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December 17, 2009

VIA ELECTRONIC MAIL AND FEDERAL EXPRESS

Public Utilities Commission of Oregon
Attention: Filing Center
550 Capitol Street N.E., Suite 215
Salem, OR 97301-2551

Re: UM 1431 -- Joint Application of Verizon Communications Inc. and Frontier Communications Corporation for an Order Declining to Assert Jurisdiction Over, or, in the Alternative, Approving the Indirect Transfer of Control of Verizon Northwest Inc.; Testimony in Support of Stipulation by the Parties to Stipulation (Frontier Communications Corporation; Verizon Communications Inc.; Staff of the Public Utility Commission of Oregon; Citizens' Utility Board of Oregon; XO Communications Services, Inc.; Integra Telecom of Oregon Inc.; tw telecom of oregon llc; Covad Communications Company; McLeodUSA Telecommunications Services, Inc.; and 360networks (USA) Inc.)

Dear Filing Center:

Enclosed are the original and five (5) copies of joint Testimony in Support of Stipulation by the Parties to Stipulation. Also enclosed are the affidavits of Daniel McCarthy, Timothy McCallion, and Douglas Denney. Other affidavits are being filed separately by the parties.

If you have any questions in regard to this information, please feel free to contact me.

Sincerely,

Gregory M. Romano

Gregory M. Romano

GMR:pl

Enclosures
cc: *See* Certificate of Service

UM 1431
CERTIFICATE OF SERVICE

I hereby certify that I have this day served this document upon all of the following parties, as follows:

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Salem, OR 97301-2551
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DATED: December 17, 2009.

Patti La
____
Patti Lane

BEFORE THE PUBLIC UTILITY COMMISSION OF OREGON

UM 1431

In the Matter of	)
	)
VERIZON COMMUNICATIONS INC., and FRONTIER COMMUNICATIONS CORPORATION	)
	)
Joint Application for an Order Declining to Assert Jurisdiction, or, in the Alternative, to Approve the Indirect Transfer of Control of VERIZON NORTHWEST INC.	)

TESTIMONY IN SUPPORT OF STIPULATION

BY THE

PARTIES TO THE STIPULATION

FRONTIER COMMUNICATIONS CORPORATION

VERIZON COMMUNICATIONS INC.

STAFF OF THE PUBLIC UTILITY COMMISSION OF OREGON

CITIZENS' UTILITY BOARD OF OREGON

XO COMMUNICATIONS SERVICES, INC.

INTEGRA TELECOM OF OREGON INC.

TW TELECOM OF OREGON LLC

COVAD COMMUNICATIONS COMPANY

MCLEODUSA TELECOMMUNICATIONS SERVICES, INC.

360NETWORKS (USA) INC.

I. Introduction

Q. Who is sponsoring this testimony?

A. This testimony is jointly sponsored by: Frontier Communications Corporation ("Frontier"); Verizon Communications Inc. ("Verizon") (Frontier and Verizon, collectively, the "Applicants"); Staff of the Public Utility Commission of Oregon ("Staff"); the Citizens' Utility Board of Oregon ("CUB"); XO Communications Services, Inc.; Integra Telecom of Oregon Inc. (on behalf of itself and its affiliates Eschelon Telecom of Oregon, Inc., Electric Lightwave, LLC, Advanced TelCom, Inc., Oregon Telecom, Inc., and UNICOM); tw telecom of oregon llc, Covad Communications Company and McLeodUSA Telecommunications Services, Inc. d/b/a PAETEC Business Services ("Joint CLECs"); and 360networks (USA) inc. In this Joint Testimony, the parties are referred to collectively as "the Parties."

Q. Please state your names.

A. Our names are: Daniel McCarthy (Frontier); Timothy McCallion (Verizon); Michael Dougherty (Staff); Bob Jenks and Gordon Feighner (CUB); and Douglas Denney (Integra). Our qualifications are set forth in our pre-filed direct testimonies.

Q. What is the purpose of your testimony?

A. Our joint testimony describes and supports all provisions of the stipulation and attached conditions agreed upon by the parties on December 3, 2009 and filed with the Commission on December 4, 2009 ("Global Stipulation") with the exception of the most favored state condition that is the subject of separate testimony and is ripe for resolution.

As explained in greater detail below, under the Global Stipulation, the Parties acknowledge that the Applicants' application will satisfy the "in the public interest, no harm" standard (described in Order No. 09-169) upon resolution of the "Most Favored State Commitment" issue, the only issue not resolved by the Global Stipulation. The Parties request that the Commission issue an order approving the Global Stipulation and providing the approvals requested by the Applicants once it resolves the most favored state condition issue.

Also, the Joint CLECs' support of the Commission granting the requested approvals is contingent upon the Commission also approving or acknowledging the separate stipulation between the Applicants and the Joint CLECs filed in this case on December 3, 2009 ("Joint CLEC Stipulation"). The Applicants and Joint CLECs have filed separate joint testimony supporting this separate stipulation.

Q. Have all parties joined in the Global Stipulation?

A. No. As discussed at the December 3 evidentiary hearing, Comcast of Oregon ("Comcast") did not join in the Global Stipulation, but they do not object to it. On December 7, 2009, Frontier, Verizon and Comcast entered into a separate stipulation that addresses Comcast's issues ("Comcast Stipulation"). Level 3 also did not join the Global Stipulation, but they do not object to it and have entered their own settlement with Frontier ("Level 3 Stipulation").

In short, the Commission has before it four separate stipulations for consideration that resolve *all* issues raised by *all* parties: (1) the Global Stipulation; (2) the Joint CLEC Stipulation; (3) the Comcast Stipulation; and (4) the Level 3 Stipulation. Each of these stipulations is supported by separate testimony filed today, and no party objects to any of these stipulations.

II. Background

Q. Please briefly describe the history of this proceeding.

A. On May 29, 2009, Verizon and Frontier filed an application seeking Commission approval for the indirect transfer of control of Verizon Northwest Inc. ("Verizon Northwest") from Verizon to Frontier as described in the application. The applicants requested approval under ORS 759.375, ORS 759.380, OAR 860-027-0025, and any other applicable law or rule the Commission deems necessary to effect the transaction.

On July 6, Verizon and Frontier filed direct testimony in support of their application. On November 2, Staff, CUB, Integra and Comcast filed responsive testimony. Finally, on November 16, Verizon and Frontier filed their reply testimony. Collectively, the Parties have filed thousands of pages of testimony and exhibits. Moreover, the Parties have served and responded to more than 1,000 discovery requests.

The Parties have also engaged in numerous settlement discussions from July through December 2009. For example, settlement workshops were held on July 27, August 19, and September 24, and many settlement meetings and calls took place throughout October and November. In late November and early December, the Parties met or talked almost on a daily basis. All these discussions resulted in the Global Stipulation that is now before the Commission.

Q. Please summarize the Global Stipulation.

A. As evidenced by the pre-filed testimony, many of the parties had different interests and different views on the issues.

After much discussion and negotiation, the Parties entered into the attached Global Stipulation. This stipulation, including resolution of the most-favored states issue, provides that the Applicants have satisfied the "public interest, no harm" standard as described in Order No. 09-169. Indeed, the fact that so many parties with such diverse views and interests have been able to reach agreement is itself compelling evidence that approving the proposed transaction subject to the terms and conditions of the Global Stipulation is in the public interest.

The Global Stipulation includes 55 enumerated and agreed-upon conditions, some of which have additional sub-conditions. The conditions are grouped into categories that assure the Commission that key customer-facing and service-related protections are implemented.

- Records/Rates/Tariffs/Access to books (Conditions 1-13), which assures the Commission that Oregon customers will not be harmed by changes in rates or services resulting from the transaction and confirms that the Commission will have ongoing access to documents, data, records, and information about material changes, as well as other general matters;
- Broadband (Condition 14), which includes commitments by Frontier, in terms of investment levels and timing, regarding enhanced broadband deployment in Oregon;
- Financial (Conditions 15-17), which includes Frontier's commitment to notify Staff regarding the financing associated with the transaction, assurances that

the Oregon assets will not be encumbered, and a commitment that customers will not be obligated to pay for any acquisition premium;

- Retail Service Quality (Conditions 18-23), which includes Frontier's commitments to certain reporting requirements to the Commission on retail service quality metrics and to providing information regarding the condition of specific network assets and planned capital expenditures;
- Safety (Conditions 24-27), which includes compliance with all applicable federal and Oregon standards and requirements, as well as commitments to honor Verizon's previous safety-related obligations;
- Operating Support Systems (Condition 28), which includes commitments by Frontier and Verizon regarding replication and transition of retail and wholesale operating systems, specific sharing of information with Staff and CUB regarding the software and systems transitions, an agreement by Verizon to employ a third-party reviewer of the results associated with systems replication and performance, and commitments by Frontier regarding any subsequent transition to other wholesale operating systems in the future;
- Long Distance (Conditions 29-31), which ensures ongoing services and rates, and provides certain rights to consumers to change carriers without change-related charges for a period of time following the transaction;
- Wholesale Services (Conditions 32-45),which includes assurances that Frontier will honor all wholesale obligations of Verizon Northwest, including commitments to rates, service quality and performance levels, and that there is continuity regarding systems and terms for intrastate services;

- OTAP/Lifeline (Conditions 46-50), which includes a commitment by Frontier to process various data on a weekly basis and certain reports on a monthly basis;
- Affiliated Interests/Non-regulated Operations (Conditions 51-53), which assures the Commission that Frontier will comply with all applicable affiliated interest reporting requirements; and
- FiOS (Conditions 54-55), which includes terms for commitments by Frontier to continue to provide FiOS video services for a period of two years and to waive FiOS-related termination charges under certain circumstances.

Q. How is the rest of your testimony organized?

A. Section III addresses issues the Administrative Law Judge ("ALJ") raised at the December 3 hearing. The ALJ explained that these issues were of particular interest to the Commission and asked the Parties to address them in detail. Specifically, Section III explains how the Global Stipulation addresses: (1) Staff's concerns about Frontier's financial ability post-transaction; (2) the transition of operating support systems ("OSS"); (3) broadband deployment; and (4) service quality issues, including Frontier's provision of existing FiOS services.

Section IV elaborates on each of the conditions and the implications for the public interest. Section V specifically addresses how Staff's initial concerns were alleviated by the conditions included in the Global Stipulation, and Section VI offers a conclusion.

III. <u>Responses to the Issues Raised by the ALJ</u>

A. Frontier's Financial Ability

Q. In its testimony, Staff expressed concerns about Frontier's financial ability post-transaction. Does the Global Settlement address these concerns?

A. Yes. As Staff witness Michael Dougherty explained during the December 3 hearing, Staff's principal concern centered on the financial problems associated with the FairPoint and Hawaiian Telecom transactions. In these transactions, the acquiring entities, FairPoint and Hawaiian Telecom, experienced financial problems after they acquired properties from Verizon. Staff wanted to ensure that this transaction addresses the risks and problems that arose in these prior transactions. (*See, e.g.*, Staff 100/at 12.)

Significantly, as Staff witness Dougherty explained at the hearing, the financial problems in both the FairPoint and Hawaiian Telecom transactions were caused by the OSS problems that occurred post-transaction. (Tr. 51: 8-14.) This critical link between the financial problems in the prior transactions and the OSS is further illustrated in Staff's pre-filed testimony. For example, Staff's testimony quotes the Maine Public Utilities Commission, which stated that "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*." (Staff/100 at 39.) Also, Staff's testimony quotes from FairPoint's 10-Q filing with the Securities and Exchange Commission (SEC), which attributes its financial problems with an unsuccessful cutover: "Because of cutover issues that have prevented us from executing fully on our operating plan for 2009, our revenue has continued to decline." (Staff/100 at 39.)[1] Similarly, Applicants' pre-filed testimony explains that Hawaiian Telecom's financial problems were directly caused by its post-transaction OSS

[1] FairPoint's SEC Form 10-Q is included in Staff/102 at 119.

problems: "The inability [of Hawaiian Telecom] to build and operate such systems precipitated rapid line loss and customer dissatisfaction. The root problems, therefore, arose because of the need to assemble an entirely new management team and the inability to install and operate an effective and entirely new back-office system." (FTR Reply/200 at 78.) Indeed, Hawaiian Telecom admitted this in its SEC filings.[2] In short, the record makes clear that the financial concerns raised by the prior transactions were caused by the OSS issues.

In order to address the Staff's concerns, Frontier and Verizon provided additional detail on the OSS replication process for the systems that will be delivered to Frontier. In summary, Verizon will replicate its GTE OSS and then test the systems before they are put into operation. Verizon will then use those replicated systems to serve Oregon customers. At closing, Frontier will obtain a replicated system that will have been operated by Verizon's North Central business unit for at least 60 days. The process and anticipated timing for major steps in the process are as follows:

1. Hardware and coding (to be completed by the end of December 2009) – this step in the process involves installing the requisite hardware and servers in the Fort Wayne Data Center ("Data Center"), developing routing configurations for the Data Center, and testing of the database migration strategy.

2. Configure systems (to be completed by the end of January 2010) – this second step in the process involves stabilizing the hardware and software in the Data Center, and systems interface testing.

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[2] Hawaiian Telcom, Annual Report (Form 10-K), at 15 (Mar. 31, 2008) ("In addition to the significant expenses we have incurred, because we do not have fully functional back-office and IT systems, we have been unable to fully implement our business strategy and effectively compete in the marketplace, which has had an adverse effect on our business and results of operations. While we are continuing to work to improve the functionality of our systems and we have seen improvement, there is no certainty that these activities will be successful or when we will achieve the desired level of functionality. Until we are able to achieve this level of functionality, our lack of critical back-office and IT infrastructure will negatively impact our ability to operate as a stand-alone provider of telecommunication services, and will have an adverse effect on our business and operations."). This report is quoted in FTR Reply/200 at 78.

3. Testing (to be completed by the end of March 2010) – there will be an early data migration to the replicated systems in the January/February 2010 timeframe, followed by end-to-end readiness testing for all services, flows and business processes; subsequently, there will be operational readiness testing.

4. Data migration and synchronization (to be completed prior to closing, all systems will be available in the Data Center as of April 2010) – in this step, Verizon will copy the latest production data files to the replicated systems and maintain one-way transaction log updates on the replicated systems in the Data Center.

5. Replicated systems proving (to be completed prior to closing) – the final step before closing will involve deleting the data for the Verizon/GTE operations that will not be transferred as part of the proposed transaction from the replicated systems to be transferred to Frontier.

(FTR Reply/200 at 54-55.) As explained in the Reply Testimony of Stephen Smith of Verizon, Verizon is developing the detailed testing plan for the replicated systems (Step 3 above), which will involve sample data flowing through the test environment, with results checked against the production environment results. After reviewing the Verizon testing plan, Frontier can request additional testing. Verizon will then share the test results with Frontier. Frontier will review the results of Verizon's testing both before and after the replicated systems go into production on April 1, 2010 (after Steps 1-3 above).

Another built-in safeguard is the fact that Verizon will use the replicated systems to serve retail consumers, business customers, and wholesale customers for at least 60 days prior to close. After April 1, 2010, new customer orders will be taken by Verizon representatives who will be assigned to transfer with the transaction and the orders will be placed in the replicated VSTO ordering systems. These new customer orders will be provisioned from the replicated VSTO provisioning systems. Verizon's technicians that will be assigned to continue with Frontier will provision the service. Calls to retail care centers will be fielded by a Verizon representative who will be assigned to continue with Frontier. The representative will access the customer's account on the replicated systems, use the replicated system to answer the customer's questions, and make any service changes using the replicated system. Service outage reports/calls will be handled by Verizon representatives who will be assigned to continue with Frontier, and who will enter repair tickets that are tracked and dispatched from the replicated ticketing and dispatching systems to repair technicians who will be assigned to transfer with the transaction. Customers will receive bills generated from the replicated billing systems. Bill inquiries will be handled by Verizon representatives who will be assigned to continue with Frontier, and will be processed using the replicated systems. So, the replicated systems will, in fact, be supporting the VSTO operations starting in April of 2010, well before the systems are transferred to Frontier at the closing of the proposed transaction.

At the evidentiary/settlement hearing, Staff witness Dougherty explained that Staff's concerns about Frontier's financial ability post-transaction were addressed based on the additional detailed plans Verizon and Frontier have provided regarding the OSS and in the Global Stipulation's treatment of the OSS issues, found in Condition 28. (Tr. 51:8-14.) This condition sets forth numerous obligations and protections for both the retail and wholesale systems being transferred to Frontier. (Also, as discussed later in our testimony, other conditions in the Global Stipulation and other evidence in the record satisfy Staff's concerns about Frontier's financial ability post-close.) With the other conditions and resolution of the most-favored state provision, Staff supports approval of the application.

Q. Please provide a summary of Condition 28.

A. This condition further ensures that the systems being transferred to Frontier are functioning both *before* and *after* the systems go into production mode. It also requires Frontier to continue using these systems for at least one year after closing, and to give at least six months' notice of its intent to transition to any new system. Here is a summary:

First, on the *retail* side, before Verizon puts the replicated systems into production mode, which will occur prior to close, it will share (subject to confidentiality protection) with Staff and CUB the "Program Test Strategy" Plan to be used to review the replicated systems, and the results of pre-production tests on the customer-affecting systems that serve retail customers. These tests must show that the systems are working, and that if there were any "full service denials" associated with the systems they have been resolved. Also, a third party reviewer must validate that the test results are accurate. And the settlement sets forth a process by which the Staff and CUB participate in the selection of the third party reviewer that will be retained and paid for by Verizon.

Furthermore, prior to closing, Verizon will share with Staff and CUB (subject to confidentiality protection) the results for three key, specific retail measures: installation commitments met; customer network trouble reports; and repairs cleared within 48 hours. On these key measures, Verizon must show that the results are not materially less favorable than benchmark data from the 12 months prior to production mode. And here, too, a third party reviewer must validate that the results are accurate.

As further assurance that the systems are working properly prior to close, the settlement provides that the closing will not occur unless and until Frontier validates and confirms that the replicated systems are fully operational. Also, Frontier must provide Staff and CUB with notice once it finalizes its validation and confirmation.

On the *wholesale* side, the settlement provides that Verizon will take full responsibility for replicating its existing systems and transferring data to the replicated systems, and that Verizon will undertake testing of the systems during the replication process and *before* the systems are put into production and utilized. This testing will consist of the processing and flow through of sample data and the verification of the results of that testing. Also, Frontier will have the opportunity to provide feedback on the test plan, to review the results of Verizon's testing, and to request that other tests be run. Once the pre-production testing results confirm the replication has been successful, Verizon will complete the replication and physically separate the CLEC operations support systems to be transferred to Frontier. Verizon will put the CLEC systems into real time use to operate its Northwest region, which includes Oregon.

After the existing Verizon wholesale operations support systems are replicated and physically separated, those replicated systems must be used *by Verizon* to support the wholesale service it provides in Oregon for at least 60 days prior to the closing. During this period, Verizon will receive CLEC orders, provision, and bill for services in the normal course of its business. Also, Frontier will validate the performance of the replicated systems to ensure the systems are fully operational. In the event that issues or problems arise, including problems identified by CLECs, Verizon and Frontier will investigate, and Verizon will make any necessary system modifications to remedy those issues. And the closing will not occur unless and until those systems are fully operational.

Furthermore, Frontier has agreed to continue to use the replicated wholesale systems for at least one year after closing. Frontier and Verizon have committed that

Frontier will receive Verizon maintenance and support for at least one year after closing and, subject to the terms and conditions of the agreement between the parties, Verizon will be required to offer this support for a minimum of at least four years, if Frontier desires such support. This support will include new system releases, updates to source code, patches and bug fixes associated with the replicated systems conveyed to Frontier.

Also, at least 180 days before any transition of the replicated OSS system to any *other* wholesale operations support systems, Frontier will file its proposed transition plan with the Commission and seek input from interested carriers. Before implementing such a transition, Frontier will allow for coordinated testing with the settling CLECs as described in the settlement.

In summary, the Global Stipulation specifically addresses Staff's concerns about Frontier's financial ability post-close by addressing in a comprehensive fashion the critical OSS issues that caused the financial (and customer service) problems in the FairPoint and Hawaiian Telecom transactions.

Q. Are there any other provisions in the Global Stipulation that address Staff's concerns with Frontier's financial ability post-close?

A. Yes. As Staff witness Dougherty and CUB witness Bob Jenks explained at the evidentiary hearing, the condition addressing Frontier's broadband commitment, Condition 14, also addresses the financial issues. (Tr. 51:15-20, 39:13-23.) Both Staff and CUB wanted assurance that financial resources would be quickly invested to deploy broadband in Oregon.

Under Condition 14, Frontier must begin spending funds on broadband deployment in Oregon almost immediately after close. Specifically, before July 1, 2011, Frontier must spend $10 million on broadband deployment in the Frontier Northwest territory in Oregon. Frontier Northwest must deploy broadband service in not less than 95% of the Frontier Northwest Oregon wire centers within two years of closing of the proposed transaction, and it must make broadband available to specific percentages of households within certain wire centers by specified dates. Furthermore, within 180 days after closing, Frontier Northwest will submit to the Commission Staff a detailed broadband deployment plan identifying the wire centers and geographic areas Frontier is targeting for additional broadband deployment, and Frontier must consult with Staff regarding the timing of the deployment in specific wire centers and geographic areas the Commission identifies as priority areas. The Parties assume the detailed plan will include "middle-mile" network improvements that will benefit all customers. The improvement of wire centers and interoffice transport as well as end-user loop plant is a major benefit for the Oregon economy and for all carriers serving the state.

Also, during the three- year period after closing, Frontier Northwest will file confidential, quarterly reports with the Commission, for Commission and CUB review, detailing the broadband deployment that Frontier has completed to date, identifying the additional number of households capable of receiving broadband during that preceding period, identifying any impediments that may prevent fulfillment of this condition and describing additional deployment Frontier Northwest plans to implement in the following year.

Significantly, within 30 days of closing, Frontier must deposit in an account approved by the Commission $15 million (this is in addition to the $10 million it must spend by July 2011) to ensure fulfillment of its remaining broadband commitment. The $15 million shall remain in the account until the Commission determines that Frontier has met all its broadband commitments. This requirement does not sunset after the three-year period following close of the transaction. And if Frontier fails to spend the $10 million in the first year as committed, any portion of the unspent funding will be added to the $15 million account. In short, these immediate spending and funding commitments ($10 million plus $15 million) provide assurances that Frontier will have the financial ability to deploy broadband in Oregon, as explained by Staff and CUB at the hearing. Regardless, it is the expectation of Staff and the commitment of the Applicants that $10 million in broadband investments will occur within one year. Furthermore that by making this investment, there will be no diminishment in outside plant investments and that this will be verified through a reporting requirement.

Q. What other conditions are included in the Global Settlement that address Staff's concerns about Frontier's financial ability?

A. In its pre-filed testimony, Staff recommended three additional conditions to address its concerns: "enhanced reporting Net debt/earnings before interest, tax, depreciation and amortization (EBITDA), a restriction of including any acquisition premium in rates, and a restriction of requesting approval from the Commission to encumber the assets of the Operating Companies." (Staff/100 at 31.)

Each of these conditions is reflected in the Global Settlement (Conditions 15-17), and applies for a period of three years. The conditions read:

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

16. Frontier will not encumber the assets of the Operating Companies. (In Oregon, if Frontier wanted to pledge the assets of its operating companies to secure debt, it would have to ask the Commission for approval. Under this condition, Frontier agrees not to even *request* Commission approval to use the operating company assets to secure debt for a period of three years.)

17. Frontier Northwest 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. Any acquisition premium will be recorded in the books at the parent level.

Q. In its pre-filed testimony, Staff expressed concern about Frontier's high leverage and the amount of debt ($3.3 billion) involved in this transaction, and Staff proposed other financial conditions. (Staff/100 at 29-30.) How have these issues been resolved?

A. First, as discussed above, Staff's concerns about Frontier's financial ability post-close, including its proposed conditions, were centered on the financial problems faced by FairPoint and Hawaiian Telecom that were primarily caused by the OSS issues. These OSS issues have been resolved.

Second, Applicants addressed every concern in its rebuttal testimony, and explained the significant differences in the financial metrics of, on the one hand, FairPoint and Hawaiian Telecom and, on the other hand, Frontier. This testimony shows that Frontier believes it is in a significantly stronger financial position pre-close than the other companies were, and that post-close, Frontier will be in an even stronger financial position. (*See. e.g.*, FTR Reply/200 at 69-79.) Indeed, post-close, Frontier's leverage and amount of debt will be *reduced* and Frontier will have an even stronger balance sheet than it has today and greater cash flow generation capabilities.[3]

Third, the record in this proceeding shows that independent research analyst reports on the Verizon-Frontier transaction recognize Frontier's ability to execute the transition effectively. For example, on June 12, 2009, Raymond James and Associates, Inc. issued a report explaining that it viewed the transaction as very different from the FairPoint transaction, and, in the analyst's professional opinion, Frontier was making a "prudent acquisition." The report states:

> We note several significant differences between [this transaction and the FairPoint transaction]: Frontier is de-levering (not re-levering) significantly through the transaction, should be solidly in investment grade range, is proactively cutting its dividend, and plans on driving broadband penetration and availability much higher than current levels, (Verizon properties have 60% availability, Frontier's have 92%). . . .
>
> Frontier will acquire GTE's entire legacy IT systems in 13 of the 14 states, giving it the ability to run parallel systems for all products in those 13 states. This is different from a forced cutover or new systems development, which actually requires a hastened time frame and can be fraught with peril. Effectively, these are stand-alone systems with a general manager overseeing them and won't

[3] Frontier Communications' leverage is approximately 3.8 x EBITDA; after the transaction, its leverage will be reduced to 2.6 x EBITDA. (EBITDA is earnings before interest, taxes, depreciation, and amortization.) FTR Reply/200 at 72; FTR Reply/203 at 6. The record also reflects that Frontier will be a stronger company financially post-transaction even if it did not achieve any of its expected $500 million in synergies. Specifically, the record shows that Frontier's "no synergy" leverage ratio would be 3.2 times, which is considered reasonable in the industry and would still result in a financially stronger Frontier. *See, e.g.*, FTR Reply/200 at 86-87.

> require any new systems development on the part of Frontier until management is ready to move them over. . . .
>
> Overall, we believe Frontier is making a prudent acquisition, which will expand its scale, lower its leverage, and improve its dividend sustainability, thus rewarding patient investors over time.[4]

Similarly, Morgan Stanley's senior telecommunications analyst explained that "[The Frontier] deal lowers leverage by more than a turn (3.8x to 2.6x) instead of increasing it."[5]

Fourth, telecommunications is an industry in transition. There are only three major carriers with investment grade credit ratings—Verizon, AT&T, and CenturyLink. Because the credit metrics of pro forma Frontier will be very similar to those of CenturyLink, it is possible that the company will be rated "investment grade" after the completion of the transaction. In fact, Moody's Investors Service and Fitch Ratings indicated at the time of the transaction announcement that Frontier's credit rating would be placed on "watch" for positive upgrade.

To be clear, not all the parties to the Global Stipulation agree with each other on all respective positions. The point here, though, is that, after carefully considering *all* the evidence introduced in this proceeding, and limiting their decisions to the *specific facts and issues* in this proceeding, the Parties have concluded that the Global Stipulation in its entirety, including resolution of the most favored state issue, will result in meeting the "in the public interest, no-harm" standard and should be adopted by the Commission.

B. <u>OSS Transition</u>

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[4] FTR/107, Raymond James & Associates, FTR: Notes From the Road (June 12, 2009).

[5] FTR Reply/202 at 3, Morgan Stanley August Report.

Q. At the hearing, the ALJ asked the Parties to explain how the Global Stipulation addresses the "smooth transition" of the OSS from Verizon to Frontier. Does the Global Stipulation address this issue?

A. Yes. As explained above, Condition 28 ensures that the systems being transferred to Frontier are functioning both *before* and *after* the systems go into production mode, and it calls for an independent third party to review the relevant test results. Also, it requires Frontier to continue using these systems for at least one year after closing, and to give at least six months' notice of its intent to transition to any new system. These provisions will ensure a smooth transition.

Also, it is important to note the fundamental difference between this transaction and the FairPoint and Hawaiian Telecom transactions regarding support systems. In the prior transactions, both FairPoint and Hawaiian Telecom developed and deployed brand new, untested systems, which did not work as intended and which led to financial and service quality problems. (*See, e.g.*, Staff/100 at 39.) This transaction, however, is different. Here, Frontier will acquire and use Verizon existing, tested systems, which Verizon will replicate, test, and use prior to close. And as noted above, Frontier will validate and confirm that these systems function properly before closing. In short, the systems issues faced by FairPoint do not exist here. This fact, coupled with the OSS provisions in the Global Stipulation, will ensure a smooth transition.

Q. The ALJ asked the Parties to address whether Verizon had sufficient "skin in the game" to ensure a smooth transition of support systems. Please respond.

A. The Parties agree that Verizon has sufficient incentive to ensure a smooth transition of its replicated support systems to Frontier. Most significantly, Condition 28 provides that the transaction cannot close unless and until: (1) Verizon performs significant testing and reports the test results to Staff and CUB; (2) an independent third party validates that the test results are accurate; and (3) based on these test results Frontier confirms and validates that the support systems are fully operational. In short, as Condition 28 explains, *"The closing will not occur unless and until those systems are fully operational."* This is a powerful incentive for Verizon to ensure a smooth transition.

Q. Does the Global Stipulation also address the Software License Agreement ("SLA"), under which Verizon will provide systems maintenance services to Frontier after closing?

A. Yes. Condition 28 requires that "Frontier will receive Verizon maintenance and support for at least one year after closing and subject to the terms and conditions of the agreement," and it requires Verizon to offer this support "for a minimum of at least four years, if Frontier desires such support." This support must include "new system releases, updates to source code, patches and bug fixes associated with the replicated systems conveyed to Frontier." These conditions are "locked in" by the Global Stipulation – Verizon cannot change them through any contract modifications. Verizon's contractual obligation to fix, for a flat fee, any software code problems with the replicated systems constitutes additional "skin in the game" that aligns Verizon's post-transaction incentives with those of Frontier and its retail and wholesale customers.

Q. In its pre-filed testimony, Staff recommended that the $94 million fee for maintenance services be replaced by a fee based on "time and materials." Has this issue been resolved?

A. Yes. The Global Stipulation does not require the Applicants to change the fee arrangement they have agreed upon, but, as noted above, it ensures that critical services such as "new system releases, updates to source code, patches and bug fixes associated with the replicated systems conveyed to Frontier" are included in the services Verizon provides.

Also, in response to Staff's pre-filed testimony, Applicants filed reply testimony explaining that (1) in the absence of a maintenance agreement with Verizon, Frontier would be required to obtain these services from a third party or by hiring sufficient IT personnel, and Frontier has determined that a "cost certain" is preferable to a time and materials approach; (2) the agreed-upon maintenance fee is fair and equitable and well within industry benchmarks;[6] and (3) the agreed-upon fee represents less than $2.00 per line per month based on over 4 million lines that are part of the proposed transaction. By contrast, the cost for FairPoint of the Transition Services Agreement with Verizon was approximately $9.29 per line per month.[7] Also, as noted, Frontier has the flexibility to modify that maintenance fee after the first year, and therefore Frontier has the option to avoid or reduce the fee. (*See, e.g.*, FTR Reply/200 at 64-65; Verizon/300 at 15, 25-27.)

[6] As discussed in Verizon/300 at 25-26, IT costs are often measured by industry analysis in terms of costs to "maintain and operate the organization, systems and equipment" or "MOOSE." On average, U.S, mid-tier telephone companies incur MOOSE representing 2.6% of revenues, while global large telephone companies incur MOOSE representing 3.8% of revenues. Taking into account Spinco's operating costs, facilities costs, and the maintenance fee, the MOOSE for Spinco is 2.8% of revenues. Accordingly, the maintenance fee is well within industry benchmarks.

[7] *See* Transition Services Agreement by and among Verizon Information Technologies LLC, et. al and FairPoint Communications, Inc. (Form 425) (January 19, 2007) at pp. 7-8, listing the monthly fee as $14.2 million. (available at: **http://sec.gov/Archives/edgar/data/1062613/000110465907003518/a07-1924_2ex10d1.htm**).

Again, Staff does not necessarily agree with all the points raised in Applicants' rebuttal testimony on this issue, but based on a careful review of all the evidence in light of all the other conditions, these maintenance arrangements are acceptable and supported by the record.

C. Broadband Deployment

Q. Please describe the broadband commitments in the Global Stipulation.

A. As discussed above, Condition 14 addresses Frontier's broadband commitment. Under this condition, Frontier must begin spending funds on broadband deployment in Oregon almost immediately after close. Specifically, before July 1, 2011, Frontier must spend $10 million on broadband deployment in the Frontier Northwest territory in Oregon. It must deploy broadband service in not less than 95% of the Frontier Northwest Oregon wire centers within two years of closing of the proposed transaction. For 15 new wire centers in which broadband service is deployed, Frontier Northwest will make broadband available to 50% of the households in each of the 15 new wire centers within two years, and it will make broadband available to 75% of the households in 10 of the new wire centers within two years. Also, no less than 40% of all households over the 22 currently non-served wire centers and the Scholls, Dayton and Banks wire centers, will have broadband available within two years.

Condition 14 also has minimum download speed commitments: it requires that, in aggregate, no less than 60% of households in the 15 new wire centers will have broadband available at no less than 1.5 mbps download speed within two years. (Frontier

Northwest may petition the Commission for a slower speed if 1.5 mbps download speed cannot effectively be deployed.)

Furthermore, within 180 days after closing, Frontier Northwest must submit to the Commission Staff a detailed broadband deployment plan identifying the wire centers and geographic areas Frontier is targeting for additional broadband deployment, and it must consult with Staff regarding the timing of the deployment in specific wire centers and geographic areas the Commission identifies as priority areas.

Also, during the three-year period after closing, Frontier Northwest will file confidential, quarterly reports with the Commission, for Commission and CUB review, detailing the broadband deployment that Frontier has completed to date, identifying the additional number of households capable of receiving broadband during that preceding period, identifying any impediments that may prevent fulfillment of this condition and describing additional deployment Frontier Northwest plans to implement in the following year.

Condition 14 also ensures sufficient funding for this broadband deployment. Within 30 days of closing, Frontier must deposit in an account approved by the Commission $15 million (this is in addition to the $10 million it must spend by July 2011) to fulfill its remaining broadband commitment. The $15 million shall remain in the account until the Commission determines that Frontier has met all its broadband commitments. This provision is not subject to the three-year expiration timeframe that applies to most of the stipulated conditions.

As Staff and CUB explained at the December 3 hearing, this comprehensive broadband condition satisfies their concerns about the scope of broadband deployment and the sufficiency of assets to pay for such deployment. (Tr. 39:18-23, 49: 23-50:8.)

D. Retail Service Quality/Safety/FiOS

Q. Please explain how the Global Stipulation addresses retail service quality issues.

A. In their pre-filed testimony, Staff witnesses White (White/400) and Birko (Birko/500) discussed service quality issues and associated safety concerns resulting from the transfer, and they recommended certain conditions to ensure that adequate service quality is maintained through enhanced service quality and safety reporting. (*See* Staff/100 at 54-55, Conditions 18-27.) All these conditions have been adopted and are reflected in the Global Stipulation, Conditions 18-27.

In general, these conditions require Frontier Northwest to report monthly service quality results; implement an organizational structure described by Staff to ensure quality service; maintain current Commission minimum service quality standards as are currently being reported in the Verizon's monthly service quality reports to the Commission; and be liable for penalties if it fails to meet these standards, as set forth in ORS 759.450.

Also, these conditions address Staff's concerns about the remaining life of existing switches. Specifically, no later than one year from the close of the transaction, Frontier Northwest will provide to the Commission:

(1) A multi-year strategic plan that identifies the expected remaining life of each of the base unit and remote switches currently deployed in Verizon Northwest's franchise area in Oregon and a proposed replacement plan for the switches, if any, so that

Frontier Northwest will be able to meet the then current service standards pursuant to Oregon statutes and rules; and

(2) An annual report detailing Oregon capital expenditures concerning planned actions on subsection (a) 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.

Finally, these conditions (Conditions 24-27) include *all* of Staff's safety-related proposals.

Q. Please describe the FiOS-related conditions.

A. As CUB witness Jenks stated at the hearing, one of CUB's principal concerns was the continued availability of Verizon's "FiOS" video and high-speed internet offerings post-close. (Tr. 39:24-40:1.) Mr. Jenks explained that CUB's concerns were resolved by Conditions 54 and 55. (Tr. 40:1-13.)

By way of background, certain Verizon Northwest video local franchise agreements permit Verizon NW, and would also permit Frontier Northwest on completion of the proposed transaction, to "walk away" from the franchise agreements during an open window period occurring within the first two years after closing of the proposed transaction. This means that Frontier Northwest could discontinue providing FiOS video services during the open window period and prior to the end of two years. Notwithstanding its ability to "walk away" from certain video services, under Condition

54, Frontier Northwest commits to the continuation of video services for two years in all cases except those where failure to opt out during this "walk away" window would bind the company to a commitment that is longer than two years.

Also, Condition 55 generally allows Oregon FiOS customers to terminate a long term contract without incurring any termination fees if Frontier Northwest reduces or substitutes one or more video channels from an Oregon customer's existing FiOS video service, or if Frontier Northwest takes any action intended to reduce the internet speed for existing FiOS Internet service customers.

Conditions 54 and 55 were particularly important to CUB, which believes that these conditions adequately demonstrate Frontier's commitment to FiOS services.

IV. <u>Discussion of Conditions and Implications for Public Interest</u>

A. <u>Records/Rates/Tariffs/Access to Books (Conditions 1-13)</u>

Q. What protections are provided to Oregon customers through the first set of conditions in the Global Stipulation?

A. The Parties believe that the conditions pertaining to reporting requirements provide the Commission with sufficient access to the books of account, all documents and data regarding the transaction, and information regarding material changes, in order to allow the Commission and Staff to effectively monitor the performance and financial condition of Frontier. That access is viewed as an important element in properly positioning the Commission to protect the public interest. This set of conditions also provides important protections to ensure that Oregon customers are not harmed by increases in regulated rates or reductions in regulated services as a result of the transaction. Specifically, Frontier has committed, among other things, that there will be no change in rates or regulations in certain Verizon tariffs and price lists without a rate application, consistent with the Commission's rules; that Frontier will not advocate for a higher cost of capital in rates as a result of the transaction; and that no rates will include any costs related to the one-time transition from Verizon's ownership to Frontier's ownership. In addition, customers will be notified of the change in their local exchange and long distance provider resulting from the transaction (notification of "name" change). Finally, Frontier has agreed to enhanced reporting of integration activities, expected cost savings, and anticipated impacts on Oregon operations and customers. The Parties believe that this set of conditions adequately ensures that Oregon customers will not be harmed by transaction-related rate or service impacts, and that the Commission will have the information necessary to properly monitor and regulate Frontier post-transaction.

B. Broadband (Condition 14)

Q. Can the Parties address the specific broadband commitments made by Frontier under the Global Stipulation?

A. In testimony, a number of Parties, including Staff and CUB, raised concerns about whether, in the post-transaction period, Frontier would have the financial capacity to invest in the Oregon communications network and the sufficiency of funds to dedicate to Oregon-specific investment. As explained above, to realize public benefits and to protect against the potential for certain harms raised by some of the Parties in testimony, Frontier has agreed to specific levels of broadband capital expenditures over defined periods of time, and has agreed additionally to escrow at least $15 million until its broadband obligations under the Global Stipulation are met. The Parties believe that Frontier's broadband commitments under the Global Stipulation provide the Commission with a high degree of certainty that Frontier will in fact commit sufficient capital to maintain and enhance its Oregon network, and that dedicated funds have been allocated (to a certain extent placed under Commission authority in the case of the escrow account), to better ensure that this investment occurs. Furthermore, this entails having the broadband available within a two-year period, which further reduces the risk that some unforeseen financial circumstance would preclude the commitment from being fulfilled. As such, the Parties believe Frontier's investment commitments address any previously raised potential harms related to Frontier's ability and willingness to invest sufficient capital in the Oregon network.

Finally, Frontier has committed to file confidential quarterly reports with the Commission for three years following closing, and those reports will detail the company's broadband deployment progress. The Parties believe that this new level of accountability and reporting will permit the Commission, Staff, and CUB to better monitor Frontier's ability to fulfill its broadband commitments and to more effectively direct other resources critical to broadband growth.

C. Financial (Conditions 15-17)

Q. Can the Parties describe the specific financial conditions to which Frontier has agreed as a result of the Global Stipulation?

A. Yes. Importantly, Frontier has agreed not to encumber the assets of its Oregon operating companies for at least three years. In addition, Frontier will notify Staff of the company's post-transaction leverage ratio and the price per share used to determine the number of shares issued to Verizon shareholders. Finally, Frontier will not seek recovery of any acquisition premium in Oregon intrastate regulated rates, nor will the company include in rates any other one-time costs related to this transaction. As with certain previously described conditions, this final financial condition serves to ensure that Oregon customers are not harmed due to rate increases related to the transaction.

Q. In light of the testimony of certain of the Parties, are the financial conditions as proposed sufficient to protect the public interest?

A. In viewing this transaction all conditions should be considered in evaluating whether the transaction meets the public interest, no harm standard. In this light, the Parties find that this transaction should be approved by the Commission. The Commission should recognize that many of the conditions in other sections of the Global Stipulation serve to address directly potential harms previously raised by certain Parties.

D. Retail Service Quality (Conditions 18-23)

Q. How do the retail service quality conditions in the Global Stipulation resolve the concerns raised by intervenors?

A. Frontier will be held to the same service quality standards and penalties as those applied to Verizon in the state, and both of Frontier's ILECs in Oregon will provide monthly service quality reports after the close of the transaction. Thus, the Commission's ability to monitor and enforce the service quality required of the combined company will not be diminished as a result of the transaction. Frontier's testimony with respect to its organizational structure and employee integration plans for Oregon was responsive to the concerns of Staff and CUB, and Frontier has committed to implementing those plans as part of the Global Stipulation. Additionally, in response to concerns regarding the condition of Verizon network assets, Frontier will deliver within one year of closing a multi-year plan that identifies critical investment information regarding the condition and the replacement plan for central office switches and remote switches within the context of Oregon service standards. Frontier then will report annually on the capital expenditures described in the plan. The Commission will also gain more insight into Frontier's investments relative to its capital commitments in the broader Frontier Northwest region, including Washington and Idaho. Finally, for five years, Frontier has agreed to provide Staff with the detailed Form-477 information, which is submitted to the FCC. Form 477 is a report regarding specific broadband information (cable modems, asymmetric and symmetric DSL, etc.), including geographic deployment data (e.g., census tract), and other telephony information (local exchange service, interconnected VoIP, etc.). As such, the Global Stipulation provides the Commission and Staff with specific service quality reporting, a committed plan for core network improvements that will further reinforce high-quality service to Oregon customers, and incremental reports based on federal filings.

E. <u>Safety (Conditions 24-27)</u>

Q. To what safety-related conditions did Frontier agree?

A. As is the case with Verizon today, Frontier has agreed to comply with all applicable federal and state safety standards and requirements, including affirmative explanations of its understanding of certain laws related to the state's authority. Frontier will also provide primary and secondary points of contact within the company for safety and pole attachment matters. The Parties are convinced that Frontier is capable of meeting the various state and federal safety requirements to which it has committed as part of the Global Stipulation.

F. Operating Support Systems (Condition 28)

Q. In light of the concerns of certain Parties related to issues in other recent ILEC transactions, what are the conditions in the Global Stipulation to protect Oregon customers in the transition of operational support systems ("OSS") from Verizon to Frontier?

A. As explained in detail above, regarding the replicated systems to be transitioned to Frontier, Verizon has agreed as part of the Global Stipulation to provide Staff and CUB with additional access to the pre-production and production systems replication processes and the right to review systems testing results. In addition, Verizon is obligated to pay for the retention of an independent third-party "reviewer" of results regarding the performance of its replicated OSS prior to and subsequent to putting the replicated systems into production. As a result of these conditions, the Parties believe that Oregon retail customers will be protected from any potential harm resulting from the transition of systems to Frontier. While Frontier and Verizon have argued on the basis of significant evidence that this OSS transition is less risky than other recent transactions where problems have occurred, the other Parties believe that this set of conditions provides Oregon customers with important new protections.

Q. How do the conditions in the Global Stipulation protect Oregon wholesale customers in the transition of OSS from Verizon to Frontier?

A. Regarding wholesale systems, the Global Stipulation formalizes the transition procedures and commitments that Frontier and Verizon described in their respective testimonies in this proceeding. Verizon has committed that the wholesale OSS will be fully functional and will provide support for wholesale customers in Oregon through the implementation of the system at least 60 days prior to closing. This schedule will allow Frontier and CLECs the opportunity to confirm that the systems are functioning properly. As with the retail systems conversion, the transaction closing will not occur unless and until the wholesale systems are confirmed to be operating properly. Also, in the Global Stipulation, Frontier commits to use the replicated wholesale systems for at least one year after close and to not replace those systems during the first three years after close without providing 180 days notice. In addition, Frontier will provide a plan and seek input regarding the "2nd Transition" to its own OSS, if and when such a transition occurs. As a result of the agreed-upon procedures, the non-Applicant Parties believe that there are sufficient controls in place before any wholesale conversion, thereby assuring that the systems work properly and that any problems can be remedied.

Q. Some Parties previously expressed concern regarding Verizon's incentives to deliver fully-functional systems. Do the provisions in the Merger Agreement and the Global Stipulation ensure that Verizon is properly motivated?

A. Yes. The Parties are convinced that the proper incentives and protections are in place to ensure that Verizon does all that reasonably could be expected to ensure a successful transition and transaction. The Parties have agreed to important conditions which ensure that the transaction will not close unless Verizon delivers OSS that are fully-functional and capable of providing high-quality service to all Oregon customers. In addition, as part of the Merger Agreement, Verizon is financially responsible to take whatever actions may be necessary at whatever costs are required to deliver the replicated systems. Therefore, even after receiving approval for the transaction, the provisions of the Global Stipulation and the Merger Agreement add protections that Verizon necessarily will provide the functioning OSS and remains at-risk financially if it does not do so.

G. Long Distance (Conditions 29-31)

Q. What conditions in the Global Stipulation apply to long-distance services and how do the proposed conditions protect Oregon consumers from harm?

A. Frontier has agreed to maintain intrastate toll calling services and rates substantially similar to those offered by Verizon for a minimum of 120 days following closing. This commitment includes bundled offerings at rates that are the same as those currently provided by Verizon. In addition, Frontier will notify Verizon's Oregon intrastate long-distance customers of their new provider at least 30 days before the consummation of the transaction. Consistent with the conditions sought by certain Parties, Frontier has agreed that, for 90 days after the close of the transaction, it will waive presubscribed interexchange carrier ("PIC") charges related to Verizon Enterprise Solutions or Verizon Long Distance for current customers who wish to change to another carrier. These rate protections, notifications and waived fees related to long distances services provide sufficient protections to Oregon consumers.

H. Wholesale Services (Conditions 32-45)

Q. What conditions pertain to Frontier's wholesale services?

A. Under the Global Stipulation, Frontier is committed to honor, assume or take assignment of all obligations under Verizon's existing interconnection agreements ("ICAs"). Specifically, Frontier has agreed to abide by the rates, terms, conditions, reporting requirements, and operating procedures (including OSS functionality, performance and e-bonding) related to Verizon's wholesale agreements. Frontier is providing wholesale customers with these protections for the unexpired term of existing ICAs or for two years from closing, whichever is later. All Verizon wholesale intrastate services in effect at closing will remain available to customers for at least one year after closing. Frontier has committed to continue providing monthly wholesale performance reports to Staff, and to provide the Staff with comparison data. Further, Verizon will deliver to Staff the Joint Partial Settlement Agreement data from the year prior to the closing of the transaction. In addition to providing transparent wholesale services with functionality consistent with Verizon's, Frontier pledges timely resolution of problems at least consistent with Verizon's performance. In addition, Frontier has agreed to participate in a wholesale service quality docket, which Staff will promptly ask the Commission to open, to monitor Frontier's wholesale service quality and to establish wholesale service quality benchmarks.

The Parties assert that these wholesale service protections, coupled with Frontier's commitments related to the transition of wholesale systems and the provisions included in the separate stipulations entered into with the CLECs participating in this case ("CLEC Stipulations"), assure the Commission that Oregon wholesale customers will not be harmed as a result of the transaction. And the terms of the CLEC Stipulations will benefit not just the CLECs participating in this docket, as any aspects of those stipulations that involve prospective interconnection obligations governed by Section 251 of the Communications Act of 1934, as amended (the "Act"), will be governed by the non-discrimination protections of the Act (including section 252(i)).

I. <u>OTAP/Lifeline (Conditions 46-50)</u>

Q. What has Frontier pledged in terms of the electronic Oregon Telephone Assistance Program ("OTAP"), Lifeline, and Link-Up programs?

A. Frontier has agreed to process relevant OTAP/Lifeline/Link-Up information and to provide a variety of weekly and monthly OTAP reports, including a weekly "No Match" report and a monthly "Order Activity" report. Staff, CUB and other Parties believe that Frontier's commitments under the Global Stipulation are consistent with the public interest. In addition, since Frontier will fulfill, at a minimum, all of Verizon's existing OTAP/Lifeline/Link-Up obligations, no harm with respect to these programs will result from the transaction.

J. <u>Affiliated Interests/Non-regulated Operations (Conditions 51-53)</u>

Q. As part of the Global Stipulation, has Frontier agreed to comply with all application statutes and regulations regarding affiliated interest transactions?

A. Yes. The company has also agreed to file with the Commission within 90 days of the close of the transaction affiliated interest agreements and an updated Cost Allocation Manual. In addition, after close Frontier and Verizon will report any changes affecting their certificates as Competitive Providers in Oregon, in compliance with applicable statutes and regulations. The Parties believe that these affiliated interest commitments will provide the Commission adequate ability to monitor intra-company funds flows among Frontier's Oregon ILECs and its other operations, thus affording the Commission another avenue to ensure the Oregon operations remain properly funded.

K. <u>FiOS (Conditions 54-55)</u>

Q. Has Frontier committed to continue to provide FiOS services in Oregon?

A. Yes. Frontier has agreed not to "walk away" from any video local franchise agreements for two years except that the company retains the right to "walk away" if the failure to opt out would bind the company to a commitment that is greater than two years. The company also agreed that, if within two years after closing it reduces FiOS video or internet services to customers—e.g., reducing/substituting video channels or lowering the speed of data services—the customer will have the right to terminate a long-term contract without incurring penalties or termination charges. CUB believes that while the Commission does not have direct jurisdiction over video and broadband services, the Commission may, under the authority stemming from its direct jurisdiction over telecom utility mergers and transactions, consider the effect of other services upon the regulated telecom company. The Applicants do not share CUB's view on the Commission's jurisdiction. But with this as background, the Parties believe that the FiOS commitments provided in the Global Stipulation are positive concessions by Frontier that will benefit Oregon consumers and will make Frontier a stronger company following this transaction.

V. <u>The Global Stipulation Addresses Staff's Initial Concerns</u>

Q. Does Staff support the Global Stipulation between the parties that was filed December 4, 2009?

A. Yes.

Q. Please generally explain why Staff supports the Global Stipulation when in reply testimony Staff recommended that the Commission reject the transaction.

A. In Staff/100, Dougherty/2, Staff witness Dougherty stated:

> The Commission could approve the transaction subject to the Applicants voluntarily offering conditions or commitments that either reduce the numerous risks of the transaction (as outlined later in testimony), or offset the risks.

As part of the Global Stipulation, the Applicants offered 55 conditions that mitigate many of the risks highlighted by Staff and other parties to the docket. As previously mentioned in this supporting testimony, the conditions offered by the Applicants include conditions related to:

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

- FiOS

Q. Please list Staff's concerns as detailed in Staff testimony.

A. Staff discussed the following concerns in testimony:

1. The proposed organizational structure that will not allow effective ring fencing around the Oregon operating companies.

2. The Oregon operating companies will go from the umbrella of an investment grade Verizon (A) to a speculative grade Frontier (BB).

3. The issuance of approximately $3.2 billion in debt to close the transaction that will result in the Oregon operating companies being under a much higher leveraged parent than the current parent.

4. The projections of $500 million in synergy savings that may not occur.

5. Potential landline loss and revenue loss resulting in greater percentage of cash flow used to service debt.

6. The high dividend ($0.75 per share) and its effect to potentially divert money away from capital improvements.

7. Age of switches and potential significant cash requirements to replace switches.

8. Significant cash requirements to increase broadband accessibility.

9. The risk of Operations Supports System (OSS) problems that exist for both the transition of the replicated systems and eventual cutover to a Frontier OSS.

10. Potential impacts on long distance customers.

11. Potential impacts on competitive carriers.

Q. Staff/100, Dougherty/25-32, discussed ring fencing in detail. Please explain why the ring fencing condition was not included in the Global Stipulation?

A. Staff pointed out in Staff/100, Dougherty/2 and Dougherty/29 that ring fencing the Oregon operating companies from Frontier would be a challenge due to Frontier's proposed organizational structure. Based on the proposed organizational structure, Frontier's Oregon operating companies would not be well-defined subsidiaries that have their own credit ratings and access to capital. Further, the nature of the business activities across the Frontier subsidiaries may not be sufficiently diversified to enable a non-consolidation opinion to be obtained even if Frontier Northwest was a well-defined subsidiary. As noted in Staff/100, Dougherty/30, Staff did not recommend specific ring fencing conditions on Frontier, but proposed that Frontier take appropriate actions to obtain a non-consolidation opinion (NCO). If Frontier was unable to obtain a NCO, than Staff recommended condition 14 placed dividend restrictions to shareholders of Frontier.

Frontier's witness Whitehouse in FTR Reply/300, Whitehouse/6-7 summarizes the differences between energy utilities and telecommunications utilities and the potential problems of attempting to ring fence a telecommunications utility. Mr. Whitehouse points out that ILECs with national scope and scale and major operations in a number of states, none have state-level operating companies structured in a manner to qualify for a NCO. Mr. Whitehouse also asserts that if the Oregon operating companies were segregated, they would face a much higher interest rate and its financial risk would increase. According to Frontier, structuring the Oregon operating companies to qualify for a NCO:

"... would be inefficient, inconsistent with industry practices and conditions, and very likely harmful to Oregon customers and the company's other stakeholders."[8]

Staff's perspective continues to be that ring fencing energy utilities is always appropriate and achieves the desired effect of isolating the utility from negative financial impacts created by its parent company or other affiliates. In a bankruptcy of a energy utility, customers face significant risks due to the uncertainty of preeminence of federal versus

[8] FTR Reply/300, Whitehouse/7.

state law. For example, a plan for reorganization put forth by creditors could entail selling generation assets including low cost resources, or selling storage facilities for natural gas companies. If adopted, customers would lose the benefits of those resources and the state may not be successful in opposing such a structuring given the uncertainty over whether federal bankruptcy preempts state regulatory authority. The output from electrical generating resources can be sold in the wholesale market distinct from the retail customers of the utility.

With respect to telecommunications utilities, presumably the greatest value for creditors of local plant is one of continued operations. It is doubtful that local loop and switches would be transported and sold elsewhere and local exchange plant is for service to local customers and as such is quite different than electricity economics. Therefore, while Staff initially would have liked to have achieved a ring fencing or other kinds of financial conditions, it is still possible, as achieved in this case, to develop conditions such that the overall package results in the parties recommending Commission approval. Because of the different nature of operations between energy utilities and telecommunications, ring fencing could be counterproductive for telecommunications utilities. As Mr. Whitehouse asserts, structural changes that would be required for a NCO could actually increase the risks of ILEC operations.

Because of the issues surrounding ring fencing, and given this specific transaction and that the business at issue here is telecommunications, the parties agreed to replace the Staff recommended ring fencing condition with a broadband commitment that potentially invests up to $25 million in Oregon and increases broadband availability in 18 wire centers in Oregon. The commitment includes a fast (two-year) completion, which ensures broadband investments will be quickly focused towards Oregon.

Q. Please explain how the Global Stipulation addresses Staff's concern that the Oregon operating companies will go from the umbrella of an investment grade Verizon (A) to a speculative grade Frontier (BB).

A. Staff views the conditions as a whole with regards to meeting the statutory no-harm test. Staff also notes that:

- The reduced leverage (Net Debt/EBITDA) of 3.8x to 2.6x – without synergies. Additionally, the Company's leverage could actually be further reduced to 2.2x if the stated synergy savings are achieved;

- The possibility of Frontier going to a rating watch positive; and

- Frontier's public statement that the proposed transaction:

"... marks a shift in its perspective regarding the company's credit rating and its intention to seek an investment grade credit rating."[9]

In agreeing to the 55 conditions outlined in the Global Stipulation, Staff believes Frontier has adequately addressed its commitment to Oregon customers. Additionally, in its reply testimony, Frontier witness Whitehouse provides independent third party professional credit analysis that supports Frontier's claim that its balance sheet will be strengthened by the transaction. Based on information provided in the Company's direct and reply testimony, Staff performed additional stress testing concerning EBITDA, net income, and free cash flow that support the Company's assertions that Frontier will have adequate financial strength projected out to 2014 allowing sufficient funds to maintain operations and invest in Oregon.

[9] FTR Reply/300, Whitehouse/22.

Q. Please explain how the Global Stipulation addresses Staff's concern that the issuance of approximately $3.2 billion in debt will result in the Oregon operating companies being under a much higher leveraged parent than the current parent.

A. The financial conditions 15-17 address Staff's concern over leverage. As previously mentioned, Frontier will actually deleverage (3.9x to 2.6x without synergies; 2.2x with synergies) as a result of the transaction. Additionally, Frontier's recent debt financing of approximately $600 million at 8.375 percent demonstrates the Company's ability to access capital markets. As a result of this debt offering, Frontier was able to reduce its aggregate principal amount of debt maturing in the one-year period following the proposed close of the transaction (through 2011) to an amount that can be refinanced primarily through surplus cash on hand or through its existing $250 million undrawn credit facility, if necessary.[10] Also, as Frontier's Key Financial Characteristics demonstrate, after interest expense of $653 million, capital expenditures of $701 million, and tax expense of $554 million, the Company will have approximately $1.423 billion in free cash flow before synergies.[11] Considering all of the facts, the projected financial strength and leverage of the post-merger Frontier compares favorably with other rural local exchange carriers (RLECs) and Qwest as demonstrated in FTR Reply/300, Whitehouse/13.

Q. Please explain how the Global Stipulation addresses Staff's concern over synergy savings.

[10] FTR Reply/300, Whitehouse/29.

[11] Welcome to the New Frontier presentation, page 16.

A. Staff's concern over synergy has been addressed through several means. First, the broadband condition 14 requires Frontier to expend funds in Oregon and not at the expense of diminishment in other outside plant expenditures. The capital plan condition 22 requires the Company to report on capital expenditures in Oregon. These two conditions ensure that funds will continue to be invested in Oregon if the synergy savings are not achieved. Second, the OSS condition 28 helps ensure, through the third party reviewer, the replicated system is functioning properly. A functional OSS will allow business as usual and not cause a decline in revenue that could be attributable to an OSS failure. Third, the Company agreed to Oregon personnel conditions 19 and 20 that ensures the Oregon organizational structure will not be adversely affected if the anticipated synergy savings are not effectuated. Lastly, Frontier's pro forma financial statements indicate that even without the synergy savings, the Company will have approximately $1.423 billion in free cash flow and a leverage of 2.6x. As a result, synergy savings are not critical for Frontier to be a viable business operation.

Q. Please explain how the Global Stipulation addresses Staff's concern over potential landline loss and revenue loss resulting in greater percentage of cash flow used to service debt.

A. The broadband condition 14 in the Global Stipulation supports the Company's assertion that:

"Frontier is committed to providing broadband and highly reliable local telephone services to a much larger percentage of the entire VSTO region that is underserved or unserved."[12]

[12] FTR Reply/200, McCarthy/36.

The Company's S-4 filing, on page 120, Frontier shows a seven percent decrease in total access lines from March 31, 2008, to March 31, 2009, but an 11 percent increase in HSI (high-speed internet) subscribers during the same time period.[13] Revenue from these high capacity Internet and ethernet circuits increased revenue of $3.4 million in 2009, as compared to 2008, primarily due to the growth in the number of these circuits.[14] As a result, total revenue only decreased five percent in 2009, as compared to 2008 for the three month period.[15] The increase broadband penetration has the potential to reduce line loss and gain incremental revenue. As stated in Staff/100, Dougherty/44, it is reasonable for the Commission to expect Frontier to deliver on its promises and tracks its promises through Oregon benchmarks. Condition 14 is the mechanism for Frontier to deliver on its promise.

Additionally, Staff verified the stress testing performed by Frontier, which indicates that Frontier will have sufficient cash flow and financial flexibility to service its debt and continue to make adequate investments in its acquired territories. As previously mentioned, Frontier's recent debt financing of approximately $600 million at 8.375 percent is significantly lower than the 9.5 percent "ceiling" rate that is included in the transaction. The lower interest rate will result in lower debt service payments. Staff also presumes that Frontier will manage its cash in a prudent manner to ensure its financial commitments are met company-wide.

[13] Frontier Communications SEC Form S-4 Registration Statement (filed July 24, 2009), page 120.

[14] *Id.,* at 118.

[15] Frontier Communications SEC Form S-4 Registration Statement (filed July 24, 2009), page 120.

Q. Please explain how the Global Stipulation addresses Staff's concern over the high dividend ($0.75 per share) and its effect to potentially divert money away from capital improvements.

A. With the appreciation of Frontier's stock price, compared to $7.15 on October 27, 2009, the Company will actually issue fewer shares than previously anticipated by Staff. As a result, the total dividend payments would be approximately $698 million based on the recent stock price as compared to the $742 million stated in Staff/100, Dougherty/23. Further, while Staff was initially concerned regarding the current dividend commitments, Staff's expectation is that Frontier will prudently manage its business while meeting its commitments to Oregon.

Q. Please explain how the Global Stipulation addresses Staff's concern over the age of switches and potential significant cash requirements to replace switches.

A. This concern is addressed by the service quality condition 22 which states:

> 22. No later than one year from the close of the transaction, Frontier Northwest will provide to the Commission the following:
>
> a. A multi-year strategic plan that identifies the expected remaining life of each of the base unit and remote switches currently deployed in Verizon Northwest's franchise area in Oregon and a proposed replacement plan for the switches, if any, so that Frontier Northwest will be able to meet the then current service standards pursuant to Oregon statutes and rules.
>
> b. An annual report detailing Oregon capital expenditures concerning planned actions on subsection (a) 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.

This condition will allow Staff to monitor the condition of the switches and the amount of capital expenditures in Oregon.

Q. Please explain how the Global Stipulation addresses Staff's concern over the significant cash requirements to increase broadband accessibility.

A. Broadband condition 14, which commits $10 million to be spent in Oregon by July 2011, alleviates Staff's concern over broadband investment. The condition states in part:

> Before July 1, 2011, Frontier will expend $10 million on broadband deployment in the Frontier Northwest territory in Oregon. Frontier Northwest will deploy broadband service in not less than 95% of the Frontier Northwest Oregon wire centers within two years of closing of the proposed transaction. For 15 new wire centers in which broadband service is deployed Frontier Northwest will make broadband available to 50% of the households in each of the 15 new wire centers within two years; and will make broadband available to 75% of the households in 10 of the new wire centers within two years. No less than 40% of all households over the 22 currently non-served wire centers and the Scholls, Dayton and Banks wire centers, will have broadband available within two years. In aggregate, no less than 60% of households in the 15 new wire centers will have broadband available at no less than 1.5 mbps download speed within two years.

As previously mentioned, the commitment includes a fast (two-year) completion, which ensures broadband investments will be quickly focused towards Oregon.

Q. Please explain how the Global Stipulation addresses Staff's concern over the risk of Operations Supports System (OSS) problems that exist for both the transition of the replicated systems and eventual cutover to a Frontier OSS.

A. Condition 28 addresses Staff's concern over the OSS. Included in condition 28 is an agreement that Verizon will retain and pay for a third party reviewer. As highlighted in Staff/100, White/400, and Marinos/600, Staff strongly believed that a third party reviewer was necessary to validate the system. In addition, condition 28 allows Frontier to validate CLEC order entry for the 60 days prior to closing. It should be noted that the stipulation between the Applicants and the Joint CLECs also allows for coordinated testing with CLECs signatories on test/non-live orders prior to the second transition (replicated OSS system to any other wholesale operation). Pages 9-14 and 34-36 of the testimony provided additional detail on the OSS condition.

Q. Staff/400, White/24 recommends a time and material contract to replace the $94 million annual contract. Please explain why Staff no longer believes this is necessary.

A. As a result of the additional provisions in condition 28, Staff was not opposed to the negotiated $94 million contract. Frontier witness McCarthy points out in FTR Reply/200, McCarthy/64 that the maintenance fee represents less than $2.00 per line per month. Staff believes that condition 28 and Frontier's commitment to invest in Oregon was of greater value to Oregon customers than a revision from a fixed price contract to a time and material contract concerning the OSS.

Q. Please explain how the Global Stipulation addresses Staff's concern over potential impacts on long distance customers.

A. Conditions 29-31 fully mitigate Staff's concern over the transaction's potential impacts on long distance customers.

Q. Please explain how the Global Stipulation addresses Staff's concern over potential impacts on competitive carriers.

A. Conditions 32-45 alleviate Staff's concern over the transaction's potential impacts on competitive carriers. Additionally, the additional stipulations between the Applicants and CLECs, including Comcast, allow confidence that the concerns of competitive carriers were adequately addressed by the Applicants. Staff clarifies that "intrastate transit service" described in condition 34 refers to Commission regulated transit service.

Q. Does Staff believe the additional conditions concerning Records/Rates/Tariffs/ Access to Books, Safety, OTAP/Lifeline, and Affiliated Interests are sufficient?

A. Yes. These conditions that the Applicants agreed to with some minor modifications were included in Staff/100, Dougherty/51-59.

Q. Does Staff believe the FiOS conditions championed by the CUB are appropriate to be included in the Global Stipulation?

A. Yes.

VI. <u>Conclusion</u>

Q. Please summarize your testimony.

A. Our testimony, upon resolution of the most favored state issue, will support all provisions of the Global Stipulation, and will expressly provide that the Applicants have satisfied the "public interest, no harm" standard as described in Order No. 09-169. We think the fact that so many parties with such diverse views and interests have been able to reach agreement is compelling evidence that the Global Stipulation is in the public interest, and causes no harm.

The Parties request that the Commission (1) resolve the Most Favored State Commitment issue, and then (2) issue an order approving the Global Stipulation and providing the approvals requested by the Applicants in their application.

Q. Does this conclude the Parties' testimony in support of the Global Stipulation?

A. Yes.

**BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON**

UM 1431

In the Matter of VERIZON COMMUNICATIONS INC., and FRONTIER COMMUNICATIONS CORPORATION Joint Application for an Order Declining to Assert Jurisdiction, or, in the Alternative, to Approve the Indirect Transfer of Control of VERIZON NORTHWEST INC.	)	AFFIDAVIT OF DANIEL McCARTHY

I, Daniel McCarthy, being duly sworn on oath, say:

1. I am the Executive Vice President and Chief Operating Officer of Frontier Communications Corporation.

2. I, along with a number of other witnesses in this docket, filed joint testimony on December 17, 2009, in support of the Stipulation reached by Frontier Communications Corporation, Verizon Communications Inc., Staff of the Public Utility Commission of Oregon, Citizens' Utility Board of Oregon, XO Communications Services, Inc., Integra Telecom of Oregon Inc., TW Telecom of Oregon LLC, Covad Communications Company, McLeodUSA Telecommunications Services, Inc., and 360 Networks.

3. The testimony is true and accurate based on my information and belief. If I were to be asked the same questions today under oath, my responses would be the same.

Dated this 16 day of December, 2009

Daniel McCarthy

SUBSCRIBED AND SWORN to before me this 16th day of December, 2009.

Lisa M. Lombardo
Notary Public, State of Connecticut
County of Fairfield
My Commission expires: 10/31/11

BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON

UM 1431

In the Matter of VERIZON COMMUNICATIONS INC., and FRONTIER COMMUNICATIONS CORPORATION Joint Application for an Order Declining to Assert Jurisdiction, or, in the Alternative, to Approve the Indirect Transfer of Control of VERIZON NORTHWEST INC.	)	AFFIDAVIT OF TIMOTHY McCALLION

I, Timothy McCallion, being duly sworn on oath, say:

1. I am the President of the West Region for Verizon Communications.

2. I, along with a number of other witnesses in this docket, filed joint testimony on December 17, 2009, in support of the Stipulation reached by Frontier Communications Corporation, Verizon Communications Inc., Staff of the Public Utility Commission of Oregon, Citizens' Utility Board of Oregon, XO Communications Services, Inc., Integra Telecom of Oregon Inc., TW Telecom of Oregon LLC, Covad Communications Company, McLeodUSA Telecommunications Services, Inc., and 360 Networks.

3. The testimony is true and accurate based on my information and belief. If I were to be asked the same questions today under oath, my responses would be the same.

Dated this 17th day of December, 2009

Timothy J McCallion

Timothy McCallion

PATRICIA A. LANE NOTARY PUBLIC COMMISSION EXPIRES 04-14-10 STATE OF WASHINGTON

SUBSCRIBED AND SWORN to before me this 17th day of December, 2009.

Patricia A Lane

Notary Public, State of Washington

County of Snohomish

My Commission expires: 4-14-10

BEFORE THE PUBLIC UTILITY COMMISSION OF OREGON

UM 1431

In the Matter of VERIZON COMMUNICATIONS INC., and FRONTIER COMMUNICATIONS CORPORATION Joint Application for an Order Declining to Assert Jurisdiction, or, in the alternative, to Approve the Indirect Transfer of Control of VERIZON NORTHWEST, INC.	))))))))	AFFIDAVIT OF Douglas Denney

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STATE OF OREGON)
County of Multnomah)

I, Douglas Denney, being first duly sworn do depose and say:

1. I am the same Douglas Denney that submitted prefiled Direct Testimony dated November 2, 2009 on behalf of Integra Telecom in UM 1431.

2. I have reviewed and prepared the accompanying Testimony in Support of Stipulation and have no changes or corrections to that testimony.

3. If I were called as a witness, my answers to the written questions would be the same and I hereby swear the answers to those questions are true.

Dated this 17TH day of December, 2009.

Douglas Denney
Douglas Denney

SUBSCRIBED AND SWORN to before me this 17TH day of December, 2009.

OFFICIAL SEAL
MARI DENISE AMSTUTZ
NOTARY PUBLIC-OREGON
COMMISSION NO. 440196
MY COMMISSION EXPIRES AUGUST 28, 2013

Mari Denise Amstutz
NOTARY PUBLIC in and for the State of Oregon
Residing at OREGON.
My Commission expires: August 28. 2013