity is entitled to rely hereon. The opinion expressed herein is given on the date hereof only, and we assume no obligation to update or supplement our opinion to reflect any fact or circumstance that may hereafter come to our attention or any change in law that may hereafter occur or become effective.

Very truly yours,

Perkins Coie LLP

PERKINS COIE LLP

and Natural Resources Committee last week, Spitzer, a Republican who is now on the Arizona Corporation Commission, agreed with panel members that it is "very clear that we need additional transmission ... to provide for reliability. Investment in transmission is critical." He also called it "imperative that the FERC work with regional entities" to ensure electric reliability, something explicitly required by the Energy Policy Act.

"The great benefit that the FERC could employ" to ensure the interconnection of both renewable and traditional generation resources "is a reliable grid," Spitzer said. The commission must make certain "that the grid is robust to serve as a vehicle" for moving power to markets. EPAct mandates wholesale competition, he said, and "FERC must follow the law."

The committee's top Democrat, Senator Jeff Bingaman of New Mexico, pressed for Spitzer's views on the commission's order implementing new merger authority under EPAct. Part of that authority, the requirement that FERC examine deals to ensure there is no cross-subsidization and pledges or encumbrances of utility assets, was "at the heart of the agreement" to repeal the Public Utility Holding Company Act, Bingaman said.

What Bingaman expected was "strict structural rules" regarding cross-subsidization. Instead, FERC issued "something far different from what I had in mind," the committee's ranking minority member said in reference to FERC Order 669's requirement that merger applicants demonstrate the transaction will not result in cross-subsidization or pledges or encumbrances of utility assets.

Spitzer declined to address matters that he might be called on to decide, but he noted that, like Arizona, many states use "ring-fencing" tools to insulate utility assets from other businesses in the corporate family. For example, he said Oregon, deemed by many to be the "gold standard" when it comes to ring-fencing, was able to protect Portland General Electric even as parent Enron collapsed.

Certainly, FERC must prevent mergers from giving market power to the new company, Spitzer said. But state commissions are paying "very close attention" to cross-subsidization issues and are in a good position to deal with it, he added. "To the extent there was any regulatory gap" in this regard, the commission can address it, Spitzer said.

That line of questioning produced the only hint of disagreement at the hearing, and it did not involve Spitzer. Noting that he and Bingaman did not completely see eye-to-eye on PUHCA repeal, committee Chairman Pete Domenici, Republican of New Mexico, suggested that if FERC were to implement rules that effectively revived the old law, "obviously you will have done a great injustice" to the effort that went into the repeal.

Snohomish wins its case at FERC, but Enron will not give up ... from page 1

statements, letters and press releases from non-parties regarding what is the appropriate outcome, questioning the competency and fairness of the decision-makers, and criticizing the rules of procedure that govern every adjudicatory proceeding," Brownell wrote in a separate statement on the order (Docket No. EL05-139).

"I am concerned whether we can truly discount what has been said," she continued. "The inordinate amount of intrusion and the direct focus on a particular outcome in this matter have now reached the point where I believe the most appropriate course of action for me is to simply vote 'present.'"

An attorney for Enron, who spoke on condition of anonymity, said the company would file for rehearing at FERC and, if that is rejected, it will ask a federal appeals court to overturn the decision.

In an interview, he criticized the commission for not holding a full-blown hearing that would allow for legal discovery and cross-examination as in a trial. The process, he asserted, was poisoned by politics, resulting in a virtual summary judgment dismissing the Enron claim. "The Cantwell amendment [to the Energy Policy Act of 2005] was a revolver pointing at Enron, and FERC pulled the trigger. The party that was effectively the defendant was Enron."

The attorney said FERC Chairman Joseph Kelliher's recent comments to members of Congress that described Enron as a "criminal enterprise" added to the view that Enron could not be treated fairly. On top of that, Snohomish "has a giant media machine," the attorney said. "Maria Cantwell's running for re-election, and Enron's a great whipping boy. What else could you do in Washington to get votes than bang on Enron?"

Senator Cantwell, Democrat of Washington, has championed Snohomish's arguments vigorously, both last year and in recent months, and won a provision in EPAct last year that ensured FERC jurisdiction over the contract-termination battle.

Enron has challenged the constitutionality of the EPAct provision granting FERC authority over contracts, and its attorneys have asked the commission to defer its ruling until a federal court chimes in on the case.

FERC does not base decision on market manipulation

In giving Snohomish the victory it had sought last week, FERC sidestepped the issue that the utility and its political supporters had harped on — the assertion that Enron manipulated the Western market, driving prices above where they would have been and creating much of the 2000-2001 crisis.

Instead, the commission focused on another argument: that Enron misrepresented itself fraudulently at the time it signed the contract.

"We find that the evidence presented here," FERC said, "demonstrates clearly and convincingly that Enron engaged in financial fraud contemporaneous with its execution of the agreement, i.e., that it represented to Snohomish that it was solvent when, in fact, it was insolvent."

Because there is no federal common law on contracts, FERC said, it used state law. "Here, the parties do not dispute that the agreement should be governed by New York law," the commission explained.

Snohomish has long asserted that it was driven into a long-term power contract with Enron to seek refuge from a severely overpriced spot market manipulated by Enron. That was fraud, the utility argued. Snohomish General Counsel Michael

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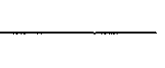
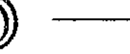
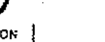
Substantial Revenue & Cost Saving Opportunities

Revenue Opportunity	• Increased Broadband availability
	• Frontier market approach improves critical customer metrics
	  • Access line losses
	  • HSI penetration
	  • Long distance penetration
	  • Video penetration	

Synergies	• Executive Management • Legal • Information Systems • Finance & Accounting • Increased purchasing power with vendors	~ $500M Annually
Non-Recurring Integration Costs	• Branding • IT Development • Severance	CapEx ~ $126M OpEx ~ $66M

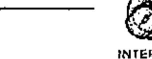


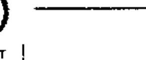
TELEPHONE | INTERNET | TELEVISION | WIRELESS DATA

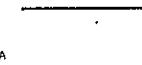
frontier® Communications

Transaction Overview

Transaction Structure	• Reverse Morris Trust • Simultaneous tax-free spin-off of SpinCo and merger with Frontier
Valuation	• SpinCo Enterprise Value: $8.6B • Implied purchase multiple of 4.5x SpinCo's FY 2008 EBITDA
Financing	• Equity consideration based on Frontier's 30 day average share price at time of close •Subject to a collar of $7.00 – $8.50, 66% - 71% VZ stockholder ownership •Fixed number of shares outside the collar • $3,208M of debt to be raised prior to closing • Proceeds to be paid to Verizon
Governance	• Maggie Wilderotter, Chairman & Chief Executive Officer • Frontier management leadership • 12 member board (Verizon elects 3 new members to Frontier existing board)
Post Closing Dividend Policy	• Annual dividend of $0.75 per share
Estimated Synergies	• Revenue upside from broadband, long distance, video and bundles • $500M of cash OpEx savings (21% of 2008 SpinCo cash OpEx)
Required Approvals	• Hart Scott Rodino • Frontier shareholder approval • Verizon IRS ruling • FCC and certain state and local regulatory approvals
Expected Closing	• Approximately 12 months







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Frontier Communications

Staff/102
Dougherty/114

1 that we stay on the Verizon systems that we'll be
2 obtaining through the transaction or at some point we
3 would move to our fully functioning systems that exist
4 today. But those plans have not been created at this
5 point.
6 Q As far as the operating system is concerned,
7 Frontier will be relying on Verizon for support for at
8 least a year after the deal is closed; isn't that right?
9 A Frontier will be relying upon Verizon. And I
10 think you're referring to, and correct me if I'm wrong,
11 to the maintenance agreement for the operational support
12 platform and systems. And that's really a five year
13 agreement. We have committed that we would be on that
14 agreement for a minimum of one year, but it certainly --
15 we will most likely be on that agreement for several
16 years.
17 Q I was referring to the statement in your direct
18 testimony on page 33, lines 12 and 13. Is that the
19 agreement that you were just discussing?
20 A Correct.
21 Q Are you familiar with some statements that
22 Verizon's CEO made to Goldman Sachs earlier this month
23 regarding the philosophy of Verizon toward land line
24 services?
25 MR. SAVILLE: Mr. Etter, do you have a
26

Staff/102
Dougherty/116

EBITDA - Leverage Look

EBITDA (No Synergies) - Decline 5% per year - 9 years

		Leverage
2009	3,125	
2010	2,969	
2011	2,820	
2012	2,679	
2013	2,545	
2014	2,418	
2015	2,297	
2016	2,182	
2017	**2,073**	**3.86**

EBITDA (Synergies) - Decline 5% per year - 12 years

		Leverage
2009	3,625	
2010	3,444	
2011	3,272	
2012	3,108	
2013	2,953	
2014	2,805	
2015	2,665	
2016	2,531	
2017	2,405	
2018	2,285	
2019	2,170	
2020	**2,062**	**3.88**

EBITDA (No Synergies) - Decline 7.5% per year - 6 years

		Leverage
2009	3,125	
2010	2,891	
2011	2,674	
2012	2,473	
2013	2,288	
2014	**2,116**	**3.78**

EBITDA (Synergies) - Decline 7.5% per year - 8years

		Leverage
2009	3,625	
2010	3,353	
2011	3,102	
2012	2,869	
2013	2,654	
2014	2,455	
2015	2,271	
2016	**2,100**	**3.81**

EBITDA (No Synergies) - Decline 10% per year - < 5 years

		Leverage
2009	3,125	
2010	2,813	
2011	2,531	
2012	2,278	
2013	**2,050**	**3.90**

EBITDA (Synergies) - Decline 10% per year - 6 years

		Leverage
2009	3,625	
2010	3,263	
2011	2,936	
2012	2,643	
2013	2,378	
2014	**2,141**	**3.74**

Leverage ($2,050 EBITDA) **3.90** Based on $8,005 debt level

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STATE OF VERMONT
PUBLIC SERVICE DEPARTMENT

Petition of the Department of Public Service for an Investigation and for an Order Directing Telephone Operating Company of Vermont LLC, d/b/a FairPoint Communications to Show Cause why its Certificate of Public Good Should not be Revoked.	))))))	Docket No. ____

PETITION

THE DEPARTMENT OF PUBLIC SERVICE ("Department"), petitions the Public Service Board ("Board") to open an investigation pursuant to 30 V.S.A. § 209 into Telephone Operating Company of Vermont LLC, d/b/a FairPoint Communications ("FairPoint") and for an Order directing FairPoint to show cause why its Certificate of Public Good should not be revoked. In support of its petition, the Department states as follows:

1. The Department has standing pursuant to 30 V.S.A. § 2 to initiate this petition.
2. FairPoint purchased the assets of Verizon New England Inc., d/b/a Verizon Vermont ("Verizon") on March 31, 2008 pursuant to Public Service Board Order of February 15, 2008 in Docket 7270.
3. On that same date, FairPoint was issued a Certificate of Public Good to operate in the State of Vermont.
4. On February 1, 2009, FairPoint began operating under its own systems rather than those of Verizon.
5. Since that date, FairPoint and consequently its Vermont customers have experienced problems due to systems, customer service and billing problems of an unprecedented nature.
6. For the months of March, 2009, April, 2009, May, 2009 and June, 2009, the Consumer Affairs and Public Information division of the Department ("CAPI") received a level of consumer complaints at unprecedented levels. (Attachment A)

We believe the record will show:

- FairPoint's systems have not worked properly since the cutover in early February from Verizon systems (for whatever reasons);
- FairPoint's ability to deliver timely and reliable retail and wholesale services is not improving in a uniform, sustainable and comprehensive fashion; and,
- Perhaps most crucially, FairPoint has failed to produce a comprehensive, holistic view of how individual OSS components are operating (or not operating) as parts of integrated systems[2] (data and databases, software, hardware, business processes and staff).

We believe that FairPoint's deteriorating financial performance is directly related to its post-cutover failure to restore itself to business as usual. We believe that failure is directly related to the lack of a stable and functional OSS. For operational reasons and for financial reasons, it is imperative that FairPoint's ability to provide safe and reliable service be restored as soon as possible. To date, more than six months since cutover, FairPoint has been unable to resolve these problems on its own. Therefore, it is incumbent on all stakeholders to work together to assess issues and cooperatively work toward a solution. In order for any such efforts to be successful, we believe an independent third-party consultant is needed to provide an objective assessment of the current functionality of FairPoint's OSS.

Background

Three-state regulators have used Liberty Consulting for monitoring and evaluation of FairPoint's cutover readiness and operational results post-cutover. To date, the three regulatory commissions in Maine, New Hampshire and Vermont have closely monitored FairPoint's attempts to rectify the systems failures but have imposed few, if any, performance or managerial requirements on FairPoint. During this monitoring period, FairPoint has made little progress in resolving its issues. Given these failures, continuation of this approach is not recommended. There is little to be gained by having non-experts attempt to identify and support repair of the system failures. This is particularly true given a growing lack of trust in

[2] The term "systems" is used above in its larger sense: i.e., "systems" composed of defined business processes, adequate personnel who understand and are trained in these business processes, consistently defined and used data and databases, and fully integrated computer hardware and software through which these processes and data "flow through".

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Liquidity and Capital Resources

Our short term and long term liquidity needs arise primarily from: (i) interest and principal payments on our indebtedness; (ii) capital expenditures, including those mandated by the state regulatory orders approving the merger; (iii) working capital requirements as may be needed to support the growth of our business; (iv) dividend payments, if any, on our common stock; (v) obligations under our employee benefit plans; and (vi) potential acquisitions.

We have a highly leveraged capital structure and have essentially fully drawn all borrowings available under our credit facility. In the future, we expect that our primary sources of liquidity will be cash flow from operations and cash on hand. Because of cutover issues that have prevented us from executing fully on our operating plan for 2009, our revenue has continued to decline. In addition, cash collections have remained below pre-cutover levels and we have incurred significant incremental costs to operate our Northern New England operations, causing further stress on our liquidity position.

Cash and cash equivalents at June 30, 2009 totaled $81.0 million compared to $92.5 million at March 31, 2009, excluding restricted cash of $3.4 million and $55.2 million, respectively. During the three months ended June 30, 2009, $51.8 million was released from restricted cash, including $50.2 million released pursuant to a letter dated May 12, 2009 from the NHPUC allowing these funds to be used for general working capital purposes. On April 1, 2009, interest payments totaling $35.6 million were made to holders of the notes and during the three months ended June 30, 2009, debt service payments of $45.3 million were made pursuant to our credit facility. At July 31, 2009, cash and cash equivalents was $75.6 million. We expect to make debt service payments under our credit facility totaling approximately $46.1 million during the three months ending September 30, 2009.

In addition, as a result of the cutover-related issues and the continuing adverse general economic conditions, prior to June 30, 2009, we believed that we were at risk of failing to comply with the interest coverage ratio maintenance covenant in our credit facility when measured for the period ending June 30, 2009. Given that we believe that our credit facility is a valuable asset, which we may not be able to refinance on reasonable terms, if at all, in the current lending environment, we initiated preliminary discussions with the administrative agent under our credit facility regarding a waiver of this potential breach of the interest coverage ratio maintenance covenant for the measurement period ending June 30, 2009. At the time, the administrative agent indicated that such a waiver would require a significant cash fee, likely result in additional restrictive provisions being placed on us and likely require us to renegotiate certain provisions in our credit facility following the expiration of such waiver. We ultimately elected not to enter into such a waiver and instead launched the exchange offer on June 24, 2009, which exchange offer was primarily designed to reduce our cash interest expense for the quarters ending June 30, 2009 and September 30, 2009 and to help us maintain compliance with the interest coverage ratio maintenance covenant in our credit facility for the measurement period ending June 30, 2009.

On July 29, 2009, we successfully consummated the exchange offer. On the settlement date, $439.6 million in aggregate principal amount of the notes (which amount was equal to approximately 83% of the then outstanding notes) were exchanged for $458.5 million in aggregate principal amount of the new notes (which amount includes new notes issued to tendering noteholders as payment for accrued and unpaid interest on the exchanged notes up to, but not including, the settlement date of the exchange offer). Interest expense paid in the form of new notes has been treated as non-cash for purposes of our financial debt covenants and, in accordance with SFAS No. 6, *Classification of Short Term Obligations Expected to Be Refinanced*, we have classified the June 30, 2009 balance of $14.4 million accrued interest on the exchanged notes as a non-current liability on the condensed consolidated balance sheet. In connection with the exchange offer and the corresponding consent solicitation, we also paid a cash consent fee of $1.6 million in the aggregate to holders of notes who

1 then would your deployment schedule for broadband be
2 delayed?
3 A No. I think the -- in our opinion, the key to
4 competing in Ohio is expanding broadband. So you will
5 see us start to expand broadband as quickly as possible
6 post close. In our opinion, and Verizon may not
7 necessarily agree with this, but not having broadband in
8 an area is a competitive disadvantage that potentially
9 leads to higher access line losses. We believe that we
10 can change the trends in the business by getting
11 aggressive broadband offers out into the market. And the
12 only way to do that is to invest in the infrastructure.
13 Q And how would you do that if you don't get the
14 kind of broadband subscribership that you would like?
15 A Well we -- it's kind of a chicken and the egg.
16 You really have to build the network before you can start
17 to drive those incremental subscribers. So we'll start
18 with very detailed designs probably as we get through
19 into the end of the first quarter, into the second
20 quarter next year so that we can go to market right at
21 the close of the transaction. And what we tend to do,
22 which is a little different than maybe Verizon, is very
23 focused and targeted marketing in those areas where we're
24 expanding network. And you couple that with our legal
25 engagement philosophy as far as general management and
26

1 push the envelope on trying to grow broadband. And
2 that's the way we've attained those levels today.
3 And I think you will find that Frontier looks
4 at opportunities perhaps a little bit differently than
5 Verizon who may have other needs for capital. Broadband
6 and expanding broadband is our strategy. It's one of our
7 key ways that we're going to change the business as I
8 said before. And where somebody else might say you need
9 1,000 homes in an area to really make it economic, we
10 really try to look at things on a case by case basis and
11 we're out there looking for clusters of homes that are 25
12 to 50 homes as target opportunities to build out to.
13 So I think you'll see us come out of the gate
14 probably a little bit different than what you've seen in
15 the past; but it will take time. I think probably
16 everybody knows that. It's not something that you can
17 flip a switch and overnight it happens. But we will
18 develop that plan and we will be going to market as
19 quickly as possible after close.
20 Q Actually the quote was on page 46, lines 15 and
21 16. So if you can look at that. In light of what you
22 just said, you know, do you perceive Ohio to be a typical
23 deployment schedule regarding your broadband plans?
24 A I think that Ohio is an excellent opportunity
25 for us to move the needle on broadband and to drive
26

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Directory Services

Directory services revenue for the three months ended March 31, 2009 decreased $0.9 million, or 3%, to $27.7 million, as compared with the three months ended March 31, 2008, primarily due to lower revenues from yellow pages advertising, mainly in Rochester, New York.

Other

Other revenue for the three months ended March 31, 2009 decreased $1.7 million, or 7%, to $21.5 million, as compared with the three months ended March 31, 2008, primarily due to fewer equipment sales, reduced pole attachment fees and decreased "bill and collect" fee revenue, partially offset by higher DISH Network video and wireless revenues.

OTHER FINANCIAL AND OPERATING DATA

	As of March 31, 2009	As of March 31, 2008	% Change
Access lines:			
Residential	1,427,149	1,553,094	-8%
Business	789,654	832,979	-5%
Total access lines	2,216,803	2,386,073	-7%
HSI subscribers	600,047	543,020	11%
Video subscribers	146,010	101,410	44%

($ in thousands)	2009	2008	$ Change	% Change
	For the three months ended March 31,			
Revenue:				
Residential	$230,466	$241,362	$(10,896)	-5%
Business	217,425	220,025	(2,600)	-1%
Total customer revenue	447,891	461,387	(13,496)	-3%
Regulatory (Access Services)	90,065	107,818	(17,753)	-16%
Total revenue	$537,956	$569,205	$(31,249)	-5%
Switched access minutes of use (in millions)	2,377	2,602		-9%
Average monthly total revenue per access line	$ 80.21	$ 78.81		2%
Average monthly customer revenue per access line	$ 66.78	$ 63.88		5%

Expenses

OPERATING EXPENSES

NETWORK ACCESS EXPENSES

($ in thousands)	2009	2008	$ Change	% Change
	For the three months ended March 31,			
Network access	$60,684	$60,549	$ 135	0%

Network access expenses for the three months ended March 31, 2009 was relatively unchanged as compared with the three months ended March 31, 2008. Long distance carriage costs declined $4.5 million in the first quarter of 2009 due to decreasing rates resulting from more efficient circuit routing for Frontier's long distance and data products. In the first quarter of 2009, Frontier expensed $6.7 million for the cost of new personal

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access and subsidy revenue, has declined in the first quarter of 2009 by less than 3 percent as compared to the prior year period. The average monthly customer revenue per access line has improved and resulted in an increased wallet share, primarily from residential customers. A substantial further loss of access lines, combined with increased competition and the other factors discussed herein, may cause Frontier's revenue, profitability and cash flows to decrease in 2009.

The financial tables below include a comparative analysis of Frontier's results of operations on a historical basis for the three months ended March 31, 2009.

REVENUE

($ in thousands)	For the three months ended March 31, 2009	2008	$ Change	% Change
Local services	$200,896	$217,158	$(16,262)	-7%
Data and Internet services	156,393	145,982	10,411	7%
Access services	90,065	107,818	(17,753)	-16%
Long distance services	41,412	46,453	(5,041)	-11%
Directory services	27,705	28,628	(923)	-3%
Other	21,485	23,166	(1,681)	-7%
	$537,956	$569,205	$(31,249)	-5%

Local Services

Local services revenue for the three months ended March 31, 2009 decreased $16.3 million, or 7%, to $200.9 million, as compared with the three months ended March 31, 2008, primarily due to the continued loss of access lines which accounted for $11.6 million of the decline and a reduction in all other related services of $4.7 million. Enhanced services revenue in the first quarter of 2009 decreased $3.1 million, as compared with the first quarter of 2008, primarily due to a decline in access lines and a shift in customers purchasing Frontier's unlimited voice communications packages with features included in the bundle instead of purchasing individual features.

Economic conditions or increasing competition could make it more difficult for Frontier to sell its packages and bundles, and cause Frontier to increase its promotions or lower its prices for those products and services, which would adversely affect its revenue, profitability and cash flow.

Data and Internet Services

Data and Internet services revenue for the three months ended March 31, 2009 increased $10.4 million, or 7%, to $156.4 million, as compared with the three months ended March 31, 2008, primarily due to the overall growth in the number of data and HSI customers. As of March 31, 2009, the number of Frontier's HSI subscribers had increased by approximately 57,000, or 11%, since March 31, 2008. Data and Internet services also include revenue from data transmission services to other carriers and high-volume commercial customers with dedicated high-capacity Internet and ethernet circuits. Revenue from these dedicated high-capacity circuits increased $3.4 million in 2009, as compared with 2008, primarily due to growth in the number of those circuits.

President Obama signed into law an economic stimulus package that includes $7.2 billion in funding, through grants and loans, for new broadband investment and adoption in unserved and underserved communities. The federal agencies responsible for administering the programs are currently developing the rules and evaluation criteria. Depending on these and any conditions included with respect to acceptance and use of the money, Frontier may apply to receive funds from this package. These funds, if received, would be used by

Docket No. UM-1431
Verizon and Frontier Responses to STAFF Data Requests Nos. 1-46
June 25, 2009

DATA REQUEST NO. 4:

If any patent agreements will terminate, will Frontier be able to maintain all current operations currently being performed Verizon? Please explain.

Frontier Response:

Without limitation of its other General Objections, please see, in particular, General Objections Nos. 3, 8, 9, 11, 12. Subject to and without waiver of its general and specific objections, Frontier responds as follows:

Yes, Frontier will be able to maintain all current operations currently performed by Verizon with respect to the regulated telecommunications services provided in Oregon. To the extent Frontier does not already have licenses in place with such third parties for patents that would apply to the current operations of Verizon in Oregon, Frontier will either obtain licenses under such applicable patents, if any, directly from those third parties or seek to make alternative technological or operational changes to continue to provide the same regulated telecommunications services provided in Oregon.

Prepared By: Cassandra Guinness
Date: June 25, 2009

BEFORE THE PUBLIC UTILITY COMMISSION
OF THE STATE OF OREGON

VERIZON NORTHWEST INC.	)	
	)	Docket UI 207
Application for authority to enter into	)	Order 03-291
a Financial Services Agreement	)	

Short-term Note Activity Report – 3rd Quarter 2008

Pursuant to Order 03-291 in Docket UI 207, Verizon Northwest Inc. ("Verizon" or "Company") makes the following report regarding short-term note activities with Verizon Network Funding Corp. ("VNFC") during the period July 2008 through September 2008:

Month-end note balances and the interest rate billed and/or received for the month are as follows:

Month	Month-End* Note Balance	Interest Rate
July 08	$300,292,140	2.4705%
August 08	$310,352,142	2.4910%
September 08	$305,920,551	2.4910%

* Balances due Verizon Northwest shown in parenthesis ().

The interest rate is equal to VNFC's cost of short-term funds, which is defined as the weighted average of all interest, premiums, discounts, commission and fees paid by VNFC in connection with Verizon Communications, Inc.'s short-term borrowings from commercial paper dealers and banks for each month. Since the interest rates are directly based on Verizon Communication's borrowings from the capital markets, they are by definition at the lower of cost or market.

Funds were used to finance Verizon's on-going operations and construction program.

Increases in loan balances were recorded on the books of the Company with a credit to Notes Payable (Account 4020) and a debit to Cash (Account 1130). Decreases in loan balances were recorded on the books of the Company with a debit to Notes Payable (Account 4020) and a credit to Cash (Account 1130).

Docket No. UM-1431
Verizon and Frontier Responses to STAFF Data Requests Nos. 1-46
June 25, 2009

DATA REQUEST NO. 33:

Please explain how Frontier will replace the short-term note between Verizon and Verizon Network Funding Corp (VNFC) that was approximately $489 million in December 2008.

Response:

Without limitation of its other General Objections, please see, in particular, General Objections Nos. 3, 7 and 12. Subject to and without waiver of its general and specific objections, Verizon and Frontier respond as follows:

Frontier will not have any obligation to repay this short-term note. This obligation will be settled by Verizon prior to the closing of the transaction.

Prepared By: James Miggans & Cassandra Guinness
Date: June 25, 2009

Docket No. UM-1431
Verizon and Frontier Responses to STAFF Data Requests Nos. 1-46
June 25, 2009

DATA REQUEST NO. 34:

Without the VNFC note, what funding will Frontier use finance Verizon's on-going operations and construction program?

Frontier Response:

Without limitation of its other General Objections, please see, in particular, General Objections Nos. 3, 7 and 12. Subject to and without waiver of its general and specific objections, Frontier responds as follows:

Frontier will fund on-going operations and construction programs with cash from operations and /or available borrowings under its credit facilities.

Prepared By: Cassandra Guinness
Date: June 25, 2009

Docket No. UM-1431
Verizon and Frontier Responses to STAFF Data Requests Nos. 1-46
June 25, 2009

DATA REQUEST NO. 30:

Does Frontier anticipate any changes in current affiliated interest service and other agreements? Please explain.

Frontier Response:

Without limitation of its other General Objections, please see, in particular, General Objections Nos. 3 and 12. Subject to and without waiver of its general and specific objections, Frontier responds as follows:

Yes. Frontier anticipates that Verizon Northwest and the other acquired entities would be included in affiliated interest service agreements. As a result, allocation adjustments may be made. However, Frontier does not anticipate any methodology changes and will continue to comply with all applicable Commission requirements.

Prepared By: Cassandra Guinness
Date: June 25, 2009

CASE: UM 1431
WITNESS: Jorge Ordonez

PUBLIC UTILITY COMMISSION
OF
OREGON

STAFF EXHIBIT 200

Direct Testimony

November 2, 2009

1 **Q. PLEASE STATE YOUR NAME, OCCUPATION, AND BUSINESS**
2 **ADDRESS.**
3 A. My name is Jorge Ordonez. I am employed by the Public Utility Commission of
4 Oregon (Commission) as the Senior Financial Economist in the Economic and
5 Policy Analysis Section. My business address is 550 Capitol Street NE, Suite
6 215, Salem, Oregon 97301-2551.
7 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND WORK**
8 **EXPERIENCE.**
9 A. My Witness Qualifications Statement is found in Exhibit Staff/201, Ordonez /1.
10 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**
11 A. The purpose of my testimony is to review the impact on Oregon customers of
12 Verizon Northwest, Inc. (VNW) of the proposed merger between Frontier
13 Communications Corporation (Frontier) and New Communications Holdings,
14 Inc. (NCH), the latter being a newly formed subsidiary of Verizon
15 Communications, Inc. (Verizon). My analysis covers the financial leverage and
16 credit ratings aspects of the merger.
17 **Q. DID YOU PREPARE AN EXHIBIT FOR THIS DOCKET?**
18 A. Yes, I have prepared Exhibit Staff 201, consisting of one page; Exhibit Staff
19 202, consisting of six pages; Exhibit Staff 203, consisting of 22 pages; Exhibit
20 Staff 204, consisting of one page; Exhibit Staff 205, consisting of two pages;
21 Exhibit Staff 206, consisting of 14 pages; and Exhibit Staff 207, consisting of
22 five pages.
23

1 **Q. HOW DID YOU APPROACH YOUR TESTIMONY?**
2 A. Staff's initial approach consisted in covering the following: (1) leverage
3 analysis, (2) credit rating aspects of the transaction and (3) financial
4 performance of Frontier after the merger. However, Staff focused on the first
5 and second topics because of difficulties getting complete and timely
6 information from the Applicants to address Topic 3.
7 **Q. PLEASE EXPLAIN MORE ABOUT THE YOUR PROBLEMS WITH**
8 **OBTAINING INFORMATION RELATED TO TOPIC 3.**
9 A. Initially, Staff requested the Applicants provide information through Staff's Data
10 Requests (DRs). In Staff's DR-62 released on June 18, 2009, I requested *pro-*
11 *forma* financial statements of Frontier covering the period from 2010-2011. On
12 July 2, 2009, the Applicant responded to Staff's DR-62 and represented that
13 the requested information would be provided in Frontier's registration
14 statement S-4 filed with Securities and Exchange Commission (SEC).[1]
15 Unfortunately, this information did not appear in Frontier's registration
16 statement S-4, filed with the SEC on July 24, 2009.
17 **Q. DID YOU FOLLOW UP ON THIS REPONSE TO OBTAIN THE**
18 **INFORMATION REQUESTED?**
19 A. Yes. In Staff's DR-198 released on August 25, 2009, I followed up and
20 reiterated the need of this important piece of information. Additionally, in
21 Staff's DR-199, I requested the Applicants perform sensitivity analysis
22 considering four scenarios. On September 9, 2009, the Applicants provided

[1] See Exhibit Staff/207 Ordonez/1.

1 the information requested on DR-198; however, the Applicants did not provide
2 the information requested in DR-199, stating that they had previously provided
3 a model in Excel that shows projected financial information for 2010 and 2011
4 in which various assumptions in the model can be revised by the user[2].
5 Unfortunately, the Excel workbook was not satisfactory because it was linked
6 to worksheets not present in the Excel workbook, even though I requested the
7 information to be provided in electronic format with formulae and cell
8 references intact[3].

9 **ORGANIZATION OF THE TESTIMONY**

10 **Q. HOW HAVE YOU ORGANIZED YOUR TESTIMONY?**

11 A. My testimony is organized into four parts as follows:

12 1. I describe the proposed "organizational structure" aspects of the merger
13 between Frontier and NCH to form the post-merger new company Frontier;
14 2. I describe the results of my "leverage" analysis of the merger;
15 3. I comment on the "credit ratings" aspects of the merger between Frontier and
16 NCH; and
17 4. I provide the conclusions resulting from my analysis.

18 **ORGANIZATIONAL STRUCTURE**

19 **Q. HOW IS THE MERGER TAKING PLACE?**

20 A. On May 29, 2009, Verizon and Frontier submitted a joint application
21 (Application) to the Commission for approval of the merger between Frontier
22 and NCH.

[2] See Exhibit Staff/207 Ordonez/4
[3] See Exhibit Staff/207 Ordonez/2, DR-198: "… with annual totals where appropriate, in electronic format with formulae and cell references intact. Please provide standard ratio calculations, including (but not limited to):…"

1 **Q. WHAT IS NCH?**

2 A. NCH is a direct subsidiary of Verizon and a new Delaware corporation formed
3 for purposes of this transaction. NCH has two direct subsidiaries: New
4 Communications Online and Long Distance, Inc. and New Communications
5 ILEC Holdings, Inc. The latter has six direct subsidiaries, one of which is
6 VNW.[4]

7 **Q. WHAT IS VNW?**

8 A. VNW is an incumbent local exchange carrier (ILEC) serving a territory
9 consisting of local access and transport areas (LATAs) in California, Idaho,
10 Oregon and Washington.[5] VNW served approximately 310,000 access lines[6]
11 in Oregon as of December 31, 2008. When the proposed transaction is
12 concluded, VNW will be renamed because it will then be a subsidiary of post-
13 merger Frontier.[7] For the purposes of this testimony, the name VNW will be
14 used for the company both before the merger and Frontier Northwest (FNW)
15 after the merger.

16 **Q. DOES FRONTIER CURRENTLY HAVE CUSTOMERS IN OREGON?**

17 A. Yes. Citizens Telecommunications Company of Oregon (CTCO), dba Frontier
18 Communications of Oregon, is currently a telecommunications utility providing

---

[4] See Exhibit Staff/202 Ordonez/1-6 for additional information regarding Verizon's spin-off of NCH.
[5] See Exhibit Staff/203 Ordonez/9 of VNW's consolidated financial statements as of December 31, 2008.
[6] For purposes of this testimony, the terms "access lines" and "customers" are used interchangeably.
[7] See page 5 of the Application.

1 local exchange services throughout the state. CTCO has approximately
2 12,000 access lines in Oregon. CTCO is subsidiary of Frontier.[8]

3 **Q. PLEASE PROVIDE METRICS ILLLUSTRATING THE SIZE OF THE**
4 **COMPANIES INVOLVED IN THE TRANSACTION AND A COMPARISON**
5 **WITH THE INDUSTRY?**

6 A. Table 1 provides certain metrics of the size of the companies involved in the
7 transaction.

8 Table 1
9

Selected metrics: Industry, pre-merger Frontier, post-merger Frontier and Verizon
Annualized from information as of the First Quarter of 2009

		INDUSTRY[1]	Pre-merger FRONTIER[2]		Post-merger FRONTIER[2]		Pre-merger VERIZON[3]	
Metric	Units			% of Industry		% of Industry		% of Industry
Revenues	$million	640,000	2,152	0.3%	6,248	1.0%	106,364	16.6%
Net profit	$million	61,000	144	0.2%	552	0.9%	12,840	21.0%
Total capital	$million	910,000	5,214	0.6%	13,649	1.5%	136,228	15.0%
Net plant	$million	485,000	3,202	0.7%	8,635	1.8%	89,855	18.5%

1 From Value Line Investment Survey, June 26, 2009. Composite Statistics: Telecommunications Services Industry.
2 From Frontier's Form S-4 registration statement filed with the Securities and Exchange Commission (SEC) on July 24, 2009
3 From Verizon's Form 10-Q, as of first quarter of 2009, filed with SEC on May 11, 2009.

10
11
12 Staff considered as a proxy for the industry the composite statistics of the
13 telecommunications services industry as reported in the Value Line Investment
14 Survey (Value Line)[9]. Post-merger Frontier's market share will increase from
15 0.3 percent to one percent, while Verizon's market share declines from
16 approximately 17 percent to approximately 16 percent; additionally, post-

[8] See page 5 of the Application.
[9] See Exhibit Staff/204 Ordonez/1

1 merger Frontier is estimated to have almost three times its pre-merger
2 revenue, net profit, total capital, and net plant.

3 **LEVERAGE ANALYSIS**

4 **Q. WHAT IS FINANCIAL LEVERAGE AND WHY IS IT IMPORTANT?**

5 A. Financial leverage is the extent to which a company relies on debt rather than
6 equity for capitalization. Measurements of financial leverage assist in
7 determining the likelihood a firm will default on its contractual debt. The more
8 debt on a company's balance sheet relative to equity, the greater the
9 probability that it will be unable to fulfill its contractual obligations.[10]

10 **Q. WHAT IS THE CURRENT AND ANTICIPATED LEVERAGE OF THE**
11 **PARTIES INVOLVED IN THE TRANSACTION?**

12 Table 2
13

Leverage metrics: Industry, Frontier, New Frontier and Verizon for the first quarter of 2009 as of March 31, 2009.

Ratio	Pre-merger Frontier[1]	Post-merger Frontier[1]	Pre-merger Verizon [2]	Industry [3]
Debt ratio	93%	67%	64%	N/A
Debt-to-equity ratio	12.79	2.07	1.82	N/A
Book long-term debt ratio	91%	58%	41%	39%
Book common-equity ratio	9%	42%	59%	56%
Market long-term debt ratio	67%	52%	40%	N/A
Market common-equity ratio [4]	33%	48%	60%	N/A

1 From Frontier's Form S-4 registration statement filed with SEC on July 24, 2009
2 From Verizon's Form 10-Q filed with SEC on May 11, 2009.
3 From Value Line Investment Survey, June 26, 2009. Composite Statistics: Telecommunications Services Industry for 2009.
4 The market value of common equity was calculated using stock prices for the first quarter of 2009.

14

[10] Ross, Westerfield and Jaffe, Corporate Finance 36 (McGraw-Hill Irwin, 2005).

1 A. Table 2 above illustrates that all leverage ratios[11] of Verizon are superior to
2 those of post-merger Frontier.
3 **Q. IS A COMPARISON OF FRONTIER'S FINANCIAL LEVERAGE PRE- AND**
4 **POST-MERGER RELEVANT?**
5 A. No. The relevant comparison is Verizon's current and projected financial
6 strength and leverage as compared to post-merger Frontier. Approval of the
7 transaction is a transfer of customers' service provided by Verizon to post-
8 merger Frontier.
9 **Q. HOW COULD THE MERGER IMPACT THE CURRENT 310,000 OREGON**
10 **CUSTOMERS OF VNW?**
11 A. From the point of view of financial leverage, the current 310,000 Oregon
12 customers of VNW may be harmed by leaving the umbrella of Verizon and
13 becoming part of post-merger Frontier. As shown in Table 2, the leverage of
14 post-merger Frontier, indicated by its book long-term debt ratio of 58 percent, is
15 greater than Verizon's 41percent. Additionally, post-merger Frontier's
16 leverage, indicated by its book long-term debt ratio of 58 percent, is estimated
17 to be more leveraged than the 39 percent average for other companies in the
18 telecommunications services industry for 2009 as reported in Value Line[12].
19

[11] See Exhibit Staff/205 Ordonez/1 for ratio definitions.
[12] See Exhibit Staff/204 Ordonez/1

1 **CREDIT RATINGS**

2 **Q. WHAT IS A BOND RATING AND WHY IS IMPORTANT FOR**
3 **COMPANIES?**

4 A. “A bond rating is a grade given to bonds indicating their credit quality.
5 Independent rating services such as Standard & Poor's, Moody’s, and Fitch
6 provide these evaluations of a bond issuer's financial strength - the issuer’s
7 ability to pay a bond's principal and interest in a timely fashion. The ratings
8 services express bond ratings as letters ranging from 'AAA', which is the
9 highest grade, to 'C', which is the lowest grade. Different rating services use
10 the same letter grades, but use various combinations of upper- and lower-case
11 letters to differentiate themselves”[13].

12 “The ratings assigned to bond issues are important in terms of the marketability
13 and effective cost to the ratepayer. Bond issues having the top four letter
14 ratings, AAA down to BBB, are considered to be investment grade securities,
15 meaning that financial institutions can purchase such bonds without violating
16 the laws of prudent investment. Not only are investment grade bond ratings
17 crucial for a utility to maintain continued access to capital, but the rating
18 determines the cost and terms of the issue. Corporate bonds are discounted at
19 progressively higher discount rates as their ratings deteriorate.[14]

20

[13] www.investopedia.com
[14] Roger Morin, New Regulatory Finance 91-92 (Public Utilities Reports, Inc., 2006).

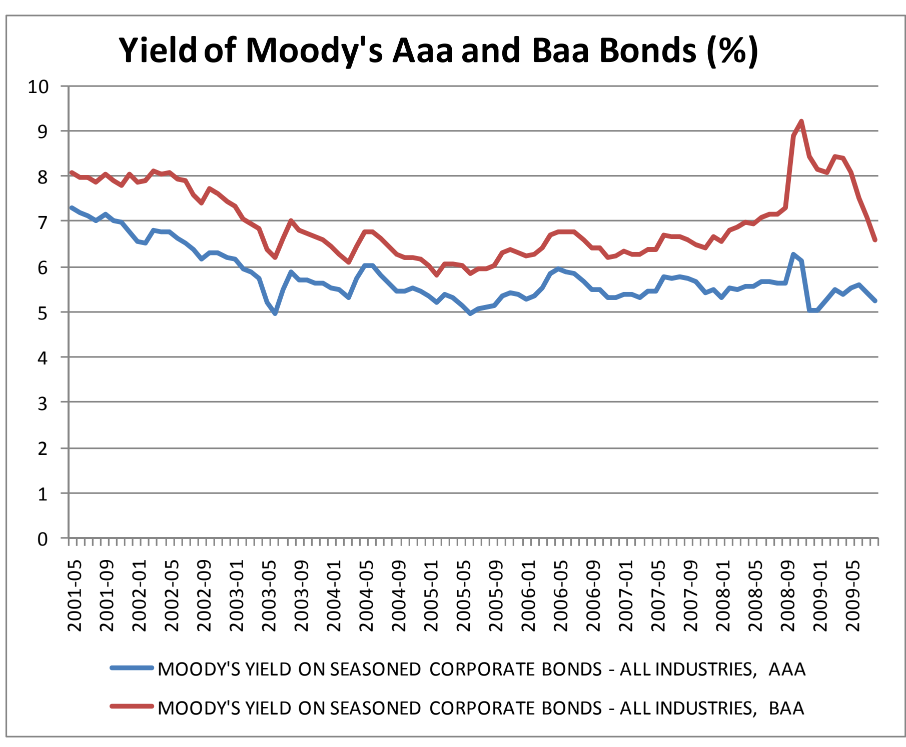
1 **Q. CAN YOU PROVIDE A COMPARISON OF THE LONG-TERM CREDIT**
2 **RATING SCALES FROM THE THREE MAJOR CREDIT AGENCIES?**
3 A. Yes. Table 3 shows the scales from the three major credit rating agencies:
4 Table 3

Moody's	S&P	Fitch	
Aaa	AAA	AAA	Investment grade
Aa1	AA+	AA+	
Aa2	AA	AA	
Aa3	AA-	AA-	
A1	A+	A+	
A2	A	A	
A3	A-	A-	
Baa1	BBB+	BBB+	
Baa2	BBB	BBB	
Baa3	BBB-	BBB-	
Ba1	BB+	BB+	Speculative grade
Ba2	BB	BB	
Ba3	BB-	BB-	
B1	B+	B+	
B2	B	B	
B3	B-	B-	
Caa1	CCC+	CCC+	
Caa2	CCC	CCC	
Caa3	CCC-	CCC-	
Ca	CC	CC	
C	C	C	
C	D	D	In default

* Source: Edison electric institute; Q2-2009 Financial Update, Quarterly Report of the U.S. Shareholder-owned Electric Utility Industry.

5
6

1 **Q. CAN YOU GIVE AN EXAMPLE OF HOW BONDS WITH DIFFERENT**
2 **RATINGS HAVE DIFFERENT YIELDS?**
3 A. Yes. Figure 1 shows index yields of Moody's Aaa and Baa industrial bonds.
4 The average difference in yields between May, 2001 and August, 2009 was
5 1.18 percent. It should be noted that bond issues with either Moody's Aaa or
6 Baa ratings are within the "investment-grade" category. This difference may
7 increase for bonds rated in the "speculative-grade" category, which have
8 correspondingly greater yields.
9 Figure 1



10
11 Source: Federal Reserve www.federalreserve.gov/releases/h15/update/
12 **Q WHAT WAS THE DIFFERENCE IN YIELD IN THE LAST YEAR?**
13 A. The difference was even higher. In the period of September, 2008 to August
14 2009, the difference was 2.5 percent.

1 **Q DID STAFF CALCULATE THE DIFFERENCE IN YIELD BETWEEN**
2 **VERIZON AND FRONTIER?**
3 A. No. In Staff's DR-207 Staff requested indicative quotes from Investment banks
4 for the issuance of debt securities with 5-, 7-, 10-, 15- and 30-year maturities
5 for Frontier and Verizon. On September 29, 2009 the Applicants did not
6 provide the information requested but instead only provided the yields of
7 Frontier's existing debt. The Applicants did not provide any information for
8 Verizon, stating the following: "Debt associated Verizon Communications Inc. is
9 not relevant to the transaction…"[15]
10 **Q WHAT IS YOUR OPINION ABOUT THE RELEVANCE OF VERIZON BOND**
11 **SECURITIES' YIELDS IN YOUR ANALYISIS?**
12 A. Yields of Verizon debt securities are vital for analysis. It is important to know
13 what levels of yields VNW is foregoing by leaving the umbrella of Verizon.
14 **Q WHAT ARE THE CURRENT RATINGS FOR THE COMPANIES INVOLVED**
15 **IN THE MERGER?**
16 A. Table 4 shows the current ratings on senior unsecured long-term debt
17 securities for Verizon and pre-merger Frontier:
18

[15] See Exhibit Staff/207 Ordonez/5.

1 Table 4

Rating Agency	Pre-merger Verizon[1]	Pre-merger Frontier	Notch/difference
Moody's	A3	Ba2	5
Standard and Poor's	A	BB	6
Fitch	A	BB	6

[1] VNW has the same credit ratings of Verizon

2 Source: Rating agencies' websites as of October 13, 2009.

3 **Q. DID STAFF HAVE ACCESS TO RATING AGENCIES' REPORTS ABOUT**
4 **THE MERGER?**

5 A. Yes. Frontier's response to Staff's Data Requests 63, 64 and 65 (DR-63-65)[16]
6 contains reports on the merger from Fitch, Moody's and S&P.

7 **Q. PLEASE SUMMARIZE THE THREE CREDIT AGENCIES' ANALYSES OF**
8 **THE TRANSACTION.**

9 A. Fitch, Moody's, and S&P agree that post-merger Frontier may have less
10 financial leverage than Frontier does currently.[17] However, S&P points out that
11 the improvement in leverage is offset by the integration costs and ongoing
12 access-line losses.[18]

13 **Q. HOW COULD FNW BE AFFECTED?**

14 A. The likelihood of Frontier to default on its debt is higher than Verizon's.
15 Verizon has an investment-grade rating of "A3" from Moody's[19], which is

[16] See Exhibit Staff/206 Ordonez/1-13
[17] See Exhibit Staff/206 Ordonez/1-13. Fitch: "The company to be merged into Frontier will be moderately levered, and post-merger Frontier is expected be less leveraged than currently…" Moody's: "The transaction is expected to result in significant deleveraging at Frontier…" S&P: The rating affirmation reflects the lower pro forma leverage of the combined company, which we believe will be at or under 3.0x adjusted post-transaction close, compared to 4.2x as of March 31, 2009…"
[18] See Exhibit Staff/206 Ordonez/4
[19] Standard and Poor's "A", Moody's "A3" and Fitch "A".

1 superior to Frontier's speculative-grade rating of "Ba2" from Moody's. Moody's
2 has also placed the VNW's A3 senior unsecured debt rating on review for a
3 possible downgrade. Finally, Moody's also considers that it is unlikely that
4 FNW will be rated at that level.[20]

5 **CONCLUSIONS**

6 **Q. WHAT CONCLUSIONS HAVE YOU REACHED REGARDING THE**
7 **PROPOSED MERGER?**
8 A. From the perspective of financial leverage and credit ratings, the merger may
9 harm Oregon customers of VNW (and it would harm the customers of FNW,
10 the surviving subsidiary of post-merger Frontier) if the Application is approved
11 without Staff's conditions. VNW may leave the umbrella of Verizon, an
12 investment-grade, highly rated holding company and becoming part of Frontier.
13 Frontier is a more leveraged company, with current bond ratings of
14 "speculative."
15 **Q. IS STAFF PROPOSING CONDITIONS THAT CAN ADDRESS THE**
16 **CONCLUSIONS YOU ARRIVED?**
17 A. Yes. In Exhibit Staff/100, Mr. Dougherty proposes several financial conditions
18 that address my conclusion.
19 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**
20 A. Yes.
21

[20] See Exhibit Staff/206 Ordonez/9, third paragraph.

CASE: UM 1431
WITNESS: Jorge Ordonez

PUBLIC UTILITY COMMISSION
OF
OREGON

STAFF EXHIBIT 201

Witness Qualification Statement

November 2, 2009

WITNESS QUALIFICATION STATEMENT

NAME	Jorge D. Ordonez
EMPLOYER	Public Utility Commission of Oregon
TITLE	Senior Financial Economist, Economic and Policy Analysis Section
ADDRESS	550 Capitol Street NE, Suite 215, Salem, Oregon 97301-2115
EDUCATION AND TRAINING	Fulbright Scholar, MBA, concentration in finance, Willamette University, Oregon, 2005 BS, Mechanical Engineering, energy and thermal power efficiency, Electrical & Mechanical Engineering School San Antonio Abad University, Peru, 1998 Utility Management Certificate, Willamette University, Oregon, 2008 Certificate in Management of Hydropower Development Swedish International Development Cooperation Agency and Vattenfall Power Consultant AB. Sweden, 2006 & South Africa, 2007 Certificate in Project Appraisal and Management Maastricht School of Management, Netherlands, 2002
EXPERIENCE	I received a Bachelors of Science degree in Mechanical Engineering from San Antonio Abad University in Cusco, Peru in 1998. Subsequently, as a Fulbright Scholar, I received an MBA with an emphasis in finance from Willamette University in 2005. From 1999 to 2008, I worked for a Peruvian power generation company and was promoted many times, working as an Engineer, Resource Scheduler, Manager of Economic Planning and Vice-President of Generation, Commercial and Trading. Since January 2009, I have been employed by the Public Utility Commission of Oregon as a Senior Financial Economist in the Economic Research and Financial Analysis Division, evaluating utilities' financial applications and researching utilities' cost of capital.

CASE: UM 1431
WITNESS: Jorge Ordonez

PUBLIC UTILITY COMMISSION
OF
OREGON

STAFF EXHIBIT 202

Exhibits in Support
Of Direct Testimony

November 2, 2009

EXHIBIT 3

Corporate Structure Pre- and Post-Merger

Corporate Structure Pre- and Post-Merger

The following slides illustrate the Frontier Communications Corporation and Verizon Communications Inc. corporate structure for the affected incumbent local exchange companies (ILECs) and long distance service companies pre- and post-merger.

Slide 1 (page 2 of 5) shows the current Verizon structure for the Verizon entities involved in this transaction. All the affected Verizon ILECs (except Verizon West Virginia Inc.) are subsidiaries of GTE Corporation, which is a subsidiary of Verizon Communications Inc. Verizon West Virginia Inc. is a direct subsidiary of Verizon Communications Inc. New Communications Holdings Inc. (NCH) is a newly created Delaware corporation, formed for purposes of this transaction, and that currently is a direct subsidiary of Verizon Communications Inc.

Slide 2 (page 3 of 5) shows the Verizon structure after the ILECs are transferred to NCH. NCH has two subsidiaries: New Communications ILEC Holdings Inc., and New Communications Online and Long Distance Inc. The affected Verizon ILECs will be moved from GTE Corporation (or, in the case of Verizon West Virginia Inc., from Verizon Communications Inc.) to New Communications ILEC Holdings Inc. Certain non-ILEC assets, including the accounts receivables, liabilities, and customer relationships related to the long distance operations being transferred to Frontier, will be moved to New Communications Online and Long Distance Inc.

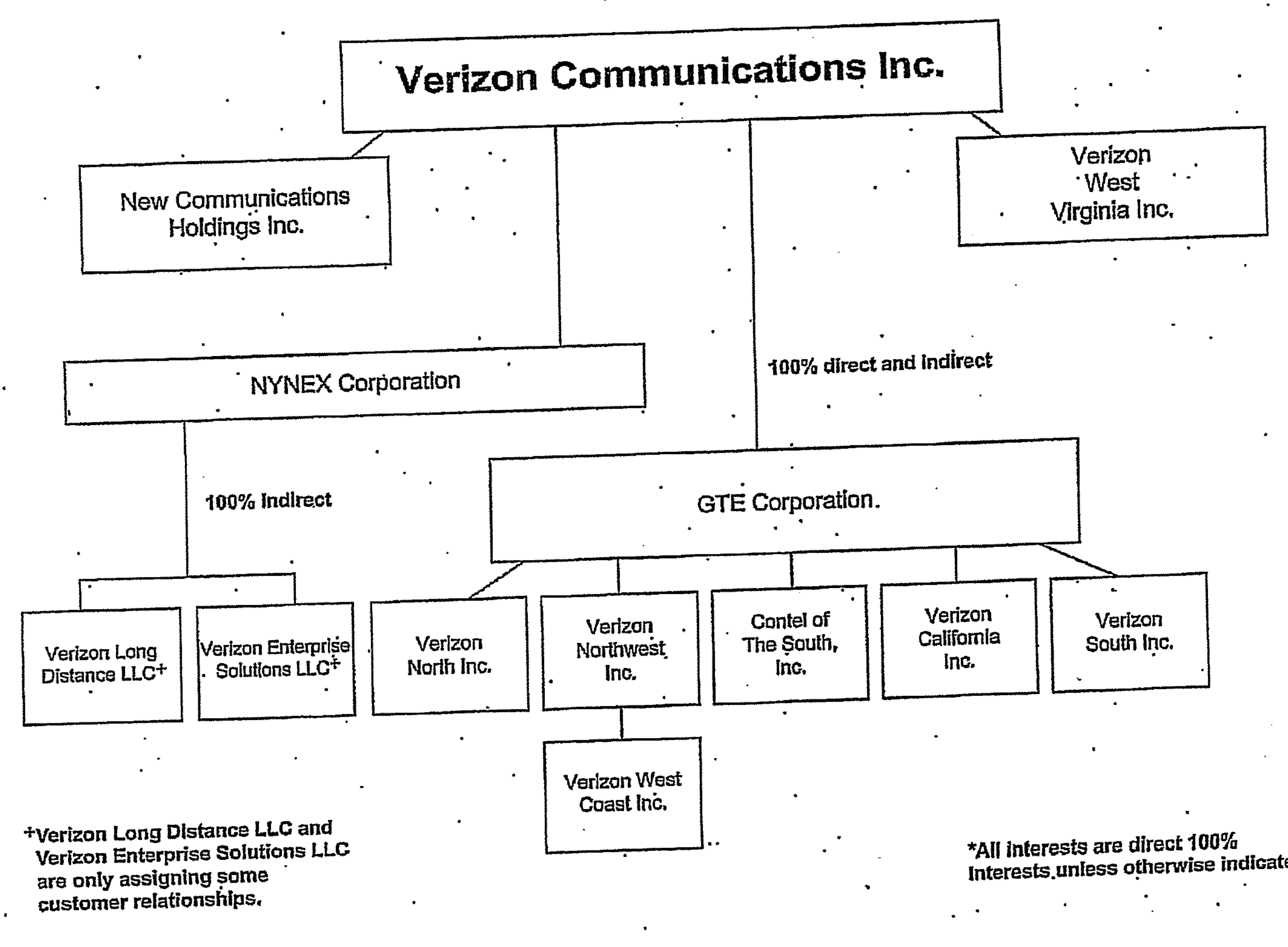
Slide 2 also shows two newly created ILEC subsidiaries of New Communications ILEC Holdings Inc.: New Communications of the Southwest Inc., and New Communications of the Carolinas Inc. New Communications of the Southwest Inc. will hold the assets of Verizon California Inc. that serve Arizona, Nevada, and those portions of California bordering Arizona and Nevada that are being transferred to Frontier. New Communications of the Carolinas Inc. will hold the assets of Verizon South Inc. that serve North Carolina, South Carolina, and a portion of Illinois. (Verizon California Inc. and Verizon South Inc. serve other areas not included in the transaction, and therefore Verizon will retain these companies.)

Slide 2 also shows a new ILEC subsidiary of GTE Corporation: Verizon North Retain Co. When created, this company will hold the assets of Verizon North Inc. that currently serve portions of Pennsylvania. These Pennsylvania assets will not be transferred to Frontier; Verizon will retain them.

Slide 3 (page 4 of 5) shows the distribution of NCH to Verizon's shareholders.

Slide 4 (page 5 of 5) shows Frontier Communications' corporate structure after NCH has been merged into it. Ownership and control of the existing Frontier ILECs and Frontier Communications of America, Inc. will not change as a result of the transaction.

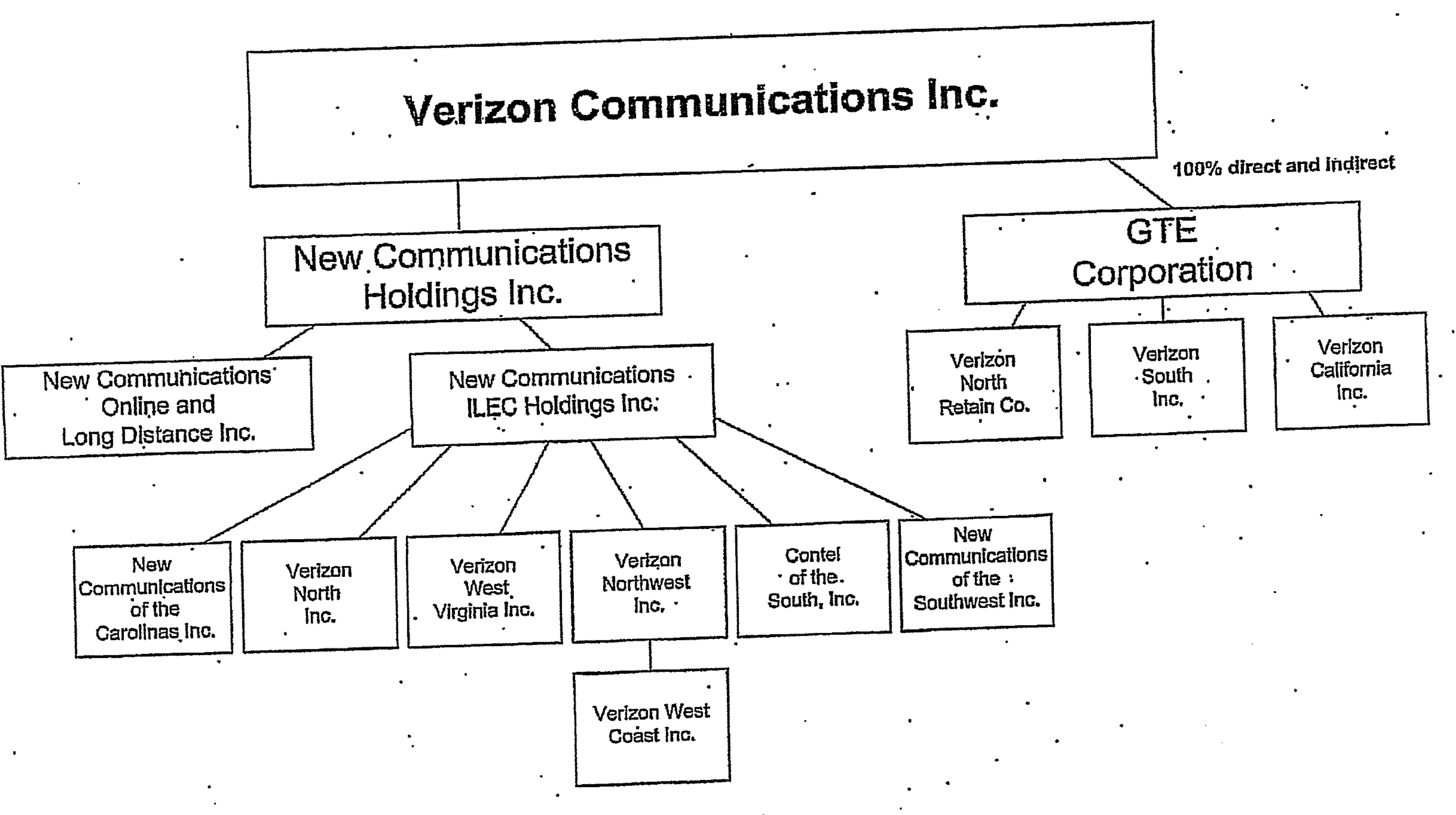
Current Verizon Structure



+Verizon Long Distance LLC and Verizon Enterprise Solutions LLC are only assigning some customer relationships.

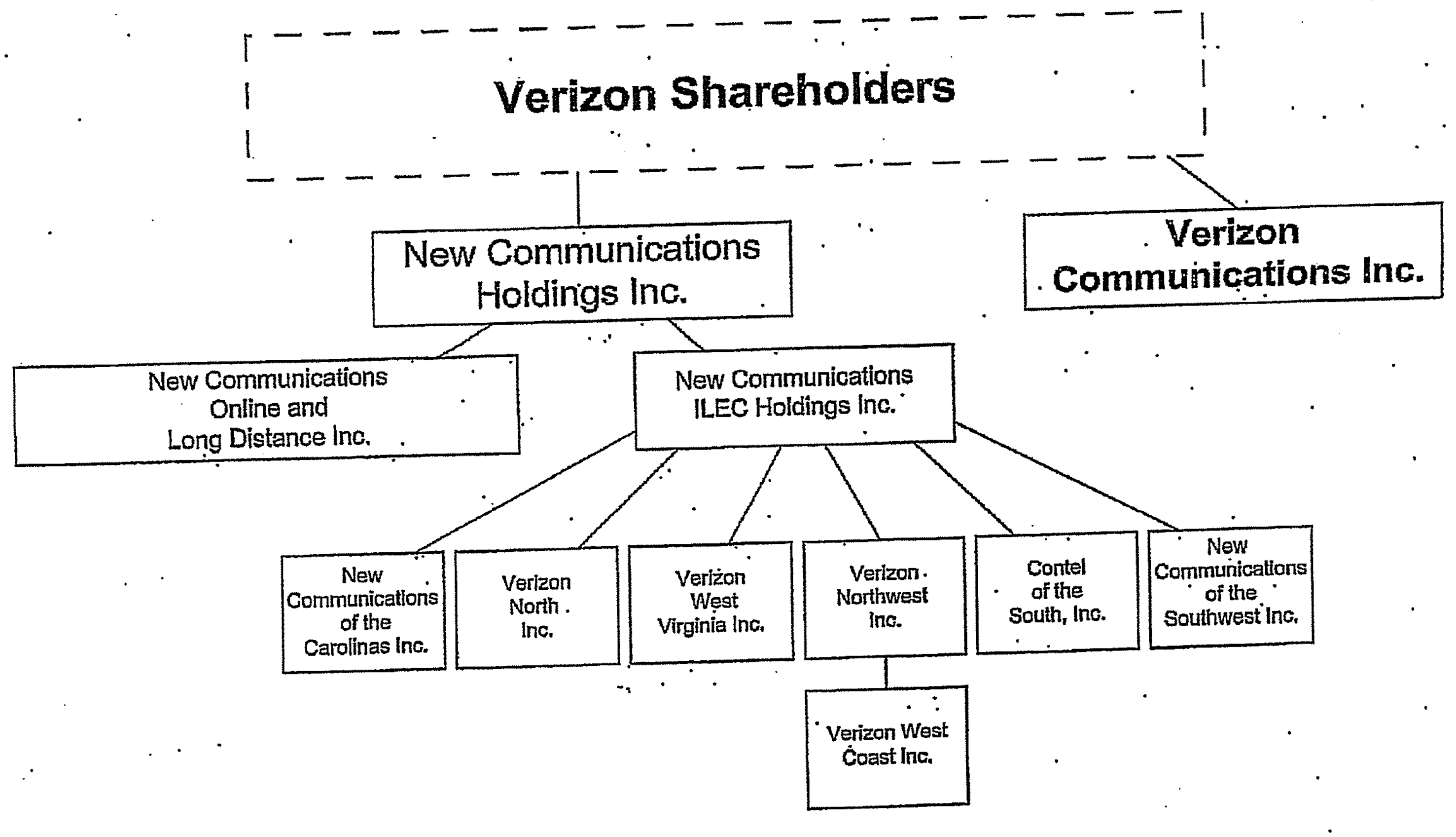
*All interests are direct 100% interests unless otherwise indicated.

Verizon Structure After Internal Reorganization



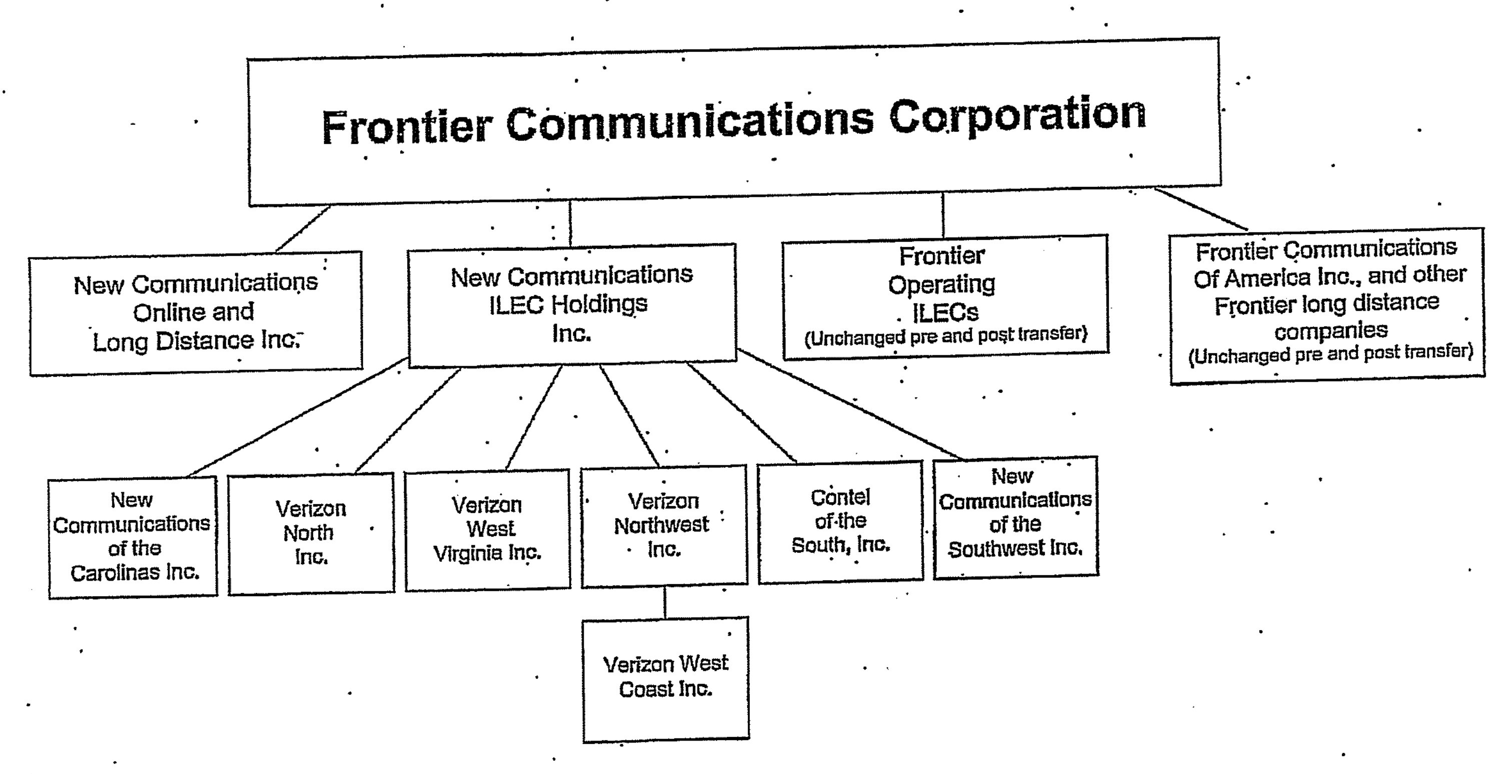
*All interests are direct 100% Interests unless otherwise indicated.

Spin-off to Verizon Shareowners



*All interests are direct 100% interests unless otherwise indicated.

Frontier Structure After Transaction



*All interests are direct 100%
Interests unless otherwise indicated.

CASE: UM 1431
WITNESS: Jorge Ordonez

PUBLIC UTILITY COMMISSION
OF
OREGON

STAFF EXHIBIT 203

Exhibits in Support
Of Direct Testimony

November 2, 2009

Verizon Northwest Inc.

Consolidated Financial Statements
As of December 31, 2008 and 2007
and for the years then ended

Verizon Northwest Inc.

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Verizon Northwest Inc.

REPORT OF INDEPENDENT AUDITORS

To The Board of Directors and Shareowner of Verizon Northwest Inc.

We have audited the accompanying consolidated balance sheets of Verizon Northwest Inc. ("the Company"), a subsidiary of Verizon Communications Inc., as of December 31, 2008 and 2007, and the related consolidated statements of income, changes in shareowner's investment, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Verizon Northwest Inc. at December 31, 2008 and 2007, and the consolidated results of its operations and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the consolidated financial statements, the Company changed its method of accounting for uncertainty in income taxes effective January 1, 2007.

Ernst & Young LLP

New York, New York
March 27, 2009

Verizon Northwest Inc.

CONSOLIDATED STATEMENTS OF INCOME

Years Ended December 31,		(dollars in millions) 2008		2007
Operating Revenues	$	955	$	1,000
Operating Expenses				
Cost of services and sales (exclusive of items shown below)		272		287
Selling, general and administrative expense		235		233
Depreciation expense		198		203
Total Operating Expenses		705		723
Operating Income		250		277
Other income (expense), net		1		3
Interest expense		(29)		(40)
Income Before Provision for Income Taxes		222		240
Provision for income taxes		(80)		(88)
Net Income	$	142	$	152

See Notes to Consolidated Financial Statements.

Verizon Northwest Inc.

CONSOLIDATED BALANCE SHEETS

ASSETS

At December 31,	2008	2007
	(dollars in millions)	
Current assets		
Short-term investments	$ 6	$ 37
Accounts receivable:		
Trade and other, net of allowances for uncollectibles of $8 and $10	110	114
Affiliates	7	20
Material and supplies	7	5
Prepaid expenses	8	6
Deferred income taxes	2	---
Deferred charges and other	22	24
Total current assets	162	206
Plant, property and equipment	5,041	4,796
Less accumulated depreciation	3,300	3,190
	1,741	1,606
Prepaid pension asset	284	281
Other assets	15	19
Total assets	$ 2,202	$ 2,112

See Notes to Consolidated Financial Statements.

Verizon Northwest Inc.

CONSOLIDATED BALANCE SHEETS

LIABILITIES AND SHAREOWNER'S INVESTMENT

At December 31,	2008	2007
	(dollars in millions)	
Current liabilities		
Debt maturing within one year:		
Notes payable to affiliates	$ 489	$ 329
Other	—	200
Accounts payable and accrued liabilities:		
Affiliates	56	39
Other	74	64
Deferred income taxes	—	3
Other current liabilities	69	92
Total current liabilities	688	727
Long-term debt	175	174
Employee benefit obligations	182	171
Deferred credits and other liabilities		
Deferred income taxes	250	216
Other	34	37
	284	253
Shareowner's investment		
Common stock (one share, without par value)	448	448
Contributed capital	107	107
Reinvested earnings	318	232
Total shareowner's investment	873	787
Total liabilities and shareowner's investment	$ 2,202	$ 2,112

See Notes to Consolidated Financial Statements.

Verizon Northwest Inc.

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREOWNER'S INVESTMENT

Years Ended December 31,	(dollars in millions) 2008	2007
Common Stock		
Balance at beginning of year	$ 448	$ 448
Balance at end of year	448	448
Contributed Capital		
Balance at beginning of year	107	106
Tax benefit on stock options	—	1
Balance at end of year	107	107
Reinvested Earnings		
Balance at beginning of year	232	155
Net income	142	152
Dividends declared	(55)	(75)
Other	(1)	—
Balance at end of year	318	232
Total Shareowner's Investment	$ 873	$ 787

See Notes to Consolidated Financial Statements.

Verizon Northwest Inc.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years Ended December 31,	(dollars in millions) 2008	2007
Cash Flows from Operating Activities		
Net income	$ 142	$ 152
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	198	203
Deferred income taxes, net	28	(17)
Employee retirement benefits	27	17
Provision for uncollectible accounts	6	6
Changes in current assets and liabilities:		
Accounts receivable	10	3
Material and supplies	(2)	2
Other current assets	1	3
Accounts payable and accrued liabilities	23	(23)
Other current liabilities	(7)	6
Other, net	(35)	(17)
Net cash provided by operating activities	391	335
Cash Flows from Investing Activities		
Capital expenditures (including capitalized network software)	(330)	(273)
Purchases of short-term investments	(3)	(34)
Proceeds from sale of short-term investments	34	39
Proceeds from sales of assets	(1)	18
Net cash used in investing activities	(300)	(250)
Cash Flows from Financing Activities		
Principal repayments of borrowings and capital lease obligations	(200)	—
Net change in current notes payable to affiliates	160	(9)
Dividends paid	(55)	(75)
Net change in outstanding checks drawn on controlled disbursement accounts	4	(1)
Net cash used in financing activities	(91)	(85)
Net change in cash	—	—
Cash, beginning of year	—	—
Cash, end of year	$ —	$ —

See Notes to Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. DESCRIPTION OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Business

Verizon Northwest Inc. (Verizon Northwest or the Company) is a wholly owned subsidiary of GTE Corporation (GTE), which is a wholly owned subsidiary of Verizon Communications Inc. (Verizon). We presently serve a territory consisting of Local Access and Transport Areas (LATA) located in California, Idaho, Oregon and Washington. We have one reportable segment which provides domestic wireline telecommunications services. We currently provide two basic types of telecommunications services:

- *Exchange telecommunication service* is the transmission of telecommunications among customers located within a local calling area within a LATA. Examples of exchange telecommunications services include switched local residential and business services, local private line voice and data services and Centrex services. We also provide toll services within a LATA (intraLATA long distance).

- *Exchange access service* links a customer's premises and the transmission facilities of other telecommunications carriers, generally interLATA carriers. Examples of exchange access services include switched access and special access services.

The communications services we provide are subject to regulation by the state regulatory commissions of California, Idaho, Oregon and Washington with respect to intrastate rates and services and other matters. The Federal Communications Commission regulates rates that we charge long distance carriers and end-user subscribers for interstate access services.

Basis of Presentation

We prepare our financial statements using U.S. generally accepted accounting principles which require management to make estimates and assumptions that affect reported amounts and disclosures. Actual results could differ from those estimates. Examples of significant estimates include the allowance for doubtful accounts, the recoverability of long-lived assets, unrealized tax benefits, and pension and postretirement benefit assumptions.

The consolidated financial statements include the accounts of Verizon Northwest Inc. and its wholly owned subsidiary, Verizon West Coast Inc. All significant intercompany accounts and transactions have been eliminated.

We have reclassified certain amounts from prior periods to conform with our current presentation.

Revenue Recognition

We recognize service revenues based upon usage of our local exchange network and facilities and contract fees. Fixed fees for local telephone, long distance and certain other services are recognized in the month the service is provided. Revenue from other products that are not fixed fee or that exceed contracted amounts is recognized when such services are provided. We recognize revenue for services, in which we bundle the equipment with maintenance and monitoring services, when the equipment is installed in accordance with contractual specifications and ready for the customer's use. The maintenance and monitoring services are recognized monthly over the term of the contract as we provide the services. Long-term contracts are accounted for using the percentage of completion method. We use the completed contract method if we cannot estimate the costs with a reasonable degree of reliability.

Non-recurring customer activation fees, along with the related costs up to, but not exceeding the activation fees, are deferred and amortized over the customer relationship period.

We report taxes imposed by governmental authorities on revenue-producing transactions between us and our customers that are within the scope of Emerging Issues Task Force (EITF) No. 06-3, *How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement* (EITF No. 06-3) in the financial statement on a net basis.

Maintenance and Repairs

We charge the cost of maintenance and repairs, including the cost of replacing minor items not constituting substantial betterments, primarily to Cost of services and sales as these costs are incurred.

Cash and Cash Equivalents

We consider all highly liquid investments with a maturity of 90 days or less when purchased to be cash equivalents. Cash equivalents are stated at cost, which approximates market value and include amounts held in money market funds.

Short-term Investments

Our short-term investments, which are stated at fair value, consist of cash equivalents held in trust to pay for certain employee benefits. The decline in Short-term investments at December 31, 2008 was due to a decrease in the annual trust funding.

Trade and Other Accounts Receivable

Trade and other accounts receivable are stated at the amount we expect to collect. We maintain allowances for uncollectible accounts for estimated losses resulting from the inability of our customers to make required payments. In determining these estimates, we consider historical write-offs and the aging of the receivables, among other factors, such as overall economic conditions.

Material and Supplies

Material and supplies include new and reusable materials which are stated principally at average original cost, except that specific costs are used in the case of large individual items.

Plant and Depreciation

We record plant, property and equipment at cost. Depreciation expense is principally based on the composite group remaining life method and straight-line composite rates. This method provides for the recognition of the cost of the remaining net investment in telephone plant, less anticipated net salvage value, over the remaining asset lives. This method requires the periodic revision of depreciation rates.

The asset lives used by our operations are presented in the following table:

Average Useful Lives (in years)	
Buildings	45
Central office equipment	5-11
Outside communications plant	
Copper cable	14-18
Fiber cable	20-25
Poles and conduit	30-50
Furniture, vehicles and other	5-15

When we replace, retire or otherwise dispose of depreciable plant used in our local telephone network, we deduct the carrying amount of such plant from the respective accounts and charge it to accumulated depreciation.

We capitalize network software purchased or developed in connection with related plant assets. We also capitalize interest associated with the acquisition or construction of plant assets. Capitalized interest is reported as a cost of plant and a reduction in interest expense.

Annually, we review the estimated useful lives of plant, property and equipment along with the associated depreciation rates. Effective January 1, 2009 the average useful lives of fiber cable would be increased to 25 years from 20 to 25 years and the average useful lives of copper cable was changed to 15 years from 14 to 18 years. Effective January 1, 2008, the average useful lives of fiber cable was increased from 20 years to 20 to 25 years. As a result, 2008 depreciation expense decreased by $6 million ($4 million after tax). Effective January 1, 2007, the life for buildings was increased to 45 years from a previous range of 25 to 42 years. As a result, 2007 depreciation expense decreased by $9 million ($5 million after tax). In addition, the life for circuit equipment was increased from 8 to 9 years, effective January 1, 2007. This resulted in a decrease in 2007 depreciation expense of $9 million ($6 million after tax).

We believe that the current estimated useful asset lives are reasonable, although they are subject to continual review and analysis. In the evaluation of asset lives, multiple factors are considered, including, but not limited to, the ongoing plans to roll out the broadband network, technology upgrades and enhancements, planned retirements, and the adequacy of reserves.

Impairment of Long-Lived Assets

Our plant, property and equipment and intangible assets that do not have indefinite lives are amortized over their useful lives and reviewed for impairment in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* (SFAS No. 144), whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. If any indications were present, we would test for recoverability by comparing the carrying amount of the asset to the net undiscounted cash flows expected to be generated from the asset. If those net undiscounted cash flows do not exceed the carrying amount (i.e., the asset is not recoverable), we would perform the next step, which is to determine the fair value of the asset and record an impairment, if any.

Computer Software Costs

We capitalize the cost of network and non-network software which has a useful life in excess of one year in accordance with Statement of Position (SOP) No. 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*. Subsequent additions, modifications or upgrades to the network and non-network software are capitalized only to the extent that they allow the software to perform a task it previously did not perform. Software maintenance and training costs are expensed in the period in which they are incurred. Also, we capitalize interest associated with the development of non-network software. Capitalized non-network computer software costs are amortized using the straight-line method over a period of 5 to 7 years.

Advertising Costs

Advertising costs for advertising products and services are charged to Selling, general and administrative expense in the period in which they are incurred.

Stock-Based Compensation

We participate in the Verizon Communications Long Term Incentive Plan (the Plan). The Plan permits the granting of nonqualified stock options, incentive stock options, restricted stock, restricted stock units, performance shares, performance share units and other awards.

Restricted Stock Units

The Plan provides for grants of restricted stock units (RSUs) that vest at the end of the third year after the grant. The RSUs are classified as liability awards because the RSUs will be paid in cash upon vesting. The RSU award liability is measured at its fair value at the end of each reporting period and, therefore, will fluctuate based on the performance of Verizon's stock. Dividend equivalent units are also paid to participants at the time the RSU award is paid.

Performance Share Units

The Plan also provides for grants of performance share units (PSUs) that generally vest at the end of the third year after the grant. As defined by the Plan, the Human Resources Committee of the Board of Directors determines the number of PSUs a participant earns based on the extent to which the corresponding goals have been achieved over the three-year performance cycle. All payments are subject to approval by Verizon's Human Resources Committee. The PSUs are classified as liability awards because the PSU awards are paid in cash upon vesting. The PSU award liability is measured at its fair value at the end of each reporting period and, therefore, will fluctuate based on the price of Verizon's stock as well as performance relative to the targets. Dividend equivalent units are also paid to participants at the time that the PSU award is determined and paid, and in the same proportion as the PSU award.

Stock Options

The Plan provides for grants of stock options to employees at an option price per share of 100% of the fair market value of Verizon Stock on the date of grant. Each grant has a 10 year life, vesting equally over a three year period, starting at the date of the grant. We have not granted new stock options since 2004.

The structure of Verizon's stock incentive plans does not provide for the separate determination of certain disclosures for our company. The required information is provided on a consolidated basis in Verizon's Annual Report on Form 10-K for the year ended December 31, 2008.

After-tax compensation expense for other stock-based compensation included in net income as reported for the years ended December 31, 2008 and 2007 was not material.

Employee Benefit Plans

We participate in Verizon's benefit plans and the structure of these plans does not provide for the separate disclosure of the related pension and postretirement assets and obligations at a company level. The annual income and expense related to our employees are allocated to the Company based on employee obligations and are included in the consolidated statements of income in cost of services and sales and selling, general and administrative expenses. The related pension and postretirement benefit asset/obligations have been accumulated over time based on accruals net of payments and termination/settlement charges and are included in prepaid pension assets and employee benefit obligations in the consolidated balance sheets (see Note 6).

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans—an amendment of FASB Statements No. 87, 88, 106, and 132(R)* (SFAS No. 158). Effective December 31, 2006, SFAS No. 158 requires the recognition of a defined benefit postretirement plan's funded status as either an asset or liability on the balance sheet. SFAS No. 158 also requires the immediate recognition of the unrecognized actuarial gains and losses and prior service costs and credits that arise during the period as a component of Accumulated other comprehensive income, net of applicable income taxes. Verizon adopted SFAS No. 158 effective December 31, 2006. Because of the structure of the plans, the SFAS No. 158 related adjustments recorded by Verizon to recognize the funded status are not reflected in the consolidated balance sheets as of December 31, 2008 or 2007.

We maintain ongoing severance plans for both management and associate employees, which provide benefits to employees that are terminated. The costs for these plans are accounted for under SFAS No. 112, *Employers' Accounting for Postemployment Benefits—an amendment of FASB Statements No. 5 and 43.* We accrue for severance benefits based on the terms of our severance plan over the estimated service periods of the employees. The accruals are also based on the historical run-rate of actual severances and expectations for future severances. Severance costs are included in selling, general and administrative expense in our consolidated statements of income.

Fair Value Measurements

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework for measuring fair value and establishes a hierarchy that categorizes and prioritizes the sources to be used to estimate fair value. SFAS No. 157 also expands financial statement disclosures about fair value measurements. Under SFAS No. 157, fair value is defined as an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. SFAS No. 157 also establishes a three-tier hierarchy for inputs used in measuring fair value, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

Level 1 - Quoted prices in active markets for identical assets or liabilities
Level 2 - Observable inputs other than quoted prices in active markets for identical assets and liabilities
Level 3 - No observable pricing inputs in the market

Financial assets and financial liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurements. Our assessment of the significance of a particular input to the fair value measurements requires judgment, and may affect the valuation of the assets and liabilities being measured and their placement within the fair value hierarchy.

On February 12, 2008, FASB issued FASB Staff Position (FSP) No. FAS 157-2, *Effective Date of FASB Statement No. 157* (FSP 157-2), which delays the effective date of SFAS No. 157 for one year for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis. We elected a partial deferral of SFAS No. 157 under the provisions of FSP 157-2 related to the measurement of fair value used when evaluating other intangible. On October 10, 2008, the FASB issued FSP 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active*, (FSP 157-3), which clarifies application of SFAS No. 157 in a market that is not active. FSP 157-3 was effective upon issuance, including prior periods for which financial statements have not been issued. The impact of partially adopting SFAS No. 157 on January 1, 2008 and the related FSPs 157-2 and 157-3 had no impact to our consolidated financial statements.

SFAS No. 159

SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities – Including an Amendment of SFAS No. 115* (SFAS No. 159), permits but does not require us to measure financial instruments and certain other items at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. As we did not elect to fair value any of our financial instruments under the provisions of SFAS No. 159, our adoption of this statement effective January 1, 2008 did not have an impact on our consolidated financial statements.

Income Taxes

Verizon and its domestic subsidiaries, including us, file a consolidated federal income tax return. We participate in a tax sharing agreement with Verizon and remit tax payments to Verizon based on the respective tax liability determined as if on a separate company basis. Current and deferred tax expense/(benefit) is determined by applying the provisions of SFAS No. 109, *Accounting for Income Taxes*, (SFAS No. 109) to each subsidiary as if it were a separate taxpayer.

Effective January 1, 2007, we adopted FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48), which requires the use of a two-step approach for recognizing and measuring tax benefits taken or expected to be taken in a tax return and disclosures regarding uncertainties in income tax positions. The first step is recognition: we determine whether it is more likely than not that a tax position will be sustained upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. In evaluating whether a tax position has met the more-likely-than-not recognition threshold, we presume that the position will be examined by the appropriate taxing authority that has full knowledge of all relevant information. The second step is measurement: a tax position that meets the more-likely-than-not recognition threshold is measured to determine the amount of benefit to recognize in the financial statements. The tax position is measured at the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement. Differences between tax positions taken in a tax return and amounts recognized in the financial statements will generally result in one or more of the following: an increase in a liability for income taxes payable, a reduction of an income tax refund receivable, a reduction in a deferred tax asset, or an increase in a deferred tax liability. As a result of the implementation of FIN 48, we recorded adjustments to liabilities that resulted in a less than one million net increase in the liability for unrecognized tax benefits with an offsetting decrease to reinvested earnings as of January 1, 2007.

2. PLANT, PROPERTY AND EQUIPMENT

The following table displays the details of plant, property and equipment, which is stated at cost:

	(dollars in millions)	
At December 31,	**2008**	2007
Land	**$ 12**	$ 12
Buildings	**292**	291
Central office equipment	**1,899**	1,846
Outside communications plant	**2,669**	2,480
Furniture, vehicles and other work equipment	**111**	123
Construction-in-progress	**32**	25
Other	**26**	19
	5,041	4,796
Less accumulated depreciation	**3,300**	3,190
Total	**$ 1,741**	$ 1,606

3. LEASES

We lease certain facilities and equipment for use in our operations under operating leases. Total rent expense amounted to $42 million in 2008 and $48 million in 2007. Of these amounts, $32 million in 2008 and $38 million in 2007 were lease payments to affiliated companies. Rental commitments under noncancelable leases were not material at December 31, 2008.

This table displays the aggregate minimum rental commitments under noncancelable operating leases for the periods shown at December 31, 2008, excluding those with affiliated companies:

Years	(dollars in millions)
2009	$ 2
2010	1
2011	1
2012	1
2013	---
Thereafter	1
Total minimum rental commitments	$ 6

4. DEBT

Debt Maturing Within One Year

Debt maturing within one year as follows:

At December 31,	(dollars in millions) 2008	2007
Notes payable to affiliate (VNFC)	$ 489	$ 329
Long-term debt maturing within one year	—	200
Total debt maturing within one year	$ 489	$ 529
Weighted average interest rate for notes payable outstanding at year-end	2.93%	4.69%

The fair value of our short-term and long-term debt, excluding capital leases, is determined based on market quotes for similar terms and maturities or future cash flows discounted at current rates. The fair value of our long-term and short-term debt, excluding capital leases, was $664 million and $712 million at December 31, 2008 and 2007, respectively, as compared to the carrying value of $664 million and $703 million, respectively at December 31, 2008 and 2007.

We have a contractual agreement with an affiliated company Verizon Network Funding Corp. (VNFC), for the provision of financing and cash management services.

Long-Term Debt

Outstanding long-term debt are as follows:

At December 31,	Interest Rate	Maturity	(dollars in millions) 2008	2007
Ten year debenture	5.550 %	2008	$ —	$ 200
Twelve year debenture	6.300	2010	175	175
			175	375
Unamortized premium and discount, net			—	(1)
Total long-term debt, including current maturities			175	374
Less maturing within one year			—	200
Total long-term debt			$ 175	$ 174

During the fourth quarter of 2008, $200 million of 5.55% ten year debenture matured and was repaid.

The aggregate principal amount of bonds and debentures that may be issued is subject to the restrictions and provisions of our indentures. None of the securities shown above were held in sinking or other special funds or pledged by us. Debt discounts and premiums on our outstanding long-term debt are amortized over the lives of the respective issues.

We are in compliance with all of our debt covenants.

5. FINANCIAL INSTRUMENTS

Concentrations of Credit Risk

Financial instruments that subject us to concentrations of credit risk consist primarily of short-term investments and trade receivables. Concentrations of credit risk with respect to trade receivables, other than those from AT&T Inc. (AT&T) and Sprint Nextel Corporation (Sprint), are limited due to the large number of customers. We generated revenues from services provided to AT&T and Sprint (primarily network access and billing and collection) of $49 million and $21 million in 2008 and $77 million and $21 million in 2007, respectively.

While we may be exposed to credit losses due to the nonperformance of our counterparties, we consider this risk remote and do not expect the settlement of these transactions to have a material effect on our results of operations or financial position.

6. EMPLOYEE BENEFITS

We participate in Verizon's benefit plans. Verizon maintains noncontributory defined benefit pension plans for many of our employees. The postretirement health care and life insurance plans for our retirees and their dependents are both contributory and noncontributory and include a limit on the Verizon's share of cost for recent and future retirees. Verizon also sponsor defined contribution savings plans to provide opportunities for eligible employees to save for retirement on a tax-deferred basis. We use a measurement date of December 31 for our pension and postretirement health care and life insurance plans.

The structure of Verizon's benefit plans does not provide for the separate determination of certain disclosures for our company. The required information is provided on a consolidated basis in Verizon's Annual Report on Form 10-K for the year ended December 31, 2008.

Pension and Other Postretirement Benefits

Pension and other postretirement benefits for the majority of our employees are subject to collective bargaining agreements. Approximately 84% of our employees (associates) are covered by collective bargaining agreements. Modifications in benefits have been bargained from time to time, and Verizon may also periodically amend the benefits in the management plans.

The structure of Verizon's benefit plans does not provide for the separate determination of certain disclosures for our company. The required information is provided on a consolidated basis in Verizon's Annual Report on Form 10-K for the year ended December 31, 2008.

Benefit Cost

The following table displays the details of net periodic pension and other postretirement costs:

(dollars in millions)

	Pension		Health Care and Life	
Years Ended December 31,	**2008**	2007	**2008**	2007
Net periodic benefit (income) cost	$ (15)	$ (12)	$ 30	$ 29
Settlement Loss	12	---	—	---
Total (income) cost	$ (3)	$ (12)	$ 30	$ 29

In 2008, we recorded a pension settlement loss of $12 million as lump-sum payments exceeded the threshold of service and interest costs. The settlement of pension obligation is recorded in accordance with SFAS No. 88, *Employers' Accounting for Settlements and Curtailments of Defined Pension Plans and for Termination Benefits.*

Amounts recognized in the consolidated balance sheet consist of:

(dollars in millions)

	Pension		Health Care and Life	
At December 31,	**2008**	2007	**2008**	2007
Prepaid pension asset	$ 284	$ 281	$ —	$ ---
Employee benefit obligations	1	1	162	149

The changes in the employee benefit asset and obligations from year to year were caused by a number of factors, including changes in actuarial assumptions (see Assumptions) and settlement.

Assumptions

The weighted-average assumptions used in determining benefit obligations follow:

At December 31,	Pension		Health Care and Life	
	2008	2007	2008	2007
Discount rate	6.75%	6.50%	6.75%	6.50%
Rate of compensation increases	4.00	4.00	N/A	4.00

The weighted-average assumptions used in determining net periodic cost follow:

Years Ended December 31,	Pension		Health Care and Life	
	2008	2007	2008	2007
Discount rate	6.50%	6.00%	6.50%	6.00%
Expected return on plan assets	8.50	8.50	8.25	8.25
Rate of compensation increases	4.00	4.00	4.00	4.00

In order to project the long-term target investment return for the total portfolio, estimates are prepared for the total return of each major asset class over the subsequent 10-year period, or longer. Those estimates are based on a combination of factors including the current market interest rates and valuation levels, consensus earnings expectations, historical long-term risk premiums and value-added. To determine the aggregate return for the pension trust, the projected return of each individual asset class is then weighted according to the allocation to that investment area in the trust's long-term asset allocation policy.

The assumed Health Care Cost Trend Rates at December 31,

At December 31,	Health Care and Life	
	2008	2007
Health care cost trend rate assumed for next year	9.00%	10.00%
Rate to which cost trend rate gradually declines	5.00	5.00
Year the rate reaches level it is assumed to remain thereafter	2014	2013

Savings Plans and Employee Stock Ownership Plans

Substantially all of our employees are eligible to participate in savings plans maintained by Verizon. Verizon maintains four leveraged employee stock ownership plans (ESOP). Only one plan currently has unallocated shares. Under this plan, a certain percentage of eligible employee contributions are matched with shares of Verizon's common stock. We recognize savings plan cost based on our matching obligation attributed to our participating management employees. In addition to the ESOP, Verizon also maintains a savings plan for associate employees. We recorded total savings plan costs of $5 million in 2008 and $6 million in 2007.

The following table provides an analysis of our severance liability recorded in accordance with SFAS No. 112, *Employers Accounting for Postemployment Benefits* (SFAS No. 112):

(dollars in millions)

Year	Beginning of Year	Charged to Expense (a)	Payments	End of Year (b)
2007	$ 5	$ 19	$ (7)	$ 17
2008	**17**	**5**	**(9)**	**13**

(a) Includes accruals for ongoing employee severance costs and $5 million of special charges in 2008 and $18 million of special charges in 2007.

(b) The remaining severance liability includes future contractual payments to employees separated as of the end of the year.

Verizon Northwest Inc.

7. INCOME TAXES

The components of income tax expense (benefit) are presented in the following table:

Years Ended December 31,	(dollars in millions) 2008	2007
Current:		
Federal	$ 48	$ 97
State and local	4	8
	52	105
Deferred:		
Federal	26	(16)
State and local	2	(1)
	28	(17)
Total income tax expense	$ 80	$ 88

The following table shows the primary reasons for the difference between the effective income tax rate and the statutory federal income tax rate:

Years Ended December 31,	2008	2007
Statutory federal income tax rate	35.0%	35.0%
State income taxes, net of federal tax benefits	1.9	1.8
Other, net	(0.9)	(0.2)
Effective income tax rate	36.0%	36.6%

Deferred taxes arise because of differences in the book and tax bases of certain assets and liabilities. Significant components of our deferred tax assets and liabilities are shown in the following table:

Years Ended December 31,	(dollars in millions) 2008	2007
Deferred tax assets:		
Allowance for uncollectible accounts	$ 2	$ 2
Other - assets	1	13
Total deferred tax assets	3	15
Deferred tax liabilities		
Employee benefits	29	52
Depreciation	218	182
Other - liabilities	4	---
Total deferred tax liability	251	234
Net deferred tax liability	$ 248	$ 219

FASB Interpretation No. 48

FIN 48 prescribes the recognition, measurement and disclosure standards for uncertainties in income tax positions. A reconciliation of the beginning and ending balance of unrecognized tax benefits is as follows:

(dollars in millions)	2008	2007
Balance at January 1	$ 21	$21
Additions based on tax positions related to the current year	2	1
Additions for tax positions of prior years	1	—
Reductions for tax positions of prior years	(4)	(1)
Settlements	(8)	—
Lapses of statutes of limitations	—	—
Balance at December 31,	$ 12	$ 21

Included in the total unrecognized tax benefits at December 31, 2008 and 2007 is $1 million and $1 million, respectively that, if recognized, would favorably affect the effective income tax rate.

We recognize any interest and penalties accrued related to unrecognized tax benefits in income tax expense. During the year ended December 31, 2008, we recognized a net after tax benefit in the income statement related to interest and penalties of approximately $4 million. We had approximately $4 million (after-tax) and $8 million (after-tax) for the payment of interest and penalties accrued in the balance sheets at December 31, 2008 and December 31, 2007, respectively.

During the year ended December 31, 2007, we recognized approximately $2 million (after-tax) for the payment of interest and penalties. We had approximately $8 million (after-tax) and $6 million (after-tax) for the payment of interest and penalties accrued in the balance sheet at December 31, 2007 and January 1, 2007, respectively.

Verizon or one of its subsidiaries files income tax returns in the U.S. federal jurisdiction, and various state and local jurisdictions. The Company is generally no longer subject to U.S. federal, state and local income tax examinations by tax authorities for years before 2004. The Internal Revenue Service will begin its examination of the Company's U.S. income tax returns for years 2004 through 2006 in the first quarter of 2009. As a result of the anticipated resolution of various income tax audits within the next twelve months, we believe that it is reasonably possible that the amount of the unrecognized tax benefits will decrease. An estimate of the range of the possible change cannot be made until issues are further developed.

8. TRANSACTIONS WITH AFFILIATES

Our consolidated financial statements include transactions with the following affiliates:

Years Ended December 31,	(dollars in millions) 2008	2007
Operating revenues:		
GTE.Net LLC	$ 110	$ 91
Verizon Business	57	64
Verizon Wireless Inc.	18	21
Verizon Services	1	—
Verizon Long Distance	12	14
Verizon Operating Telephone Companies	4	5
Other	1	1
	$ 203	$ 196
Operating expenses:		
Verizon Services	$ 143	$ 150
Verizon Data Services Inc.	31	28
GTE Communication Systems Corporation	2	2
Verizon Wireless Inc.	4	4
Verizon Business	1	1
	$ 181	$ 185
Other Income and (Expense), net:		
Interest Income from Verizon Services	$ —	$ 1
Interest income from Verizon Affiliate Companies	1	—
	$ 1	$ 1
Interest expense:		
Interest expense to Verizon Network Funding Corp.	$ 11	$ 18
	$ 11	$ 18
Purchases from GTE Communication Systems Corporation	$ 12	$ 9
Dividends paid to GTE Corporation	$ 55	$ 75

Outstanding balances with affiliates are reported in the consolidated balance sheets at December 31, 2008 and 2007 as Accounts Receivable from Affiliates, Notes Payable to Affiliates, and Accounts Payable and Accrued Liabilities to Affiliates.

GTE.Net LLC

Our operating revenues include transactions with GTE.Net LLC (GTE.Net) associated with the provision of network access and billing and collection services. These revenues are earned from GTE.Net who utilizes our facilities to provide Internet access services to their customers.

Verizon Business

Our operating revenues include transactions with Verizon Business associated with the provision of network access services, wholesale interconnection service agreements and from billing and collection services.

Our operating expenses also include transactions with Verizon Business. We recognize costs associated with interconnection agreements and capacity services agreements.

Verizon Wireless Inc.

Our operating revenues include transactions with Verizon Wireless Inc. (Verizon Wireless) associated with the provision of local and network access services, billing and collection services and from interconnection agreements and commission fees. These revenues are earned from Verizon Wireless who provides wireless voice and data services, paging services and equipment sales to their customers.

Our operating expenses also include transactions with Verizon Wireless. We recognize costs associated with wireless voice and data services, paging services and for interconnection agreements.

Verizon Services

We have contractual arrangements with Verizon Services for the provision of various centralized services. These services are divided into two broad categories. The first category is comprised of network related services which generally benefit only Verizon's operating telephone subsidiaries. These services include marketing, sales, legal, accounting, finance, data processing, materials management, procurement, labor relations, and staff support for various network operations. The second category is comprised of overhead and support services which generally benefit all subsidiaries of Verizon. Such services include corporate governance, corporate finance, external affairs, legal, media relations, employee communications, corporate advertising, human resources, treasury, and rent expenses associated with the rental of facilities and equipment. Costs may be either directly assigned to one subsidiary or allocated to more than one subsidiary based on functional reviews of the work performed.

Verizon Long Distance

Our operating revenues include transactions with Verizon Long Distance associated with the provision of local and network access and billing and collection services. These revenues are earned from Verizon Long Distance who utilizes our facilities to provide long distance services to their customers.

Verizon Operating Telephone Companies

Our operating revenues include transactions with other Verizon operating telephone companies. Revenues associated with transactions with these affiliates are primarily earned from the rental of our facilities and equipment.

Verizon Data Services Inc.

Verizon Data Services Inc. provides data processing services, software application development and maintenance, which generally benefit Verizon's operating telephone subsidiaries, including us. We are charged for these affiliated transactions based on proportional cost allocation methodologies.

GTE Communication Systems Corporation

GTE Communication Systems Corporation (GTE Communication Systems) provides construction and maintenance equipment, supplies and electronic repair services to us. We record these purchases and services at cost, including a return realized by GTE Communication Systems.

Verizon Network Funding Corporation

We recognize interest expense in connection with a contractual agreement with an affiliated company, Verizon Network Funding Corp. (VNFC), for the provision of short-term financing, short-term investing and cash management services.

Other Affiliates

Other operating revenues include miscellaneous items of income resulting from transactions with other affiliates. These transactions include the provision of local and network access services, billing and collection services, rental of facilities and equipment, and sales of material and supplies. We also earn revenue from an agreement to provide subscriber lists to an affiliate and transactions with Verizon Services.

9. ADDITIONAL FINANCIAL INFORMATION

The tables below provide additional financial information related to our consolidated financial statements:

Years Ended December 31,	2008	2007
	(dollars in millions)	
Cash Flows Information:		
Cash paid during the year for:		
Income taxes paid, net	$ 53	$ 114
Interest, net of amounts capitalized (excluding affiliates)	21	22
Statements of Income Information:		
Depreciation expense	198	203
Interest costs incurred	31	41
Advertising expense (allocated to us by Verizon Services)	16	11
Capitalized interest	(2)	(1)

10. COMMITMENTS AND CONTINGENCIES

Various legal actions and regulatory proceedings are pending to which we are a party and claims which, if asserted, may lead to other legal actions. We have established reserves for specific liabilities in connection with regulatory and legal matters that we currently deem to be probable and estimable. We do not expect that the ultimate resolution of pending regulatory and legal matters in future periods will have a material effect on our financial condition, but it could have a material effect on our results of operations.

From time to time, state regulatory decisions require us to assure customers that we will provide a level of service performance that falls within prescribed parameters. There are penalties associated with failing to meet those service parameters and we, from time to time, pay such penalties. We do not expect these penalties to have a material effect on our financial condition, but they could have a material effect on our results of operations.

11. SUBSEQUENT EVENT

On February 2, 2009 we declared and paid a dividend in the amount of $58 million to our parent, GTE.

CASE: UM 1431
WITNESS: Jorge Ordonez

PUBLIC UTILITY COMMISSION OF OREGON

STAFF EXHIBIT 204

Exhibits in Support Of Direct Testimony

November 2, 2009

TELECOMMUNICATIONS SERVICES INDUSTRY

INDUSTRY TIMELINESS: 43 (of 99)

In recent months, the Telecommunications Services Industry gained on the broader stock market, rising several positions and moving back into the top half of our ranking system. As the global economy weakened in 2008, the telecoms saw mounting negative pressure on demand, revenue, operating profit and finances. This year, the situation remains challenging, but managements have taken a proactive stance, pursuing lucrative markets, while cutting costs and scaling back capital outlays. Long-term demand and share-price recovery prospects are favorable. Telecom stock valuations appear to have already bottomed, and investor confidence seems to be building. We caution, though, that a number of these equities may have difficulty recapturing the record highs attained in 2007 by 2012-2014.

Market Strategy

Current economic weakness has had the greatest impact on landline companies. Faced with reduced disposable income, consumers are shedding traditional phone service in favor of wireless and broadband offerings. Too, businesses are paring spending on enterprise services. Wired telcos are managing operations with an emphasis on cash flow. Bundled services, including local and long distance phone, broadband, data, video and wireless, are helping to retain customers. Rural carriers, facing less competition than their metropolitan counterparts, have fared well. Operating costs are tightly controlled in an effort to boost cash flow. Cash is earmarked for network improvements, debt reduction, stock buybacks and dividend maintenance.

Merger & acquisition activity is apparent in this segment. For example, at press time, *CenturyTel* was close to finalizing its acquisition of *Embarq*, *Windstream* had a deal pending to buy D&E Communications, and *Frontier Comm.* was purchasing wireline assets across 14 states from *Verizon Comm.* M&A transactions hold good potential for revenue and cost synergies.

Stocks of landline companies offer investors very attractive, relatively safe dividend yields. It should be noted, however, that *FairPoint*, under financial stress and having trouble integrating operations acquired from *Verizon*, eliminated its dividend earlier this year.

Industry giants *AT&T* and *Verizon* are also under pressure from a soft economy. They too are losing residential access lines and enterprise business. Additionally, their profitable postpaid wireless operations are dealing with competitive, low-cost, flat-rate prepaid services offered by *Leap Wireless*, *MetroPCS* and *Sprint Nextel*. Operating and capital outlays are significant, since the two big telcos are working to enhance and expand wireless, broadband, data and video services. Workforce reductions and asset sales have supported overall finances.

AT&T and *Verizon* shares offer conservative investors decent growth & income to 2012-2014. The stocks of *Leap* and *MetroPCS* hold good long-term recovery/growth potential. They are positioned well in a rapidly expanding niche of the wireless market. Furthermore, speculative investors may want to consider that there are rumors these two companies will participate in wireless segment consolidation.

Those investors seeking overseas exposure, via American Depository Receipts, will find the economic situation more dire in Europe. But interest in *BT Group* and *Vodafone* has picked up lately, probably due to their modest valuations. The Latin America market has proved more resilient to global economic turmoil. Still, Argentina and Brazil have had some difficulty, and Mexico is in a recession. In our view, *America Movil* is an attractive growth selection, and U.S.-based *NII Holdings* has fair recovery prospects to 2012-2014.

Cash Management

Managements are taking a cautious stance, building cash reserves. Resources are concentrated on promising growth areas, i.e., wireless, broadband and Internet Protocol-platform services. Less appealing operations are being subjected to cuts in marketing, staffing and investment. Across the board, companies are endeavoring to improve work processes to boost efficiency and save money. Also, debt refinancings and retirements are pulling down interest expense.

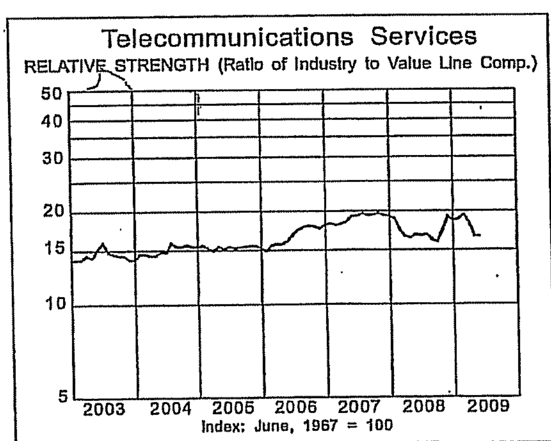
Conclusion

This year is playing out as another challenging one for the telecoms. Assuming the U.S. economy and major world markets establish a firm trend toward recovery by yearend, revenue and share-net match-ups should turn positive next year. Though the economic rebound will probably be gradual in the coming 3 to 5 years, consumers and businesses likely will allocate more funds to high-end wireless, data and broadband services, auguring well for the telcos' operating performance and stockholder value.

David M. Reimer

Composite Statistics: Telecommunications Services Industry

2005	2006	2007	2008	2009	2010		12-14
444660	544271	663191	632000	640000	660000	Revenues ($mill)	880000
24422	33898	68866	54800	61000	70000	Net Profit ($mill)	118000
13.2%	17.1%	28.4%	28.0%	29.0%	30.0%	Income Tax Rate	33.0%
5.5%	6.2%	10.4%	8.7%	9.5%	10.6%	Net Profit Margin	13.5%
38.7%	38.8%	40.3%	40.0%	39.0%	38.0%	Long-Term Debt Ratio	36.0%
57.9%	56.5%	55.0%	55.0%	56.0%	57.0%	Common Equity Ratio	59.0%
722096	888202	920608	900000	910000	920000	Total Capital ($mill)	970000
399228	467430	485124	480000	485000	490000	Net Plant ($mill)	530000
4.7%	5.2%	10.2%	7.5%	8.0%	9.0%	Return on Total Cap'l	12.5%
5.8%	6.7%	13.6%	10.0%	11.0%	12.5%	Return on Shr. Equity	19.0%
5.8%	6.7%	13.6%	11.0%	12.0%	13.5%	Return on Com Equity	21.0%
NMF	.6%	5.2%	4.5%	5.0%	5.5%	Retained to Com Eq	9.0%
109%	91%	62%	60%	59%	58%	All Div'ds to Net Prof	56%
16.3	17.1	16.1	17.0	Bold figures are Value Line estimates		Avg Ann'l P/E Ratio	15.0
.87	1.03	.85	1.02			Relative P/E Ratio	1.00
3.8%	5.0%	3.8%	3.5%			Avg Ann'l Div'd Yield	3.7%



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VERIZON NYSE-VZ

RECENT PRICE **29.54** | P/E RATIO **11.6** (Trailing: 11.5 / Median: 15.0) | RELATIVE P/E RATIO **0.77** | DIV'D YLD **6.2%** | VALUE LINE

TIMELINESS **3** Lowered 6/26/09
SAFETY **1** Raised 9/20/07
TECHNICAL **4** Lowered 6/26/09
BETA .70 (1.00 = Market)

High:	61.2	69.6	66.0	57.4	51.1	44.9	42.3	41.1	38.9	46.2	44.3	34.8
Low:	40.4	50.6	39.1	43.8	26.0	31.1	34.1	29.1	30.0	35.6	23.1	26.1

Target Price Range 2012 | 2013 | 2014

LEGENDS
—— 1.45 x Dividends p sh divided by Interest Rate
.... Relative Price Strength
2-for-1 split 6/98
Options: Yes
Shaded area: prior recession
Latest recession began 12/07

2012-14 PROJECTIONS

	Price	Gain	Ann'l Total Return
High	60	(+105%)	23%
Low	50	(+70%)	18%

Insider Decisions

	A	S	O	N	D	J	F	M	A
to Buy	0	0	0	3	0	0	1	0	0
Options	0	0	0	0	0	0	0	0	0
to Sell	0	0	0	0	0	0	0	0	0

Institutional Decisions

	3Q2008	4Q2008	1Q2009
to Buy	489	601	545
to Sell	566	508	565
Hld's(000)	1728507	1716270	1660750

Percent shares traded 9 / 6 / 3

% TOT. RETURN 5/09

	THIS STOCK	VL ARITH. INDEX
1 yr.	-19.5	-23.9
3 yr.	8.2	-16.0
5 yr.	6.9	7.6

1993	1994	1995[E]	1996	1997[F]	1998	1999	2000[G]	2001	2002	2003	2004	2005	2006[H]	2007	2008	2009	2010	© VALUE LINE PUB., INC.	12-14
14.89	15.81	15.34	14.94	19.61	20.32	21.39	23.93	24.73	24.63	24.46	25.73	25.59	30.29	32.56	34.27	37.85	39.00	Revenues per sh	41.20
4.62	4.81	4.94	4.95	5.97	6.50	6.99	7.53	8.11	7.93	7.55	7.64	7.24	7.07	7.40	7.65	7.70	7.75	"Cash Flow" per sh	8.80
1.70	1.77	1.84	1.98	2.48	2.72	3.01	2.92	3.00	3.05	2.62	2.59	2.56	2.54	2.36	2.54	2.55	2.65	Earnings per sh (A)	3.10
1.34	1.38	1.40	1.43	1.49	1.54	1.54	1.54	1.54	1.54	1.54	1.54	1.62	1.62	1.65	1.78	1.84	1.84	Div'ds Decl'd per sh (B) ■	1.96
2.89	3.04	3.05	2.92	4.95	4.79	5.59	6.52	6.39	4.36	4.29	4.79	5.24	5.88	6.11	6.07	5.70	5.85	Cap'l Spending per sh	6.00
9.43	6.97	7.63	8.48	8.24	8.39	10.24	12.79	11.90	11.88	12.08	13.56	13.56	16.68	17.62	14.68	18.10	18.40	Book Value per sh	18.85
872.44	872.60	875.53	875.63	1553.0	1553.3	1550.7	2703.6	2717.2	2745.8	2769.4	2770.0	2926.8	2909.9	2871.0	2840.6	2830.0	2820.0	Common Shs Outst'g (C)	2820.0
17.0	15.1	14.8	15.8	14.9	17.7	20.1	18.1	17.3	13.0	13.7	14.8	13.2	13.4	17.6	13.7	Bold figures are	Value Line	Avg Ann'l P/E Ratio	17.5
1.00	.99	.99	.99	.86	.92	1.15	1.18	.89	.71	.78	.78	.70	.72	.93	.82	estimates		Relative P/E Ratio	1.15
4.7%	5.2%	4.9%	4.6%	4.0%	3.2%	2.6%	2.9%	3.0%	3.0%	4.3%	4.0%	4.8%	4.8%	4.0%	5.1%			Avg Ann'l Div'd Yield	3.6%
						33174	64707	67190	67625	67752	71283	74910	88144	93469	97354	107760	109950	Revenues ($mill)	116150
						4621.0	8101.0	8391.0	8361.0	7282.0	7261.0	7151.0	6021.0	6854.0	7235.0	7215	7500	Net Profit ($mill)	8775
						37.8%	34.0%	39.8%	30.5%	31.4%	28.2%	30.9%	33.3%	35.6%	34.4%	35.0%	35.0%	Income Tax Rate	35.0%
						13.9%	12.5%	12.5%	12.4%	10.7%	10.2%	9.5%	6.8%	7.3%	7.4%	6.7%	6.8%	Net Profit Margin	7.6%
						53.1%	43.0%	45.5%	44.1%	40.5%	36.3%	32.4%	27.1%	25.4%	37.3%	30.0%	32.0%	Long-Term Debt Ratio (D)	30.0%
						45.6%	35.0%	32.4%	32.1%	34.4%	39.2%	40.4%	46.0%	45.6%	33.1%	37.0%	38.0%	Common Equity Ratio	37.0%
						34801	98899	100345	101548	97227	98287	98303	105518	111072	125864	104100	105250	Total Capital ($mill) (D)	110750
						39299	69504	74419	74496	75316	74124	75305	82356	85294	86546	81500	82000	Net Plant ($mill)	83250
						14.9%	12.3%	10.8%	10.9%	10.1%	10.1%	10.1%	7.9%	8.8%	8.3%	7.0%	7.0%	Return on Total Cap'l	8.0%
						29.1%	23.4%	25.8%	25.6%	21.8%	19.3%	18.0%	12.4%	13.6%	17.3%	12.5%	13.0%	Return on Shr. Equity	14.5%
						29.1%	23.4%	25.8%	25.6%	21.8%	19.3%	18.0%	12.4%	13.6%	17.3%	12.5%	13.0%	Return on Com Equity	14.5%
						14.0%	10.6%	13.0%	12.8%	9.1%	8.0%	6.9%	2.7%	4.1%	5.4%	7.0%	7.5%	Retained to Com Eq	9.0%
						52%	55%	50%	50%	58%	59%	62%	78%	70%	69%	74%	69%	All Div'ds to Net Prof	64%

CAPITAL STRUCTURE as of 3/31/09
Total Debt $69133 mill. Due in 5 Yrs $25602 mill.
LT Debt $55674 mill. LT Interest $1650 mill.
Incl. $240.0 mill. capitalized leases.
(Total interest coverage: 7.1x)

Leases, Uncapitalized Annual rentals $1620 mill.
Pension Assets-12/08 $30346 mill.
Oblig. $57490 mill.

Pfd Stock None

Common Stock 2,840,573,919 shs.
MARKET CAP: $83.9 billion (Large Cap)

CURRENT POSITION ($MILL.)	2007	2008	3/31/09
Cash Assets	3397	10291	4351
Other	15301	15784	17527
Current Assets	18698	26075	21878
Accts Payable	14462	13814	14403
Debt Due	2954	4993	13459
Other	7325	7099	7207
Current Liab.	24741	25906	35069

ANNUAL RATES of change (per sh)	Past 10 Yrs.	Past 5 Yrs.	Est'd '06-'08 to '12-'14
Revenues	6.0%	5.5%	5.0%
"Cash Flow"	2.5%	-1.5%	3.5%
Earnings	0.5%	-3.0%	6.0%
Dividends	1.5%	2.0%	1.0%
Book Value	7.0%	6.5%	2.5%

Cal-endar	QUARTERLY REVENUES ($ mill.) Mar.31	Jun.30	Sep.30	Dec.31	Full Year
2006	21221	21876	22449	22598	88144
2007	22584	23273	23772	23840	93469
2008	23833	24124	24752	24645	97354
2009	26591	26900	27150	27119	107760
2010	26625	27605	27850	27870	109950

Cal-endar	EARNINGS PER SHARE A Mar.31	Jun.30	Sep.30	Dec.31	Full Year
2006	.60	.64	.68	.62	2.54
2007	.53	.58	.63	.62	2.36
2008	.61	.67	.66	.60	2.54
2009	.63	.63	.65	.64	2.55
2010	.64	.67	.68	.66	2.65

Cal-endar	QUARTERLY DIVIDENDS PAID B ■ Mar.31	Jun.30	Sep.30	Dec.31	Full Year
2005	.405	.405	.405	.405	1.62
2006	.405	.405	.405	.405	1.62
2007	.405	.405	.405	.43	1.66
2008	.43	.43	.46	.46	1.78
2009	.46	.46			

BUSINESS: Verizon Communications was created by the merger of Bell Atlantic and GTE in June of 2000. It is a diversified telecom company serving more than 140.3 million access line equivalents and 72.1 million wireless customers. Acquired MCI in January of 2006. Also the largest provider of print and on-line directory information. Has a wireline presence in 28 states & Washington, D.C.; a wireless presence in 50 states & D.C.; operations in 19 countries. 2008 revenue breakdown: wireline (includes telecom & business), 49%; domestic wireless, 51%. Has approximately 223,900 employees. Chairman & CEO: Ivan Seidenberg. Incorporated: Delaware. Address: 140 West Street, New York, NY 10007. Telephone: 212-395-1000. Internet: www.verizon.com.

In keeping with its recent efforts to bolster its strategic growth areas, Verizon has agreed to divest wireline businesses in 14 states. In early May, the company announced plans to sell its local wireline operations serving residential and small-business customers in mostly rural areas in 14 states. Frontier Communications, which has about 2.3 million access lines in 24 states, will acquire these operations for roughly $8.6 billion, thereby enabling Verizon to focus on the fastest-growing sections of its business: wireless, FiOs (fiber-based wireline) and global IP (Internet Protocol) networks. The transaction, which ought to close within the next 12 months, requires Frontier shareholder approval, certain regulatory approvals, and satisfaction of other customary closing conditions, including the obtaining of financing.

The company seems set to post a flat year-over-year earnings comparison in 2009. VZ started off the current year with a modest 3% uptick in earnings, on a somewhat more impressive 12% top-line improvement. A lion's share of this revenue improvement may be attributed to the early January acquisition of Alltel. And although this created the largest wireless company in the United States in terms of total customers and revenues, the final cost of the transaction was higher than originally expected. As such, it may be difficult to achieve the dime-a-share Alltel-related accretion originally expected for 2009. Nevertheless, the wireless division continues to ring up impressive results, adding 1.3 million new customers during the March interim (excluding customers acquired in the Alltel acquisition). This, in conjunction with a hefty double-digit jump in data revenues, led to almost a 30% increase in wireless-generated revenues. Separately, although the current economic environment may have a bit of an impact on the Business segment, the Wireline division ought to generate solid results, driven by excellent demand for FiOS TV and FiOS Internet services.

This stock is neutrally ranked for the next six to 12 months. Moreover, at the current quotation, the issue offers worthwhile total-return potential through the early years of the coming decade.

Kenneth A. Nugent *June 26, 2009*

(A) Based on average shares out thru '97, then diluted. Excl. n/r gains (losses): '93, $0.04; '94, ($2.63); '95, $0.18; '96, $0.16; '97, $0.90; '98, $0.86; '99, $0.36; '00, $1.40; '01, ($2.86); '02, ($1.66); '03, ($1.51); '04, $0.08; '06, ($0.42). Next earnings report in late July. (B) Div'd paid in early Feb., May, Aug. & Nov. ■ Div'd reinv. plan avail. (C) In mill. adj. for split. (D) Incl. fin. sub. from '88. (E) Cell. ops. in revs. before 7/95, then equity income. (F) '97 data NYNEX pro forma. (G) '00 GTE pro forma. (H) '06 MCI pro forma.

Company's Financial Strength	A+
Stock's Price Stability	100
Price Growth Persistence	10
Earnings Predictability	90

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CASE: UM 1431
WITNESS: Jorge Ordonez

PUBLIC UTILITY COMMISSION
OF
OREGON

STAFF EXHIBIT 205

Exhibits in Support
Of Direct Testimony

November 2, 2009

Ratio	Definition
Debt ratio	Total debt / total assets
Debt-to-equity ratio	Total debt / stockholders equity
Book - Long-term debt ratio	Long-term debt / (long-term debt + Stockholders equity)
Book - Common-equity ratio	Stockholders equity / (long-term debt + Stockholders equity)
Market - Long-term debt ratio	Long-term debt / (long-term debt + market value of common stock)
Market - Common-equity ratio	Market value of common stock / (long-term debt + market value of common stock

CASE: UM 1431
WITNESS: Jorge Ordonez

PUBLIC UTILITY COMMISSION OF OREGON

STAFF EXHIBIT 206

Exhibits in Support Of Direct Testimony

November 2, 2009

Docket No. UM-1431
Verizon and Frontier Responses to STAFF Data Requests Nos. 54-79
July 2, 2009

DATA REQUEST NO. 63:

Please provide a copy of each Moody's, Fitch's, and Standard & Poor's credit rating report related to the Company from the beginning of 2006 through the present.

Frontier Response:

Without limitation of its other General Objections, please see, in particular, General Objections Nos. 3, 7, 12, please see Frontier Attachment 11 (OR 63 – Rating Agency Reports.pdf) which includes a copy of the credit ratings issued for Frontier Communications Corporation by Standard & Poors, Moody's and Fitch, following the announcement of the proposed transaction.

Prepared By: Cassandra Guinness
Date: July 2, 2009

Frontier Attachment 11

(OR 63 – Rating Agency Reports.pdf)

STANDARD & POOR'S

RATINGSDIRECT

May 13, 2009

Research Update:

Frontier Communications 'BB' Corporate Credit Rating Affirmed Following Proposed Acquisition Of Verizon Access Lines

Primary Credit Analyst:
Allyn Arden, CFA, New York (1) 212-438-7832;allyn_arden@standardandpoors.com

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Research Update:

Frontier Communications 'BB' Corporate Credit Rating Affirmed Following Proposed Acquisition Of Verizon Access Lines

Overview

- We are affirming the ratings on Frontier Communications Corp. following its announced acquisition of certain Verizon landline properties.
- The affirmation reflects the lower leverage of the combined company and potential for meaningful operating synergies, which is offset by integration concerns and ongoing access-line losses.
- Our affirmation of the unsecured debt ratings assumes no material change in recovery as a result of the prospective financing, although the company has not identified a pro forma capital structure.

Rating Action

On May 13, 2009, Standard & Poor's Rating Services affirmed all ratings, including the 'BB' corporate credit and senior unsecured debt ratings on Stamford, Conn.-based Frontier Communications Corp. The outlook is stable.

The '3' recovery rating on the senior unsecured debt remains unchanged and indicates expectations for meaningful (50%-70%) recovery in the event of payment default. However, our affirmation of the current unsecured debt ratings assumes no material change in recovery as a result of the prospective financing although the company has not identified a pro forma capital structure.

The affirmation follows the company's announcement that it has signed a definitive agreement to acquire approximately 4.8 million lines and 1 million broadband customers in 14 states created by a spin-off of a portion of Verizon Communications Inc.'s (A/Negative/A-1) wireline assets in a stock-based transaction valued at about $8.6 billion. The new entity will carry approximately $3.3 billion of debt, about $3 billion of which will be debt issued at the new entity while the remainder is existing debt at Verizon. Verizon shareholders will receive shares of Frontier common stock, which is expected to have a value of $5.25 billion.

Rationale

The ratings affirmation reflects the lower pro forma leverage of the combined company, which we believe will be at or under 3.0x adjusted post-transaction close, compared to 4.2x as of March 31, 2009, as well as the potential for meaningful operating synergies. These factors are largely offset by our concerns regarding the integration of the acquired Verizon properties longer term, given that the new company will be about 3x the size of Frontier on a

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stand-alone basis, as well as the potential for accelerating line losses in these markets because of competitive challenges currently facing the wireline industry. While the above average line losses and lower digital subscriber line (DSL) penetration in the legacy Verizon markets provides opportunities for Frontier, during an extended transition period, they also entail the risk of further customer losses. Access-line losses at stand-alone Frontier were about 7.1% during the first quarter of 2009, in line with the industry average. However, line losses at the legacy Verizon properties are greater, at over 10%, despite the rural nature of these markets.

The combined company will have 7 million access lines in 27 states, which should improve Frontier's scale and diversify its footprint. However, the legacy Verizon markets have about 70% of its access lines in rural areas, with an average population density greater than stand-alone Frontier at 35 access lines per square mile, which implies that competition could increase and access-line losses accelerate in the near term. However, high-speed data (HSD) penetration in the legacy Verizon properties is below the industry average at about 21% and DSL availability is substantially lower at 60%, which could bolster growth prospects in the intermediate term as Frontier invests in these markets.

The ratings on Frontier continue to reflect rising competition from cable telephony and wireless substitution, the lack of a facilities-based video strategy, an aggressive financial policy, and integration risk of the announced Verizon properties purchase. Tempering factors include the company's solid position as an incumbent local exchange carrier (ILEC), primarily in less competitive rural areas; relatively stable cash flow and high margins; and modest growth in HSD services, which has helped mitigate revenue declines from line losses.

Frontier's financial profile is aggressive. Despite anticipated pro forma adjusted leverage of about 3x, we are concerned that execution missteps or accelerating line losses could result in higher leverage over the next couple of years. Nonetheless, we expect improvement from over the current 4.2x level. As part of the transaction, Frontier will need to raise about $3.2 billion of new debt, which may be challenging unless capital market conditions improve. The pro forma EBITDA margin is about 48%, somewhat lower than stand-alone Frontier's 53.5% margin as of March 31, 2009, although still healthy relative to the industry. Nevertheless, margins could decline in the near term because of line losses. Potential operating synergies are meaningful at about $500 million, or 21% of cash operating expenses, 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.

Concerns about system switchovers from Verizon are mitigated by Frontier's ability to continue to operate under the legacy systems, if it chooses to.

Liquidity

Frontier's current liquidity is adequate, consisting of roughly $177 million in cash and $250 million from an undrawn unsecured revolving bank loan as of March 31, 2009. The company generated about $144 million in discretionary cash flow in during the last 12 months, which should remain stable over the next

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year because of lower levels of capital spending. We expect the company to have moderate headroom over the next year relative to the bank facility's maximum net debt to EBITDA covenant, which is 4.50x through the term of the agreement. Frontier amended the $200 million term loan with the Rural Telephone Finance Cooperative (RTFC) increasing the net debt to EBITDA covenant to 4.5x from 4.0x until maturity, which should provide it with sufficient cushion over the next year. Leverage under both the revolver and the RTFC term loan is calculated after subtracting cash in excess of $50 million from debt. Debt maturities as of the March 2009 quarter are manageable, including about $1.1 billion due in 2011, a portion of which was repaid with proceeds from the company's recent $600 million notes issue.

On a pro forma basis, the combined company generated about $1.7 billion of free operating cash flow, which could decline over the next few years because of ongoing access-line losses. As part of the transaction, the company announced that it would reduce its dividend by 25%, resulting in a dividend payout ratio of about 43% compared to 65% for legacy Frontier. The company will need to raise about $3.2 billion of new debt over the coming year to fund the transaction, the maturities, covenants, collateral (if any), and terms of which are currently unknown.

Outlook

The outlook is stable. Despite the expectation for continued access-line erosion in both the legacy Verizon markets as well as the existing customer base because of increased cable telephony competition and wireless substitution, the outlook is supported by the company's more moderate pro forma leverage, high margins, and free cash flow generation. Still, we could revise the outlook to negative if line losses accelerate from current levels, which results in materially lower EBITDA from the pro forma $3.1 billion. Although unlikely in the near term, we could revise the outlook to positive if operating trends stabilize, including the stabilization of line losses, and the company maintains adjusted leverage below 3x. This would likely entail the successful integration of the Verizon properties and execution of its enhanced marketing plans to increase DSL penetration and stem churn.

Ratings List

Ratings Affirmed

Frontier Communications Corp.	
Corporate Credit Rating	BB/Stable/--
Senior Unsecured	BB

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Moody's Investors Service

Global Credit Research
Rating Action
13 MAY 2009

Rating Action: Frontier Communications Corporation

Moody's: Frontier's ratings on review for possible upgrade; Verizon - NW, North and WV on review for possible downgrade

New York, May 13, 2009 -- Moody's Investors Service has placed the debt ratings of Frontier Communications Corporation ("Frontier") on review for possible upgrade, following the announcement that it plans to merge with a company to be spun out of Verizon Communications' northern and western operations (VZ-Spinco) in a reverse Morris Trust transaction, valued at $8.6 billion in cash and stock, where by Verizon shareholders will own between 66% and 71% of the post-merger entity. However, Moody's believes the change of control provisions in Frontier's debt are unlikely to be triggered and Moody's expects the existing Frontier debt to stay in place.

As part of the transaction, VZ-Spinco will issue approximately $3 billion of new debt, while it is anticipated that $250 million of existing debt at the Verizon entities to be acquired will remain in place post-merger, although the amount may be up to $425 million, depending on the final timing of the merger closing. As a result Moody's has also placed the A3 senior unsecured debt ratings of Verizon - Northwest, North, and West Virginia on review for a possible downgrade, as it is unlikely that the post-merger entity will be rated at that level.

The ratings actions incude:

On Review for Possible Downgrade:

..Issuer: Verizon North Inc.

....Senior Unsecured Regular Bond/Debenture, currently A3

..Issuer: Verizon Northwest Inc.

....Senior Unsecured Regular Bond/Debenture, currently A3

..Issuer: Verizon West Virginia, Inc.

....Senior Unsecured Regular Bond/Debenture, currently A3

On Review for Possible Upgrade:

..Issuer: Frontier Communications Corporation

....Corporate Family Rating, currently Ba2

....Probability of Default Rating, currently Ba2

....Senior Unsecured Bank Credit Facility, currently Ba2 LGD4-53%

....Senior Unsecured Regular Bond/Debenture, currently Ba2 LGD4-53%

....Senior Unsecured Shelf, currently (P)Ba2

Outlook Actions:

..Issuer: Frontier Communications Corporation

....Outlook, Changed To Rating Under Review From Stable

..Issuer: Verizon North Inc.

....Outlook, Changed To Rating Under Review From Negative

..Issuer: Verizon Northwest Inc.

....Outlook, Changed To Rating Under Review From Negative

..Issuer: Verizon West Virginia, Inc.

....Outlook, Changed To Rating Under Review From Negative

Frontier expects to generate significant expense savings from the merger, initially estimated at about $500 million annually. Non-recurring integration costs will likely be in the $200 million range, while the company is likely to ramp up capital expenditures during the first years of integration in order to increase VZ-Spinco properties' high speed data addressability. Frontier's current high speed data availability is approximately 90%. The merger will produce a company with operations in 27 states serving over 7 million access lines. The increase in scale is expected to bolster Frontier's overall competitive position and increase operational and capital efficiencies, especially those related to network modernization and new product development. However, the challenge to Frontier of integrating a company more than twice its size is substantial and will be an additional and significant focus of Moody's review of the ratings.

Frontier believes that the operating systems transition in this situation will be easier than in some recent Verizon asset sales, as only the West Virginia operations, which represent about 13% of the VZ-Spinco lines, will require a systems conversion at closing. For the remaining lines, VZ-Spinco will be operating under independent management and operating systems prior to the merger effectiveness and will not require a timed cutover, which is expected to materially reduce the transition issues that other carriers have experienced.

The transaction is expected to result in significant deleveraging at Frontier, leading to a potentially improved credit profile. The combined pro forma 2008 Debt/EBITDA would be 2.6x, while its dividend would be cut by 25% due to a $0.25 annual per share dividend reduction effective after closing of the transaction. Frontier has stated its intent to achieve investment grade financial metrics following the merger. Moody's will 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.

Before the transaction can close, numerous regulatory approvals, including those of several state Public Utility Commissions, are required. Conditions that may be imposed by some of these states' regulatory authorities could have a material impact on the combined entities' future operating performance and financial profile. In addition, the Obama administration and Federal Communication Commission could potentially put forth comprehensive reforms of intercarrier compensation and universal service rules. Changes to the current structure of these and other regulatory frameworks could also have an impact on the combined company's future operating and financial performance and will also be a focus of Moody's review.

Moody's most recent rating action for Frontier was on April 3, 2009, at which time Moody's assigned a Ba2 rating to the company's new note issuance.

Moody's most recent rating action for Verizon - Northwest, North, and West Virginia Frontier was on October 28, 2008, at which time Moody's confirmed the issuers' A3 senior unsecured rating and placed a negative outlook on the debt ratings.

The principal methodology used in rating Frontier and Verizon - was Moody's Global Telecommunications Industry rating methodology, which can be found at www.moodys.com in the Credit Policy & Methodologies directory, in the Ratings Methodologies sub-directory (December 2007, document #106465). Other methodologies and factors that may have been considered in the process of rating these issuers can also be found in the Credit Policy & Methodologies directory.

Pro-forma for the transaction, Frontier, headquartered in Stamford, CT, will become the fifth largest wireline telecommunications company in the US, serving over 7 million access lines in primarily rural areas and small- and medium-sized cities. Verizon Communications is headquartered in Basking Ridge, NJ.

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Fitch Ratings
KNOW YOUR RISK

FITCH PLACES FRONTIER COMMUNICATIONS ON RATING WATCH POSITIVE

Fitch Ratings-Chicago-13 May 2009: Fitch Ratings has placed Frontier Communications Corporation's (Frontier) (NYSE: FTR) Issuer Default Rating (IDR) of 'BB' and its securities on Rating Watch Positive owing to its proposed transaction with Verizon Communications Inc. (Verizon) (NYSE: VZ).

In the transaction, Verizon will spin-off local exchange assets in 14 states, consisting of approximately 4.8 million access lines, into a separate company which will then merge with Frontier in a tax-free transaction to create a large local exchange company. The company to be merged into Frontier will be moderately levered, and post-merger Frontier is expected be less levered than currently. As a result, Frontier's 'BB' IDR and other ratings have been placed on Rating Watch Positive.

The transaction values the company that will be merged into Frontier (Spinco) at approximately $8.6 billion, consisting of approximately $5.3 billion in equity and $3.3 billion of debt. Verizon shareholders will receive $5.3 billion in Frontier equity in the merger, and there is a share price collar of $7.00 to $8.50 on Frontier's common stock price. The transaction is subject to customary regulatory approvals, the approval of Frontier's shareholders, and the obtaining of financing.

Fitch will evaluate Frontier's prospective financial performance as well as its anticipated capital structure in determining Frontier's ratings.. Fitch believes there is execution risk regarding Frontier's integration of the former Verizon operations into its own. Fitch believes the execution risk is offset to some extent by Frontier's significant experience in integrating large transactions and the scalability of is existing systems. Fitch will evaluate Frontier's capability to mitigate such risks.

Fitch places the following ratings on Rating Watch Positive:

Frontier Communications Corporation:
--IDR 'BB';
--Senior unsecured $250 million credit facility due May 18, 2012 'BB';
--Senior unsecured $148.5 million senior unsecured term loan due Dec. 31, 2012;
--Senior unsecured notes and debentures 'BB'.

Industrial development revenue bonds (IDRBs) 'BB' as follows:
--Maricopa County Industrial Development Authority (AZ) IDRB series 1995.

Contact: John Culver, CFA +1-312-368-3216 or David Peterson +1-312-368-3177, Chicago.

Media Relations: Cindy Stoller, New York, Tel: +1 212 908 0526, Email: cindy.stoller@fitchratings.com.

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Docket No. UM-1431
Verizon and Frontier Responses to STAFF Data Requests Nos. 54-79
July 2, 2009

DATA REQUEST NO. 64:

Please provide each rating agency's current credit ratings and outlook for the Company. Please also provide S&P's current business profile and current financial profile for the Company. Please describe any changes expected in any rating.

Frontier Response:

Without limitation of its other General Objections, please see, in particular, General Objections Nos. 3, 7, 12, Frontier responds as follows:

S&P – Rating is "BB" with a "Stable" outlook
Moodys – Rating is "Ba2" with a "Positive" outlook
Fitch – Rating is "BB" with a "Positive" outlook

With respect to future changes, Frontier will continue to be financially strong following the closing of the proposed Verizon transaction. In fact, Frontier's 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 with a stronger financial structure and level of cash flow. As a result, while future ratings of any debt to be issued is not yet known, Frontier expects the debt of the combined company to obtain an investment grade rating over time.

Prepared By: Cassandra Guinness
Date: July 2, 2009

Docket No. UM-1431
Verizon and Frontier Responses to STAFF Data Requests Nos. 54-79
July 2, 2009

DATA REQUEST NO. 65:

Please list the name and employer of each credit rating analyst and each equity analyst who have published reports on the Company one or more times since 2006.

Frontier Response:

Without limitation of its other General Objections, please see, in particular, General Objections Nos. 3, 7, 12, Frontier provides the following information for the current analysts at S&P, Moody's and Fitch:

S&P – Allyn Arden – 212-438-7832
Moody's – Gerald Granovsky – 212-553-4198
Fitch – John Culver – 312-368-3216

Prepared By: Cassandra Guinness
Date: July 2, 2009

CASE: UM 1431
WITNESS: Jorge Ordonez

PUBLIC UTILITY COMMISSION
OF
OREGON

STAFF EXHIBIT 207

Exhibits in Support
Of Direct Testimony

November 2, 2009

Docket No. UM-1431
Verizon and Frontier Responses to STAFF Data Requests Nos. 54-79
July 2, 2009

DATA REQUEST NO. 62:

For the Company pre-transfer and post-transfer, please provide annual *pro forma* financial statements (balance sheets, income statements, and cash flow statements, statement of shareholder's equity) covering the period from 2010 to 2011, with annual totals where appropriate, in electronic format with formulae and cell references intact. Please provide standard ratio calculations, including (but not limited to what was requested in the preceding data request.

Response:

Without limitation of the other General Objections, please see, in particular, General Objection Nos. 2, 3, 7, 8, and 12, Verizon and Frontier respond as follows:

With respect to pro forma financial statements, Frontier and Verizon are in the process of compiling pro forma financial statements that will be included in Frontier's Proxy Statement (to be included in Frontier's Registration Statement on Form S-4 in connection with the issuance of Frontier securities in the transaction) to be filed shortly with the Securities and Exchange Commission (SEC). Frontier will supplement and provide the Registration Statement containing the pro forma financial statements as soon as it is filed with the SEC.

Prepared By: James Miggans and Cassandra Guinness
Date: July 2, 2009

Docket No. UM-1431
Frontier Responses to Staff Data Requests Nos. 198-199
September 9, 2009

FINANCIAL STATEMENTS

DATA REQUEST NO. 198:

On Frontier's (the Company) response to Staff Data Request 62, the Company noted that the *pro forma* financial information requested would be provided with Frontier's Registration Statement on Form S-4. However, this information was not provided. As follow up on Data Request 62, please provide the Company's pre-transfer and post-transfer annual *pro forma* financial statements (balance sheets, income statements, and cash flow statements, statement of shareholder's equity) covering calendar years 2010 and 2011, with annual totals where appropriate, in electronic format with formulae and cell references intact. Please provide standard ratio calculations, including (but not limited to):

a. Short term solvency
   i. Current ratio
   ii. Quick ratio

b. Activity
   i. Total asset turnover
   ii. Average total assets
   iii. Receivables turnover
   iv. Average receivables
   v. Average-collection period
   vi. Inventory turnover
   vii. Average inventory
   viii. Days in inventory

c. Financial leverage
   i. Debt ratio
   ii. Debt to equity ratio
   iii. Equity multiplier
   iv. Interest coverage
   v. Long-term debt ratio (Long-term debt/(Long-term debt + Common equity + Preferred equity)
   vi. Common equity ratio (Common equity/(Long-term debt + Common equity + Preferred equity)
   vii. Preferred equity ratio (Preferred equity/(Long-term debt + Common equity + Preferred equity)

d. Profitability
   i. Net profit margin
   ii. Gross profit margin
   iii. Net return on assets (ROA)
   iv. Gross return on assets (gross ROA)

v. Return on Equity (ROE)
vi. Net return on assets (ROA) on Oregon regulated assets.
vii. Gross return on assets (gross ROA) on Oregon regulated assets
viii. Payout ratio

e. Market value ratios
   i. Price-to-earnings (P/E)
   ii. Dividend Yield
   iii. Market to Book Value (M/B)
   iv. Revenues per share
   v. Cash flow per share
   vi. Earnings per share
   vii. Dividends declared per share
   viii. Capital spending per share
   ix. Book value per share
   x. Common shares outstanding
   xi. Average Annual Dividend Yield

Response:

Without limitation of the other General Objections, please see, in particular, Applicants' General Objection Nos. 3, 4, 5, 8 and 10. Subject to and without waiver of the general and specific objections, Frontier responds as follows:

Frontier has previously produced a Highly Confidential financial model in native Excel format that shows projected financial information and results for 2010 and 2011 based on completion of the proposed transaction and using Frontier's assumptions as identified in the model. Various assumptions in the model can be revised by the user. Frontier has undertaken the calculation of certain ratios using the Frontier assumptions - see highly confidential attachment "OR Staff22 FRO198 Ratios Model Projection 2010 2011 highly confidential.xls."

Prepared By: Cassandra Guinness
Date: September 9, 2009

Docket No. UM-1431
Frontier Responses to Staff Data Requests Nos. 198-199
September 9, 2009

DATA REQUEST NO. 199:

Repeat the preceding Data Request under each of the following assumptions:

a. Annual access line loss from 2009 of 4%
b. Annual access line loss from 2009 of 8%
c. Average total company interest on debt increases by 1%, with a 70/30 debt/equity capital structure (market value) and 90/10 Long-term debt/Total shareholders' equity (from financial statements).
d. Average total company interest on debt increases by 3%, with a 70/30 debt/equity capital structure (market value) and 90/10 Long-term debt/Total shareholders' equity (from financial statements).

Response:

Without limitation of the other General Objections, please see, in particular, Applicants' General Objection Nos. 3, 4, 5, 8 and 10. In addition to its General and Specific objections, Frontier does not agree with the Request's assumptions and premises and the reasonableness of the requested calculations. Subject to and without waiver of the general and specific objections, Frontier responds as follows:

Frontier has previously produced a Highly Confidential financial model in native Excel format that shows projected financial information and results for 2010 and 2011 based on completion of the proposed transaction and using Frontier's assumptions as identified in the model. Various assumptions in the model can be revised by the user. Frontier has not input into the model or undertaken an analysis using the specific assumptions identified in this request and therefore has not calculated the ratios using these assumptions.

Prepared By: Cassandra Guinness
Date: September 9, 2009

DATA REQUEST NO. 207:

As follow up on the Company's response to Staff Data Request 78, where the company did not provide the information requested, please provide indicative quotes for Verizon Communications Inc. (VZ) and for Frontier Communications Corporation (FTR) from three different investment banks for an issuance of $3.1 billion in each of 5-, 7-, 10-, 15-, 20-, and 30-year maturities for senior-secured and for senior-unsecured bonds, as of the present time. Please include the spread over the benchmark Treasury's yield as well as detailed estimates of all expenses. If indicative quotes are not available, please provide any information available to the Company which provides current market pricing for each series specified above.

Response:

Without limitation of the other General Objections, please see, in particular, Applicants' General Objection Nos. 3 and 7. Subject to and without waiver of the general and specific objections, Applicants respond as follows:

Debt associated with Verizon Communications Inc. is not relevant to the transaction. For Frontier, indicative quotes are not available and the following information provides current market pricing.

Secondary Market Pricing of Existing Debt as of 9/24/09

Coupon	Maturity		Current Yield
9.25%	May	2011	3.51%
6.25%	Jan	2013	6.76%
8.25%	May	2014	7.34%
6.63%	Mar	2015	7.42%
7.13%	Mar	2019	7.88%
7.00%	Nov	2025	9.96%
7.88%	Jan	2027	8.84%
9.00%	Aug	2031	9.24%
7.45%	Jul	2035	10.50%
7.05%	Oct	2046	9.83%

Prepared By: James Miggans and Cassandra Guinness
Date: September 29, 2009

CASE: UM 1431
WITNESS: Irina Phillips

PUBLIC UTILITY COMMISSION
OF
OREGON

STAFF EXHIBIT 300

Direct Testimony

November 2, 2009

1 **Q. PLEASE STATE YOUR NAME, OCCUPATION, AND BUSINESS**
2 **ADDRESS.**
3 A. My name is Irina Phillips. I am an Economist for the Economic Policy and
4 Analysis Section of the Public Utility Commission of Oregon (Commission).
5 My business address is 550 Capitol Street NE Suite 215, Salem, Oregon
6 97301-2551.
7 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND WORK**
8 **EXPERIENCE.**
9 A. I hold a Master of Science degree in Economics from Oregon State University
10 in Corvallis OR.
11 I have worked as an Adjunct Instructor of Micro and Macro Economics at
12 Western Oregon University and Linn-Benton Community College from 2005 till
13 2009.
14 Beginning June 2009, I have been employed as an Economist with the
15 Commission.
16 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**
17 A. The purpose of my testimony is to assess certain risks to customers resulting
18 from the indirect transfer of control from Verizon Communication Inc. (Verizon)
19 to Frontier Communications Corporation (Frontier or Company).
20 **Q. HOW IS YOUR TESTIMONY ORGANIZED?**
21 A. My testimony is organized as follows:

22 Introduction……………………………………………………….……………….….2
23 Issue 1 - Frontier's Future Revenue Forecast……………………………5
24 Issue 2 - Frontier's Model to Attract Customers…………….………..……8

1 Issue 3 - Frontier's Approach to Retain Customers…………….............9
2 Issue 4 - Frontier's Business Model………………………………..……......9
3 Issue 5 - Future of FIOS with Frontier……………………………..……....10

INTRODUCTION

4 **Q. HOW HAS VERIZON COMMENTED ON THE INDIRECT TRANSFER OF**
5 **CONTROL?**
6 A. As stated by Keith Fulton, President of Verizon West Virginia: "The landline
7 (component) isn't a liability per se. It is a part of the business that generates
8 some revenue, but it is a declining business for many.[1]" Verizon's overall line
9 loss was eight percent in 2007 and 10.2 percent in 2008. Verizon's line loss in
10 Oregon was 9.2 percent (12.7 percent loss of residential and 4.6 percent loss
11 of business lines).
12 **Q. WHAT STRATEGY CAN A COMPANY IMPLEMENT IF THE LANDLINE**
13 **LOSSES ARE SIGNIFICANT AND THERE IS A REVENUE DECLINE?**
14 A. One option is to cut costs. Over time this approach may lead to a decline in
15 service quality and may eventually result in certain corrective actions taken by
16 state commissions. A cost-cutting strategy that negatively impacts service
17 quality can postpone the immediate effects of an operating loss problem, but
18 will result in more problems over the long-term. Other options include selling
19 the business or abandoning service. In this case, Verizon chose to transfer
20 control of certain properties to Frontier.

[1] http://www.statejournal.com/story.cfm?func=viewstory&storyid=66718&catid=182

Q. WHAT IS FRONTIER'S POSITION ON THE INDIRECT TRANSFER OF CONTROL?

A. Frontier asserts that many people in rural areas will continue using landlines and that the existing infrastructure could be used to provide telephone and high-speed Internet services, especially to areas that otherwise would not have access to these services.[2] Frontier reported overall line loss for 2008 at 7.3 percent. Frontier recognizes the decline in basic access lines but hopes that the corresponding loss of revenue will be offset by increase in data and Internet service revenues.[3]

Q. PLEASE DESCRIBE THE POTENTIAL PROBLEMS WITH THE PROPOSED TRANSACTION.

A. Frontier currently carries a significant amount of indebtedness ($4.7 billion at the end of first quarter of 2009), and after the merger this amount will increase to about $8.0 billion. The possible negative consequences of such high indebtedness include limitations on the merged company's ability to obtain additional financing, which will necessarily cause an allocation of a substantial portion of Frontier's cash flow from operations to service its debt. The internal case for reinforcement and upgrade of the current network may be difficult for the Company to make when overall demand for landlines is falling. Frontier might find itself burdened with debt and losing customers and unable to make the necessary upgrades to existing infrastructure. The loss of customers may cause necessary reductions in the work force (or freezing payroll, furloughs

[2] Frontier Communications. Welcome to the New Frontier. May 13, 2009, p. 5, 7, 8, and 24.
[3] Page 20, form Q-10 (SEC) filed on 08/04/2008.

1 and wage reductions), issues with the customer billing services, and possibly
2 even interruptions of 9-1-1 services.

3 **Q. CAN YOU BRIEFLY OUTLINE THE COMPETITIVE CLIMATE AROUND**
4 **THE TRANSFER?**

5 A. The telecommunications industry is very competitive because there are many
6 players and they are using different technologies. Many large cable television
7 companies have entered the voice market, and these companies are a
8 powerful new force. Many customers now have two wires to their homes that
9 can provide telephone service, one from the telephone company and one from
10 the cable company. In addition, wireless substitution is gradually reducing the
11 number of wire line subscribers. Approximately 20 percent[4] of U.S. homes
12 now report using only wireless phones. As a result of these industry changes,
13 a financial and operational failure by a landline phone company is no longer a
14 highly implausible event that can be safely ignored by the Commission. The
15 traditional approach of allowing higher tariffs and subscriber rates may not
16 work because of high demand elasticity for local exchange service in such a
17 diverse multi-vendor environment.

18 Frontier failed to demonstrate to Staff that it assessed the intense competition
19 from TV cable companies (Comcast) in Portland metropolitan area.[5] I received
20 the following response from the Company to my data request about
21 competition from the cable companies in Oregon:

[4] http://wirelessguide.org/2009/090508.php
[5] DR201-2 and http://seekingalpha.com/article/153702-frontier-communications-corporation-q2-2009-earnings-call-transcript?page=7

> Frontier has some knowledge of the competition in Oregon service areas and whether or not there are broadband products. Frontier did not analyze the specifics of each competitor's broadband or telephone offerings on a wire center by wire center basis. Rather, it relied on its review of historical unit and revenue trends and its experience competing with the various competitors in its current operational footprint.

Frontier did not assure Staff that it will be able to compete efficiently and keep the customers.

ISSUE 1 - FRONTIER FUTURE REVENUE FORECAST

Q. WHAT IS CURRENT REVENUE TREND FOR FRONTIER?

A. I used in my analysis quarterly revenue data for 2007 through 2009, but the conclusions are confirmed by the long-term industry trend. The following table highlights revenue trends.

Table 1 – Revenue Trends (in 000s)

Quarter	Revenue	Percent Change
June 2009	$532,142	-1.08%
March 2009	$537,956	-1.72%
December 2008	$547,392	-1.88%
September 2008	$557,871	-0.83%
June 2008	$562,550	-1.17%
March 2008	$569,205	-1.39%
December 2007	$577,228	+0.51%
September 2007	$575,814	-

Frontier's revenue for local services declined eight percent in 2008 to $198.3 million while data and Internet services revenue increased six percent to $160.6 million. Switched access service revenue declined 13 percent to $87.4 million while revenue from long-distance services fell 14 percent to

1 $40.6 million. The company lost 27,700 voice-access lines in the second
2 quarter of 2009 and had 2.19 million access lines, down six percent from a
3 year ago.[6]

4 **Q. BASED ON YOUR ANALYSIS, WHAT MAY HAPPEN TO FRONTIER'S**
5 **REVENUE AFTER THE TRANSFER?**

6 A. Frontier's "pro forma" projections rely on Verizon's year-end 2008 results.
7 Verizon lost 136,000 access lines (2.9 percent of all its lines) during the second
8 quarter of 2009. Since June 30, 2008, Verizon has lost more than
9 11 percent of its access lines, resulting in a significant decline in revenues,
10 cash flow, and net income. In the best case scenario, I predict that there will
11 be a revenue decline of at least two percent a year from Frontier's revenue
12 base (including Spinco). If I take into account merger tensions, then the more
13 realistic short-run revenue loss is around four percent per year for the first
14 three years. By merger tensions I mean the following[7]:

15 • The ability to successfully integrate the Verizon
16 operations into Frontier`s existing operations; the effects
17 of increased expenses due to activities related to the
18 Verizon transaction;
19
20 • The ability to migrate Verizon`s West Virginia operations
21 from Verizon owned and operated systems and
22 processes to Frontier owned and operated systems and
23 processes successfully;
24
25 • The risk that the growth opportunities and cost synergies
26 from the Verizon transaction may not be fully realized or
27 may take longer to realize than expected;
28

[6] SEC Form 10-Q
[7] http://uk.reuters.com/article/idUS178062+27-Oct-2009+BW20091027?symbol=FTR.N

- The sufficiency of the assets to be acquired from Verizon to enable us to operate the acquired business;
- Disruption from the Verizon transaction making it more difficult to maintain relationships with customers, employees or suppliers;
- The effects of greater than anticipated competition requiring new pricing, marketing strategies or new product or service offerings and the risk that we will not respond on a timely or profitable basis;
- Reductions in the number of our access lines and High-Speed Internet subscribers; and
- Our ability to sell enhanced and data services in order to offset ongoing declines in revenue from local services, switched access services and subsidies.

Q. HOW SHOULD THE COMMISSION REVIEW THIS TRANSACTION FROM A FINANCIAL POINT OF VIEW?

A. in terms of financial perspective, it is necessary to consider whether Frontier has the financial fitness and ability to generate realistic cash flows to meet its goals (capital investment and employee obligations are among them). If the operating environment proves more negative than the company's modeling, the company should plan to have the flexibility to meet its obligations in several other ways. For example, Frontier could reduce line losses by adding incremental revenues through new products, or meet this reduction with adjustment in the company's cost structure, reduction in capital expenditure, or alteration of the company's dividend policy.

ISSUE 2 - FRONTIER'S MODEL TO ATTRACT CUSTOMERS

Q. BRIEFLY DESCRIBE FRONTIER'S MODEL TO ATTRACT NEW CUSTOMERS?

A. Frontier uses the image of rural America in its advertising campaigns.[8] Providing service in rural areas is more expensive than in urban areas, and price competition has been increasing over the last two years.[9] The age demographic of Frontier customers is: more than 70 percent are over 30 years old. Frontier mentions on its web page that its customers have greater disposable income.[10] Both factors, rural setting and greater income, are a natural rationale from company's point of view to allow higher prices.

Q. WHAT ARE FRONTIER'S RATES FOR SELECTED SERVICES?

A. Frontier files a local tariff with Commission and lists the flat rate basic access rate of $12.67. Business one-party access is $22.32 per month and multi-line is $37.75. The lowest Internet rate is $24.99 with 30 minutes of monthly Long Distance (zip code 97410). This is comparable with other telecommunication services providers in Oregon. There are no basic prices listed on Frontier's web page in the residential customer section, so the customer would need to access the company's tariffs and regulations and scan through several legal documents, but prices of bundles are easily visible.

[8] http://www.frontier.com/InternetSolutions/internetadvertising/
[9] http://www.telecommagazine.com/newsglobe/article.asp?HH_ID=AR_3982
http://www.comscore.com/Press_Events/Press_Releases/2009/8/Broadband_Plays_Catch-Up_in_Rural_Areas_Outpaces_Growth_in_Big_Cities
[10] http://www.quantcast.com/frontiercommunications.com

1 **ISSUE 3 - FRONTIER'S APPROACH TO RETAIN CUSTOMERS**

2 **Q. HOW DOES FRONTIER RETAIN ITS CUSTOMERS?**

3 A. My conclusion is that Frontier's retention practice is based on offering bundled
4 products and services under one, two, or three-year price protection plans with
5 penalties for not completing the term. Frontier also advertises itself as
6 providing exemplary customer service and introducing a number of new
7 products, like "Frontier Piece of Mind."

8 **Q. WHAT IS FRONTIER'S PIECE OF MIND OPTION?**

9 A. If you are a Windows XP or Vista user, Frontier offers you hard-drive backup
10 for a starting rate of $4.99. For an additional charge, a customer may
11 subscribe for additional technical support (e.g. for wireless network or printer
12 setup).

13 **ISSUE 4 - FRONTIER'S BUSINESS MODEL**

14 **Q. WHAT IS FRONTIER'S APPROACH TO CAPITAL EXPENDITURES AND**
15 **INVESTING ACTIVITIES?**

16 A. In its March 31st SEC Form 10-Q, the Company states:

17 > We continue to closely scrutinize all of our capital projects,
18 > emphasize return on investment and focus our capital
19 > expenditures on areas and services that have the greatest
20 > opportunities with respect to revenue growth and cost
21 > reduction."
22

23 My concern is that if the revenue growth does not materialize, Frontier is going
24 to reduce costs. Reduction of necessary capital expenditures in maintenance
25 could translate into service quality problems in the future.

Q. WHAT IS FRONTIER'S DIVIDEND POLICY?

A. The Company expects to pay regular quarterly dividends.[11] Frontier wants to have an annuity-like reputation and deliver stable and consistent returns. Frontier pays very high dividends in relation to its net income. Frontier must play a balancing act, preserving an attractive dividend portion of its return, while also executing capital expenditure plans that involve infrastructure investment and staying focused on customer service.

ISSUE 5 - FUTURE OF FIOS WITH FRONTIER

Q. WHAT DOES FIOS STAND FOR?

A. As noted in Verizon's trademark, *fios* is a Gaelic word, translated into English as "knowledge." FiOS is a bundled (Internet, television (TV) and phone) service, operating over fiber to the Verizon home network. Most telecommunication companies (including Frontier) use fiber optics in the network backbone and use existing copper infrastructure for the end user.

Q. DOES FRONTIER OFFER A SIMILAR INTERNET/TV/PHONE BUNDLE?

A. Not exactly. Frontier offers bundles of TV, internet and phone service starting at $109.97 per month and up. However for TV service, Frontier uses DISH Network Satellite TV service. It does not appear that Frontier has experience operating a cable company.

[11] SEC Form 10-Q, Dividends page 23

1 **Q. WHERE DID VERIZON BUILD FIOS IN OREGON?**

2 A. Verizon built its FiOS network mainly in the Portland metropolitan area where
3 Comcast is an existing strong competitor. Frontier does not seem to be
4 seriously concerned about increased competition from Comcast in Oregon.
5 Frontier provided me with Oregon Loop Cost Model developed with the goal of
6 providing 85% of the households in the Verizon's Oregon exchanges with
7 speed of 3Mbps[12]. Current Verizon FiOS plans offer much higher speeds. For
8 $49.99 a customer can download up to15 Mbps and upload up to five Mbps.

9 My concern is about the Portland metropolitan area after the transfer.
10 Frontier may experience significant loss of customers there and a
11 corresponding decline in revenue.

12 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

13 A. Yes.

[12] DR202

CASE: UM 1431
WITNESS: Roger White

PUBLIC UTILITY COMMISSION OF OREGON

STAFF EXHIBIT 400

Direct Testimony

November 2, 2009

CERTAIN INFORMATION CONTAINED IN STAFF EXHIBIT 400

IS HIGHLY CONFIDENTIAL AND SUBJECT TO

SUPERSEDING

HIGHLY CONFIDENTIAL PROTECTIVE

ORDER NO. 09-273. YOU MUST HAVE SIGNED

APPENDIX B OF THE SUPERSEDING HIGHLY CONFIDENTIAL

PROTECTIVE ORDER IN

DOCKET UM 1431 TO RECEIVE THE

HIGHLY CONFIDENTIAL VERSION

OF THIS EXHIBIT.

1 **Q. PLEASE STATE YOUR NAME, OCCUPATION, AND BUSINESS**
2 **ADDRESS.**
3 A. My name is Roger White. I am the Program Manager for the
4 Telecommunications Cost Analysis Section of the Public Utility Commission of
5 Oregon. My business address is 550 Capitol Street NE Suite 215, Salem,
6 Oregon 97301-2551.
7 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND WORK**
8 **EXPERIENCE.**
9 A. My Witness Qualification Statement is found in Exhibit Staff/ 401.
10 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**
11 A. The purpose of my testimony is to discuss Engineering and Service Assurance
12 issues, Broadband/DSL issues, and Operation and Business Support System
13 issues and to recommend ordering conditions that, in part, will mitigate the
14 problems I have identified.
15 **Q. DID YOU PREPARE AN EXHIBIT FOR THIS DOCKET?**
16 A. Yes, Exhibit Staff/401 consisting of one page, Exhibit Staff/402 consisting of
17 four pages, Confidential Exhibit Staff/403 consisting of one page and Highly
18 Confidential Exhibit Staff/404 consisting of 12 pages.
19 **Q. HOW IS YOUR TESTIMONY ORGANIZED?**
20 A. My testimony is organized as follows:

21 ENGINEERING AND SERVICE ASSURANCE ISSUES 2
22 BROADBAND/DSL ISSUES 7
23 OPERATIONS AND BUSINESS SUPPORT SYSTEMS ISSUES 12

1 **ENGINEERING AND SERVICE ASSURANCE ISSUES**

2 **Q. PLEASE EXPLAIN WHAT YOU ARE REFERRING TO BY ENGINEERING**
3 **AND SERVICE ASSURANCE ISSUES.**
4 A. By engineering and service issues, I refer to network issues or potential issues
5 that could impact the quality or availability of products and services that will be
6 provided by the New Communications ILEC.
7 **Q. ARE THERE ANY EXISTING ISSUES THAT COULD IMPACT THE**
8 **QUALITY AND AVAILABILITY OF SERVICES IN THE CURRENT**
9 **VERIZON SERVICE AREA?**
10 A. Yes, the age of the switches may be a potential issue. In a highly confidential
11 response to one of Staff's data requests[1], the Applicants responded with an
12 Excel spreadsheet containing a list of Verizon's switches and their in-service
13 dates. From this information I was able to establish the age of each base unit
14 and each remote as well as the average age of the base units and the remotes.
15 **Q. DID THE APPLICANTS PROVIDE YOU WITH ANY OTHER**
16 **INFORMATION REGARDING THEIR SWITCHES?**
17 A. Yes, in response to my data request[2], the Applicants provided me with the
18 average depreciation life that Verizon uses for the digital switching account,
19 which is 11 years.

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[1] Applicants' response to Staff Data Request No. 53. Included in Highly Confidential Exhibit Staff 404, page 1-5.
[2] Applicants' response to Staff Data Request No.220.

1 **Q. USING THE AVERAGE LIFE THAT THE APPLICANTS PROVIDED, WERE**
2 **YOU ABLE TO PLACE AN UPPER BOUND ON THE LIFE OF THE**
3 **SWITCHES?**
4 A. Yes, I was able to estimate the upper bound on the life of individual switches.
5 Using the 11-year average life and the R3 Iowa Curve[3] found in the
6 Depreciation Study Parameter Guidelines[4], I was able to calculate an upper
7 bound on the lives of the switches.
8 **Q. WHAT WAS THE NATURE OF THE UPPER BOUND THAT YOU**
9 **CALCULATED?**
10 A. The Iowa Curve[5] that I used showed how many out of a pool of █ switches
11 survived after a given number of years in-service. The upper bound was
12 established when the whole number of surviving switches dropped below one.
13 **Q. DID YOU COMPARE THE UPPER BOUND TO THE AGES OF VERIZON'S**
14 **SWITCHES?**
15 A. Yes, I compared the 17-year upper bound that I calculated with the current ages
16 of the base units. I found that currently there are █ switches at or above the
17 upper bound that I calculated and █ switches that are below it. Also, by the
18 end of 2014, █ percent of the switches will be at or above the upper bound.

[3] The R3 Iowa Curve is the survivor curve that best fits the data used to develop the depreciation guidelines for the small companies.
[4] This is a book of published by GTE that contains tables of Iowa Curves, which are a particular type of survivor curve used in depreciation studies. For any given average life, the curves show how many systems units are still in place from year to year.
[5] The Iowa Curve selected for the study was an R3 with an 11-year average life.

1 **Q. DID THE APPLICANTS PROVIDE ANY INFORMATION ON THE**
2 **CURRENT REPLACEMENT COST OF ANY OF THE TYPES OF**
3 **SWITCHES CURRENTLY IN USE?**
4 A. Yes, the Applicants provided the current, average replacement cost[6] for one
5 type of switch that is deployed by Verizon in Oregon.
6 **Q. WAS THE AMOUNT IN THE $150 TO $500 PER LINE RANGE?**
7 A. Yes, the dollar amount that the Applicants provided for the cost of a switch
8 would fall into the $150-to-$500 per line range.[7]
9 **Q. IF ALL OF THE SWITCHES THAT FRONTIER PURCHASED FROM**
10 **VERIZON HAD TO BE REPLACED, WHAT WOULD YOU ESTIMATE THE**
11 **DOLLAR IMPACT TO BE?**
12 A. Based on the $150-to-$500 per line amount and the reported 4.79 million lines,
13 I would expect to see somewhere between a $718 million and $2.4 billion[8]
14 increase in capital expenditure in the Baseline[9] program between 2010 and
15 2014.
16 **Q. DID THE BUDGET INFORMATION PROVIDE ANY INDICATION THAT**
17 **FRONTIER WAS ANTICIPATING HAVING TO MODERNIZE THE**
18 **SWITCHES THAT IT HAD PURCHASED FROM VERIZON?**

---

[6] Applicants' response to Staff Data Request No. 169.
[7] This is a typical cost per line range that could be calculated from ARMIS data.
[8] The $718 million dollar amount was calculated by multiplying $150 times 4.79 million lines. Likewise, the $2.4 million was calculated by multiplying $500 times 4.79 million lines.
[9] The programs identified in the capital expenditures budget are: Baseline, FiOS, DSL Availability, Backbone, ISP, Operator Services, Fleet, Information Services, and Other. Included in Highly Confidential Exhibit Staff 404, page 12.

1 A. No. There was no indication that Frontier was anticipating having to modernize
2 its switches. The budget information that I reviewed showed capital
3 expenditures by program starting in 2006 and running through 2014. The
4 program entitled Baseline, which is the program which would contain switch
5 modernization, shows an [redacted] percent drop in average expenditures.

6 **Q. IS THIS THE BUDGET PATTERN THAT YOU WOULD EXPECT TO SEE**
7 **GIVEN THE AGE OF THE VERIZON NETWORK?**

8 A. No. This is not the pattern that I would have expected to see. Given the age of
9 the switching, I would have expected capital expenditures to be increasing
10 between now and 2014.

11 **Q. SINCE THE BUDGET DID NOT REFLECT ANY SWITCH**
12 **MODERNIZATION, COULD FRONTIER BE PLANNING TO EXTEND THE**
13 **LIVES OF THE SWITCHES BY BUYING REPLACEMENT PARTS FROM**
14 **THE MANUFACTURER?**

15 A. The purchase of replacement parts has already been taken into account. The
16 average depreciation life provided by the Applicants already takes into account
17 the normal business practices of the firm. The purchase of replacement parts
18 would be a normal business practice that Verizon would have followed and
19 which would have been incorporated in the average life of the switches.

20 **Q. DO YOU CONSIDER THE AGE OF THE SWITCHES A POTENTIAL RISK?**

21 A. Yes. I see two potential risks with having the switches near the end of their
22 expected lives. The first risk is that Frontier does not seem to have
23 incorporated the need to update its switches sometime over the next five years

1 as an assumption in its cash flow projections. Having to replace all of its
2 switches could result in a $718 million-to-$2.4 billion incremental cash
3 requirement between 2010 and 2014. When compared to what Frontier has
4 budgeted for that period, this amount is very substantial. Having to upgrade
5 the switches could put the company at financial risk when it tries to raise the
6 money. The second risky situation could result if Frontier does not upgrade the
7 switches and there is a significant deterioration of service.

8 **Q. DO YOU RECOMMEND ANY ORDERING CONDITIONS THAT CAN BE**
9 **USED TO REDUCE THE RISK RELATED TO THESE SWITCHES?**

10 A. Yes. I recommend ordering conditions 22a and 23c that requires Frontier to
11 put together a strategic plan that establishes end-lives for each of the switches
12 and an estimate of the required capital expenditures that will be required to
13 modernize the switches. A copy of this strategic plan and the discussion of
14 capital expenditures will be provided to the Commission and used to track
15 Frontier's performance.

16 **Q. DO THESE RECOMMENDED ORDERING CONDITIONS PROVIDE A**
17 **REMEDY FOR THIS POTENTIAL PROBLEM?**

18 A. The recommended ordering conditions provide only a partial remedy to the
19 problem. The conditions will make Frontier aware of the state of the switches
20 that it is acquiring and the cost to modernize them, but it does not address how
21 Frontier is going to raise the needed funds to carry out the modernization.

1 **BROADBAND/DSL ISSUES**

2 **Q. PLEASE EXPLAIN STAFF'S CONCERN REGARDING**
3 **BROADBAND/DSL[10] ISSUES?**

4 A. In the Embarq-Century merger, the Federal Communications Commission
5 (FCC) imposed the following condition on the CentryLink:

6 The merged company expects to make substantial additional investment in
7 broadband services. The merged company will offer retail broadband Internet
8 access service to 100 percent of its broadband eligible access lines within
9 three years of the Transaction Closing Date.
10

11 • To meet this commitment the merged company will make
12 available retail broadband Internet access service with a
13 download speed of 768 kbps to 90 percent of its broadband
14 eligible access lines using wire line technologies within three
15 years of the Transaction Closing Date. The merged
16 company will make available retail broadband Internet
17 access service in accordance with the FCC's current
18 definition of broadband to the remaining broadband eligible
19 access lines using alternative technologies and operating
20 arrangements, including but not limited to satellite and
21 terrestrial wireless broadband technologies.

22 • In addition, the merged company will make available retail
23 broadband Internet access service with a download speed of
24 (1) 1.5 Mbps to 87% of the broadband eligible access lines
25 within two years of the Transaction Closing Date and (2) 3
26 Mbps to 75% of broadband eligible access lines within one
27 year of the Transaction Closing Date, 78% of broadband
28 eligible lines within two years of the Transaction Closing
29 Date, and 80% of broadband eligible lines within three years
30 of the Transaction Closing Date.

31 • Broadband eligible access lines are defined as retail single-
32 line residential and single-line business access lines.[11]

[10] DSL stands for Digital Subscriber Line (or loop), which is an Internet connection technology delivering high bandwidth over ordinary telephone lines. Typically DSL providers offer 128 kilobits per second speeds for uploading and 1.5 megabits per second for downloading. DSL technology is one means of providing broadband service to customers.

[11] FCC Order 09-54, WC Docket No. 08-238, Appendix C, page 30.

Q. HOW DOES THIS RULING IMPACT FRONTIER?

A. Since the FCC imposed this condition on CenturyLink, it is highly likely that the FCC will impose the same condition on Frontier.

Q. WHAT PERCENT OF THE VERIZON LINES ARE PRESENTLY DSL-QUALIFIED?

A. Based on the exhibit provided to Staff,[12] ■ percent of its business and residence locations are DSL-qualified. The same exhibit shows that ■ out of ■ locations have no qualified lines and ■ out of the ■ locations have less than 80 percent qualified lines.

Q. DID FRONTIER BUDGET FOR UPGRADES TO THE NETWORK TO ADDRESS THIS DSL REQUIREMENT?

A. Yes, one of the programs broken out in its capital expenditures exhibit[13] explicitly addresses DSL.

Q. DO THE BUDGETED FRONTIER EXPENDITURES SEEM REASONABLE?

A. No, the projected expenditures seem to be very low relative to Frontier's estimate of what it would cost to provide broadband service to its own

[12]Frontier Due Diligence Documents, DSL Availability. Included in Highly Confidential Exhibit Staff 404, page 6.
[13] Applicants' response to IBEW Data Requests Nos. 264-280. Included in Highly Confidential Exhibit Staff 404, page 1.

1 customers.[14] Based on the Frontier information and applying it to locations that
2 Verizon has classified as unqualified[15], Oregon alone would account for
3 55 percent of Frontier's total budgeted expenditures on DSL Program.[16] There
4 are presently nine states Oregon's size, so one would expect Oregon's share
5 to be approximately 11 percent, not 55 percent.

6 **Q. DO YOU CONSIDER THE UNDERESTIMATION OF BROADBAND**
7 **EXPENDITURES A RISK?**

8 A. Yes, I see this as a definite risk. It is highly likely that the FCC will require
9 Frontier to upgrade its network and Frontier has clearly not incorporated this
10 event in its cash flow projections for the next five years.

11 **Q. DO YOU HAVE ANY CONDITIONS THAT WILL REDUCE THE RISK**
12 **ASSOCIATED WITH THE POSSIBILITY THAT THE FCC WILL ISSUE A**
13 **BROADBAND REQUIREMENT LIKE THE ONE IT ISSUED FOR**
14 **CENTURYLINK?**

15 A. Yes. I have two conditions that address the potential risk of the FCC requiring
16 Frontier to deploy DSL service to 100 percent of its customers. They are
17 ordering conditions 22b and 22c that require Frontier to put together a strategic
18 plan that establishes how they will go about upgrading the network to meet the
19 FCC requirement and an estimate of the required capital expenditures that will

[14] Applicants' response to Staff Data Request No. 40. Included in Confidential Exhibit Staff 404, page 1.
[15] An unqualified location, as Verizon is using the term, is a location that is not capable of receiving DSL service.
[16] The amount is calculate by multiplying the estimated Frontier cost per line times the number of Verizon reported lines that do not have DSL service. The calculation is included in Highly Confidential Exhibit Staff 404, page 7.

be required to perform the upgrade. A copy of this strategic plan and the discussion of capital expenditures will be provided to the Commission and used to track Frontier's performance.

Q. DO THESE RECOMMENDED ORDERING CONDITIONS PROVIDE A REMEDY FOR THIS POTENTIAL CASH FLOW PROBLEM?

A. No. The recommended ordering conditions provide only a partial remedy to the potential cash flow problem. The ordering conditions will make Frontier plan for the deployment of broadband services and make it aware of the cost of deploying the plant necessary to provide the service, but it does not address how the company is going to raise the funds needed to pay for the plant.

Q. DO YOU HAVE ANY OTHER ORDERING CONDITIONS?

A. Yes. Ordering condition 23 requires Frontier to provide data that can be used to track the deployment of broadband services. This is data that is annually provided to the FCC so there is only a small incremental cost in providing this data to the Commission.

Q. PLEASE LIST THE RECOMMENDED ORDERING CONDITIONS CONCERNING ENGINEERING, SERVICE ASSURANCE, AND BROADBAND ISSUES.

A. The following are my recommended ordering conditions for engineering, service assurance, and broadband issues:

22. No later than one year from the close of the transaction, Frontier will provide to the Commission the following:

    a. A multi-year strategic plan that establishes the end-life of each of the base units and remote switches currently being deployed

in Verizon's franchise area in Oregon and a proposed replacement for the switch, if any, that ensures Frontier will be able to meet current service standards pursuant to Oregon statutes and rules.

b. In the event the FCC has a merger condition that requires the Company to make additional investment in broadband services, the Company will develop a multi-year strategic plan. This strategic plan will establish the timeline for the deployment of broadband services to each of what are currently Verizon Northwest's 61 wire centers.

c. The planned Oregon capital expenditures concerning the implementation and actions concerning subsections (a) and (b) above. Included in the report will be a comparison of the amount of planned Oregon capital expenditures as a percentage of total system expenditures; and a comparison of the amount of capital expenditure per Oregon access line with the amount of capital expenditure per Frontier Northwest system-wide access lines.

23. The new company will provide in electronic form the detailed, Form-477 data that Verizon is currently providing to the FCC for its service areas. This will be done annually for five years beginning with the final approval of the new company.

1 OPERATIONS AND BUSINESS SUPPORT SYSTEMS ISSUES

2 **Q. WHAT ARE OPERATION SUPPORT SYSTEMS (OSS) AND BUSINESS**
3 **SUPPORT SYSTEMS (BSS)?**

4 A. OSS/BSS are a collection of computer programs and associated databases
5 developed, often in different programming languages, on different computers,
6 using different operating systems. These programs are generally designed
7 independent of one another for very specific purposes. For many activities,
8 such as placing an order, these disparate systems have to "talk" to each other
9 and understand each other. The information pulled from one system often has
10 to be modified and in some cases enhanced in order to be used by another
11 system.

12 **Q. WHAT ACTIVITIES ARE CONTROLLED BY THE OSS/BSS?**

13 A. The OSS/BSS touch almost every activity performed by a telecommunications
14 company. These activities range from engineering activities such as identifying
15 the location of specific cables and pairs and spots where there has been
16 trouble reported to financial activities such as billing customers. Verizon, in its
17 System Overview found in its Realignment Plan, has clustered the systems into
18 18 groups: External IXC Wholesale Access; External CLEC Wholesale Access;
19 Carrier Access Billing; Wholesale Ordering; External Customer and Web &
20 Portal Access; Rating and Customer Billing; Ordering & CRM; Repair/Tech
21 Support; Test Management; Enterprise Management; Billing Mediation;
22 Inventory Provisioning & Activation, Network Plan & Design; Network

1 Engineering; Fault Management; Security Management; Workforce
2 Management; and Performance & SLA Monitoring.[17]

3 **Q. IS THE PROPER FUNCTIONING OF THESE SYSTEMS IMPORTANT TO**
4 **A COMPANY'S SUCCESS?**

5 A. Yes. Failure of the systems to function correctly can lead to serious problems
6 for both the company and its customers.

7 **Q. CAN YOU PROVIDE A SPECIFIC EXAMPLE OF WHERE THIS WAS THE**
8 **CASE?**

9 A. Yes. FairPoint Communications (FairPoint) is a specific example of where
10 failure of its OSS/BSS is having a serious impact on both the company and its
11 customers. The company filed for bankruptcy because of financial problems
12 arising in part because of its OSS/BSS problems. Due to system failures the
13 company has been unable to meet its contractual agreements with the
14 Competitive Local Exchange Carriers (CLECs) and has incurred substantial
15 expenses trying to remedy the problems. These expenses are in addition to
16 the fines imposed by the state regulatory commissions. The following
17 passages taken from the Kennebec Journal give some idea of the problems:

18 FairPoint Communications owes more than $845,000 to
19 competitive local phone carriers in Maine for giving them poor
20 wholesale service, but is asking the Maine Public Utilities
21 Commission to toss out the penalties.
22
23 Bragdon, who also represents GWI, Time Warner and other
24 competitive carriers in the data request, said FairPoint's service
25 problems on the network have cut into carrier profit margins.
26 They lose money when people and businesses sign up to

[17] NCIH Realignment Plan, September 22, 2009, p. 106.

> change carriers, but are unable to make the switch. And they spend money and use up work time trying to compensate for Fairpoint's problems, she said.[18]

Q. HOW DID THESE PROBLEMS WITH OSS/BSS MANIFEST THEMSELVES?

The following passage taken from Billing and OSS World provides a good look at what happened at cut over to the new systems:

> FairPoint rescheduled its final cutover several times and, when it did move all subscribers onto a single system, chaos ensued. Many customers lost phone and Internet access for days and billing errors became the norm. In fact, FairPoint only recently removed a notice from its Web site that warned customers of continued miscalculations — more than six months after switching from Verizon's software.[19]

Q. HAVE FAIRPOINT'S OSS/BSS PROBLEMS HAD A FINANCIAL IMPACT ON ANY OF ITS CUSTOMERS?

A. Yes. As was mentioned in the above quotes taken from the Kennebec Journal, the CLECs have been financially hurt by FairPoint's inability to provide them on a timely basis the network components that they need to provision the services that the CLECs provide their customers. Even CLECs that only require the telephone numbers to be transferred to them for their customers have been impacted.

[18] "FairPoint Seeks Debt Relief" Kennebec Journal, July 7, 2009.
[19] "FairPoint: Back-Office Snafus Crushed a Company--Rural LEC on Verge of Bankruptcy", Billing and OSS World, 10/05/2009.

Q. DO YOU THINK THE PROBLEM THAT FAIRPOINT IS HAVING WITH ITS OSS/BSS IS DUE TO THE LACK OF EXPERIENCE OF CAPGEMINI, THE CONSULTING COMPANY THAT ASSEMBLED THE SYSTEMS?

A. Initially I did. My first thought was that Fairpoint had hired an inexperienced company to put together its OSS/BSS, but after investigating Capgemini, I no longer hold that belief. Even though Capgemini had never put together a fully integrated OSS/BSS, the company was experienced at modifying the individual software packages that made up the OSS/BSS. When questioned about its expertise, Capgemini had the following response to the assertion that it did not have any experience with this type of project:

> In fact, Capgemini is unaware of any previous ILEC full system suite start-up other than the Hawaiian Telecom project. Capgemini has informed FairPoint that it has been previously engaged by 7 of the 10 largest ILECs. Those engagements have included work in customer care and ordering systems, billing systems, wholesale systems, network management and OSS systems, and accounting and financial systems. They have also been involved with data migrations and data conversions involving millions of customers. Additionally, Capgemini has done full system suite start-ups for CLECs and very large wireless telecommunications carriers. Capgemini has also been involved with very significant network technology in-service migrations.[20]

Q. WAS CAPGEMINI USING IT OWN SOFTWARE PACKAGES TO BUILD THE SYSTEM?

A. No, Capgemini was not using its own software. It was using commercially available packages that had been successfully used for similar applications and modifying them to fit this specific application.

1
2 **Q. WHAT DO YOU THINK WENT WRONG WITH FAIRPOINT'S OSS/BSS**
3 **CONVERSION?**

4 A. Clearly trying to make the conversion without allowing enough time was a
5 major problem. The $16 million per month that FairPoint had to pay Verizon for
6 using Verizon's systems almost certainly forced FairPoint to reduce the scope
7 of testing that it performed on the systems. Another major problem was the
8 data that FairPoint was entering into the system.

9 **Q. WHY DO YOU THINK THERE WAS A PROBLEM WITH THE SCOPE OF**
10 **TESTING?**

11 A. The tests that were performed on the systems with the sample data provided
12 by Verizon all indicated that the systems were functioning as they should be
13 and that there would be no major problems when the systems went live.[21]
14 When the system went live, it was no longer using the sample data that
15 Verizon had been providing; it was using the actual, unedited data. Had the
16 company requested samples of the data that the OSS/BSS was actually going
17 to use, the testing might have uncovered the problems that were later
18 discovered only after the systems went live.

19

[20] State of New Hampshire, Docket No. DT 07-011, NECT AICPNH FDR III-16, June 11, 2007.
[21] "FairPoint Cutover Monitoring Status Report", Summary, The Liberty Consulting Group, January 14, 2009, page 8. Include in Exhibit Staff 402, page 1.

Q. WHY WAS THE DATA THAT CAPGEMINI WAS ENTERING INTO THE SYSTEM A PROBLEM?

A. The data that Verizon had provided to Capgemini and Fairpoint was a set of samples that Verizon had pulled from its systems and modified so all the data sets were in their ideal form: completely populated and all input errors removed. When the FairPoint systems went live, the data sets were the raw data, not the modified one. The following discussion taken from the Liberty Consulting Group's "Cut Over Status Report" provides a good look at what happened with the data (emphasis added):

> FairPoint and Capgemini performed simulations and tests of the conversion of the extracted Verizon data **using several rounds of test data extracts received from Verizon**. These tests were performed to assure that the converted data was as complete as possible and properly mapped into the new systems. Through this testing, FairPoint and Capgemini identified a number of gaps in the Verizon data. They understood these gaps to be inherent in the data and expected them to be filled in after cutover. In addition, FairPoint and Capgemini concluded that it was not feasible to convert all the data automatically and therefore established manual processes to convert this data. Some of those processes were expected to continue for a number of weeks after cutover. **In addition, given the extent and complexity of the Verizon data and extraction process and the fact that Verizon often uses multiple data sources for the same data types,** it was anticipated that additional data defects and incorrect data mapping would be uncovered at cutover. However, the impact of these data issues should have been relatively limited, affecting such transactions as ordering, trouble reporting, and billing on only a few accounts. **Instead, data problems have affected a large number of accounts. These unexpected problems have included such issues as incorrect data mapping and misinterpretation of Verizon data, and have had a major impact on such critical functions as loop qualification, validation of customer addresses, assignment**

of telephone numbers, and identification of serving wire centers for customers.[22]

Q. WHAT HAVE YOU LEARNED FROM WHAT HAPPENED TO FAIRPOINT?

A. There are number of things that I learned concerning OSS/BSS conversions. First, OSS/BSS systems are critical to both the company and the customers of the company, in particular the CLECs. Second, comprehensive conversions of OSS/BSS should be done more slowly and tested in parallel with the existing systems. Third, the data being passed to the new OSS/BSS needs to be thoroughly reviewed and edited so all entries in each field are correct. And last, there should be comprehensive training on the systems that make up the OSS/BSS provided to all user groups, both inside and outside the company.

Q. ARE THERE ANY SIMILARITIES THAT YOU SEE BETWEEN FAIRPOINT'S OSS/BSS CONVERSION AND WHAT FRONTIER IS PLANNING ON DOING WITH THE VERIZON OSS/BSS SOMETIME AFTER THE TRANSACTION IS COMPLETED?

A. Yes. On the issue of OSS/BSS, I see a number of similarities between the two companies: first, FairPoint wanted to convert all of the Verizon OSS/BSS to its own OSS/BSS; Frontier would like to do the same; second FairPoint was facing a $16 million dollar per month charge for using the Verizon systems; Frontier is facing a $94 million dollar per year maintenance charge; and third both companies are having to extract data from Verizon systems so they both did or will be facing the same data problems.

[22] "FairPoint Post-Cutover Status Report", The Liberty Consulting Group, April 1, 2009.

1 **Q. IS VERIZON STILL RUNNING GTE SYSTEMS TEN YEARS AFTER THE**
2 **BELL ATLANTIC-GTE MERGER?**
3 A. Yes. Verizon is still running legacy GTE systems.[23] Apparently, Verizon never
4 created a standard OSS/BSS for all of its operations.
5 **Q. PLEASE FURTHER EXPLAIN THE $94 MILLION DOLLARS THAT YOU**
6 **MENTIONED ABOVE.**
7 A. One of the merger agreements is the Software License Agreement, which
8 requires Frontier to pay $94 million dollars a year for maintenance services on
9 the Verizon proprietary systems that it is receiving from Verizon. This
10 agreement appears to be similar to the agreement that Fairpoint signed with
11 Verizon for $16 million per month. The $94 million plus an adjustment for
12 inflation is due at the end of each year that the agreement is in force.
13 **Q. DOES $94 MILLION FOR MAINTENANCE ON THESE SYSTEMS SEEM**
14 **TO BE EXCESSIVE?**
15 A. Yes. Based on my calculations, the $94 million per year is roughly equivalent
16 to [redacted] hours of maintenance[24] each year on systems that are supposed to
17 be fully functional and tested at the time that they are handed off to Frontier.
18 What makes the $94 million seem high is the fact that Verizon is transferring
19 support personnel to Frontier to run and perform maintenance on these same

---

[23] Public Utility Commission of Ohio, Case No. 09-454-TP-ACO Oral Deposition of Mr. Timothy McCallion, September 30, 2009, p 17. Included in Exhibit Staff 402, page 2.
[24] This is estimated by dividing the $94 million by [redacted] per hour training rate provided in the Software License Agreement.

1 systems.[25] The $94 million dollars is for services beyond those provided by the
2 people who will be transferred.

3 **Q. ASIDE FROM THE SIZE OF THE DOLLAR AMOUNT, WHAT IS UNUSUAL**
4 **ABOUT THIS SOFTWARE MAINTENANCE CONTRACT?**

5 A. What I found particularly unusual about the contract is that a price was agreed
6 to before either company knew what activities or what level of activities were to
7 be performed. On the first page of the Verizon Software License Agreement[26],
8 in section 1.3, the Annual Maintenance Fee is set at $94 million. At the end of
9 section 7.4, the reader is sent to Schedule A for a full description of the
10 services that will be provide. In Schedule A, the only reference to the nature of
11 the services to be provided is the following:

12
13

14 **Q. AS PART OF THE AGREEMENT VERIZON PERSONNEL WILL BE**
15 **TRANSFERRED TO FRONTIER TO RUN THE VERIZON PROPRIETARY**
16 **SYSTEMS BEING GIVEN TO FRONTIER. HAVE YOU BEEN ABLE TO**
17 **DETERMINE IF THESE ARE THE CRITICAL PERSONNEL NEEDED TO**
18 **ENSURE THAT THE SYSTEMS ARE FUNCTIONING CORRECTLY?**

19 A. Yes. I have been able to determine that the people who will be running the
20 systems are not necessarily the experts on those systems. The personnel
21 being transferred are the ones already working at the Fort Wayne data

[25] Oral Deposition of Mr. Timothy McCallion, Ohio PUC, September 30, 2009, page 58. Included in Exhibit Staff 402, page3.

1 center.[27] Some of these people will be familiar with the systems presently
2 running on the Fort Wayne computers, but it is unlikely they will be familiar with
3 the systems that are being replicated and ported to the Fort Wayne data
4 center. Even if they are familiar with the systems, it is highly unlikely that they
5 are the system experts. The people who will be running all of the systems that
6 will be located at Fort Wayne are the people who are presently located at Fort
7 Wayne.

8 **Q. DOES THIS MEAN THE SYSTEM EXPERTS MAY NOT BE**
9 **TRANSFERRED TO FRONTIER?**

10 A. Yes, it does. If the system is one that is being replicated and ported to the Fort
11 Wayne data center, it will not have the system experts supporting it. It is
12 possible under this circumstance to have someone with no knowledge of the
13 software trying to support it.

14 **Q. ARE THERE ANY OTHER CONCERNS THAT YOU HAVE REGARDING**
15 **THE SOFTWARE LICENSE AGREEMENT?**

16 A. Yes, I have another concern. On page 8, Paragraph 6.1 of the Software
17 License Agreement[28]
18

[26] Software License Agreement. Included in Staff Exhibit 404, pages 8-11.
[27] Oral Deposition of Mr. Timothy McCallion, Ohio PUC, September 30, 2009, page 27. Included in Exhibit Staff 402, page 4.
[28] Included in Highly Confidential Staff Exhibit 404, page 9.

[redacted]. To make changes one would have to have the source code

Q. WHY IS THIS A CONCERN?

A. With programs provided in [redacted], Frontier would have to go back to Verizon to get help if there were errors in the code, changes that need to be made to the code, or there is a requirement to understand what the code is doing.

Q. WHAT ARE YOUR CONCLUSIONS ABOUT THE OSS/BSS PACKAGE THAT FRONTIER WILL BE RECEIVING?

A. Based on the information provided by the Applicants, as well as information gathered during interviews with the people in Vermont, New Hampshire, and Maine, I conclude that there are numerous potential risks associated with a full conversion of the OSS/BSS. I encourage Frontier to address these risks and explain how the risks will be mitigated in its reply testimony.

Q. WHAT ARE THE POTENTIAL RISKS THAT YOU WISH TO SEE ADDRESSED?

A. If the OSS/BSS systems do not work properly, I see financial risks to Frontier, like the one that occurred with FairPoint. If Frontier encounters the same problems that FairPoint encountered, Frontier could encounter higher than expected costs in the form of fines and generally increased system operating expenses. It could also experience higher than expected revenue losses

---

[29] Object Code is the machine-language output of a compiler that is ready for execution on a particular computer.

resulting from the OSS/BSS problems, as customers walk away from what they perceive to be a poorly run company. I also see risks for Frontier's CLEC customers whose businesses are dependent upon the timely supply of the components needed to provision the services that they provide their own customers.

Q. DO YOU HAVE ANY CONDITIONS THAT WILL INCREASE THE LIKELIHOOD THAT FRONTIER WILL MAKE THE NECESSARY UPGRADES TO ITS NETWORK?

A. Yes, conditions 28 and 29. Condition 28 lays out the steps that Frontier and Verizon must go through to get the replicated systems up and running properly and to get the complete set of data feeding into those systems reviewed and edited. Condition 28 also requires Frontier to use the Verizon systems for a minimum of three years while its personnel get familiar with the data contained in those systems. Condition 29 requires Verizon to provide a time and material replacement for the $94 million per year Maintenance Service agreement.

Q. DO THESE CONDITIONS PROVIDE A REMEDY FOR THIS POTENTIAL PROBLEM?

A. No. The conditions only provide a partial remedy to the problem. The full remedy would require monitoring and controlling the actions of the company as it migrates from the Verizon systems to its own OSS/BSS.

Q. PLEASE LIST YOUR RECOMMENDED ORDERING CONDITIONS CONCERNING THE OSS/BSS.

A. The following are my OSS/BSS recommended ordering conditions:

28. For a period of not less than three years after the close of the transaction, Frontier will use the Verizon replicated OSS/BSS systems.

    a. During the six-month period before the close of the transaction, Frontier, with Verizon's assistance and that of a third party tester, will validate that all of the OSS/BSS systems have been completely replicated based on a test plan that has been distributed to all UM 1431 parties for review and comment. The test plan must be distributed at least two weeks prior to the beginning of the tests. A copy of a report detailing the test and results will be provided to the Commission.

    b. During the six-month period before the close of the transaction, Verizon with a third party reviewer will review and correct data errors in all data bases being passed to Frontier and ensure that at least ninety-nine percent of the records have all critical fields correctly populated. Verification results will be provided to the Commission.

    c. At least two weeks prior to the final cut over, CLECs will be allowed to test the systems using their own data. The replicated wholesale systems will not be used until a majority of the CLECs approve the systems or upon Commission order.

29. Prior to the close of the transaction, Frontier and a subsidiary of Verizon shall have entered into an agreement which obligates Verizon to provide system support on a time and material basis for a minimum of ten years. The hourly charge will not exceed the training rate of $125 per hour, adjusted for inflation, and will replace the $94 million per year contract currently in place. No fees will be charged for entering into this agreement.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes.

CASE: UM 1431
WITNESS: Roger White

PUBLIC UTILITY COMMISSION OF OREGON

STAFF EXHIBIT 401

Witness Qualification Statement

November 2, 2009

WITNESS QUALIFICATION STATEMENT

NAME:	Roger White
EMPLOYER:	Public Utility Commission of Oregon
TITLE:	Program Manager Cost Analysis
ADDRESS:	550 Capitol St. NE, Suite 215 Salem, Oregon 97301-2551
DEGREES:	MBA – Finance /Quantitative Methods University of Washington
	BS –Mathematics, Minors: Physics/Chemistry University of Washington
OTHER EDUCATION:	Ph.D. Candidate in Business Economics/Finance University of Texas-Arlington
	Technical Certification: Electronics and Calibration Techniques. Aberdeen Proving Grounds

PROFESSIONAL EXPERIENCE:

Program Manager Cost Analysis, Public Utility Commission of Oregon (OPUC), 2008- Present.

Prior Experience:
Senior Telecommunications Analyst, OPUC, 2001-2008.
Manager Cost Models and Methodology, GTE/Verizon-Irving, 1995-2001.
Manger Process Cost, GTE, 1994-1995, GTE-Irving.
Manager Research/Methods, GTE-Stamford, 1989-1994.
Staff Manager Pricing Policy, GTE-Stamford, 1987-1989.
Administrator Demand Analysis, GTE-MTO, 1982-1987.
Administrator Pricing, GTE-Northwest, 1981-1982.
Administrator Economic Research, GTE-Northwest, 1977-1981.
Administrator Operations Research, GTE-Northwest, 1976-1977.

CASE: UM 1431
WITNESS: Roger White

PUBLIC UTILITY COMMISSION
OF
OREGON

STAFF EXHIBIT 402

Exhibits in Support
Of Direct Testimony

November 2, 2009

problems affecting the ordering and provisioning do not materialize, FairPoint may be able to improve on its current projections for the post-cutover provisioning intervals. If this occurs, FairPoint has indicated that it will communicate with its retail and wholesale customers about the availability of improved provisioning intervals. FairPoint also has contingency plans if the opposite occurs, and additional problems arise to lengthen the intervals, including such actions as further redeployment of existing employees.

6. Other Cutover Preparation Matters.

On January 6, FairPoint successfully received E911 data from Maine and transmitted this information to Intrado, the vendor FairPoint is using to maintain the Automatic Location Identification ("ALI") database that will support E911 service in Maine after cutover. On January 9, FairPoint began the dual processing of E911 database updates on schedule in order to be prepared to transition from the Verizon to the FairPoint/Intrado management of the E911 system in Maine at cutover.

FairPoint is continuing its dry runs of the cutover process to assure that it proceeds efficiently. In addition, FairPoint is continuing to refine its cutover project plan and the roles and responsibilities of the Cutover Mission Control Center ("CMCC"), which will operate out of Manchester, NH, and will coordinate and track all the activities during cutover.

Summary

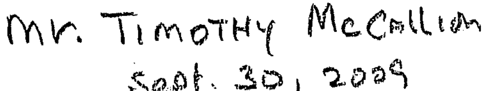
Overall FairPoint appears to be on track to achieve a relatively successful cutover beginning on January 30. In particular, the following issues that were the subject of concern in November are proceeding satisfactorily:

- Documentation of key business processes
- Training
- Data extract and conversion testing
- Plans for temporary staffing.

On the other hand, DUF testing is still in progress and may not be complete by cutover. Some other wholesale issues also remain open. Nevertheless, Liberty notes that if these issues remain open at cutover, they will have limited overall impact, although definitely of concern for those customers affected.

As Liberty has noted in the past, it is likely that material unexpected issues will arise during cutover. However, Liberty believes that FairPoint's preparations overall are adequate to reduce the likelihood that these issues will be serious ones.

1 Now, back to that question regarding the
2 statement regarding long distance service on page three
3 of your testimony, that it would stay substantially the
4 same, what does the word "substantially" mean there?
5 A. And you're referring to lines --
6 Q. Lines 14 and 15, I'm sorry.
7 A. Okay. Very similar to what we meant with the
8 ILEC services, that to the extent that there are raise in
9 charges for services, that they will continue to be the
10 same as they are today.
11 The rationale for putting in substantially
12 there is there may be a situation, for example, if a
13 calling card is bundled with long distance services, it
14 would no longer be the Verizon calling card. That would
15 remain with Verizon, but Frontier may very well offer a
16 Frontier calling card associated with the service.
17 Q. Now, on pages two and three of your
18 testimony -- of your direct testimony, you state that
19 Frontier North will use the same back office and networks
20 used by Verizon North. Is the current system in Ohio a
21 legacy GTE system or is that one Verizon installed after
22 the merger between GTE and Bell Atlantic?
23 A. The operation support systems are generally
24 legacy GTE systems.
25 Q. Will Frontier physically use the same system or



1 software.

2 Q. Under the terms of the Maintenance Agreement,

3 will Verizon be operating parts of the systems that are

4 transferred to Frontier?

5 A. Frontier will be operating the systems out of

6 the Fort Wayne -- will be operating the systems out of

7 the Fort Wayne data center. Verizon will be providing

8 the maintenance service for those systems.

9 Q. And those maintenance services will include

10 operations of some of those systems; is that right?

11 A. You know, I wouldn't call it operations of the

12 systems. What maintenance for software typically

13 includes is providing updates to the systems, if there's

14 bugs identified in systems. You know, with any computer

15 system, even if it's been operating for many years, there

16 are bugs that occur from time to time that have to be

17 taken care of. There's ongoing maintenance for something

18 that wasn't contemplated when the system was designed.

19 That's the type of work that we will be doing.

20 Systems require not only operations, but they

21 require ongoing maintenance on a regular basis and that's

22 what Verizon will be -- that's what Verizon will be

23 performing under this agreement.

24 Q. And Verizon will also provide training

25 services, correct?

1 of the long distance where we were before.

2 Q. Yeah.

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

13 But I'm sure you're aware there is a
14 maintenance agreement that Frontier has entered into on a
15 commercial basis with Verizon and Verizon personnel will
16 be maintaining those systems on Frontier's behalf for a
17 minimum of one year and possibly five years or more. So
18 on the -- on the portion of the maintenance, it will, in
19 fact, be Verizon personnel who will be maintaining them
20 both for Verizon and for Frontier.

21 Q. Now, you know, we obviously are concerned with,
22 you know, the level of employment that Frontier will
23 continue to maintain here. And on page 16, and I've got
24 the line numbers here, 11 through 13 of your direct
25 testimony, you state that Verizon employees in the State

Mr. Timothy McCallion
Sept. 30, 2009

CASE: UM 1431
WITNESS: Roger White

PUBLIC UTILITY COMMISSION
OF
OREGON

STAFF EXHIBIT 403

Exhibits in Support
Of Direct Testimony

November 2, 2009

STAFF EXHIBIT 403

IS CONFIDENTIAL AND SUBJECT TO PROTECTIVE

ORDER NO. 09-197. YOU MUST HAVE SIGNED

APPENDIX B OF THE PROTECTIVE ORDER IN

DOCKET UM 1431 TO RECEIVE THE

CONFIDENTIAL VERSION

OF THIS EXHIBIT.

CASE: UM 1431
WITNESS: Roger White

PUBLIC UTILITY COMMISSION
OF
OREGON

STAFF EXHIBIT 404

Exhibits in Support
Of Direct Testimony

November 2, 2009

STAFF EXHIBIT 404

IS HIGHLY CONFIDENTIAL AND SUBJECT TO

SUPERSEDING HIGHLY CONFIDENTIAL PROTECTIVE

ORDER NO. 09-273. YOU MUST HAVE SIGNED

APPENDIX B OF THE SUPERSEDING HIGHLY CONFIDENTIAL

PROTECTIVE ORDER IN

DOCKET UM 1431 TO RECEIVE THE

HIGHLY CONFIDENTIAL VERSION

OF THIS EXHIBIT.

CASE: UM 1431
WITNESS: Wolodymyr Birko

PUBLIC UTILITY COMMISSION OF OREGON

STAFF EXHIBIT 500

Direct Testimony

November 2, 2009

Q. PLEASE STATE YOUR NAME, OCCUPATION, AND BUSINESS ADDRESS.

A. My name is Wolodymyr Birko. I am a Senior Telecommunications Engineer for the Public Utility Commission of Oregon (Commission). My business address is 550 Capitol Street NE Suite 215, Salem, Oregon 97301-2551.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND WORK EXPERIENCE.

A. I hold a degree of Bachelor of Science in Electrical Engineering from Wayne State University in Detroit MI.

I worked as a Telephone Engineer at the Michigan Bell Telephone Company as a central office, PBX and Teletype engineer from 1968 to 1974.

I worked as a Telecommunications Engineer with the Michigan Public Service Commission dealing primarily with Quality of Service issues from 1974 to 1979.

I have been working as a Senior Telecommunications Engineer with the Public Utility Commission of Oregon from 1979 to the present.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. My testimony analyzes the quality of voice telecommunications service (POTS) currently provided by Frontier and Verizon and evaluates the service-quality related testimony of the Frontier and Verizon witnesses. I also present my analysis on the impact this merger will have on the quality of voice telecommunications service to be provided by the two “incumbent local exchange carrier” (ILEC) entities created by the merger of Verizon and Frontier: (1) the former Verizon will become Frontier Northwest (FNW) and (2) Citizens Telecommunications Company of Oregon CTCO.

1

2 **Q. HOW IS YOUR TESTIMONY ORGANIZED?**

3 A. My testimony is organized as follows:

4 Issue 1, ------Conclusions and recommendations 2
5 Issue 2, ------Consequences of unmet service quality standards 6

<u>ISSUE 1, CONCLUSIONS AND RECOMMENDATION</u>

6 **Q. WHAT ARE YOUR SERVICE QUALITY CONCLUSIONS AND**
7 **RECOMMENDATIONS BASED UPON?**

8 A. My conclusions and recommendation are based upon statements Frontier
9 makes in its opening testimony about the proposed transaction. In particular,
10 Frontier testifies that all necessary Verizon network support personnel and
11 operational support systems will be kept after the merger so that the FNW
12 service quality levels should be maintained or improve. This is described in
13 FTR/100, McCarthy 48-50.

14 **Q. WHAT SERVICE QUALITY MEASUREMENTS MUST BE REPORTED BY**
15 **FNW)?**

16 A. The FNW entity will be a "large" ILEC subject to ORS 759.450 and OAR 860-
17 0023-0055. As such, FNW must report the following service quality measures:

18 • Repair Service Center Answer Time-Standard: Average speed of
19 answer 50 seconds or 80% within 20 seconds per month;

20 • Business Office Center Answer Time-Standard: Average speed of
21 answer 50 seconds or 80% within 20 seconds per month;

22 • Commitments for service-Provisioning-Standard: 90%;

1 • Repair cleared within 48 hours-Standard by repair center: 95%; and
2 • Monthly trouble report rate by wire center-Standard: greater than 1000
3 lines-2 per 100 working access lines; less than 1000 lines- 3 per 100
4 working access lines. If a wire center exceeds these numbers for four
5 out of twelve months, it is deemed out of standard.
6 **Q. WHAT SERVICE QUALITY MEASUREMENTS MUST BE REPORTED BY**
7 **CTCO?**
8 A. Pursuant to ORS 759.040, CTCO is a “small” ILEC that is subject to the service
9 quality standards and reporting requirements set forth in OAR 860-034-0390.
10 As such, CTCO must report Commitments met-provisioning, Repair Cleared
11 within 48 hours, and Monthly Trouble Report rates by wire center. CTCO is not
12 required to report Business Office or Repair Service center answer times in
13 accordance with ORS 759.450 (9).
14 Neither FNW nor CTCO may change the form of the reports after the merger
15 without Staff concurrence. Further, FNW and CTCO should report service
16 quality measurements on a monthly basis so Commission Staff (Staff) can
17 ensure that service quality levels are being maintained.
18 **Q. WHY SHOULD BOTH OPERATING COMPANIES BE REQUIRED TO**
19 **REPORT SERVICE QUALITY LEVELS?**
20 A. The current service quality levels as of May, 2009, indicate that both FNW and
21 CTCO are providing adequate levels of voice telecommunications service.
22 However, I should point out that service quality levels for both entities may
23 degrade to the minimum acceptable service levels as described in the two

1 administrative rules before Staff would take actions related to inadequate
2 service.

3 **Q. WHAT DO YOU CONCLUDE WITH RESPECT TO FNW'S ABILITY TO**
4 **PROVIDE ADEQUATE INTRASTATE VOICE TELECOMMUNICATIONS**
5 **SERVICE?**

6 FNW is capable of providing adequate service as a large telecommunications
7 utility.

8 **Q. HOW DID YOU ARRIVE AT THIS CONCLUSION?**

9 I arrived at this conclusion based on the current service quality measures for
10 Verizon and by examining a list of major cities throughout the country that
11 Frontier currently serves. Some of these cities and their populations are:

12 - Rochester, NY – 231,636
13 - Elk Grove, CA – 17,483
14 - South Minneapolis/ St. Paul Metro, MN - 119,362
15 - Dallas/Wilkes-Barre /Scranton, PA – 131,895
16 - Lake Havasu City, AZ – 24,363
17 - Bullhead City, AZ – 21,951

18 This latter examination assuaged my concern that Frontier is too small to take
19 over the Verizon customer base, especially in the economically sensitive areas
20 surrounding the Portland/Beaverton metro area. Additionally, I called the
21 regulatory commissions in New York and Minnesota to ask about Frontiers'
22 service quality. The regulatory commissions made favorable comments
23 regarding Frontiers' service.

1 **Q. WHAT DOES YOUR REVIEW OF SERVICE QUALITY LEVELS FOR BOTH**
2 **VERIZON AND CTCO SHOW?**
3 A. My review of 12 months of Verizon service quality results indicates that
4 Verizon is currently providing adequate service. PUC Order No. 07-500
5 relieved Frontier from reporting service quality results because Frontier met all
6 service standards for 12 consecutive months in all of their wire centers. I
7 obtained 12 months of service data from Frontier as a result of Staff Data
8 Request No. 47. My evaluation of those results is that they exceed minimum
9 acceptable standards.
10 **Q. IN YOUR OPINION, WHAT WILL HAPPEN TO THE VOICE SERVICE**
11 **QUALITY OF FNW (VERIZON) AND CTCO AFTER THE MERGER?**
12 A. I do not expect any degradation of service provided by FNW or CTCO. That
13 service should stay about the same, assuming all the necessary Verizon
14 maintenance personnel and Operational Support Systems are kept after the
15 merger.
16 **Q, WHAT SHOULD FNW REPORT TO THE COMMISSION CONCERNING**
17 **TELECOMMUNICATIONS SERVICE QUALITY?**
18 A. FNW should report the following items monthly:
19 - Repair Service Center Answer Times
20 - Business Office Service Center Answer Times
21 - Commitments Met for Provisioning
22 - Repair Cleared Within 48 Hours
23 - Monthly Trouble Reports by Wire Center

1 **Q. WHAT SHOULD CTCO REPORT TO THE COMMISSION CONCERNING**
2 **TELECOMMUNICATIONS SERVICE QUALITY?**
3 A. CTCO should report the following items monthly:
4 - Commitments Met for Provisioning
5 - Repair Cleared Within 48 Hours
6 - Monthly trouble Reports by Wire center

7 **Q. WHY SHOULD THESE REPORTS BE SUBMITTED MONTHLY?**
8 A. Both the FNW (55) wire centers and the CTCO (Frontier (10)) wire centers
9 should be reported. The Commission should rescind Order No 07-500 granting
10 Frontier exclusion from filing service quality reports, not as an indication of poor
11 service, as that order states, but to allow the Commission to monitor service
12 quality trends post merger for the two entities.

13 **Q. FOR HOW LONG SHOULD THESE REPORTS BE SUBMITTED?**
14 The reporting should be maintained for a minimum of three years. After three
15 years, the companies should be able to petition for an exception.

16 **ISSUE 2, CONSEQUENCES OF UNMET SERVICE QUALITY STANDARDS**

17 **Q. WHAT WILL HAPPEN IF FNW OR CTCO DO NOT MEET THE CURRENT**
18 **VOICE SERVICE STANDARDS?**
19 A. Staff will review the FNW and CTCO reports monthly. If the reported
20 measurements degrade, Staff may apply the procedures and remedies found
21 in ORS 759.450 and OAR 860-0023-0055 and OAR 860-034-0390. These

1 procedures can also include seeking fines in accordance with ORS 759.450
2 and 759.990.

3 **Q. PLEASE PROVIDE AN EXAMPLE OF HOW YOU MIGHT APPLY THESE**
4 **PROCEDURES IN THE CASE OF INADQUATE VOICE SERVICE**
5 **QUALITY.**

6 A. As stated in ORS 759.450 (5), the Commission could require either CTCO or
7 FNW (or both) to file a plan for improving performance to meet the standards in
8 the relevant Commission rules that were not met. The Commission, at a public
9 meeting, would review the plan and either approve or disapprove of it. If the
10 carrier does not meet the goals of its improvement plan within six months or if
11 the Commission disapproves the plan, penalties may be assessed against the
12 offending entity. Penalties would be assessed in accordance with the
13 provisions of ORS 759.990 (6). The total annual penalties are not to exceed
14 two percent of Frontier's and Verizon's gross intrastate revenue from the sale
15 of Commission-regulated voice telecommunications services for the calendar
16 year proceeding the year in which the penalties are assessed.

17 **Q. WHAT IF THESE PROCEDURES AND REMEDIES ARE NOT**
18 **SUCCESSFUL IN RESTORING SERVICE TO A LEVEL MEETING THE**
19 **GOALS OF THE PERFORMANCE PLAN?**

20 A. If, after applying these procedures and remedies, Staff determines that FNW,
21 CTCO, or both, are not substantially complying with the Commission's retail
22 service standards, then Staff may offer testimony in a future rate case
23 recommending the use of the lowest rate of return until there is substantial

1 compliance with the Commission's retail service quality standards as set forth
2 in the performance improvement plan.

3 **Q. WHAT REQUIREMENTS DO YOU RECOMMEND THE COMMISSION**
4 **ORDER IF IT APPROVES THE ACQUISITION?**

5 A. I recommend

6 • Frontier (CTCO) be ordered to resume reporting service quality results
7 monthly by rescinding order No. 07-500 and ordering such reporting.
8 This is not indicative of substandard service. CTCO may not change
9 the format of the reports without Staff concurrence. This is covered by
10 condition 18 below.

11 • Verizon (FNW) should continue to report service quality results
12 monthly. The format of the reports may not change without Staff
13 concurrence. This is covered by condition 18 below.

14 • The Commission order FNW to execute the maintenance personnel
15 transition described in Frontier witness McCarthy's testimony to include
16 all necessary maintenance personnel and their management
17 personnel, and operational support systems. This is covered by
18 conditions 19 and 20 below.

19 These recommendations are presented as the following Staff recommended
20 ordering conditions:

21 18 Immediately after the close of this transaction, Citizens
22 Telecommunications Company of Oregon (CTCO) will resume
23 reporting service quality results monthly. Frontier Northwest will
24 continue to report service quality results monthly.
25

19. Frontier Northwest will implement an organizational structure described in FTR/100, McCarthy/48-49.

20. Frontier Northwest will implement the employee integration described in FTR/100, McCarthy/49-50.

21. Frontier Northwest will maintain current Commission's minimum service quality standards as are currently being reported in Verizon's monthly service quality reports to the Commission. If Frontier fails to maintain the current service quality levels, it will be liable for penalties as set forth in ORS 759.450.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes.

CASE: UM 1431
WITNESS: Kay Marinos

PUBLIC UTILITY COMMISSION
OF
OREGON

STAFF EXHIBIT 600

Direct Testimony

November 2, 2009

CERTAIN INFORMATION CONTAINED IN STAFF EXHIBIT 600

IS CONFIDENTIAL AND SUBJECT TO PROTECTIVE

ORDER NO. 09-197. YOU MUST HAVE SIGNED

APPENDIX B OF THE PROTECTIVE ORDER IN

DOCKET UM 1431 TO RECEIVE THE

CONFIDENTIAL VERSION

OF THIS EXHIBIT.

1 **Q. PLEASE STATE YOUR NAME, OCCUPATION, AND BUSINESS**
2 **ADDRESS.**
3 A. My name is Kay Marinos. I am the Program Manager for the Competitive
4 Issues Section of the Public Utility Commission of Oregon. My business
5 address is 550 Capitol Street NE Suite 215, Salem, Oregon 97301-2551.
6 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND WORK**
7 **EXPERIENCE.**
8 A. My Witness Qualification Statement is found in Exhibit Staff/601.
9 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**
10 A. The purpose of my testimony is to identify the potential harms of the proposed
11 transaction, and to recommend remedies to mitigate those potential harms, as
12 they pertain to: 1) Verizon's current long distance service customers, and 2)
13 competitive carriers and their customers in Oregon.
14 **Q. DID YOU PREPARE EXHIBITS FOR THIS DOCKET?**
15 A. Yes, in addition to Exhibit Staff/601, I prepared Exhibit Staff/602, consisting of
16 42 pages, Exhibit Staff/603, consisting of 12 pages, and Exhibit Staff/604,
17 consisting of 3 pages.
18 **Q. HOW IS YOUR TESTIMONY ORGANIZED?**
19 A. My testimony is organized as follows: Page
20 Impacts on long distance customers………………………………… 1
21 Impacts on competitive carriers……………………………………… 6
22 **Q. HOW WILL VERIZON'S CURRENT LONG DISTANCE SERVICES BE**
23 **AFFECTED BY THE PROPOSED TRANSACTION?**

1 A. In their Joint Application of May 29, 2009[1], Verizon Communications Inc.
2 (Verizon) and Frontier Communications Corporation (Frontier) (Applicants)
3 state on page 2 that the accounts receivable and customer relationships for
4 "certain" long distance customers of Verizon Long Distance, LLC (VLD) and
5 Verizon Enterprise Solutions (VES) in Oregon will be transferred to NewLD.
6 These customer relationships include those for intraLATA as well as for
7 interLATA toll services. The customer relationships to be transferred are
8 generally those belonging to Verizon's current local exchange customers
9 who also subscribe to Verizon's long distance services (provided by VZ LD
10 and VES). These customers will be transferred, and receive long distance
11 services from, a new Frontier direct subsidiary, NewLD, formed specifically
12 to effectuate the proposed transaction. VLD and VES will remain in
13 business in Oregon to serve other customers who will not be transferred to
14 Frontier as part of the transaction. NewLD will be a new direct subsidiary of
15 Frontier for long distance (among other) services.
16 Frontier Communications currently offers long distance services through
17 Frontier Communications of America, Inc. (FCA) which will remain a
18 separate entity after the transaction. FCA does not own its own facilities in
19 Oregon, but resells the services of Global Crossing. As of the end of July of

[1] Joint Application of Verizon Communications, Inc., and Frontier Communications Corporation for an Order Declining to Assert Jurisdiction Over, or, in the Alternative, Approving in the Indirect Transfer of Control of Verizon Northwest, Inc., filed May 29, 2009 (Application).

1 this year, Frontier had not yet decided which carrier it will use to carry the
2 calls of NewLD customers.[2]

3 **Q. HOW WILL THE PROPOSED TRANSACTION AFFECT VERIZON'S**
4 **CURRENT LONG DISTANCE CUSTOMERS?**

5 A. Some current Verizon long distance customers will remain with VLD or VES,
6 but most will be transferred to NewLD. In his direct testimony, Mr. McCallion
7 states at page 3 that "All customer transfers will be made in accordance with
8 the FCC's and this Commission's rules, and the new long distance company
9 will offer substantially the same services under the same rates, terms, and
10 conditions that exist immediately prior to closing."[3] Mr. McCallion also states at
11 page 9 that "… if VLD transfers one of its new customers to NewLD as part of
12 the Transaction, that customer may elect to return to VLD. The parties'
13 agreements do *not* contain a "non-compete" clause." However, in response to
14 a Staff data request,[4] the Applicants state that "VLD and VES do not currently
15 advertise their long distance services to customers other than Verizon local
16 exchange customers in Oregon." Therefore, Verizon is not likely to court these
17 customers after they are transferred to Frontier.

18 **Q. DO YOU FORESEE ANY POTENTIAL HARMS TO THE LONG**
19 **DISTANCECUSTOMERS WHO WILL BE TRANSFERRED TO NEWLD IN**
20 **THIS MANNER?**

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[2] Applicants' response to Staff Data Request No.109. Included in Exhibit Staff 602, page 1.
[3] Direct Testimony of Timothy McCallion on Behalf of Verizon filed in Docket No. UM 1431, July 6, 2009.
[4] Applicants' response to Staff Data Request No.111. Included in Exhibit Staff 602, page 2.

A. Yes. First, Applicants state that the new long distance company will offer substantially the same services that exist immediately prior to closing, but do not specify for how long. Customers who are transferred to NewLD should be given some specified minimum window of rate stability in which to decide whether to change long distance companies.

Second, customers should be given sufficient notice of the transfer and adequately informed of their rights to choose a different carrier. The Applicants argue in footnote 1 of their Application that the transaction is not subject to the abandonment rules in OAR 860-032-0020 because Verizon will continue to provide long distance services in Oregon after the transaction occurs. These rules are intended to protect consumers when their service provider goes out of business. I agree that the rules may not apply in this case. However, some type of similar protection is needed to help mitigate the harm. In Exhibit 1 of their merger application filed with the Federal Communications Commission (FCC),[5] the Applicants state that they will comply with any anti-slamming requirements in the FCC rules that arise from the transaction. Section 64.1120(e) of the FCC rules applies in this case. The rules require the carrier acquiring the customers (Frontier) to provide written notice to each affected subscriber not later than 30 days before the transfer. Certain information must be in the notice, including the date the new service begins, the rates, terms and conditions of the service to be provided, and the subscriber's right to select a

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[5] Consolidated Application for Transfer of Control and Assignment of International and Domestic Section 214 Authority, filed with the FCC on May 28, 2009, Exhibit 1, footnote 11.

1 different long distance carrier. Frontier should commit to notifying customers in
2 a manner consistent with this FCC rule for not only interstate but *intrastate* long
3 distance services as well.
4 Third, if a customer does wish to switch to a different long distance carrier,
5 the customer would generally be subject to a "PIC" change charge that is
6 currently in Verizon's intrastate tariff at a rate of $4.35. Customers should not
7 have to incur costs because of this transaction. The FCC apparently agrees
8 because Section 64.1120(e)(3)(iii) of its rules requires that the *acquiring carrier*
9 be responsible for any carrier change charge, e.g., any PIC.
10 **Q. PLEASE STATE THE CONDITIONS YOU RECOMMEND RELATING TO**
11 **THE CHANGE IN INTRASTATE LONG DISTANCE SERVICES**
12 **PROPOSED IN THIS TRANSACTION.**
13 A. The recommended conditions are:
14 • For at least 120 days following the close of the proposed transaction,
15 Frontier Northwest will offer substantially the same intrastate toll calling
16 services, at the same rates, as provided by Verizon Northwest
17 immediately prior to closing. This includes the bundled service
18 offerings of local and long distance at the same rates as set forth in the
19 price lists of Verizon Northwest.
20 • Frontier will notify each of its Oregon intrastate long distance
21 customers at least 30 days in advance of their transfer to Frontier,
22 consistent with the anti-slamming requirements in Section 64.1120 of

1 the FCC rules. The notifications will include the requirements set forth
2 in those rules.
3 - For 90 days following the customer transfers, Frontier will waive any
4 change charges, e.g., PICs, for any customer choosing to change
5 carriers.

6 These recommended ordering conditions are listed as conditions 30-32 in Staff
7 Exhibit 100.

8 **Q. WHAT IS THE SECOND AREA ADDRESSED IN YOUR TESTIMONY?**

9 A. The second area addressed in my testimony is the potential impact of the
10 proposed transaction on competitors. To the extent that the transaction harms
11 competitors, it also likely harms competitors' customers and reduces the level
12 of competition. Verizon Northwest's competitors include "competitive local
13 exchange carriers" (CLECs), cable companies, wireless carriers, interexchange
14 carriers and Internet Services Providers (ISPs), among others. Competitors
15 rely on Verizon Northwest for services comprising essential inputs that enable
16 them to offer services in competition with Verizon Northwest in the retail
17 market. These services include interconnection services, unbundled network
18 elements, and access services, among others, and are generally referred to as
19 "wholesale" services.

20 **Q. IN GENERAL, HOW WOULD YOU DETERMINE IF THE TRANSACTION IS**
21 **CREATING HARM TO COMPETITORS AND COMPETITIVE MARKETS?**

22 A. Competitors should be able to obtain post-transaction at least the same
23 services, at rates no higher than current rates, and with the same ease and

speed as they would have *absent the transaction*. The Applicants tend to assert that they will provide services that are the same as those offered "pre-transaction" or "immediately prior to closing of the transaction." However, that is not necessarily the same as "absent the transaction," especially if Verizon is purposely decreasing services or raising costs to customers in the interim in anticipation of the sale. For instance, Verizon has already notified wholesale customers in the SpinCo states (those to be spun off to Frontier) that it plans to realign its data centers in the second quarter of 2010. The notice states that as a result, customers may need to change their current connections to access OSS functions. If changes are needed, the customers will be responsible for any associated Verizon charges.[6] Would the carriers have had to incur these costs absent the transaction? No. Will the carriers already be incurring these additional costs "immediately prior to the closing?" Yes. This sort of "gaming" behavior should not be permitted. This case also serves as a good example of the importance of defining the relevant baseline when crafting a commitment or a condition of the acquisition. My conditions generally use the word "current" instead of "at the close of the transaction" or "pre-transaction" in an attempt to reflect this important distinction.

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[6] *See* Verizon Industry Letter dated October 8, 2009, Re: Verizon Data Center Connectivity Charges/Action Required. Included in Exhibit Staff 602, page 3. As a second example, Verizon announced that it eliminated all funding for 2009 for the Change Management Process (CMP). This process is intended to resolve OSS changes requested by CLECs. *See* Verizon Change Management Meeting Transcript for January 13, 2009, at pages 9-10. Included in Exhibit Staff 602, pages 4-22. Frontier should continue the CMP at reasonable funding levels.

1 The transaction should not upset the market for wholesale services, or tilt the
2 balance of competition unreasonably toward Frontier. If Frontier raises rates to
3 its competitors for the services they use, then those competitors will be forced
4 to accept reduced profit margins or raise rates to their customers. If Frontier
5 discontinues certain essential services to competitors, then the competitors
6 may be forced to discontinue service to their customers or go out of business.
7 If Frontier is unable to adequately operate Verizon's replicated Operations
8 Support Systems (OSS), then competitors will be unable to obtain the
9 wholesale services they need to provide services to their customers in a timely
10 fashion. Depending on the nature of the OSS failure, service delivery times
11 could be so long that competitors would lose their customers (who would then
12 turn to Frontier for retail services instead).

13 Just as Verizon's current retail customers should not suffer a reduction in
14 services from the proposed transaction, neither should the competitors' retail
15 customers. If Frontier cannot maintain Verizon's current level of service to
16 competitors, then the competitors' customers will experience longer delivery
17 and repair times for their services. This group of customers currently numbers
18 [ ]. According to confidential data submitted by the
19 Applicants, Verizon Northwest in Oregon provides approximately [ ]
20 resold lines to competitors' customers and over [ ] UNE loops.[7] In total,

[7] Applicants' confidential response to IBEW Data Request No. 67(m). The resold lines include the "Wholesale Advantage" offering. Included in Exhibit Staff 603 (Confidential), pages 1-6.

1 that means that over [█████] competitors' customer lines are at risk in this
2 transaction.

3 **Q. WHY MIGHT THE TRANSACTION CREATE HARM TO COMPETITORS?**

4 A. First, Frontier's stated business priority is to focus on serving rural customers.
5 However, as a result of the transaction, it will be acquiring urbanized areas
6 surrounding Portland, Oregon, as well as Seattle, Washington, and Charleston,
7 West Virginia. These are areas where competitors that rely on Verizon's
8 wholesale services are present in significant numbers. Frontier's rural priorities
9 could result in reductions in pre-transaction levels of service to wholesale
10 customers. Second, the transaction will significantly increase the scope and
11 size of Frontier's wholesale business. However, Frontier's experience in
12 wholesale markets is dwarfed in comparison to Verizon's experience. As a
13 result, wholesale customers are likely going to experience a "step down" in
14 service as a result of the transaction. Third, Frontier's success or failure after
15 the transaction will depend heavily on the successful transference of Verizon's
16 Operations Support Systems (OSS) and any future conversion from Verizon to
17 Frontier OSS. Should either fail, the implications for competitors could be
18 disastrous.
19

1 **Q. PLEASE EXPLAIN WHY FRONTIER'S RURAL FOCUS MAY HARM**
2 **COMPETITORS.**
3 A. The presentation "Welcome to the New Frontier" filed by Frontier with the SEC[8]
4 states on page 7 that "Serving rural America IS our business" and that the
5 transaction will make Frontier "the largest 'pure' rural communications
6 provider." While the presentation materials do not explain what a "pure" rural
7 communications provider is, the point is obvious that Frontier's priorities will be
8 on rural consumers. As further evidence, Frontier's Senior Vice President of
9 Government and Regulatory Affairs, Steve Crosby, has stated that serving
10 rural landline customers is Frontier's top – and only – priority. "We've really
11 narrowed our focus to the rural market," Crosby said. "We're not stretched into
12 other directions." [9] The SEC presentation also states that of the SpinCo
13 properties to be acquired, 70 percent of lines are in rural areas. That leaves
14 almost 1.5 million Verizon customers across the country that Frontier will
15 acquire who will not be Frontier's focus or priority.
16 With so much emphasis on serving and developing rural markets, Frontier's
17 executives' statements raise concerns as to how retail and wholesale
18 customers in Verizon's more urbanized areas, such as Portland, will fare after
19 Frontier assumes control. The Verizon properties in Oregon reflect a different
20 rural-urban mix than the SpinCo totals. While 70 percent of total SpinCo lines

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[8] In Form 425 filed by Frontier with the Security and Exchange Commission (SEC) on May 13, 2009. Included in Exhibit Staff 602, pages 23-25.
[9] "Frontier's Plan to Buy Verizon's Assets in Ohio Worries Consumer Advocate," Cleveland Ohio Business News, August 25, 2009 at www.cleveland.com. Included in Exhibit Staff 602, pages 26-27.

1 are in rural areas, [REDACTED] of Verizon's Oregon lines are in the Portland
2 metro area alone and [REDACTED] of the UNEs that Verizon provides in Oregon
3 are in that area as well.[10] The more urbanized areas are markets where
4 competition is most vibrant, and the wholesale services Verizon currently
5 provides are critical to maintaining, or improving, the current level of
6 competition.
7 In addition, Frontier has few reasons to strive to provide services to
8 competitors, and many reasons not to. Frontier's future success rests heavily
9 on stemming the reduction in access lines that Verizon has been experiencing
10 across all areas. To accomplish this objective, Frontier will be going head-to-
11 head with cable companies, wireless carriers, competitive local exchange
12 carriers and internet service providers, the same competitors to whom they
13 promised to offer interconnection and certain other services at the same level
14 that Verizon currently does. Frontier offers little, if any, convincing evidence
15 that after making all the investments in broadband and customer retention
16 efforts that it plans, it will have sufficient resources to devote to maintaining
17 wholesale services. In short, Frontier's rural priorities may be good for rural
18 consumers, but its gains should not come at the expense of customers and
19 competitors in more populated areas. In that regard, it would be helpful to
20 know what message Frontier is conveying to the local cable/TV franchise
21 authorities in areas where the company will acquire Verizon's FiOS customers.

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[10] Applicants' confidential response to IBEW Data Request No. 67(m). Included in Exhibit Staff 603 (Confidential), pages 1-6.

1 **Q. DOES THE TELECOMMMUNICATIONS ACT OF 1996'S DEFINITION OF**
2 **"RURAL" IMPACT THIS ARGUMENT IN ANY WAY?**
3 A. Yes, it does. "Rural" has a very specific connotation under the
4 Telecommunications Act of 1996 (Act).[11] 47 U.S.C. Section 153(47) states:

5 The term "rural telephone company" means a local exchange carrier
6 operating entity to the extent that such entity –
7 (A) Provides common carrier service to any local exchange carrier
8 study area that does not include either –
9 (i) any incorporated place of 10,000 inhabitants or more, or
10 any part thereof, based on the most recently available
11 populations statistics of the Bureau of the Census; or
12 (ii) any territory, incorporated or unincorporated, included in
13 an urbanized area, as defined by the Bureau of the
14 Census as of August 10, 1993;
15 (B) provides telephone exchange service, including exchange access,
16 to fewer than 50,000 access lines;
17 (C) provides telephone exchange service to any local exchange carrier
18 study area with fewer than 100,000 access lines; or
19 (D) has less than 15 percent of its access lines in communities of more
20 than 50,000 on the date of enactment of the Telecommunications
21 Act of 1996.

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[11] The Act has been codified at 47 U.S.C. Section 151, e*t. seq*.

1 Frontier is classified as a rural local exchange carrier (LEC) under the Act in
2 all but one of the states in which it operates – New York. In contrast, Verizon is
3 classified as a non-rural carrier in at least ten of the fourteen states that
4 Frontier proposes to acquire from Verizon. Although the Application at page 13
5 notes that Frontier currently serves "non-rural, mid-sized communities including
6 Elk Grove, California, the South Metro Area of Minneapolis/St. Paul, Minnesota
7 and Rochester, New York…." Frontier is nevertheless classified as a rural LEC
8 under the Act in both its California and Minnesota service areas.

9 The classification of an incumbent LEC (ILEC) as "rural" under the Act has
10 significant implications for the development of competition in those ILEC areas.
11 The Act exempts rural ILECs from obligations to provide certain services to
12 competitors until they receive a bona fide request for such services, and the
13 state commission determines when the exemption should be lifted.[12] An ILEC
14 with less than two percent of the nation's subscriber lines can petition a state
15 commission to suspend or modify these requirements. I have not had sufficient
16 time to determine in which states Frontier is subject to or has claimed the rural
17 exemption. However, in response to Staff's Data Request No. 125 asking
18 whether the transaction will negate Frontier's eligibility for the rural exemption
19 under 47 USC Section 251(f) for its Citizens ILEC in Oregon (CTCO), the
20 Applicant responded as follows: "No. The transfer will have no effect on the
21 current status of Citizens Telecommunications of Oregon's rural exemption

[12] *See* 47 U.S.C. Section 251(f).

because it will remain a separate legal entity and operating company in Oregon."[13] The accuracy of the Applicants' claim in this regard may be open to debate, but it does represent Frontier's lack of willingness to open its markets to competitors. The CTCO exemption issue aside, Frontier's proposed acquisition of so many new non-rural Verizon service areas will force it to assume the provisioning and maintenance of wholesale services at a level it has never experienced. The company's sole focus on rural areas will need to make room for the new non-rural area requirements it is about to encounter.

Q. TO YOUR SECOND REASON, HOW DOES FRONTIER'S EXPERIENCE WITH PROVIDING COMPETITIVE SERVICES COMPARE TO VERIZON'S?

A. Because Frontier serves areas that are largely rural and subject to the rural exemption under the Act, it has far less experience than Verizon in providing services to competitors. Several types of data clearly demonstrate the extent of the differences. First, Frontier currently has interconnection agreements (ICAs) in Oregon with fewer than 15 carriers, while Verizon has ICAs with over 70 carriers. Frontier must be prepared to assume administration of the Verizon agreements, and perform functions related to maintenance, negotiations, and arbitrations that the ICAs entail. The Verizon agreements are lengthier and far more complicated than most of Frontier's agreements.

[13] Applicants' response to Staff Data Request No.125. Included in Exhibit Staff 602, page 28.

1 Second, in Oregon, Frontier's key wholesale offerings are minimal compared
2 to Verizon's. Frontier currently has no carriers collocated in its ILEC central
3 offices in Oregon, while Verizon has collocators leasing [■] collocation
4 arrangements in [■] different central offices[14]. Similarly, Frontier currently
5 provides no resold lines to competitors, nor does it provide any unbundled
6 network element (UNE) loops[15] to competitors in Oregon. In contrast, Verizon
7 provides over [■] resold lines to competitors, and over [■] UNE
8 loops.[16] Surely, the data support the fact that Frontier's experience in offering
9 wholesale services to competitors in Oregon is minimal compared to Verizon's.
10 Of course, Oregon alone is not a measure of Frontier's entire experience in
11 servicing competitors. However, even on the national level, the differences are
12 substantial as evidenced by the Applicants' response to a Staff data request.[17]
13 On a nationwide level, Frontier provides [■] resold lines while Verizon
14 provides [■] in the SpinCo areas to be acquired. That means that
15 Frontier will acquire resold lines that number almost [■] times as many as it
16 currently has. Also, Frontier currently offers resale in only [■] of the states it
17 will acquire from Verizon, while Verizon offers resale in [■]
18 states in the SpinCo area. Frontier provides [■] UNE loops and
19 "enhanced extended loops" (EELs), while Verizon in SpinCo areas provides

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[14] Applicants' response to Staff Data Request No. 149. Non-confidential response included in Exhibit Staff 602, page 29. Highly confidential response included in Exhibit Staff 604, pages 1-3.
[15] Applicants' responses to Staff Date Requests No.128 and No.126, respectively. Included in Exhibit Staff 602, pages 30 and 31.
[16] Applicants' confidential response to IBEW Data Request No. 67(m). Included in Exhibit Staff 603 (Confidential), pages 1-6.

[redacted]. Frontier currently offers UNEs in only [redacted] states, only [redacted] of which are in the SpinCo area.

This analysis shows how Frontier's wholesale services customer base will grow tremendously and almost overnight as a result of the proposed transaction. If the analysis were expanded to compare all the UNE and resale customers that Frontier currently serves with all the customers Verizon as a corporation serves across the country (not just the SpinCo properties), the disparities would be substantially greater. While Frontier touts the increases in scale and scope it expects to gain as a result of the acquisition, the data presented here strongly suggest that Verizon's current wholesale customers will certainly experience no such benefits when they are acquired by Frontier. Although its wholesale service performance is not perfect, Verizon certainly has far more breadth and depth of experience providing wholesale services than does Frontier.

Q. TO YOUR THIRD REASON, HOW WILL THE TRANSFER OF OSS IMPACT SERVICES TO COMPETITORS AS A RESULT OF THE PROPOSED TRANSACTION?

A. At the outset, Frontier plans to use the Verizon OSS, including those for the wholesale services. These systems are needed for pre-ordering, ordering, provisioning, maintenance and billing the wholesale services currently provided by Verizon to competitors. Additionally, at some as yet undetermined point in

[17] Applicants' confidential response to Staff Data Request No. 172. Included in Exhibit Staff 603, page 7-8.

1 the future, Frontier plans to migrate from the Verizon replicated OSS to its own
2 systems that it currently uses in non-SpinCo areas. If each of these OSS
3 transitions is successful, wholesale customers should feel no impacts. But if
4 either fails, competitors could face substantial harm. The risks associated with
5 OSS are addressed by Roger White in Staff Exhibit 400. His testimony
6 discusses OSS used for wholesale as well as retail services. I am in
7 agreement with Mr. White and his recommendations. I would add some points
8 that highlight the criticality of uninterrupted availability of wholesale services
9 and the associated risks to competitive carriers that rely on those services.
10 First, the systems needed for correct and timely delivery of competitive
11 services are numerous, complicated, interdependent and located in several
12 areas across the country, as evidenced in the Applicants' confidential response
13 to a Staff data request.[18] From the time of pre-ordering or ordering on through
14 numerous other steps to final delivery and activation of the service, each step
15 of the process depends on the preceding and subsequent systems. Failure of
16 one system to perform properly impacts the flow through subsequent systems
17 and delays delivery of the final product. After the competitive carrier's service
18 is up and running for its customer, it still depends on ILEC systems that control
19 trouble reporting and repair should network or other problems occur. While
20 references are often made to billing systems, billing systems are just one type
21 of system that is involved in a very complicated and related set of systems that

[18] Applicants' confidential response to Staff Data Request No.130. Included in Exhibit Staff 603, pages 9-13.

can impact the success with which competitors deliver service to their customers. Errors that occur at any step in the wholesale services process delay competitors' delivery of services to their retail customers. Depending of the number of errors and time needed to correct the errors, competitors' abilities to retain existing or gain new customers could be seriously impaired.

Second, should Frontier experience systems failures that also impact its own retail customers, it will undoubtedly try to fix those problems first, and leave the wholesale problems until later. The natural inclination is to try to make your own customers happy before you worry about fixing a competitor's problems. In fact, if competitors encounter service delivery problems their customers are more likely to return to the incumbent carrier for service instead.

Third, while Frontier asserts that it will improve on Verizon's in-state presence to interface locally with retail service customers, it makes no such promises for improved "customer care" to its wholesale customers. The systems and the people who run the systems are all currently located at concentrated centers outside the state, and will continue to be, albeit at new locations. In addition, the wholesale support services personnel, account managers and contract administrators are all concentrated at locations outside the state, and will continue to be. The Applicants have yet to finalize plans regarding wholesale support personnel.[19] One can reasonably assume that Verizon will be inclined

[19] Applicant's response to Staff Data Request No. 64. Included in Exhibit Staff 602, page 32. *See* also Testimony Under Oath of Daniel J. McCarthy before the Public Utilities Commission of Ohio, PUC Case No. 09-454-TP-ACO, dated September 30, 2009, page 61. Included as Exhibit Staff 602, pages 33-34.

1 to keep its best people as it will continue to need people skilled in operating
2 and maintaining the same former GTE systems that it is transferring to Frontier.
3 Verizon will still run these systems to serve the customers it retains in its large
4 markets in California, Texas and Florida. Similarly, Verizon will continue to
5 need wholesale customer support personnel for account management and
6 contract negotiations in those retained areas. If the employees that Verizon
7 chooses to transfer to Frontier do not wish to physically relocate (in some
8 cases across the country), Frontier will have to hire and train employees new to
9 the systems and processes. Verizon's recent in-house move of its wholesale
10 call center from Coeur d'Alene, Idaho to Maryland demonstrates the difficulties
11 that can ensue when customer service centers are relocated.[20] In short, the
12 risks associated with taking over Verizon's OSS are substantial, as are the
13 potential harms to competitors.
14 Finally, the magnitude of the number of customers (retail and wholesale) that
15 will be transferred all at one time presents an unprecedented challenge to any
16 company. Although Frontier has acquired other properties in the past, those
17 acquisitions have occurred over a period of several years, and no single
18 acquisition involved the large number of customers proposed in this
19 transaction. This transaction differs from Frontier's past acquisitions of
20 Rochester Telephone and Commonwealth as those were total acquisitions

[20] Oral Deposition of Mr. Timothy McCallion dated September 30, 2009, pages 79-80, before the Public Utilities Commission of Ohio in Case No. 09-454-TP-ACO. Included as Exhibit Staff 602, pages 35-37.

1 transferring all property, systems and personnel familiar with the acquired
2 companies' businesses. In this transaction, significant portions of Verizon's
3 systems, personnel and customers will be carved out of the larger organization
4 and transferred to Frontier. This transaction also differs from the CenturyTel
5 and Embarq merger in that regard, i.e., each of those entities remained intact
6 (personnel, OSS, etc.).

7 **Q. DO THE APPLICANTS ADDRESS THE IMPACT OF THE TRANSACTION**
8 **ON COMPETITION?**

9 A. Yes. On page 3 of their Application, the Applicants explain why they believe
10 the proposed transaction will not result in any competitive harm in Oregon.
11 The Applicants put forth the following arguments:

12 - The number of competitors will not be reduced.
13 - Frontier ILEC will make available to competitors the same services that
14 the Verizon ILEC currently does.
15 - Customers have no reason to fear disruption to the services they currently
16 receive because "Frontier will not need to convert billing and other
17 operational systems."

18 **Q. DO YOU AGREE THAT THE TRANSACTION WILL NOT RESULT IN ANY**
19 **COMPETITIVE HARM?**

20 A. No. No one can say with certainty that there is not the potential for competitive
21 harm. Frontier envisions a transition that will proceed smoothly, but that vision
22 depends heavily on Frontier's ability to actually make it happen, as well as the
23 Commission's ability to craft conditions that eliminate any potential harms.

Following, I address each of the Applicant's three arguments made in support of their claim of "no harm."

Q. PLEASE DISCUSS THE APPLICANTS' FIRST REASON WHY THEY BELIEVE THE TRANSACTION WILL NOT RESULT IN COMPETITIVE HARM.

A. In their filing at page 3, the Applicants conclude that no competitive harm will result because "…the Transaction will not reduce the number of competitors in any region." They put forth two justifications for this conclusion. The first is that "none of the local exchanges being acquired by Frontier overlap with any of the local exchanges served by Frontier." From an ILEC-only point of view, it is true that no ILEC exchanges overlap any other ILEC exchanges because ILEC boundaries are established by the Commission with the express intention of keeping the areas separate. In that sense, the statement is irrelevant to a competitive analysis, unless one realizes that the transaction will actually result in a reduction in the number of ILECs in the state. The second justification given is that "Frontier and Verizon do not currently compete for customers in any of the affected exchanges." If the "affected exchanges" refer to current Frontier ILEC exchanges, this statement is not accurate as Verizon Wireless competes in Frontier's area. On the other hand, if the "affected exchanges" refers only to the Verizon ILEC exchanges to be acquired, the statement implies that the Frontier corporate entity has no subsidiary operating in the Verizon ILEC exchanges. However, this appears to be contradicted by the fact that Frontier Communications of America holds a certificate of authority

1 granted by the Commission (Order No. 06-648 entered November 22, 2006) to
2 provide local exchange services as a competitive provider throughout Oregon,
3 including in the Verizon service areas. Even if this entity has no local
4 exchange customers at this time, it requested a certificate authorizing it to
5 provide such services in competition with Verizon.
6 The Applicants' arguments only serve to cloud the issue and they fail to
7 address a very significant point. That is, after Frontier acquires the Verizon
8 ILEC properties, Frontier will face intense and less cordial (or corporate-
9 orchestrated) competition from Verizon's remaining Oregon entities, including
10 Verizon Wireless, VLD, VES, Verizon Business and Verizon Select Services, to
11 name a few.[21] The Verizon corporate entity is not transferring all of its current
12 customers to Frontier. It is retaining the largest (and presumably most
13 profitable) customers of its other corporate entities that will remain to compete
14 with the Frontier ILEC after the transaction closes. While this will actually
15 result in greater competition after the transaction, it will certainly pose a
16 challenge to Frontier's critical objective of stemming Verizon Northwest's
17 current line losses in the territory it proposes to acquire. With the Verizon ILEC
18 gone, the remaining Verizon affiliate competitors are likely to put significant
19 pressure on Frontier to maintain wholesale services at acceptable levels.

[21] In Exhibit 1 of the Applicants' Section 214 application submitted to the FCC on May 28, 2009, footnote 12 states that the transfer excludes the services, business and assets of Verizon Business Global LLC (former MCI LLC), Federal Network Systems LLC, Verizon Network Integration Corp., Verizon Global Networks, Inc., Verizon Federal, Inc., Verizon Select Services Inc., and any other Verizon businesses in the state.

1 **Q. PLEASE DISCUSS THE JOINT APPLICANTS' SECOND ARGUMENT AS**
2 **TO WHY THE TRANSACTION WILL NOT RESULT IN COMPETITIVE**
3 **HARM.**
4 A. In their filing at page 3, the Applicants assert that competition will not be
5 harmed because "As to wholesale customers, Frontier will honor all obligations
6 under Verizon's current interconnection agreements, tariffs, and other existing
7 arrangements." While Frontier agrees to "honor" the obligations, it does not
8 commit to any specific time frame to ensure service and rate stability through a
9 transition period. The new Frontier ILEC entity must provide many services
10 that competitors rely on to compete with the ILEC and with each other,
11 including those related to access, interconnection, unbundled network
12 elements, and resale services. These services are offered through tariffs,
13 interconnection agreements, or other types of agreements.
14 Tariffs are subject to Commission review and approval and are generally
15 available offerings. The tariffed services that competitors rely on are generally
16 offered through the ILEC access service tariffs. ILECs can change service
17 offerings and rates in intrastate tariffs by filing with the Commission. Services
18 offered through interstate tariffs are not under the Commission's jurisdiction.
19 They are under the jurisdiction of the FCC and therefore I do not address them
20 in my testimony.
21 Interconnection agreements are more individualized agreements made
22 between the ILEC and another carrier. They generally begin with an agreed
23 upon termination date, typically two to three years, that is part of the terms of

the contract. Thereafter, the contract continues until either the ILEC or the other carrier indicates its desire to end or change it. Most of Verizon's contracts allow either party to end or renegotiate the contract upon 90 days notice.

While Frontier promises to "honor" all obligations under Verizon's current ICAs, tariffs and other arrangements, it did not commit to a specific duration for that promise. Without specifying a timeframe for the commitment, Frontier could immediately file for tariff changes, or give 90-days notice to customers with ICAs that have original termination dates that have expired. The vast majority of ICAs are in that category. Because Frontier will be new to Verizon's wholesale business, it is imperative that there be some period of stability in competitive service offerings and rates during a transition period. Without some guarantee of stability, turmoil in the wholesale markets could cause competitive harm quickly after the transaction closes.

Q. DO YOU RECOMMEND ANY CONDITIONS TO ADDRESS THESE CONCERNS?

A. Yes. In order to ensure stability relative to the offering of wholesale services that competitors need in order to compete with the new Frontier ILEC during the transition period after the closing, and to ensure that Frontier keeps its commitments, I recommend the following conditions.

- Frontier Northwest will assume or take assignment of all obligations under Verizon Northwest's existing interconnection agreements and other existing arrangements with wholesale carriers ("Assumed Agreements").

1 Frontier Northwest will not terminate, change the conditions of (with the
2 exception of those governing termination), or increase the rates in, any
3 effective interconnection agreement during the unexpired term of the
4 Agreement, or for a period of three years from the Closing Date,
5 whichever occurs later, unless requested by the interconnecting party,
6 approved by the Commission, or required by a change of law.
7 Furthermore, Frontier Northwest will allow requesting carriers to extend
8 existing Agreements, whether or not the initial or current term has expired,
9 until at least three years from the Closing Date, or the date of expiration,
10 whichever is later. Frontier Northwest will similarly apportion on a pro-rata
11 basis any volume thresholds or minimum revenue commitments relating in
12 part to service outside of Oregon.

13 • Frontier Northwest will assume or take assignment of all obligations under
14 Verizon Northwest's current intrastate tariffs and price lists for wholesale
15 services. Frontier Northwest will not increase rates for such services or
16 discontinue any such services currently offered for a period of at least
17 three years from the Closing Date.

18 • Frontier Northwest will continue to provide transit service subject to the
19 same rates, terms and conditions that are currently provided by Verizon
20 Northwest unless directed otherwise by the Commission.

21 • Frontier Northwest will comply with statutory obligations applicable to all
22 incumbent LECs under 47 U.S.C. Sections 251 and 252. Frontier
23 Northwest will not seek to avoid any of its obligations on the grounds that

1 it is exempt from any of the obligations pursuant to Section 251(f)(1) or
2 Section 252(f)(2).
3 These recommended ordering conditions are listed as conditions 33-36 in Staff
4 Exhibit 100.

5 **Q. PLEASE DISCUSS THE APPLICANTS' THIRD ARGUMENT AS TO WHY**
6 **THE TRANSACTION WILL NOT RESULT IN COMPETITIVE HARM.**

7 A. In their filing at page 3, the Applicants assert that "because Frontier will not
8 need to convert billing and other operational systems, customers have no
9 reason to fear disruption of the services they are receiving." In other words,
10 wholesale customers will be able to order and obtain the same services from
11 Frontier post-transaction as they did from Verizon pre-transaction, and with the
12 same ease and speed. According to the Applicants, disruptions in the
13 wholesale processes and systems should not be a concern because of the
14 manner in which Frontier will take over Verizon's support systems, i.e., the
15 "replication" method. I earlier addressed these issues and concerns related to
16 OSS and the potential for harm to competitors if Frontier experiences problems
17 in assuming control of Verizon's OSS. The risks are real and the potential for
18 significant harm has been demonstrated and documented in the cases of
19 Hawaiian Telcom and FairPoint.

20 **Q. DOES STAFF RECOMMEND ANY CONDITIONS TO ADDRESS THESE**
21 **POTENTIAL HARMS?**

22 A. Yes. Conditions related to OSS generally, and in some cases specifically as
23 they relate to competitors, are put forth in Roger White's testimony found at

Exhibit Staff 400. I concur with Mr. White's conclusions and conditions. In addition, I recommend the following conditions related specifically to remedying any potential harms to competitors in the current Verizon areas. While these conditions are of a general nature, the competitive providers that are parties to this docket are likely to offer more informed insight into other conditions that might be needed to ensure they are not harmed as a result of this transaction. I urge the Commission to carefully consider the arguments and recommendations made by these parties as they are the ones who will suffer the consequences of Frontier's failures.

- Frontier Northwest will maintain OSS functionality, performance and interfaces (e.g., e-bonding) for wholesale services that are at least equal to those Verizon currently provides.
- Frontier Northwest will provide ordering, provisioning and maintenance processes and intervals consistent with those Verizon currently provides.
- Frontier Northwest will provide timely resolution of wholesale service problems consistent with Verizon's existing level of performance.

These recommended ordering conditions are listed as conditions 37-39 in Staff Exhibit 100.

Q. ARE THERE OTHER WAYS IN WHICH COMPETITORS OR COMPETITION MAY BE HARMED AS A RESULT OF THIS TRANSACTION?

1 A. Yes. The Applicants make no mention in their filing regarding continuation of
2 the "human" customer support services that Verizon currently provides
3 competitive carriers. This support will be especially critical as the new
4 company assumes control of the wholesale processes and systems, moves
5 experienced personnel and hires new support people. Frontier should commit
6 to providing the same support services to competitive customers that Verizon
7 currently does.
8 For these reasons, I recommend the following conditions:
9 - Frontier Northwest will provide and maintain on a going-forward basis
10 updated escalation procedures, contact lists and account manager
11 information at least 30 days prior to the transaction close date. The
12 updated contact list shall identify and assign a single point of contact
13 for each wholesale carrier with the authority to address ordering,
14 provisioning, billing and OSS systems maintenance issues of that
15 carrier.
16 - Frontier Northwest will continue to make available to each wholesale
17 carrier the types of information and customer communications avenues
18 that Verizon currently makes available concerning wholesale
19 operations support systems and wholesale business practices, at no
20 charge to the carriers.
21 - Frontier Northwest will ensure that the Wholesale and CLEC support
22 centers are sufficiently staffed by adequately trained personnel so as

1 to provide a level of service that is comparable to that currently
2 provided by Verizon.
3 These recommended ordering conditions are listed as conditions 40-42 in Staff
4 Exhibit 100.

5 **Q. BY WHAT MEANS WILL THE COMMISSION BE ABLE TO DETERMINE**
6 **WHETHER THE TRANSACTION RESULTS IN A DECLINE IN**
7 **WHOLESALE SERVICE PERFORMANCE?**

8 A. The Commission would likely receive a barrage of complaints from the
9 competitive carriers. Other than the complaint process, the Commission
10 currently has no specific mechanism to monitor changes in wholesale service
11 performance. Unlike for retail service quality, Verizon does not currently report
12 any wholesale service performance metrics to the Commission. However,
13 Verizon does compile metrics which are available only to CLECs through
14 restricted web access. Verizon makes these service quality measurements
15 available for Oregon customers under the California OSS OII Performance
16 Measurement Plan, as amended and approved by the California Public Utility
17 Commission in Decision 03-07-035 (Joint Partial Settlement Agreement,
18 "JPSA").

19 **Q. DO YOU SEE A NEED FOR WHOLESALE SERVICE QUALITY**
20 **MEASURES AS A CONDITION FOR APPROVAL OF THE PROPOSED**
21 **TRANSACTION?**

22 A. Yes. As previously discussed, there are several substantial reasons to expect
23 that the proposed transaction could harm competitors. These include the risks

1 associated with the transfer of OSS from Verizon to Frontier, the substantial
2 increase in the number and nature of wholesale service offerings as well as the
3 number of competitors that Frontier will serve post-transaction compared to
4 pre-transaction, and the changes in wholesale support centers and personnel
5 that are yet to be determined by Frontier. If Frontier is to provide wholesale
6 services at the same level as Verizon and in a manner transparent to
7 wholesale customers, as it asserts in the Application, the Commission must
8 have some way to monitor whether Frontier delivers on its promises. In
9 addition, it must have a measure of whether Frontier meets the conditions that
10 form the basis for approval of the acquisition.
11 At a minimum, this requires some initial data that reflects Verizon's pre-
12 transaction performance to serve as a starting point or baseline for comparison
13 purposes. Since Verizon already reports some metrics under the JPSA to its
14 wholesale customers, I recommend that the Applicants submit to the
15 Commission the metrics pertaining to Verizon's Oregon wholesale customers
16 for the year leading up to the close of the transaction. After the transaction
17 closes, Frontier should continue reporting the same metrics to enable Staff to
18 monitor and compare Frontier's performance with that of Verizon's. If other
19 parties to this proceeding offer alternative performance monitoring proposals
20 prior to a decision in this docket, the Commission may wish to consider those
21 for adoption in lieu of the JPSA metrics.
22 This initial approach will serve for an interim period, but is insufficient for the
23 longer term. Since no benchmarks for performance and no penalties for poor

1 performance currently exist, I recommend the Commission open a docket to
2 consider implementing a performance assurance plan for Frontier Northwest
3 shortly after the transaction closes.
4 The need for wholesale performance monitoring as a condition for the
5 proposed transaction is echoed by The National Association of State Utility
6 Consumer Advocates (NASUCA) and the New Jersey Division of Rate
7 Counsel. In their comments filed with the FCC regarding the proposed
8 transaction, they state on page 31 that "Monitoring the performance of
9 Frontier's post-merger wholesale provisioning following the merger is
10 essential……Given the size and geographic scope of the 'New Frontier,' and
11 the potential for additional Frontier acquisitions in the future, Frontier could gain
12 from anticompetitive activity directed at competitive local exchange carriers
13 ('CLECs')." [22]

14 **Q. DO ANY OTHER ILECS IN OREGON REPORT WHOLESALE SERVICE**
15 **PERFORMANCE RESULTS TO THE COMMISSION?**

16 A. Yes, Qwest does. Qwest reports wholesale service performance results under
17 the Qwest Performance Assurance Plan (QPAP). Qwest and competitive
18 carrier customers voluntarily agreed to the terms of the QPAP in conjunction
19 with Qwest's application for approval under Section 271 of the
20 Telecommunications Act of 1996 to offer in-region long distance service. The
21 QPAP includes measures for performance and self-executing remedies. The

1 QPAP may serve as a model for consideration in the context of the docket that
2 the Commission opens to address future wholesale performance measures for
3 Frontier.

4 **Q. PLEASE STATE YOUR RECOMMENDED CONDITIONS RELATED TO**
5 **WHOLESALE SERVICE PERFORMANCE MONITORING.**

6 A. I recommend the Commission adopt the following conditions:

7 - The Applicants will submit to the Commission the Joint Partial
8 Settlement Agreement wholesale data for Verizon's Oregon ILEC for
9 the year leading up to the transaction closing date.
10 - After closing, Frontier will continue to provide the same types of
11 monthly reports of wholesale performance metrics that Verizon
12 currently provides to wholesale customers and will also submit these
13 metrics to Commission Staff.
14 - Within 60 days after the closing date, Frontier will participate in a
15 docket to be opened by the Commission to examine the need for
16 establishing a wholesale service performance plan for Frontier in
17 Oregon.

18 These recommended ordering conditions are listed as conditions 43-45 in Staff
19 Exhibit 100.

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[22] Comments of the National Association of State Utility Consumer Advocates and the New Jersey Division of Rate Counsel, Filed September 21, 2009, in WC Docket No. 09-95. Included in Exhibit Staff 602, pages 38-42.

1 **Q. PLEASE SUMMARIZE YOUR TESTIMONY REGARDING POTENTIAL**
2 **IMPACTS OF THE PROPOSED TRANSACTION ON COMPETITORS AND**
3 **COMPETITION IN OREGON.**
4 A. In summary, Frontier proposes to acquire and operate a wholesale services
5 operation that far exceeds the size and scope of its current wholesale services
6 business. This is true not only for the Oregon properties, but for the entire
7 proposed purchase area outside of Oregon as a whole. Frontier boasts that it
8 is a rural carrier, but [REDACTED] of the Verizon lines it proposes to acquire in
9 Oregon are not in rural areas. Frontier will assume Verizon's responsibilities in
10 the Portland metropolitan area, as well as in the Seattle/Tacoma and
11 Charleston, West Virginia areas. Frontier alleges that the proposed transaction
12 will be transparent to wholesale customers (competitors), but it fails to give
13 convincing arguments that it has the experience and resources to make that a
14 reality. It also fails to explain how it can stem the Verizon ILEC's current line
15 losses to competition and still ensure that competitors will be able to obtain the
16 wholesale services it must provide to them. And perhaps most importantly,
17 Frontier fails to provide evidence that the Commission can feel confident that
18 OSS transitions to Verizon's replicated systems, or from Verizon's to Frontier's
19 systems, will go smoothly. The risks to Frontier are great, but if the company's
20 plans fail, it is not the only one who will be harmed. Frontier's numerous
21 competitors could suffer irreparable damage to their business and their
22 [REDACTED] customers could experience degraded service. If the Commission
23 decides to approve the proposed transaction, it must protect competitors and

1 their customers in Oregon to the maximum extent possible by adopting the
2 conditions recommended above.

3 **Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

4 A. Yes.

5

CASE: UM 1431
WITNESS: Kay Marinos

PUBLIC UTILITY COMMISSION
OF
OREGON

STAFF EXHIBIT 601

Witness Qualification Statement

November 2, 2009

WITNESS QUALIFICATION STATEMENT

NAME: Kay Marinos

EMPLOYER: Public Utility Commission of Oregon

TITLE: Program Manager, Competitive Issues

ADDRESS: 550 Capitol St NE Suite 215
Salem, Oregon 97301-2551

EDUCATION: PhD/ABD and MA in Economics
University of Hawaii, 1981

BA in Economics
Hofstra University, 1975

PROFESSIONAL EXPERIENCE:

Program Manager, Competitive Issues, Public Utility Commission of Oregon, 2007 – Present
Manage group responsible for telecommunications competitive issues, competitive provider certifications, carrier agreements, Eligible Telecommunications Carrier (ETC) designations, federal universal service programs and ILEC service territory allocations. Staff member of Federal-State Joint Board on Universal Service.

Senior Telecommunications Analyst, Public Utility Commission of Oregon, 2004 - 2007
Responsible for federal ETC designations, annual ETC recertifications, and universal service issues. Developed ETC requirements adopted by the state Commission and served as expert witness in Docket UM 1217.

Senior Consultant, Verizon Communications, 2000 -2003
Led special project teams to ensure compliance with regulatory and legal requirements in various aspects of national telecommunications business, including new product development, wholesale service offerings, and customer proprietary network information. Coordinated responses to federal audit of wholesale services.

Senior Specialist, Bell Atlantic & NYNEX, 1988 - 2000
As subject matter expert, performed wide range of analytic functions to develop and support company's objectives in federal regulatory proceedings pertaining to wholesale services. Major issues included Telecom Act implementation, competitive markets, interconnection, access services, pricing flexibility, price caps, rate restructuring, cost recovery, and cost allocation.

Manager, National Exchange Carrier Association (NECA), 1984 -1988
Managed development of telecom industry forecasts of interstate usage and dedicated access services used to determine nationwide carrier pool rates.

Business Research Analyst, GTE Hawaiian Telephone, 1982 - 1983
Developed revenue and demand forecasts for budgeting and network planning.

Economist & Planner, State of Hawaii, 1978 – 1982
Managed energy conservation and emergency planning projects, lectured in economics at the University of Hawaii, and supervised economic and demographic studies for urban redevelopment in industrial area of Honolulu.

CASE: UM 1431
WITNESS: Kay Marinos

PUBLIC UTILITY COMMISSION
OF
OREGON

STAFF EXHIBIT 602

Exhibits in Support
Of Direct Testimony

November 2, 2009

OR Docket No. UM 1431
Verizon and Frontier Responses to Staff Data Request Nos. 106-146
July 27, 2009

DATA REQUEST NO. 109:

Which carrier's facilities will New LD use to provide long distance services to Verizon Northwest customers after the transfer, and under what type of financial arrangement?

Response:

Without limitation of their other General Objections, please see, in particular, General Objection Nos. 3, 10 and 12. Subject to and without waiver of their general and specific objections, Applicants respond as follows:

A determination regarding which carrier's facilities will be used by NewLD to provide long distance service has not yet been made. Frontier will evaluate alternative arrangements that will provide high quality service for the underlying toll services.

Prepared By: Cassandra Guinness
Date: July 27, 2009

OR Docket No. UM 1431
Verizon and Frontier Responses to Staff Data Request Nos. 106-146
July 27, 2009

DATA REQUEST NO. 111:

Do VLD and VES currently advertise their long distance services to customers other than Verizon local exchange customers in Oregon? If so, by what means? Will the advertising strategy change after the transfer?

Response:

Without limitation of its other General Objections, please see, in particular, Applicants' General Objection Nos. 3, 7, 12. Subject to and without waiver of its general and specific objections, Applicants respond as follows:

No. VLD and VES do not currently advertise their long distance services to customers other than Verizon local exchange customers in Oregon.

Frontier has no plans to change this advertising strategy after the transfer.

Prepared By: Jim Miggans and Cassandra Guinness
Date: July 27, 2009

October 8, 2009

Audience: CLEC, Reseller, ISP, IXC, Wireless

Re: Verizon Data Center Connectivity Changes / Action Required

Verizon plans to realign its data centers in the second quarter of 2010. If you interconnect with the Verizon Fort Wayne, Indiana data center, or if you do business with Verizon in Arizona, California, Idaho, Illinois, Indiana, Michigan, Nevada, North Carolina, Ohio, Oregon, South Carolina, Washington, or Wisconsin, you may need to change your connections with Verizon through which you conduct electronic data transactions with Verizon (for instance, to access Operations Support Systems functions, such as submitting orders for service and repair requests).

We would like to meet with you to develop a coordinated schedule of any Verizon data connectivity-related changes that may be required. Some data connections between Verizon and other companies currently are provided by 56KB, T1 or DS3 circuits. Other data connections are made by means of a VPN arrangement (Virtual Private Network-encrypted IPSEC interconnect tunnel). Verizon's preferred data connection is through a VPN arrangement.

Rearrangements, if necessary, must be completed by April 1, 2010. You will be responsible for paying any Verizon charges that apply to these data connection changes, as well as for any other charges or costs you may incur in relation to the data connection changes and your data connection arrangements with Verizon.

At this time, we would like to meet with you to develop a coordinated schedule of any data connectivity related changes that are required. Please contact connectivity.management.team@verizon.com at your earliest convenience to set up a meeting.

In general, the timelines to complete data connectivity changes are:

- Dedicated Circuit: It typically takes from 30 to 90 days to establish a dedicated circuit.
- VPN (preferred method): It usually takes about two (2) weeks to build the VPN tunnel configuration and complete the firewall policy.

If you have any questions about this process, please feel free to contact your Verizon Partner Solutions account manager.

Verizon Change Management Meeting

Moderator: Wanda Cox
January 13, 2009
2:00 pm ET

Woman: (Unintelligible) was busy too.

Man: Everybody's back from vacation.

Coordinator: Welcome and thank you for standing by. All lines are open for today's conference call. To mute or un-mute your phone when you're not speaking, please press star 6.

Today's conference is being recorded. If anyone has an objection, you may disconnect at this time. I'd like to go ahead and turn today's call over to Wanda Cox. Ma'am, you may begin.

Wanda Cox: Thank you (Julie). Good afternoon everyone. Welcome to the 2000 -- let me try it again -- January 2009 Change Management Meeting and I hope it's not too late to say this, but Happy New Year to all of you.

In addition to please making sure that you keep your phone on mute if you're not speaking, I will ask you to identify yourself if you do speak so that we can

capture that for the transcript and in a moment when everyone is ready, she's going to review our attendance for today.

(Evelyn): Hello everyone. So far I have (Madison Barry) from Frontier, (Roger Del Grosso) from Concretio, (Jamie Rhein) from (Winn Telecom), Jamie Shay from Integra, (Peggy Rubino) from Paetec, (Tracy Zurfluh) from Cavalier, (Demetrius Robinson) from Cox Communications, Liz Balvin from Covad, Kerri Burke from Comcast, Antoinette Griffin from Cox.

(Judy Harpold) from Cybernet, Loriann Burke from XO, (Cristal Causey) from HTC, (Stephanie Reynolds), (Angela Meng) from Cavalier, Kim Isaacs from Integra, (Mary Conquest) from (Novox), (Dok Matthews) from Consolidated, (Jeanne Kulesa) from (Synchronoss.

(Bennett Pang) from Comcast, (Chris Gilpin) from AT&T, (Elizabeth Garcia) from AT&T, (Shelly Pascoe) from (One Communications), Mary Ewing from One Communications, (Benny Almas) from TelePacific and I think that's everybody.

Carol Frike: Carol Frike with Sprint.

(Evelyn): Oh, hi Carol.

Carol Frike: Hello. Thank you.

(Stephanie Reynolds): And that's (Stephanie Reynolds) from (Nationsline).

(Evelyn): Okay, thank you (Stephanie).

(Sherry): And this is (Sherry) (Zheng) with (NeuStar).

(Evelyn): Hi (Sherry).

(Sherry): Hello.

(Ninfa Bennett): And we also have (Ninfa Bennett) with Cox Communications.

Woman: Hello.

Woman: Hello.

Woman: (Unintelligible).

(Evelyn): Thank you everyone.

Wanda Cox: Okay. Thank you (Evelyn). All right. We'll get started with our agenda and first up we have (Paul White) from the PSCC with an update on system availability.

(Paul White): Thank you and today I'm just reporting that the Verizon systems and bases are indeed operational with no major processing issues and currently - so we're experiencing normal transaction processing. And Wanda that is all I have.

Wanda Cox: Great. Thank you, (Paul). Any questions? Okay. Next up we have (Joanne Thetga) from CTE.

(Joanne Thetga): Thanks Wanda. Good afternoon everyone. Just wanted to touch base with everyone regarding the February release. We have posted the expected results for the test decks on the Web and email notifications have gone out.

Testing will begin for the February release on January 26 and hope to have that all wrapped up by the 19th of February. If you have not gotten your test plan to us for all of those that are testing EDI and/or CORBA, they were due yesterday.

Please get them to us as soon as possible so that we can make sure that everything is there, accounts are built for you and that you're ready to begin on the 26th of January. That's all I have. Anyone have any questions for testing?

Wanda Cox: Great. Thank you (Joanne).

(Joanne Thetga): Sure.

Wanda Cox: Next on our agenda we have Patty Dooley who will be giving a review of the latest Web enhancements.

Patty Dooley: Thanks Wanda. Good afternoon everyone. The Web enhancements email went out yesterday morning and it includes the 2009 local and access provisioning.

Availability schedules have been posted to the VPS Web site. The local ordering guide (UNE) West order sample number 2 has been - that's the new order sample that's been posted.

For contact us for local, there have been updates to the PSCC mobility services and the national market center. For access services, updates to the OCEC, the wireless special access provisioning for the West, (UNE) high cap provisioning for the West.

We have added provisioning contacts for East and West for the fast packet operations. Updates have been made to project management for special access switched and wireless.

Also, updates have been made to wireless switch provisioning for New York. Switch provisioning for New York and provisioning for (UNE) special access switched and wireless for New Jersey.

And one note is coming next month, we'll have a new order sample R27 for resale DID, DOD and PBX for the West and that is in development and we hope to have it available by the end of the month. And that's all I have Wanda.

Wanda Cox: Great. Thank you. Any questions?

Jamie Shay: This is Jamie from Integra. I did notice this morning that there is an error on the Web site under Contact Us.

Patty Dooley: Okay.

Jamie Shay: In the RCCC (UNE) (POTS)...

Patty Dooley: Yes.

Jamie Shay: Or the (POTS) (UNE-P), it comes up and says no results found.

Patty Dooley: For which...

Jamie Shay: RCCC (POTS).

Patty Dooley: For which area? Any particular state?

Jamie Shay: Oh, I'm sorry. Washington. Sorry.

Patty Dooley: Washington State?

Jamie Shay: Yes.

Patty Dooley: Okay. Thank you Jamie.

Loriann Burke: Hi this is Loriann at XO. Just a quick question on the provisioning availability schedule, I noticed that Inauguration Day is a holiday in the Potomac region. Will that have an impact on maintenance and also LNP orders which are actually worked out of Boston?

Patty Dooley: I'm not sure about that, but I'll take that back and find out and get back to Wanda with an answer on that.

Loriann Burke: Great. Okay. Thank you.

Patty Dooley: Thank you.

Wanda Cox: Any more questions? Excuse me.

(Chris Gilpin): This is (Chris Gilpin) with AT&T. Can you clarify about the Inauguration Day again? In Virginia - any of your offices in Virginia such as the (NOMC), is that going to be open?

Patty Dooley: I honestly - I'll have to look into that and get back to Wanda. (NOMC) in Virginia.

Loriann Burke: Well this is Loriann again. I had left a message for (Michael Hill) yesterday and he called back this morning saying that his office is going to be open. I guess the folks who are processing the West orders...

(Chris Gilpin): Oh.

Loriann Burke: ...they'll be working, but not the people processing the orders for the Potomac region I guess.

Wanda Cox: Okay and we'll get some clarification.

(Chris Gilpin): Okay.

Wanda Cox: Sorry about that. Excuse me. Any more questions? Okay. Next up the topic has to do with the dial-in procedures for this call. Starting with the February meeting the dial-in process will change.

This will eliminate the time waiting in queue for an operator to add you to the (bridge) each month and we have (Terry Agnew) here from Conference Services to walk us through the new process and answer any questions that you may have. (Terry)?

(Terry Agnew): Thank you. Going forward a week before your February 10 conference call you will receive an email inviting you to the February 10 conference call. The email will be sent from Verizon Change Management Mailbox.

Included in that invitation will be a URL that you will need to log on to and register for each call. In order to log on and register for each call, you must do that at least an hour before the scheduled start time.

Otherwise, the system will automatically lock you out and you will no longer be able to register for that particular conference call.

After you are finished with a registration process, you will be sent an email with your personal pin number. Going forward in the February conference call, you will still dial a toll-free number.

You will now be required to enter a seven digit participant pass-code and then each individual need to enter their personal pin-code.

You will not want to share your pin-code with other users. It is assigned to your name and that's how you will be able - we will be able to recognize when you've joined the conference call.

Once again, the point to remember, you must register at least an hour before the scheduled start time or you will be locked out. Any questions?

Kim Isaacs: This is Kim Isaacs from Integra and we will have to register each month?

(Terry Agnew): Yes ma'am.

Kim Isaacs: Okay. And for the month of February, will there be operator backup in case people are unaware of this or forget?

(Terry Agnew): Yes ma'am.

Kim Isaacs: Thank you.

(Terry Agnew): You're welcome.

Wanda Cox: Okay. Any other questions? Great. I do just want to point out, there is an hour shutoff prior to the call, but we will continue to send out the meeting notice one week in advance. So you can register at that point as well. So you don't have to worry about missing it and doing it at the last minute. All right.

Next, we'll move onto the PWG section of our call and if you turn to the PWG doc, we rated two requests last month and on Page 13 -- excuse me -- Page 11, item number 13 we rated reduce the system downtime for maintenance release weekends and that had an overall rating of a 4.9. Any questions?

The second item we reviewed last month is item number 31 which is found on Page 12 to expand the (tele no) field to 14 characters. That had an overall rating of a 4.4. Any questions on that?

Okay. Great. I also have an update - excuse me for just one second. Sorry, that will teach me to have water for these calls.

I also have an update regarding the end-user listing project. We had targeted that for the February release. However, due to funding issues, it will not be implemented in the February timeframe and at this time I do not have a new release date. Any questions?

Woman: I'm sorry. Did you say - you said no release date for...

Wanda Cox: For the end-user listing project.

Woman: Okay. Thank you.

Wanda Cox: You're welcome. And finally, regarding the 2009 (CNP) budget, I did want to make you aware that there is no funding for this year in order for us to do any

initiatives I guess is the best way to say it. That is the latest information I have on our budget. Any questions?

(Laurie): This is (Laurie) with Integra. So all of these CRs that we have had hanging out here for years, nothing's going to happen this year?

Wanda Cox: That is correct.

Liz Balvin: Hey Wanda. This is Liz Balvin. Is that for both retail and wholesale?

Wanda Cox: That is for anything brought to (CMP).

Liz Balvin: I'm sorry. Maybe it's because I'm - never gone through a negative IT budget, but how is that possible that (unintelligible) designated any resources?

Wanda Cox: Because there is no budget to do them with. I'm sure that - as well as in other company where you're also being affected by the same economy that we are and our budgets have been drastically reduced.

Kim Isaacs: I believe - this is Kim. I believe what Liz is asking is are there no updates to the Verizon resale side as well?

Wanda Cox: I can't speak to that. I'm telling you that there is no budget for Change Management for this year.

Kim Isaacs: So, what happened to all our OSS charges?

Wanda Cox: What do you mean?

Kim Isaacs: We've paid per - we've paid an OSS charge per order. What happens to that money?

Wanda Cox: In some states there is an OSS recovery charge that pays for maintenance on a system, as well as recouping charges for previous releases. It is not for enhancements.

And if I'm incorrect, I'd be more than happy to review anything that you have said that corrects me. But that's all the digging that I've found. That's what I - that's the wording and that was the intention.

(Louis Agro): This is (Louis Agro) and we have gone down that road and in terms of trying to justify to get budgets, but right now we have not been given a budget. And we've gone down that road.

We've looked through contracts, through commissioned orders trying to look for something that says something to the effect of, you know, what needs to be provided, but in every instance that we've found thus far the charges are for past recovery and to keep the system running that's already in place.

(Dok Matthews): (Louis), this is (Doug) at Consolidated Communications.

(Louis Agro): Yes, go ahead.

(Dok Matthews): We met in Harrisburg a couple months ago.

(Louis Agro): Sure. Yes. I remember. Yes.

(Dok Matthews): So you're saying that if the (CLEC) community can get a commission to review this and produce any finding that the (CLECs) were expected to

receive ongoing changes as part of the OSS charges that you would welcome that reply from the commission?

(Louis Agro): If there's something in an order that's out there that I've missed that you'd like to point out to me, that will be great. Get it to me. If there's something in one of your contracts...

(Dok Matthews): Well no, I'm saying...

((Crosstalk))

(Dok Matthews): ...what if the commission were to make the ruling in 2009?

(Louis Agro): Well, the other option I would say would - if there's a ruling that we can get cost recovery on future.

(Dok Matthews): Okay.

(Louis Agro): That might be an option we can go down. I'd have to find out through all our finance people how we do that here.

(Dok Matthews): Okay.

(Louis Agro): But if we were to come up with a number and then I guess we'd have to figure out how you recover from each party and what state. We'd have to figure out how to divvy all that up.

(Dok Matthews): Okay. Thanks.

(Louis Agro): What states it impacted and where to be - would that be something that everyone in those states or that would use the system would support? Would they support cost recovery going forward? That could be an (unintelligible).

(Demetrius Robinson): This is (Demetrius) from Cox Communications. I had a quick question. Do you foresee possibly in the say half way into the year where this no funding may possibly change or is that just - it's been decided that it's just not in the budget at all for the year of '09?

(Louis Agro): I guess any - I don't want to raise or lower expectations...

Wanda Cox: Yes.

(Louis Agro): It's been simply, you don't have a budget at this point and...

(Demetrius Robinson): Okay.

(Louis Agro): ...it's like the no date on a release. They're not saying we're going to review it in June or July.

I would hope that - I mean when I look at - when I open a newspaper I don't have much hope, but, you know, if things were to turn around and the economy looks a little brighter on the - and the market starts growing rather than shrinking, there's probably a possibility. But I don't want to say that's a definite.

(Demetrius Robinson): Right.

(Louis Agro): Yes, anything's possible.

(Demetrius Robinson): And I would...

(Louis Agro): My door hasn't been shut for the whole year, but it's not necessarily open either.

Wanda Cox: And I would just add to that that at this point in the year obviously we've missed the February release. June would be pushing it, so we're still probably not going to look in - if that were a possibility as money should arrive, we wouldn't be looking for anything prior to October just as a kind of an aside, just the way the calendar falls.

Liz Balvin: Hey Wanda. This is Liz again. Just I just ask a clarifying question...

Wanda Cox: Sure.

Liz Balvin: ...on the process? So, (CLECs) are relying on Verizon (CMP) personnel or, you know, (Louis) yourself to advocate our budget needs and you've essentially been told we're not getting any additional enhancements. We're still going to have the release calendars...

Wanda Cox: Correct.

Liz Balvin: ...in place. So I any enhancements with the EDI interface or exact will take place.

Wanda Cox: Right. And anything - I mean, for example, in the February release there was a trouble ticket that was issued. Things that are - that need to be fixed will obviously continue to be fixed along that same calendar because that's already in place as expected. It wouldn't happen any differently than that.

But at this point - and believe me as much as you'd like, I have been advocating. I mean the list is out there. I've been talking about it, showing what the impact would be. We would start obviously with the ones that we already have in queue and work from there.

Liz Balvin: Okay and I know on other (unintelligible) regions the actual devoted resources do support both the retail and wholesale sides. True here?

Wanda Cox: Oh, you mean like the - how was our IT kind of budgeted or what the groups look like?

Liz Balvin: I guess that would be a better way to ask it, yes.

Wanda Cox: Okay. I don't know to be honest. I believe that they are separate entities. I cannot say that for certain because there are a lot of synergies between the two systems. Obviously.

Liz Balvin: Right.

Wanda Cox: There are things internally unfortunately that have been put on hold just because the funding is not there. This is - our budget's not just for IT things, but across the board have been impacted by the way things are. It's just not the IT budget. Are there any more questions?

(Demetrius Robinson): Yes this is (Demetrius) for Cox. I did notice on your Web site that you guys updated the - your holiday calendar and now it includes Inauguration Day. When the link was sent out last week this information was not on there.

Wanda Cox: Okay.

(Demetrius Robinson): However, it just - I think it just updated I think either yesterday or today.

Wanda Cox: Right and then they sent out the notice from the enhancement team. Some other notice saying it had been updated.

(Demetrius Robinson): We didn't get that enhancement.

Wanda Cox: It was on - from the Partner Solutions mailbox. We can check to make sure that you're on that (unintelligible) as well.

(Demetrius Robinson): Okay. Thank you.

Wanda Cox: You're welcome. Any more questions? Okay. Well then our next call will be held on February 10. Please keep in mind the new process for joining the conference (bridge) and we will get that information out to you by the 3rd.

Carol Frike: Hey Wanda.

Wanda Cox: Yes ma'am.

Carol Frike: It's Carol Frike at Sprint. I was wondering since it seems like we're going to have short agendas this year with...

Wanda Cox: Yes.

Carol Frike: ...no budget. Is there any chance that we could do some different things like maybe have a different (SME) on the calls to answer questions that people are having instead of all the emails that fly around?

Well like for me and my example is that I'm constantly bugging you guys with directory questions. Would it be possible to maybe get a (SME) on the call and we could hold the questions for the meeting and maybe do a different (SME) each call or something?

Wanda Cox: If there are questions that you want answers to, the best bet would be to send them to us and we can see who we can get for you.

Carol Frike: Okay.

Wanda Cox: I don't know if I can just identify a (SME) and say okay, this month it will be XYZ topic.

Carol Frike: Okay.

Wanda Cox: We can try to answer it that way.

Carol Frike: All right.

Wanda Cox: Okay.

Carol Frike: Thanks.

Wanda Cox: You're welcome. Any other questions?

(Metek): Wanda, this is (Metek). I joined late. I think you covered the new process for (CMPs) at the first part of the meeting. Can you please reiterate it really quickly or if that's better I think to follow up with a phone call I can do that later.

Wanda Cox: Regarding the conference?

(Metek): Yes.

Wanda Cox: Regarding the conference (unintelligible). (Terry), you still here? I can give it to you in a nutshell.

(Metek): Yes.

Wanda Cox: So each month you'll be responsible for registering for each call...

(Metek): Okay.

Wanda Cox: ...at least one hour in advance and that's a simple process of your name, email address and company. You'll receive back a pin that you'll need to use to access the call each month and that way you will not have to wait for an operator. You will actually be direct dialing right into the call.

(Metek): Okay.

Wanda Cox: And that - all this information will be sent to you each month when we get the - in advance, the same way we send the agenda.

(Metek): Oh, okay. Sounds good. Thank you very much.

Wanda Cox: You're welcome. Any additional questions. Okay. Great. I'll see you next month.

Woman: Thank you.

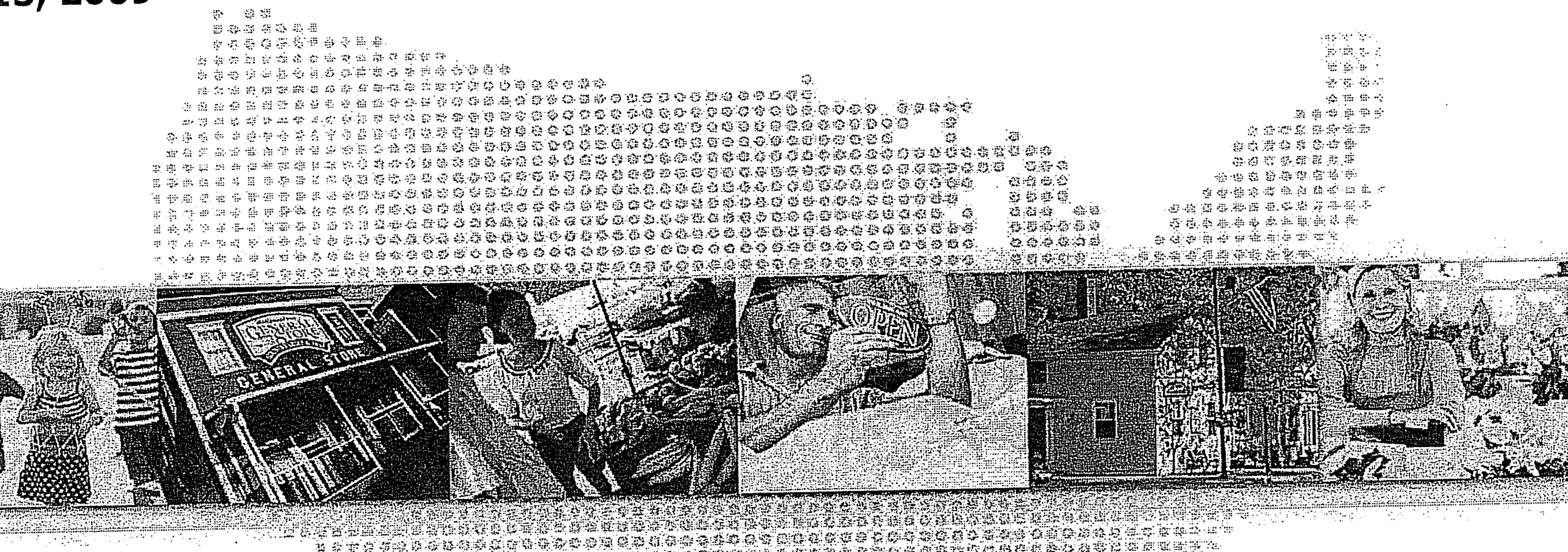
END

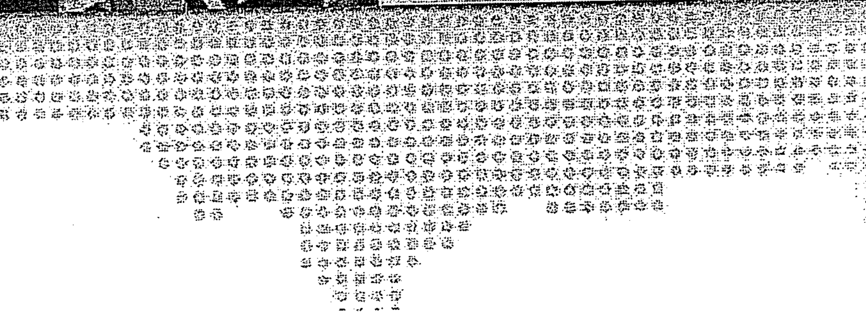
Staff/602
Marinos/23

Frontier Communications

Welcome to the New Frontier

May 13, 2009





WIRELESS DATA

frontier Communications

Transaction Rationale

- Serving Rural America IS our business
- Frontier becomes the largest "pure" rural communications provider

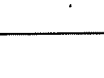
Rural Profile	• SpinCo properties have an average of 37 households per sq. mile • 70% of lines in rural areas • Less than 1% of lines in urban areas
Complementary Footprint	• Frontier currently has operations in 11 of the 14 states in which SpinCo operates
Attractive Demographics	• Properties have a similar profile to Frontier's current footprint • Median income of $50.1K, 74% home ownership, average age of 48
Upside for Organic Growth	• Ability to implement Frontier's proven "go-to-market" strategy • Local engagement model will improve customer loyalty and drive revenue performance
Ability to Leverage Scale	• Leverage scalability of common support functions (e.g. IS, Accounting) • Ability to achieve synergies from operating and capital expenditures
Reasonable Capital Investment	• Currently, broadband is only available to ~60% of households • Opportunity to expand broadband deployment
Free Cash Flow Accretive	• The transaction drives significant free cash flow per share accretion in year 2 and beyond
Improves Dividend Payout Ratio	• $0.75 per share dividend after closing • Payout ratio declines based on new dividend policy and increased cash flow

Frontier Communications

Access Line Detail

As of 12/31/08

		Frontier	SpinCo	Combined
Common Properties	West Virginia	143,982	617,036	761,018
	Indiana	4,647	718,251	722,898
	Illinois	97,461	573,321	670,782
	Ohio	552	634,153	634,705
	Michigan	19,102	507,462	526,564
	Wisconsin	62,007	281,350	343,357
	Oregon	12,626	309,904	322,530
	California	143,871	24,205	168,076
	Arizona	145,241	6,297	151,538
	Idaho	20,035	113,002	133,037
	Nevada	23,701	35,989	59,690
		673,225	**3,820,970**	**4,494,195**
SpinCo Properties	Washington	-	578,506	578,506
	North Carolina	-	263,479	263,479
	South Carolina	-	127,718	127,718
		-	**969,703**	**969,703**
Frontier Properties	New York	683,880	-	683,880
	Pennsylvania	427,489	-	427,489
	Minnesota	210,983	-	210,983
	Tennessee	79,014	-	79,014
	Iowa	44,891	-	44,891
	Nebraska	43,106	-	43,106
	Alabama	25,980	-	25,980
	Utah	21,718	-	21,718
	Georgia	19,167	-	19,167
	New Mexico	8,001	-	8,001
	Montana	7,659	-	7,659
	Mississippi	5,474	-	5,474
	Florida	3,746	-	3,746
		1,581,108	**-**	**1,581,108**
		2,254,333	**4,790,673**	**7,045,006**



Frontier® Communications

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Frontier's plan to buy Verizon's assets in Ohio worries consumer advocate

By Kathie Kroll
August 25, 2009, 7:11PM

Frontier Telephone is taking on so much debt to buy **Verizon**'s assets in Ohio and 13 other states, that the state's consumer advocate is concerned that Frontier may not be able to serve its customers well after the $8.6 billion deal goes through.

But Frontier and some analysts say that the company has its finances under control and its attempts to grow the business should benefit consumers. Frontier and Verizon announced plans for the transaction in May, and it is now pending approval from state and federal regulatory agencies.

Public hearings

The Public Utilities Commission of Ohio has ordered three public hearings where Verizon customers can voice their comments and concerns. They are scheduled as follows:

- New Philadelphia, Sept. 8, 6 p.m., Salvation Army Building, 809 Emmet Ave., N.W.
- N Marion, Sept. 9, 6 p.m., City Hall, City Council Chambers, 233 W.

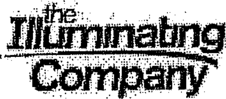
The deal will triple the size of the company, increasing its customer base from 2.3 million to 7 million nationwide.

Steve Crosby, Frontier's senior vice president of government and regulatory affairs, said the company's has a short term goal to bring broadband Internet to at least 92 percent of its 435,000 new customers in 77 counties across Ohio, including parts of Lorain, Medina, Summit and Portage Counties. It is set to become the second largest telecommunications company in the state after

Staff/602
Marinos/27

Select a date

SPECIAL FEATURE



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AT&T. Today, only about 60 percent of Verizon customers in Ohio have access to broadband through the company.

Crosby said unlike larger telecommunications companies that service big cities and offer cell phone service, serving rural landline customers is Frontier's top - and only - priority.

"We've really narrowed our focus to the rural market," Crosby said. "We're not stretched into other directions."

Verizon says it is selling off parts of its landline business in order to focus on more urban markets where it has upgraded its phone lines to fiber optics, and is now able to offer television service and ultra-fast Internet.

Ohio Consumers' Counsel Janine Migden-Ostrander, who runs the state's consumer advocacy agency, has asked that the Public Utilities Commission of Ohio put conditions on Frontier before approving the acquisition.

"We are concerned that Frontier will not be able to afford to maintain and improve residential customers' service. We need a guarantee that consumers' needs will not be on the back burner," she said in a statement.

She has asked that the PUCO require Frontier to live up to its promise to expand broadband.

Todd Rosenbluth, an equity analyst for Standard & Poor's who tracks telecommunications companies, said it is in the company's best interest expand broadband, since it's a growth area for Frontier.

"We don't think they're just going to try to milk the existing business," he said. "We think Frontier will need to invest in the business in order to grow it."

Crosby said that Frontier has borrowed wisely and plans to cut its stock dividend, which will help it pay for infrastructure improvements.

He said he expects things to eventually go smoothly for Frontier in Ohio.

"It comes down to the citizenry and the various commissions getting to know who we are," he said. "We're not starting from scratch. We've got a huge, seasoned group of people working to make this happen."

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www.FinancialTimesNY.com

2009 New Car Pricing
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www.WhyPaySticker.com

DATA REQUEST NO. 125:

Has Frontier waived the rural exemption under 47 USC 251(f) in Oregon? If not, will the transfer negate Frontier's eligibility for a rural exemption in the current Frontier study area? Please explain.

Response:

No. The transfer will have no effect on the current status of Citizens Telecommunications of Oregon's rural exemption because it will remain a separate legal and operating company in Oregon.

Prepared By: Jim Miggans and Cassandra Guinness
Date: July 27, 2009

DATA REQUEST NO. 149:

Please list in table format the Frontier and Verizon central offices (including CLLI code and city name) in which the companies lease space to CLECs (e.g., collocation space).

Response:

Without limitation of its other General Objections, please see, in particular, Applicants' General Objection Nos. 4, 7, and 8.

Subject to and without waiver of its general and specific objections, Applicants respond as follows:

Citizens Telecommunications Company of Oregon (CTC-Oregon) does not currently have carriers collocated in its Oregon central offices.

With regard to Verizon, see Highly Confidential attachment OR Staff Set14 VZ149 Attach1 Collocation arrangements dec2008 HIGHLY CONFIDENTIAL.

Prepared By: Jim Miggans; Cassandra Guinness
Date: August 3, 2009

OR Docket No. UM 1431
Verizon and Frontier Responses to Staff Data Request Nos. 106-146
July 27, 2009

DATA REQUEST NO. 128:

Please identify the states in which Frontier offers services for resale, and indicate the number of resold lines it currently provides in each.

Response:

Without limitation of their other General Objections, please see, in particular, General Objection Nos. 3 and 12. Subject to and without waiver of our general and specific objections, Applicants respond as follows:

Frontier currently does not have any competitive carriers reselling local service in Oregon.

Prepared By: Cassandra Guinness
Date: July 27, 2009

OR Docket No. UM 1431
Verizon and Frontier Responses to Staff Data Request Nos. 106-146
July 27, 2009

DATA REQUEST NO. 126:

Please identify the states in which Frontier offers unbundled network elements, and indicate the number of UNE loops it currently provides in each.

Response:

Without limitation of their other General Objections, please see, in particular, General Objection Nos. 3 and 12. Subject to and without waiver of our general and specific objections, Applicants respond as follows:

Frontier currently does not have any competitive carriers purchasing UNE loops in Oregon.

Prepared By: Cassandra Guinness
Date: July 27, 2009

OR Docket No. UM-1431
Frontier and Verizon Responses to IBEW Data Request Nos. 63-161
July 27, 2009

DATA REQUEST NO. 64:

Please provide copies of any documents that will be used by Verizon in Oregon (or for any larger area that includes Oregon) for purposes of transition to support the proposed transaction, to the extent not already provided in the filing of or in response to other interrogatories (or in addition to filed documents).

Response:

Without limitation of its other General Objections, please see, in particular, Applicants' General Objection Nos. 3, 7, 8, and 9. Subject to and without waiver of its general and specific objections, Verizon responds as follows:

The details of the realignment are still under development and no responsive documents exist. Please refer to Section 7.24 of the Merger Agreement for a description of the realignment that will take place prior to close. The purpose of the realignment plan is to ensure that the people, centers and systems supporting Oregon customers will be substantially the same the day after the transaction closes as they were the day before.

Prepared By: James Miggans
Date: July 27, 2009

1 B E F O R E
2 THE PUBLIC UTILITIES COMMISSION OF OHIO
3 OHIO PUC CASE NO. 09-454-TP-ACO
4 - :
IN THE MATTER OF :
5 :
THE JOINT APPLICATION OF FRONTIER COMMUNICATIONS :
6 CORPORATION, NEW COMMUNICATIONS HOLDINGS, INC. :
AND VERIZON COMMUNICATIONS, INC. FOR CONSENT :
7 AND APPROVAL OF A CHANGE IN CONTROL :
:
8 - :
9
10
11 TESTIMONY UNDER OATH OF DANIEL J. McCARTHY
12
13
Date: September 30, 2009
14 Time: 1:32 p.m.
15
Place: Frontier Communications Corp.
16 3 High Ridge Park
Stamford, Connecticut
17
18
19
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21
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23
24
25
26

1 Q Going back to the call center issue and I'll be
2 done.
3 You said you were not really aware of the
4 issues that Verizon had when it moved its call center.
5 Is there a plan at Frontier as to how to establish the
6 call center in North Carolina and how to avoid such
7 problems?
8 A Well I believe the call center will be
9 established well before close. So I think that Frontier
10 is developing strategies around, you know, account
11 management and identifying, you know, who the key teams
12 will be that address the various -- whether it's wireless
13 players or CLEC or others on the wholesale side. So, you
14 know, have we focused specifically on North Carolina call
15 center? No, not at this point. But it will be part of
16 the more comprehensive plan as we look to bring
17 everything together.
18 Q I take it that the people that are currently
19 operating the call center in Maryland are not going to be
20 relocated to North Carolina? It will be different
21 people?
22 A I do not have that level of detail on the
23 realignment plan at Verizon.
24 MR. HART: That's all I have. Thank you.
25 MR. KELLY: This is Hank Kelly. I was
26

1 BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO
2
IN THE MATTER OF THE JOINT)
3 APPLICATION OF FRONTIER)
COMMUNICATIONS CORPORATION,)
4 NEW COMMUNICATIONS HOLDINGS) CASE NO. 09-454-TP-ACO
INC. AND VERIZON)
5 COMMUNICATIONS INC. FOR)
CONSENT AND APPROVAL OF A)
6 CHANGE IN CONTROL.)
7
8 ----------------------------------
9 ORAL DEPOSITION OF
10 MR. TIMOTHY McCALLION
11 SEPTEMBER 30, 2009
12 ----------------------------------
13
14
15
16 ORAL DEPOSITION OF MR. TIMOTHY McCALLION, produced
17 as a witness at the instance of the Office of the Ohio
18 Consumers' Counsel, and duly sworn, was taken in the
19 above-styled and numbered cause on the 30th day of
20 September, 2009, from 9:11 a.m. to 11:50 a.m., via
21 telephone, before Karen A. Wilson, CSR in and for the
22 State of Texas, reported by machine shorthand, at
23 Verizon, 600 Hidden ridge, P.O. Box 152092, Irving, Texas
24 75015-2092, pursuant to the Federal Rules of Civil
25 Procedure.

1 assigned. I don't have an exact date, but I believe that
2 Mr. O'Rourke was named to that position in the June time
3 frame.
4 Q. Has there been any reorganization of the
5 support systems as a result of that?
6 A. Not to -- not to date. This is obviously a
7 preparation for exactly -- exactly that work. So you now
8 have a management team who focuses on the -- you know,
9 who focuses on the North Central states from an operation
10 standpoint, from a marketing standpoint, and then the
11 systems work, which I've testified at length today, will
12 be following -- will be following that.
13 Q. When did the call center become located in
14 Maryland, the one that supports Ohio CLEC activity?
15 A. It wasn't that long ago, within the last 12
16 months.
17 Q. Where was the call center prior to that?
18 A. We had a call center -- we had another call
19 center. The one in Maryland actually existed, but it was
20 handling east coast customers and we had a center before
21 that in Coeur d'Alene, Idaho.
22 Q. Is that what handled the Ohio activity?
23 A. It's my understanding, yes.
24 Q. Were there transitional issues as far as
25 handling the workload and having proper training when the

1 call center was moved to Maryland?
2 A. Unfortunately there were transitional issues.
3 Q. Are there any reports of that describing what
4 happened?
5 A. I'm -- I'm aware of the transitional problems
6 that had occurred. I'm aware of the different approaches
7 that representatives on the east coast took from the
8 approaches that representatives on the west coast took.
9 As far as a specific report, I haven't looked at it in
10 preparation for my deposition here today.
11 Q. Is there such a report?
12 A. I don't know.
13 Q. Oh, okay. Let me ask you about the DSL for a
14 minute. On page 10 of your direct testimony you say your
15 Verizon North's Broadband product is High Speed Internet,
16 HSI. Is that a form of DSL?
17 A. I'm looking at page 10 --
18 Q. Page 10, line 16.
19 A. We refer to DSL as HSI or High Speed Internet,
20 yes.
21 Q. So that's a higher frequency channel on the
22 voice line, same voice line?
23 A. Generally, yes. We do offer stand-alone DSL.
24 Q. But when you -- you have a voice customer who
25 wants a data product, you put it over the same loop; is

Before the
Federal Communications Commission
Washington, DC 20554

In the Matter of Applications filed by Frontier Communications Corporation and Verizon Communications Inc. for Assignment or Transfer of Control	)))))	WC Docket No. 09-95

COMMENTS OF THE NATIONAL ASSOCIATION OF STATE UTILITY CONSUMER ADVOCATES AND THE NEW JERSEY DIVISION OF RATE COUNSEL

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September 21, 2009

E. REPORTING REQUIREMENTS

The Frontier/Verizon transaction marks another step in what is likely to be a continuing stream of consolidation among rural ILECs.[76] This reshaping of the industry, with the potential for the emergence of "rural supercarriers,"[77] alongside the RBOC supercarriers, will have profound impact on key public policy issues, such as competition, broadband deployment, and universal service funding, facing this Commission. However, absent reasonable reporting requirements, the ability of the

Commission and other interested parties, such as consumer advocates and state public utility commissions, to monitor and assess the impact of these changes will be substantially hindered.

Applicants indicate that they believe that this transaction is in the public interest, and that the acquisition of rural exchanges from large incumbents is beneficial, pointing to a Commission conclusion that such transactions "'d[o] not raise public interest issues' and 'are unlikely to raise the potential of competitive harm.'"[78] It is most ironic that the Commission Order from which Applicants draw this quote is the *FairPoint/Verizon Order*. The potential pitfalls associated with rural divestitures are clearly illustrated by the FairPoint/Verizon transaction; so is the need for data collection and monitoring. This Frontier/Verizon Application deserves a high level of scrutiny prior to its approval, and also requires monitoring of the performance of the combined company following the

---

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

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

78 Application at 1.

closing of the transaction. Furthermore, should the Commission accept the conditions that are outlined elsewhere in these Comments (or should the Commission decide to impose additional or alternative conditions), ensuring the satisfaction of these conditions also requires monitoring and reporting.

Given that the Commission is likely to see more consolidation activity in the coming months and years, establishing a generalized approach to reporting would result in superior outcomes. It is most unfortunate that the Commission has recently eliminated data reporting requirements associated with the Automated Reporting Management Information System ("ARMIS").[79] ARMIS has provided valuable information regarding the structure and operations of the industry. As will be discussed shortly, it would serve the public interest to reinstate monitoring requirements associated with ARMIS on all carriers. However, if the Commission is unwilling to re-impose ARMIS requirements on all carriers, then requiring companies that seek merger approval, such as the post-closing Frontier and Verizon, to file ARMIS reports as a merger condition that will assist with the monitoring of company performance post-merger is a second-best option.

Monitoring the performance of Frontier's post-merger wholesale provisioning following the merger is essential. This will be particularly necessary with the audits

[79] *In the Matter of Service Quality, Customer Satisfaction, Infrastructure and Operating Data Gathering; Petition of AT&T Inc. for Forbearance Under 47 U.S.C. § 160(c) From Enforcement of Certain of the Commission's ARMIS Reporting Requirements; Petition of Qwest Corporation for Forbearance from Enforcement of the Commission's ARMIS and 492A Reporting Requirements Pursuant to 47 U.S.C. § 160(c); Petition of the Embarq Local Operating Companies for Forbearance Under 47 U.S.C. § 160(c) From Enforcement of Certain of ARMIS Reporting Requirements; Petition of Frontier and Citizens ILECs for Forbearance Under 47 U.S.C. § 160(c) From Enforcement of Certain of the Commission's ARMIS Reporting Requirements; Petition of Verizon for Forbearance Under 47 U.S.C. § 160(c) From Enforcement of Certain of the Commission's Recordkeeping and Reporting Requirements; Petition of AT&T Inc. For Forbearance Under 47 U.S.C. § 160 From Enforcement of Certain of the Commission's Cost Assignment Rules*, WC Docket No. 08-190, WC Docket8640 No. 07-139, WC Docket No. 07-204,WC Docket No. 07-273, WC Docket No. 07-21, Memorandum Opinion and Order and Notice of Proposed Rulemaking, September 6, 2008 ("*ARMIS Forbearance Order*").

recommended above. Given the size and geographic scope of the "New Frontier," and the potential for additional Frontier acquisitions in the future,[80] Frontier could gain from anticompetitive activity directed at competitive local exchange carriers ("CLECs"). While the Commission indicated in the *CenturyTel/Embarq Order* that it did not believe that the size of the entity resulting from that merger met the Commission's "big footprint" threshold, the Commission nonetheless imposed wholesale-performance monitoring on the post-merger CenturyTel.[81] Similar reporting also makes sense for the Frontier transaction, which adds urban markets to Frontier's footprint, such as Seattle/Tacoma, Washington and Charleston, West Virginia, and triples the number of Frontier access lines. While Frontier's footprint following the merger may not be as "big" as that of AT&T or Verizon, there is nonetheless the potential for the Frontier acquisition to "increase the merged entity's incentive to engage in anticompetitive behavior by allowing it to capture or internalize a higher proportion of the benefits of such anticompetitive strategies against regional or national competitors."[82] Monitoring will provide offsetting incentives for the post-merger Frontier to engage in anticompetitive strategies.

In the CenturyTel/Embarq conditions, state-level performance metrics were required to be reported for pre-ordering, provisioning, repair/maintenance (customer trouble report rate), repair/maintenance (average time to restore service), and work center

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80 See transcript of Frontier 1st Quarter Conference Call, available at http://stopthecap.com/2009/05/08/frontier-1st-quarter-2009-results-media-pack/, "*Q&A – Answering questions about "mergers and acquisitions" and consumer telephone line loss (Shasian & Wilderotter).*"

81 *CenturyTel/Embarq Order*, Appendix C at 27-28.

82 Id., ¶ 33, n.106.

responsiveness (speed of answer).[83] Similar reporting requirements also should be imposed on this merger, and state-level reporting should be required for each state in the new Frontier footprint. While Frontier insists that there will be no merger impact on wholesale customers,[84] the public interest requires that this promise be verified through effective monitoring, to enhance competition for the benefit of consumers.

The CenturyTel/Embarq conditions did not specify any service quality reporting for retail services provided to residential customers. Given that the service quality reporting required by the *ARMIS Forbearance Order* will expire in September of 2010,[85] the Commission must extend ARMIS service quality reporting for the post-closing Frontier and Verizon for a period of at least three years following the closing of this merger. Especially given the complexity of this transaction, with its dual conversion of West Virginia retail customers to Frontier's systems, and a parallel hand off of a "replicated" Verizon customer service support facility to Frontier, the potential for customer harm is substantial. Furthermore, Frontier also plans, over time, to migrate customers from the replicated Verizon system to Frontier's system, which will introduce additional opportunities for customer service problems.[86]

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83 Id., Appendix C at 27-28.

84 Application, Exhibit 1, p. 4.

85 *ARMIS Forbearance Order*, ¶12.

86 See, for example, Agreement and Plan of the Merger, §7.24(c) for a discussion of the "replication" of Verizon systems; Direct Testimony of Daniel McCarthy filed before the Washington Utilities and Transportation Commission, in Docket No. UT-090842, July 6, 2009, pp. 50-52; and Frontier Communications, "Welcome to the New Frontier," pp. 8 & 20, available at: http://phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9MzM3NTc4fENoaWxkSUQ9MzIyMTk3fFR5cGU9MQ==&t=1.

CASE: UM 1431
WITNESS: Kay Marinos

PUBLIC UTILITY COMMISSION
OF
OREGON

STAFF EXHIBIT 603

Exhibits in Support
Of Opening Testimony

<u>REDACTED VERSION</u>

November 2, 2009

STAFF EXHIBIT 603

IS CONFIDENTIAL AND SUBJECT TO PROTECTIVE ORDER NO. 09-197. YOU MUST HAVE SIGNED APPENDIX B OF THE PROTECTIVE ORDER IN DOCKET UM 1431 TO RECEIVE THE CONFIDENTIAL VERSION OF THIS EXHIBIT.

CASE: UM 1431
WITNESS: Kay Marinos

PUBLIC UTILITY COMMISSION OF OREGON

STAFF EXHIBIT 604

Exhibits in Support Of Direct Testimony

REDACTED VERSION

November 2, 2009

STAFF EXHIBIT 604

IS HIGHLY CONFIDENTIAL AND SUBJECT TO

SUPERSEDING HIGHLY CONFIDENTIAL PROTECTIVE

ORDER NO. 09-273. YOU MUST HAVE SIGNED

APPENDIX B OF THE SUPERSEDING HIGHLY CONFIDENTIAL

PROTECTIVE ORDER IN

DOCKET UM 1431 TO RECEIVE THE

HIGHLY CONFIDENTIAL VERSION

OF THIS EXHIBIT.

UM 1431
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CERTIFICATE OF SERVICE

UM 1431

I certify that I have this day served the foregoing document upon all parties of record in this proceeding by delivering a copy in person or by mailing a copy properly addressed with first class postage prepaid, or by electronic mail pursuant to OAR 860-13-0070, to the following parties or attorneys of parties.

Dated at Salem, Oregon, this 2nd day of November, 2009.

Kay Barnes

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