

**Before the  
Federal Communications Commission  
Washington, DC 20554**

In the Matter of	)	
Applications filed by Frontier	)	WC Docket No. 09-95
Communications Corporation and Verizon	)	
Communications Inc. for Assignment or	)	
Transfer of Control	)	

**COMMENTS OF THE  
NATIONAL ASSOCIATION OF STATE UTILITY CONSUMER ADVOCATES  
AND THE NEW JERSEY DIVISION OF RATE COUNSEL**

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**I. INTRODUCTION AND SUMMARY**

On May 13, 2009, Verizon Communications, Inc. (“Verizon”) and Frontier Communications (“Frontier”) (jointly, “Applicants”) announced a transaction in which approximately 4.8 million Verizon access lines in 14 states will be acquired by Frontier.<sup>1</sup> Verizon and Frontier submitted their application for approval of this transfer of control to the Federal Communications Commission (“FCC” or “Commission”) on May, 28 2009.<sup>2</sup>

Currently, on the national level, Frontier serves some 2.3 million access lines in 24 states.<sup>3</sup> The transaction will thus essentially triple the national size of Frontier.

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<sup>1</sup> Verizon News Release, “Verizon to Divest Wireline Businesses in 14 States,” May 13, 2009. See also Verizon PowerPoint (May 13, 2009) (accessible at <http://investor.verizon.com/news/20090513/20090513.pdf>) (“Verizon PowerPoint”); Frontier PowerPoint (May 13, 2009) (accessible at <http://phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9MzM3NTc4fENoaWxkSUQ9MzIyMTk3fFR5cGU9MQ==&t=1>) (“Frontier PowerPoint”). The states involved are Arizona, California, Idaho, Illinois, Indiana, Michigan, Nevada, North Carolina, Ohio, Oregon, South Carolina, Washington, Wisconsin and West Virginia. Frontier PowerPoint at 9.

<sup>2</sup> *Applications of Frontier Communications Corporation and Verizon Communications Inc. for Assignment or Transfer of Control*, WC Docket No. 09-95 (filed May 28, 2009) (“Application”) at 1. In addition to the FCC’s approval, the merger requires the approval of shareholders of both companies, state regulators, the Department of Justice, and the Securities and Exchange Commission.

<sup>3</sup> Id., Exhibit 1 at 6.

As discussed more fully below, according to Applicants, the proposed transaction is manifestly in the public interest. Applicants assert that with this transaction, residential and business customers in predominantly rural and smaller city service areas will join consumers across Frontier's territories and become a key strategic focus of Frontier. But as also discussed below, these assertions are questionable.

Despite Applicants' claims that this is an unremarkable transaction,<sup>4</sup> the transaction for which Applicants seek approval is anything but unremarkable and bears significant risks. For example, this is not a transaction where a large corporation is purchasing a smaller but still large corporation.<sup>5</sup> This is not a transaction where a small rural company in one state is being purchased by a holding company that specializes in purchasing small companies.<sup>6</sup> This also is not a transaction where all of the wireline

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<sup>4</sup> See, e.g., *In the Matter of the Joint Application of Frontier Communications Corporation, New Communications Holdings, Inc. and Verizon Communications Inc. for Consent and Approval of a Change in Control*, Public Utilities Commission of Ohio Docket No. 09-454-TP-ACO ("PUCO Case No. 09-454-TP-ACO"), Memorandum of the Joint Applicants in Response to the Motion of Comcast Phone of Ohio LLC to Intervene (August 3, 2009) ("Ohio Memorandum") at 5 ("The Application and the Testimony present straightforward and uncontested statements describing both the transaction and its consequences, none of which are either controversial or controverted.")

<sup>5</sup> *In Re Applications of Ameritech Corp. and SBC Communications Inc., for Consent to Transfer Control*, CC Docket No. 98-141, Memorandum Opinion and Order, 14 FCC Rcd 14712 (1999) ("*SBC/Ameritech Order*"); *In re Application of GTE Corporation and Bell Atlantic Corporation for Consent to Transfer Control*, CC Docket No. 98-184, Memorandum Opinion and Order, 15 FccRcd 14032 (2000) ("*BA/GTE Order*").

<sup>6</sup> See, e.g., *Notice of Domestic Section 214 Authorization Granted*, Public Notice, DA 06-2267, WC Docket No. 06-177 (reI. Nov. 2, 2006) (granting Domestic Section 214 Application Filed for Transfer of Control of The Germantown Independent Telephone Company to MJD Ventures, Inc.); *Cass County Telephone Company, Limited Partnership, and LEC Long Distance, Inc. d/b/a CasTel Long Distance, Transferors, and FairPoint Communications, Inc., FairPoint Communications Missouri, Inc., and ST Long Distance Inc., d/b/a FairPoint Communications Long Distance, Transferees, Application for Authorization Pursuant to Section 214 of the Communications Act of 1934, as Amended, for Transfer of Control of Blanket Domestic Section 214 Authority and Certain Telecommunications Assets*, Order, WC Docket No. 06-64 (reI. July 20, 2006); *Wireline Competition Bureau Grants Consent for Transfer of Control of BE Mobile Communications, Incorporated, and Bentleyville Communications Corporation, to FairPoint Communications, Inc., and MJD Ventures, Inc.*, Public Notice, DA 05-2231, WC Docket No. 05-215 (reI. Aug. I, 2005); *Wireline Competition Bureau Grants Consent for Transfer of Control of Berkshire Telephone Company to FairPoint Communications, Inc.*, Public Notice, DA 05-1095, WC Docket No. 03-184 (reI. Apr. 15, 2005).

local and long distance operations of a corporation are being spun off.<sup>7</sup> It is also not a transaction where a smaller company is acquiring all of the assets of a larger company.<sup>8</sup>

Rather, it is a transaction where a smaller company seeks to grow by acquiring the devalued assets **that another company has decided it no longer wants to maintain.**<sup>9</sup>

Again despite the Joint Applicants' protestations,<sup>10</sup> the transaction on a national level that this one most closely resembles is Verizon's decision to divest its territories in northern New England (Maine, New Hampshire and Vermont), followed by their acquisition by FairPoint Communications, Inc. ("FairPoint").<sup>11</sup> By all accounts, that transaction has been a disaster for FairPoint and for consumers.<sup>12</sup>

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<sup>7</sup> See, e.g., *Applications of Nextel Communications, Inc. and Sprint Corporation for Consent to Transfer Control of Licenses and Authorizations*, WT Docket No. 05-63, File Nos. 0002031766, et al., Memorandum Opinion and Order, 20 FCC Rcd 13967, 13976, para. 20 (2005) ("*Sprint/Nextel Order*"), ¶ 11.

<sup>8</sup> See, e.g., *In the Matter of Applications Filed for the Transfer of Control of Embarq Corporation to CenturyTel, Inc.* WC Docket No. 08-238, Memorandum Opinion and Order, 24 FCC Rcd 8741 (2009) ("*CenturyTel/Embarq Order*").

<sup>9</sup> See Verizon PowerPoint (May 13, 2009) at 3. As referred to above, in all but one of the 14 states involved in the transaction, the entirety of Verizon's operations are proposed to be transferred to Frontier. In California, however, Verizon is retaining some of its territory and divesting the rest. Throughout the nation, Verizon is retaining its enterprise services, federal networks contract business, and wireless service. See Regulatory Research Associates, LLC Report (May 14, 2009) at 1.

<sup>10</sup> See Ohio Memorandum at 4.

<sup>11</sup> *In the Matter of Applications Filed for the Transfer of Certain Spectrum Licenses and Section 214 Authorizations in the States of Maine, New Hampshire, and Vermont from Verizon Communications Inc. and its Subsidiaries to FairPoint Communications, Inc.*, WC Docket No. 07-22, Memorandum Opinion and Order, 23 FCC Rcd 514 (2008) ("*FCC FairPoint/Verizon Order*").

<sup>12</sup> See, e.g., FairPoint Communications, Inc. Form IO-Q filed with the U.S. Securities and Exchange Commission on August 5, 2009, pp. 41-42 ("Recent Developments" include an exchange of approximately 83% of 13 1/8% senior notes due 2018, in order to avoid breaching the interest coverage ratio maintenance covenant in FairPoint's credit facility, dated as of March 31, 2008. But, even with the consummation of the exchange offer, FairPoint is still at risk of breaching this covenant and the leverage ratio maintenance covenant for the measurement period ending September 30, 2009. Consequently, the Company has engaged a consultant to assist it with restructuring its debt, and if these efforts fail to produce a voluntary restructuring, the Company may proceed with involuntary restructuring through Chapter II bankruptcy). See also, id. at p. 55 (similar); and p. 63 ("*A chapter 11 proceeding may result in a protracted process which could disrupt our business, divert the attention of our management from the operation of our business and the implementation of our business plan and may ultimately be unsuccessful*") (emphasis in original). See also "FairPoint struggles with post-Verizon backlog," TelephonyOnline (March 6, 2009), available at <http://telephonyonline.com/independent/news/fairpoint-verizon-customer-backlog-0306/>; FairPoint's 1<sup>st</sup> quarter 2009 financial results ("[T]he systems cutover has resulted in a disruption to our

The National Association of State Utility Consumer Advocates (“NASUCA”)<sup>13</sup> and the New Jersey Division of Rate Counsel (“Rate Counsel”)<sup>14</sup> (collectively, “State Advocates”) submit these comments on the application pursuant to the Commission’s Public Notice.<sup>15</sup> Because of the risks inherent in this transaction, as discussed in Section V. Below, the Commission should deny the application. If the transaction is to be approved, a number of significant, enforceable conditions are required in order to ensure that the transaction will “serve the public interest, convenience, and necessity.”<sup>16</sup> Conditions are needed both in the territories that Frontier is acquiring from Verizon (and the current Frontier territory) and in the remaining Verizon territories.

Those conditions include, as discussed in Section VI.:

- Broadband deployment commitments in both Frontier and Verizon territories;
- Reporting commitments on broadband and other investments and service quality;

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operations and has negatively impacted or inconvenienced many of our customers” and “Our financial performance was negatively impacted during the first quarter as we continued to incur substantial cutover related costs”), available at [http://www.fairpoint.com/Images/05%2005%2009%20-%20FairPoint%201Q09%20Earnings%20Press%20Release-FINAL\\_tcm52-7341.pdf](http://www.fairpoint.com/Images/05%2005%2009%20-%20FairPoint%201Q09%20Earnings%20Press%20Release-FINAL_tcm52-7341.pdf); see also Telecommunications Reports (August 15, 2009) at 18-20.

<sup>13</sup> NASUCA is a voluntary national association of consumer advocates in more than 40 states and the District of Columbia, organized in 1979. NASUCA’s members are designated by the laws of their respective states to represent the interests of utility consumers before state and federal regulators and in the courts. Members operate independently from state utility commissions, as advocates primarily for residential ratepayers. Some NASUCA member offices are separately established advocate organizations while others are divisions of larger state agencies (*e.g.*, the state Attorney General’s office). Associate and affiliate NASUCA members also serve utility consumers, but have not been created by state law or do not have statewide authority.

<sup>14</sup> Rate Counsel, a member of NASUCA, is an independent New Jersey State agency that represents and protects the interests of all utility consumers, including residential, business, commercial, and industrial entities. Rate Counsel participates actively in relevant Federal and state administrative and judicial proceedings. The Rate Counsel is a Division within the Department of the Public Advocate, which is authorized by statute to “represent the public interest in such administrative and court proceedings... as the Public Advocate deems shall best serve the public interest,” N.J.S.A. § 52:27EE-57, *i.e.*, an “interest or right arising from the Constitution, decisions of court, common law or other laws of the United States or of this State inhering in the citizens of this State or in a broad class of such citizens.”

<sup>15</sup> DA 09-1793 (rel. August 11, 2009).

<sup>16</sup> 47 U.S.C. §§ 214(a) and 310(d).

- An audit of the operational support systems (“OSS”) in current Frontier territory, and in the Verizon territory to be acquired, before the transaction is closed and again one year after closing;
- A commitment regarding funding of Frontier’s pensions;
- A review of the financial aspects of the transaction in order to ensure that Frontier has adequate resources to sustain the combined company operations.

## **II. OVERVIEW OF TRANSACTION**

Frontier, Verizon, and an entity created for the purpose of the transaction, “New Communication Holdings,” entered into an Agreement and Plan of Merger (“Merger Agreement”) as of May 13, 2009. The transaction would ultimately, through a series of internal restructurings and stock transfers, lead to the transfer of Verizon’s local exchange networks in Arizona, Idaho, Illinois, Indiana, Michigan, Nevada, North Carolina, Ohio, Oregon, South Carolina, Washington, West Virginia, and Wisconsin as well as portion of Verizon’s local exchange network in California, to Frontier.<sup>17</sup> In addition to acquiring Verizon’s local exchange business in these areas, Frontier will also acquire the customer relationships for long distance and High-Speed Internet.<sup>18</sup> Frontier will not, however, acquire Verizon’s enterprise facilities or customers in the fourteen states. Applicants describe the proposed combination as a tax-free, stock-for-stock

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<sup>17</sup> Application, Exhibit 1 at 1. With the exception of West Virginia, these properties are all former GTE states that were acquired in the merger of Bell Atlantic and GTE; with the exception of California, the transaction involves acquisition of all of the Verizon territory in the state. The Verizon subsidiaries holding Section 214 authorizations that will be included in this transaction are: Contel of South, Inc. d/b/a Verizon Mid-States, Verizon California inc., Verizon North inc., Verizon Northwest Inc., Verizon South inc., Verizon West Coast Inc., Verizon West Virginia inc., Verizon Long Distance LLC, and Verizon Enterprise Solutions LLC. Id.

<sup>18</sup> Id.

transaction in which the new entity will become a wholly-owned subsidiary to be merged into Frontier.<sup>19</sup>

Verizon and its stockholders will receive approximately \$8.6 billion in exchange for its operations.<sup>20</sup> Verizon shareholders will receive approximately \$5.3 billion of Frontier common stock in the merger, subject to a collar and closing adjustments.<sup>21</sup> And Verizon itself will receive approximately \$3.3 billion in value through a combination of cash distribution to Verizon, debt securities issued to Verizon prior to the spin-off and assumption of certain debt previously issued by Verizon's telephone company subsidiaries.<sup>22</sup> Based on the midpoint of the collar, and assuming no closing adjustments, Verizon shareholders will own approximately 68 percent of the combined company, and Frontier shareholders will own approximately 32 percent, with Verizon shareholders receiving one share of Frontier stock for approximately every 4.2 shares of Verizon stock held as of the record date.<sup>23</sup>

#### **A. Description of Verizon**

Verizon is a publicly traded corporation, a holding company that has a number of operating subsidiaries that provide a range of communications services in the United States and throughout the world. The current Verizon resulted from mergers, including between NYNEX and BellAtlantic, two of the original Regional Bell Operating Companies ("RBOCs"). Much of the former GTE properties, and MCI, were added to the mix, to form the current behemoth. The company's operating subsidiaries and

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<sup>19</sup> Verizon News Release, "Verizon to Divest Wireline Businesses in 14 States" (May 13, 2009).

<sup>20</sup> Verizon Communications Inc. Form 8-K (released May 14, 2009).

<sup>21</sup> Id.

<sup>22</sup> Id.

<sup>23</sup> Id.



affiliates offer local and long distance telephone service, as well as broadband, video, and wireless services.<sup>24</sup> Even after the transaction, Verizon will be one of the largest telephone companies in the world.

### **B. Description of Frontier**

Frontier, a publicly traded corporation, is a full-service communications provider focusing on rural areas and smaller cities.<sup>25</sup> Frontier provides an array of telecommunications and broadband services, including local and long distance voice, broadband data, and video, through its wholly-owned operating companies.<sup>26</sup> It currently has approximately 2.3 million access lines in 24 states and serves predominately rural areas and smaller cities. Within its current territories, Frontier has an average line density of 17 access lines per square mile.<sup>27</sup> Frontier asserts that it has a highly successful track record of acquiring, operating, and investing in telecommunications property in rural communities and smaller cities. Frontier says it has developed relationships with peers, partners, suppliers, regulators, and customers.<sup>28</sup>

### **C. Description of Frontier after the transaction**

Upon completion of the transaction, Frontier will continue as the surviving corporation under its existing name and corporate structure. Frontier and its wholly-owned operating subsidiaries will own and control the assets, customer relationships, and operations transferred to Frontier through the transaction at issue here, as well as continue

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<sup>24</sup> Verizon will retain all of its territory on the East Coast, with the exception of West Virginia; as noted above, Verizon will also retain major territories in California.

<sup>25</sup> Application, Exhibit 1 at 6.

<sup>26</sup> Id.

<sup>27</sup> Id.

<sup>28</sup> Id.

to own and control its current businesses. Current Frontier management is expected to manage and control the day-to-day operations of Frontier and its operating subsidiaries, including the assets transferred to it through the transaction proposed here, as well as Frontier's current business.<sup>29</sup> Upon completion of the transaction, Verizon North will be a wholly-owned, indirect subsidiary of Frontier (with the name of Frontier North) and will continue to provide local exchange service in the territory it serves today.<sup>30</sup> After the completion of the transaction, Frontier will have over 7 million access lines, revenue over 6.5 billion dollars and cash flow of over 1.4 billion dollars.<sup>31</sup>

### III. STANDARD OF REVIEW

The Commission has reviewed numerous mergers among telecommunications and cable companies. In its Order issued a year ago approving the transfer of control from Verizon to FairPoint of Verizon's operations in the three northern New England states, the FCC detailed its standard of review as follows:

Pursuant to sections 214(a) and 310(d) of the Act, the Commission must determine whether the proposed transfer of control to FairPoint of certain licenses and authorizations held and controlled by Verizon **will serve the public interest, convenience, and necessity**. In making this determination, we first assess whether the proposed transaction complies with the specific provisions of the Communications Act, other applicable statutes, and the Commission's rules. If the proposed transaction would not violate a statute or rule, the Commission considers whether it could result in public interest harms by substantially frustrating or impairing the objectives or implementation of the Communications Act or related statutes. The Commission then employs a balancing test weighing any potential public interest harms of the proposed transaction against the proposed public interest benefits. The Applicants bear the burden of

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<sup>29</sup> PUCO Case No. 09-454-TP-ACO, Direct Testimony of Daniel McCarthy On Behalf of Frontier Communications Corporation (July 9, 2009) at 38-40.

<sup>30</sup> Id. at 6.

<sup>31</sup> Id. at 23.

proving, by a preponderance of the evidence, that the proposed transaction, on balance, serves the public interest. If we are unable to find that the proposed transaction serves the public interest for any reason, or if the record presents a substantial and material question of fact, we may designate the application for hearing.

Our public interest evaluation necessarily encompasses the “broad aims of the Communications Act,” which include, among other things, a deeply rooted preference for preserving and enhancing competition in relevant markets, accelerating private sector deployment of advanced services, ensuring a diversity of license holdings, and generally managing the spectrum in the public interest. Our public interest analysis may also entail assessing whether the merger will affect the quality of communications services or will result in the provision of new or additional services to consumers. In conducting this analysis, the Commission may consider technological and market changes, and the nature, complexity, and speed of change of, as well as trends within, the communications industry.

In determining the competitive effects of the merger, our analysis is informed by, but not limited to, traditional antitrust principles. The Commission is charged with determining whether the transfer of control serves the broader public interest. In the communications industry, competition is shaped not only by antitrust principles, but also by the regulatory policies that govern the interaction of industry players. In addition to considering whether the merger will reduce existing competition, therefore, we also must focus on whether the merger will accelerate the decline of market power by dominant firms in the relevant communications markets and the merger’s effect on future competition. We also recognize that the same consequences of a proposed merger that are beneficial in one sense may be harmful in another. For instance, combining assets may allow the merged entity to reduce transaction costs and offer new products, but it may also create or enhance market power, increase barriers to entry by potential competitors, and/or create opportunities to disadvantage rivals in anticompetitive ways.

The Commission has the authority to impose and enforce narrowly tailored, transaction-specific conditions that ensure that the transaction serves the public interest. Indeed, our public interest authority enables us to impose and enforce conditions based upon our extensive regulatory and enforcement experience to ensure that the merger, overall, will serve the public interest. Despite broad authority, the Commission has held that it will impose conditions only to remedy harms that arise from the transaction (*i.e.*, transaction-specific harms) and that are related to the

Commission's responsibilities under the Communications Act and related statutes.<sup>32</sup>

As stated by the Commission, applicants in these transactions bear the burden of demonstrating to the FCC that the benefits of the proposed transaction outweigh the potential harm.<sup>33</sup>

#### **IV. THE ALLEGED BENEFITS AND THE APPLICANTS' DESCRIPTION OF THE RISKS OF THIS TRANSACTION**

##### **A. Applicants' description of anticipated consumer benefits**

Applicants assert that the transaction will yield tangible, clear, and significant public interest benefits. Applicants describe the benefits of the transaction as follows: "The transaction will transfer lines predominantly in rural areas and smaller cities to a company with a proven track record of investing in and successfully serving these types of areas." Frontier asserts that its predominant business focus is delivering high quality wireline services over its own networks in rural America and smaller cities. Frontier says its business plan depends on investing in and providing efficient service to customers in rural areas and smaller cities, and it has implemented business practices, investment strategies, and customer service initiatives designed for customers in these service areas.<sup>34</sup>

Frontier asserts that the benefits customers will experience include improved broadband investment and penetration. Frontier says it has expanded its broadband offerings to approximately 92 percent of the access lines it serves, and once the

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<sup>32</sup> *FairPoint/Verizon Order*, at paras. 11-14 (cites omitted).

<sup>33</sup> *Id.*, at para. 26.

<sup>34</sup> Application, Exhibit 1 at 15.

transaction is complete, Frontier plans on investing in broadband in the acquired areas to achieve levels of broadband availability and subscribership to be contemporaneous to those in its current territories.<sup>35</sup> Applicants believe that this will help achieve public interest goals asserted by Congress and the President by bringing reliable broadband service to substantial numbers of underserved and unserved customers within the acquired areas.

The transaction will increase Frontier’s financial capacity to make network investments in rural communities and smaller cities and provide more efficient and cost effective service. The proposed transaction, according to Applicants, is structured to achieve Frontier’s broadband investment and growth strategy to serve customers in all 27 states in which it will operate after the merger.<sup>36</sup> Applicants submit that the transaction will improve Frontier’s overall financial flexibility and stability by reducing its debt leverage.

Applicants project that after the transaction Frontier’s leverage will decrease from 2.8 times earnings before interest, taxes, depreciation and amortization (“EBITDA”) to approximately 2.6, even without considering operating efficiencies.<sup>37</sup> Frontier plans on reducing its dividend by 25 percent effective with the close of the transaction. Frontier submits that the decreased dividend, with the increased cash flow, will enable Frontier to direct cash toward investments needed to increase broadband penetration and provide better service.<sup>38</sup>

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<sup>35</sup> Id.

<sup>36</sup> Id. at 16.

<sup>37</sup> Id.,

<sup>38</sup> Id. at 18.

Frontier submits that the transaction will transform Frontier into a larger, more robust carrier, and when the transaction is fully implemented, Frontier expects to yield an annual operating expense savings of \$500 million. Applicants state that these efficiencies will stem primarily from two sources. First, the transaction will enable Frontier to consolidate various administrative functions and systems such as accounting and information systems, and second, Frontier will become the largest rural carrier serving predominantly rural and smaller city service areas, which will increase its purchasing power and enable it to obtain better pricing on capital expenditures.

Frontier asserts that the Commission has long recognized that these types of benefits are public interest benefits.<sup>39</sup> Frontier recognizes the savings as a way to strengthen its provision of services to consumers in rural, high cost areas and smaller cities and to add to Frontier's financial strength to support its broadband network investment plans.

Furthermore, Applicants assert that the proposed transaction will not reduce competition or harm retail or wholesale customers.<sup>40</sup> Applicants claim that competition will not be reduced because none of the local exchanges being acquired by Frontier from Verizon overlap with any of the local exchanges already served by Frontier. Frontier and Verizon do not currently compete for customers in any of the affected exchanges as Frontier operates neither local exchange nor mobile facilities in these areas; therefore, the transaction will not reduce the number of competitors in any region.<sup>41</sup> In addition, Applicants assert that the transaction will not cause any disruption or other harm to retail

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<sup>39</sup> Id.

<sup>40</sup> Id. at 19.

<sup>41</sup> Id.

or wholesale customers. Current customers will continue to receive substantially the same services and Frontier proposes to honor the rights and obligations of Verizon in each of the areas where lines are being acquired. Therefore Applicants submit that there are public interest benefits in approval of the transaction.

Applicants submit that the transaction will generate public interest benefits without countervailing harms. But as discussed in the next section, Applicants themselves identify a significant number of possible harms.

**B. Applicants' description of possible consumer harms**

Much information about the risks of this transaction is contained in Frontier's Securities and Exchange Commission ("SEC") S-4 filing. In the following section, the Applicant's S-4 admissions are set forth. In the section after that, those admissions are analyzed in detail.

**1. Risks related to the spin-off and the merger**

Applicants admit that there will be certain risk factors involved with the merger. The acquisition by Frontier is the most significant acquisition it 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 Verizon business, which may decrease the time they will have to serve existing customers, attract new customers and develop new services strategies.<sup>42</sup> The company asserts that the size and complexity of the Verizon operating systems and the process of using Frontier's existing common support functions and systems to manage the *pro forma* Frontier after the merger, if not managed successfully by Frontier management, may result in interruptions

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<sup>42</sup> See Frontier Communications SEC Form S-4 Registration Statement (filed July 24, 2009) at 25.

of the business activities of the combined company that could have a material adverse effect on the combined company's business, financial and results of operation.<sup>43</sup>

Applicants also assert that 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.<sup>44</sup> Additionally, 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 the *pro forma* Frontier. Applicants represent that certain wholesale, large business, Internet service provider and other customer contracts that are required to be assigned to *pro forma* Frontier by Verizon require the consent of the customer party to the contract to effect this assignment.<sup>45</sup> 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.<sup>46</sup>

Furthermore, 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

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<sup>43</sup> Id.

<sup>44</sup> Id.

<sup>45</sup> Id. at 26.

<sup>46</sup> Id.



business combination proposal to Frontier prior to the closing of the merger that might result in greater value to Frontier stockholders than the merger.<sup>47</sup>

## **2. Risks related to the combined company's business following the merger**

Applicants submit that 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.<sup>48</sup> Due to economic conditions, increasing competition, changing consumer behavior, technology changes and regulatory constraints, the business that will make up the combined company can see a decrease in access lines, switched access minutes of use, long distance revenues and federal and state subsidies.<sup>49</sup> Both individual companies have faced a decline in 2008 for the above-mentioned areas and the current trends could act adversely towards the combined company.

Additionally, the combined company will face intense competition. The telecommunications industry is extremely competitive and competition continues to increase. The dividing lines between the number of serves such as local, long distance, wireless, cable, and Internet service providers are becoming blurred. The combined company's competitors will include competitive local exchange carriers and other providers of services, such as Internet service providers, wireless companies, voice over Internet protocol ("VoIP") providers and cable companies.<sup>50</sup> Applicants assert that

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<sup>47</sup> Id.

<sup>48</sup> Id. at 29.

<sup>49</sup> Id.

<sup>50</sup> Id. at 30.

competition will continue to grow and become intense following the merger, and Frontier cannot assure that the combined company will be able to compete affectively.<sup>51</sup>

Furthermore, some of the combined company's future competitors will have superior resources, which may place the combined company at a cost and price disadvantage.<sup>52</sup> Applicants assert that some of the competitors of the combined company will have market presence, engineering, technical and marketing capabilities and financial, personnel and other resources that are greater than those of the combined company. Many of these companies will be able to raise capital at a lower cost than the combined companies.<sup>53</sup> Therefore, according to Applicants, the competitors may be able to develop and expand their communication network infrastructures more quickly, adapt new or emerging technologies and changes in customer requirements, take advantage of acquisition and other opportunities more readily and devote more resources to marketing and sale of their products.<sup>54</sup> Applicants also submit that the cost advantage of some of these competitors may give them the ability to reduce their prices for an extended period of time if they so choose.<sup>55</sup>

Applicants are also aware that weak economic conditions may decrease the demand for the combined company's services. The combined company could be greatly affected by the ongoing recession if current economic conditions or their effects continue following the merger.<sup>56</sup> Downturns in the economy and competition in the combined

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<sup>51</sup> Id.

<sup>52</sup> Id.

<sup>53</sup> Id.

<sup>54</sup> Id.

<sup>55</sup> Id.

<sup>56</sup> Id. at 31.

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, making it difficult to obtain new customers.<sup>57</sup> Applicants assert that if economic conditions continue, they could cause the combined company's customers to delay or discontinue payment for its services.<sup>58</sup>

### **3. Risk related to liquidity, financial resources and capitalization**

The applicants assert that if the recent severe contraction in the global financial markets and current economic conditions continue into 2010, the economic scenario may have an impact on the combined company's business and financial conditions.<sup>59</sup> The financial well being of the company may be negatively affected if the diminished availability of credit and liquidity continues.<sup>60</sup> The combined company will have significant debt maturities. Hence, substantial debt and debt service obligations may adversely affect the combined company. Frontier has significant amount of indebtedness at \$4.725 billion as of March 31, 2009 and after the merger Frontier will have indebtedness of approximately \$7.9 billion.<sup>61</sup> Applicants submit that potential significant negative consequences on the combined company's financial condition and results of operations could result from its substantial debt. These consequences could include limitations on the combined company's ability to obtain additional debt or equity financing, that the combined company may be unable to meet the financial covenants in its debt agreements, and allocation of a substantial portion of the combined company's

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<sup>57</sup> Id.

<sup>58</sup> Id.

<sup>59</sup> Id. at 33.

<sup>60</sup> Id.

<sup>61</sup> Id.

cash flow from operations to service the combined company's debt, compromising the combined company's flexibility to plan for, or react to, competitive challenges in its business.<sup>62</sup>

#### **4. Risks related to regulation**

Applicants assert that there are risks related to regulation of the combined company. The combined company will remain highly regulated, and the combined company will likely incur substantial compliance costs that could constrain its ability to compete in its target markets.<sup>63</sup> As an incumbent local exchange company ("ILEC"), the combined company will be subject to significant regulation from federal, state and local authorities and the regulations will restrict the company's ability to change its rates, especially on its basic services and access rates.<sup>64</sup> Additionally, increased regulation will impose substantial compliance costs on the combined company. Applicants submit that 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.

#### **5. Risks related to technology**

In addition, Applicants assert that the 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 and meet the needs or expectations of the

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<sup>62</sup> Id. at 34.

<sup>63</sup> Id. at 35.

<sup>64</sup> Id.

customers.<sup>65</sup> Furthermore, rapidly changing technology in the communications industry may influence the combined company's customers to consider other service providers.<sup>66</sup>

## V. A DETAILED ANALYSIS OF THE RISKS OF THIS TRANSACTION.

Taking all of the above into account, it should be clear that the potential harms of this transaction outweigh the claimed benefits. But a closer look further emphasizes the potential harms and risks. Those risks were succinctly but comprehensively detailed in an August 15, 2009 filing by the Communications Workers of America and the International Brotherhood of Electrical Workers ("CWA/IBEW") with the PUCO in the PUCO's proceeding to review this transaction. State Advocates will quote the CWA/IBEW concerns in their entirety:

[T]he preliminary registration statement filed by Frontier and Verizon with the Securities and Exchange Commission on July 24, 2009, contains a sobering discussion of the risks of the proposed transaction (pages 24-38). Some of the most significant risks include:

### **Frontier's Ability to Finance the Transaction**

- Frontier does not have any of the approximately \$3.1 billion in financing it requires to complete the transaction.
- The merger agreement permits Frontier to walk away from the transaction if it cannot obtain that financing at an annual average interest cost of 9.5% or less (including original issue discount). Merger Agreement § 7.18(e)(ii).
- Frontier's most recent debt was issued on April 9, 2009, and carries an annual interest cost of 10.375%. Frontier's bonds have been trading in the range of 7.51% to 12.56%, with most in the 9% to 11% range.
- The combination of the currently unstable economic environment with Frontier's recently experienced debt costs leads CWA and IBEW to question whether Frontier will be able to finance this transaction on

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<sup>65</sup> Id. at 36.

<sup>66</sup> Id.

reasonable terms. Will Frontier simply walk away if interest costs exceed 9.5%? Or will it burden the Company - and ultimately the public it serves - with extraordinarily high debt costs or other onerous conditions that lenders may require?<sup>67</sup>

### **Frontier's Financial Fitness**

- Frontier's financial metrics have been deteriorating. Its leverage ratio (net debt /EBITDA) was 3.8x at the end of 2008. Annualizing its reported second quarter 2009 performance would result in a ratio of 4.2x (3.9x year-over-year). It is unlikely that performance of this level would give much comfort to prospective lenders or result in the type of interest rate that would make this transaction financially less risky. Moreover, some of Frontier's existing debt carries escalation provisions (that is, higher interest costs) if the leverage ratio exceeds 4.0x, which appears likely to happen this year.
- Frontier has been asking its workforce to take unpaid "furloughs" during this year. That is hardly a sign of a company on sound financial footing.
- After undergoing a serious financial restructuring in the early 2000s, Frontier reinstated its common stock dividend in 2004. Since then, Frontier has consistently paid out much more to shareholders than it earned in net income. During 2008, Frontier paid out dividends equal to 174% of net income. In the first two quarters of 2009, the payout has been more than 200% of net income (\$63 million of net income; more than \$130 million paid in dividends). The result is that Frontier's shareholders' equity has declined steadily -- it stood at \$2 billion in 2002, but is now less than \$450 million (as of June 30,2009).
- It simply is not sustainable for a public utility to consistently pay out more to its shareholders than it earns in net income. Cash recovered through customers' rates for depreciation and other non-cash expenses is supposed to be reinvested in the business, not paid out to shareholders to pump up the stock price.

### **Problems with Frontier's Financial Projections**

- Revenues: Frontier's so-called "pro forma" projections rely on Verizon's year-end 2008 results. But Frontier recently acknowledged (in its second quarter conference call with investment analysts) that

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<sup>67</sup> This is not merely a theoretical concern. Just weeks before closing a similar transaction with Verizon, FairPoint Communications was confronted with the choice of either accepting drastically higher interest rates on more than \$300 million in unsecured notes or abandoning the deal. FairPoint accepted the financing terms that increased the interest rate on the notes from a planned 8.5% to more than 13%, coupled with more onerous loan covenants. (Footnote from original.)

Verizon's Separate Telephone Operations (the Verizon areas that Frontier wants to buy, abbreviated as VSTO) lost 136,000 access lines (2.9% of all its lines) during just the second quarter of 2009. Since June 30, 2008, VSTO has lost more than 11% of its access lines, resulting in a significant decline in revenues, cash flow, and net income,

- **Expenses:** The key to success for Frontier is being able to substantially reduce Verizon's level of expenses in the VSTO area. Frontier has publicly said that its goal is to cut annual expenses by \$500 million (21% of total VSTO cash operating expenses) by 2013. In order to achieve savings of this magnitude Frontier will need to substantially reduce VSTO's workforce and cut deeply into other costs. By comparison, when FairPoint purchased Verizon's access lines in Maine, New Hampshire, and Vermont, FairPoint projected reducing Verizon's cash operating expenses by 8% to 10% (and FairPoint has not been able to achieve even those savings). The most recent major merger involving rural landline operations, CenturyTel's acquisition of Embarq, entailed projected savings of 9% of Embarq's cash operating expenses. It is unprecedented to have expense savings of the magnitude projected by Frontier for a transaction of this size.
- **Sensitivities:** We also are concerned that Frontier's financial projections do not appear to recognize the impacts of the economic downturn. In Ohio, Verizon continues to lose customers, Verizon employees are leaving and not being replaced, and Verizon is deferring basic maintenance. The result in Ohio, and elsewhere, is that Frontier is projecting it will have customers, a skilled workforce, and functioning equipment that may not exist by the time of closing. From day one, Frontier will have greater needs, but fewer resources to meet those needs, than its projections indicate.
- **Putting it together:** Frontier's financial projections are based on inflated revenue projections, overly optimistic expense savings, and interest costs that are well below Frontier's current interest rates. The financial risks - to the Company, its customers, and its workforce - are enormous.

### **Integration and Execution Risks**

- Neither Frontier nor any other company its size has ever taken on a deal of this complexity and magnitude - approximately 4.8 million access lines spread over parts of 14 states stretching from coast to coast.
- It does not appear that Frontier has engaged in rigorous due diligence of the service areas it is acquiring. The time of Frontier's initial

meeting with Verizon to the signing of the merger agreement was only two months. See pages 42-52 of the preliminary registration statement. That is an extremely short period of time to evaluate and plan for a transaction of this complexity and magnitude. Does Frontier understand the condition of the network, the reasons why broadband deployment lags behind levels in other locations, the quality of Verizon's equipment and facilities, the availability of spare parts for Verizon's aging equipment, and the numerous other factors that will affect Frontier's ability to do what it hopes to do?

- According to the agreement with Verizon, Frontier receives no working capital from Verizon at closing. See Distribution Agreement, § 1.1 (definition of “target working capital) and §5.1 (d). From day one, Frontier has to be able to provide the funds necessary to run the new company - invest in capital, pay employees, improve customer service, advertise to try to retain customers, restock inventory - all with its own funds.
- The biggest deal Frontier has done was Rochester Telephone, about 800,000 lines (at that time) nearly all in one state. Even then, Frontier waited more than 7 years to transition from Rochester Tel's computer and billing systems onto a common Frontier platform.
- The biggest deal ever attempted from a Verizon divestiture was the FairPoint transaction in Northern New England - about 1.6 million lines in three states. That transition has not gone well, resulting in service outages, poor customer service, and a significant loss of access lines (and the attendant revenues and earnings needed to run the company).
- No one has ever attempted a large divestiture of access lines from the former Bell Atlantic network. But this deal includes 600,000 access lines in West Virginia that will have to be cut over from those Bell Atlantic systems to Frontier's systems at closing. It's never been done before. ... Ensuring a proper transition in West Virginia (which will be Frontier's largest state) could become the primary focus of Company management and investments, and potentially jeopardize the viability of the entire transaction.
- While Frontier is confident in its ability to manage all of the integration challenges, there is a significant risk that management will be distracted and have to focus its attention on the integration and transition process, rather than on improving customer service, increasing broadband penetration, enhancing preventive maintenance activities, and all of the other things that are needed to provide high-quality service to the public.



## Impacts on Customer Service

- All of the financial and operational risks have a common endpoint: service to the customer. If Frontier does not have the financial resources it expects, it will not be able to give customers what they want: high-quality service, including high-speed broadband service, at a reasonable price. If Frontier's management is focused on integration, rather than on understanding what customers and the network need, service will deteriorate. And in at least some locations, if customers can't get the service they want from Frontier, they will look elsewhere - resulting in greater loss of revenues and a further diminution in the available resources.
- Given these significant risks, customers need to be protected. Frontier promises greater broadband deployment, but there are no guarantees. Frontier promises improved customer service, but again there are no guarantees.
- Frontier has promised a more local, customer-based operation than Verizon provides. If Frontier lacks financial resources, however, those promises of a more local focus are meaningless. Further, if resources are diverted to integration and transition efforts, rather than to local service needs, customers may be further harmed. Simply, as regulators, customers, and employees have learned the hard way, pre-transaction promises do not always translate into post-transaction reality.
- While there are ways to protect consumers from some of these risks, it is not possible to protect against all of them. In the FairPoint transaction, regulators in Maine, New Hampshire, and Vermont put in place several safety mechanisms, including additional infusions of capital from Verizon and penalties on FairPoint for non-compliance. But within the 18 months after the transaction closed regulators already back-tracked on some of those protections just to keep FairPoint out of bankruptcy. Among the so-called protections that disappeared were (1) a \$50 million fund set aside by Verizon for capital improvements (regulators allowed FairPoint to use the funds instead for operating expenses), and (2) penalties intended to provide an incentive against poor service to wholesale and retail customers (regulators forgave millions of dollars in penalties).
- As the Verizon-Frontier deal is currently structured, there is no safety net. Verizon gets to walk away with its check for more than \$3 billion;

it bears no responsibility for anything that happens to Frontier, its customers, or employees after closing.<sup>68</sup>

Taken all together, these concerns make it clear that this transaction does not meet the statutory requirement that it serve the public interest, convenience and necessity.<sup>69</sup>

Therefore, the transaction must not be approved. It is possible, however, that the imposition of conditions on the merger could make it serve the public interest, if those conditions are substantial enough.

## **VI. ANALYSIS OF THE PUBLIC INTEREST FOR THE PROPOSED TRANSACTION**

### **A. OVERVIEW**

As demonstrated above, the proposed transaction raises numerous economic and policy issues that bear directly on consumers in Frontier and Verizon territories throughout the country. These initial comments provide a preliminary analysis and discussion of the public interest aspects of the proposed transaction, including the probability of the purported consumer benefits occurring, the scope of the benefits, and whether the anticipated benefits offset any potential harm that could result from the transaction. If Applicants submit additional information and data to the Commission, State Advocates may supplement this analysis and recommendations in future filings.

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<sup>68</sup> PUCO Case No. 09-454-TP-ACO, CWA/IBEW Motion to Establish Procedural Schedule (filed August 17, 2009), Memorandum in Support at 2-6 (accessible at <http://dis.puc.state.oh.us/DocumentRecord.aspx?DocID=673fa007-a010-4f98-bcb3-625ad2bd1bc5>).

<sup>69</sup> 47 U.S.C. §§ 214(a) and 310(d).

## B. FINANCIAL ASPECTS OF TRANSACTION

**The FCC should examine the impact of the financial structure of the proposed merged entity on the applicant's ability to provide quality service at just and reasonable rates.**

According to Applicants, the transaction is valued at \$8.6 billion. Verizon stockholders will receive approximately \$5.3 billion of Frontier common stock in the merger. Verizon will receive approximately \$3.3 billion in value through a combination of cash distributions to Verizon, debt securities issued to Verizon prior to the spin-off and assumption of certain debt previously issued by Verizon's telephone company subsidiaries. Verizon may exchange these newly-issued debt securities for certain debt that was previously issued by Verizon, which would have the effect of reducing Verizon's then-outstanding debt on its balance sheet.

Applicants project that the combined company would have revenue in excess of \$6.5 billion, *pro forma* EBITDA of approximately \$3.1 billion, *pro forma* leverage of 2.2 times EBITDA and *pro forma* free cash flow of approximately \$1.7 billion, based on anticipated full run-rate synergies and operating results for the twelve months ended December 31, 2008.<sup>70</sup>

The Commission should not approve the transaction until all financial details of the Frontier's financing of additional debt are disclosed and approved by the Commission. The rates, terms and conditions of the contemplated financing can affect the financial viability of Frontier. Depending upon what the rates, terms and conditions actually are, additional conditions may be warranted. By way of example, limitations on the payment of dividends may be appropriate if net income declines.

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<sup>70</sup> Frontier Presentation at Barclays Capital – Worldwide Wireless and Wireline Conference (held May 27, 2009).

### C. BROADBAND DEPLOYMENT

#### **General promises to deploy broadband should be translated into specific commitments with measurable milestones.**

The Commission should require Verizon to use the proceeds it receives from the merger for the deployment of broadband in its remaining service territory. Verizon should commit to making broadband available to 100% of its service areas so that residential and single line business customers have access to broadband. Among other things, the Applicants point to increased broadband deployment as a benefit of the proposed merger. Verizon and its shareholders will receive approximately \$8.6 billion from Frontier as part of the agreement of merger and Verizon should use those proceeds to provide broadband to all areas within its remaining network.<sup>71</sup> The Commission recently approved the Embarq/CenturyTel merger based upon their agreement to offer retail broadband Internet access service to 100% of the broadband-eligible access lines within three years after the closing of the transaction.<sup>72</sup>

On the other hand, it is Frontier that has touted this transaction as resulting in broadband benefits to consumers in the acquired territories. Therefore, the Commission should impose on Frontier a commitment to offer retail broadband Internet access to 100% of the residential and single line business access lines within its current territory within three years after the closing of the transaction. Given that the current Verizon

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<sup>71</sup> Notably, Verizon decided not to apply for any of the American Recovery and Reinvestment Act stimulus funding. See <http://www.benton.org/node/27145>. Clearly, the Commission must substitute its regulatory authority for Verizon's reticence in order that Verizon customers will not be left on the wrong side of the digital divide. In the 2006 *SBC/AT&T Order*, the Commission allowed 15% of the customers to be served by wireless broadband. State Advocates submit that three years later, the Frontier customers should not be relegated to this second-call status.

<sup>72</sup> See *CenturyTel/Embarq Order*, Appendix C.

territory that Frontier wants to acquire is well-behind on broadband deployment,<sup>73</sup> the condition should be that Frontier deploy broadband to 100% of the newly-acquired territory within five years after the closing of the transaction.

As in CenturyTel/Embarq, the Commission should require that the broadband deployment be at a minimum speed of 768 kbps.<sup>74</sup> And that level should increase as the Commission determines a minimum speed as part of the National Broadband Plan. As discussed more fully in Section E., below, the Commission should also impose quarterly reporting requirements on both Verizon and Frontier as to each company's progress in complying with this condition and require that such reports be furnished to State Commissions and consumer advocates.

The public interest will be furthered by ensuring that the public, state commissions and consumer advocates will have access to information necessary to track the commitment for broadband deployment by Verizon and Frontier and ensure that each company continues to be financially viable and maintaining a level of service to the public including consumer protection, and competition.

#### **D. SERVICE QUALITY**

Applicants should be required to engage an independent third-party ("Auditor") to audit and test the operating systems used to provide wholesale and retail services to make sure that they will operate seamlessly to effectuate the transition of Verizon's customers to Frontier. The Auditor should issue a report on all systems necessary to support all areas of customer service including retail ordering, provisioning, service quality

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<sup>73</sup> Application, Exhibit I at 15.

<sup>74</sup> *CenturyTel/Embarq Order*, Appendix C.

including network monitoring and maintenance, billing, wholesale ordering, provisioning, service quality including network monitoring and maintenance, billing, and other service dependent functions for customer service support. The Auditor must also assess whether the operating systems of both companies will be capable of seamless and transparent transfer of customers and related records, and whether Frontier's existing systems and integration plans related thereto will actually function as intended so that Frontier's systems can in fact accommodate the change-over of customers.

The Auditor should review and report on the operational plans developed by Applicants to effectuate the contemplated transfers after closing. The Auditor would evaluate all major functional components of the operating systems and the proposed procedures for the transfer and verification of pre-ordering, provisioning, maintenance and repair, billing, and other OSS functions in order to ensure that the systems will be able to perform and function as intended. Such an audit would let all parties know whether the actual transfer of customers and related information would pose undue risk to ratepayers. The audit will also evaluate Frontier's day-to-day operational management and change-management processes to determine if the processes will in fact be able to accommodate the transfer. This will allow the FCC to know whether any problems with the system exist and whether additional testing is warranted prior to approval of the transaction. The FCC should require such audits as part of its review process and in order to ensure that the operation readiness of the operating systems in effectuating customer transfer of the transaction is offered in the public interest.

State Advocates urge the Commission to adopt an approach similar to that approved for the review of Applications for authorization under Section 271, where the

Commission relied upon an independent third-party testing of operating support systems to determine their operational status.<sup>75</sup> Frontier and Verizon should be required to demonstrate before the merger is consummated that their cut-over plans and systems will in fact operate so that there are no disruptions for wholesale and retail customers in effectuating the transfer. The Auditor should ensure that the systems of both Verizon and Frontier will be able to communicate and interface with one another to accommodate the transfer. The Auditor must ensure that the Frontier systems can accommodate both current demand and projected demand for wholesale and retail services. State Advocates submit that approval of the transfer should be conditioned upon the testing and affirmation by the Auditor that the operation support systems will function properly and without disruptions to customers. The parameters of the testing should be provided to the public as well as the reports resulting from the testing and all recommendations for correcting any deficiencies or problems.

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<sup>75</sup> By way of example, see *In the Matter of Application by Bell Atlantic New York for Authorization Under Section 271 of the Communications Act to Provide In-Region, InterLATA Service in the State of New York*, CC Docket No. 99-295, Memorandum Opinion and Order, FCC 99-404 (rel. December 22, 1999).

## E. REPORTING REQUIREMENTS

The Frontier/Verizon transaction marks another step in what is likely to be a continuing stream of consolidation among rural ILECs.<sup>76</sup> This reshaping of the industry, with the potential for the emergence of “rural supercarriers,”<sup>77</sup> 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.’”<sup>78</sup> 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

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<sup>76</sup> 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>.

<sup>77</sup> “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/>.

<sup>78</sup> 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”).<sup>79</sup> 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

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<sup>79</sup> *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 Docket 8640 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,<sup>80</sup> 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.<sup>81</sup> 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.”<sup>82</sup> 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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<sup>80</sup> See transcript of Frontier 1<sup>st</sup> 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).”

<sup>81</sup> *CenturyTel/Embarq Order*, Appendix C at 27-28.

<sup>82</sup> *Id.*, ¶ 33, n.106.

responsiveness (speed of answer).<sup>83</sup> 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,<sup>84</sup> 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,<sup>85</sup> 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.<sup>86</sup>

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<sup>83</sup> Id., Appendix C at 27-28.

<sup>84</sup> Application, Exhibit 1, p. 4.

<sup>85</sup> *ARMIS Forbearance Order*, ¶12.

<sup>86</sup> 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>.

Applicants have made improved broadband deployment a central focus of the alleged benefits of the transaction.<sup>87</sup> Monitoring broadband deployment following the merger is a critical element of the oversight needed to ensure that merger benefits arise. In the *CenturyTel/Embarq Order*, the Commission imposed conditions relating to broadband deployment, with a general requirement to make retail broadband Internet access service available in 100% of CenturyTel’s broadband eligible access lines within three years.<sup>88</sup> This commitment requires detailed reporting of the status of broadband deployment. These Comments propose similar broadband deployment conditions for approval of this merger. Here too, detailed reporting on the progress of both Frontier and Verizon to meet these conditions are needed. At least semi-annual reports should be required that identify the specific progress of broadband deployment, including the geographic scope and data speeds associated both with new broadband investments and network upgrades. Further, the reporting should be sufficient to allow the Commission to determine the extent to which rural high-cost fund support is used to construct facilities that are capable of supporting broadband deployment.<sup>89</sup>

In the context of this merger and the reporting conditions, the Commission should revisit its decision to grant Verizon conditional forbearance from cost assignment requirements. As a more general matter, the Commission must revisit its decisions to abandon the bulk of ARMIS reporting requirements. While imposing monitoring requirements on an *ad hoc* basis to address the specific concerns raised by mergers is

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<sup>87</sup> See, for example, Application, Exhibit 1, pp. 2 and 15.

<sup>88</sup> *CenturyTel/Embarq Order*, Appendix C at 30-31.

<sup>89</sup> In the *ARMIS Forbearance Order*, the Commission noted that Verizon receives high cost support and that “rural high-cost support is cost-based so the Commission would need cost-assignment data for those regions in which Verizon and Qwest receive rural high-cost support.” *ARMIS Forbearance Order*, at ¶30.

appropriate, it is also essential for the Commission to provide data regarding the structure and performance of the ILEC industry. State Advocates will not reiterate all of the arguments that they offered in the forbearance proceedings that led to the FCC abandoning its ARMIS system, but would simply point out that the availability of this data is critical to the Commission’s mission. For example, as mentioned above, while the FCC eliminated the requirement that the ARMIS service quality reports continue to be filed, the Commission compromised in this key area by requiring two additional years of service quality reporting. The value of the service quality data provided by ARMIS is clearly evident when considering the Frontier/Verizon transaction. ARMIS data shows that when compared to Verizon, Frontier performs at a lower level in several key service quality areas. For example, Table 1, below, compares Frontier and Verizon’s performance system-wide and in West Virginia, with the shaded cells identifying which company has lower performance levels in the areas studied.

Table 1: Verizon/Frontier Service Quality Metrics Compared (From ARMIS for 2008)				
Company	Commitments Met	Average Installation Interval (Days)	Monthly Trouble Reports per 100 Access Lines	Initial Out-of-Service Interval (hours)
Verizon	97.98%	1.19	1.94	31.27
Frontier	96.45%	5.80	2.77	22.03

ARMIS data on service quality also allows for time-trends to be examined, which adds to the depth of information that can be gained. The ability to draw from a time series or cross-section database of public information provides a means to benchmark performance over time, and across jurisdictions. While some of the states associated with this merger have both Verizon and Frontier operations, which would allow the individual state to be familiar with the performance of both companies based on state service quality

reporting requirements, other states do not have this basis for comparison. Thus, the availability of ARMIS data provides critical information that allows the performance of Frontier to be more thoroughly evaluated by these commissions.<sup>90</sup> The ARMIS reports have provided a critical panel of data that contributes to the monitoring of these markets, and enables those who track this industry to better understand market dynamics, the deployment of new technologies, and the level of service provided by ILECs.

Based on the foregoing, Verizon should be required to file, commencing with the 2009 reporting year:

ARMIS Reports 43-01, 43-02, and 43-03

ARMIS Reports 43-07 and 43-08<sup>91</sup>

ARMIS Reports 43-05 and 43-06<sup>92</sup>

ARMIS Report 43-04, 495A, and 495B.

Further, Frontier should be required to file, commencing with the 2009 reporting year:

ARMIS Reports 43-02, and 43-03

ARMIS Reports 43-07 and 43-08

ARMIS Reports 43-05 and 43-06

ARMIS Report 43-04, 495A, and 495B.

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<sup>90</sup> North Carolina, South Carolina, and Washington have no Frontier operations. Ohio has a very limited Frontier presence.

<sup>91</sup> In the *ARMIS Forbearance Order*, the Commission granted conditional forbearance for filing ARMIS Report 43-07 in its entirety and from filing the remaining tables in ARMIS Report 43-08 but required carriers to collect and retain the data for these reports for 24 months after September 6, 2008. The Commission should re-impose reporting and extend the filing of these reports until the Commission orders that such reports no longer need to be filed by Verizon and Frontier.

<sup>92</sup> In the *ARMIS Forbearance Order*, the Commission granted conditional forbearance for filing ARMIS Reports 43-05 and 43-06 provided that the carriers file the data voluntarily for 24 months after September 6, 2008. The Commission should re-impose the filing of these reports for Verizon and Frontier and require the filing of these reports until the Commission orders that such reports no longer need to be filed by Verizon and Frontier.

## **F. COMPETITIVE IMPACT**

NASUCA assumes that there will be competitive concerns raised in addition to those highlighted above regarding Frontier's OSS and the transition from Verizon. In West Virginia, Frontier will be required to cut over from Verizon's OSS immediately; in the other states, Frontier intends to "copy" Verizon's systems, which has never been done before on this scale. NASUCA reserves the right to address concerns raised by Verizon's and Frontier's competitors in our reply comments.

## **G. EMPLOYMENT/PENSION ISSUES**

The present depressed economic conditions pose additional risks to whether the proposed transaction is in the public interest. If conditions do not improve, Frontier may have further reductions in revenue which may impact its overall financial condition. This can result in the jettison of employees, which may undercut the ability of Frontier to provide high quality service to its customers and perform the tasks needed to integrate the Verizon customers into Frontier.<sup>93</sup> Frontier suffered substantial losses in 2008 in its pension and post retirement benefits other than pensions ("OPEB"). Frontier's pension plan has a \$232.4 million decrease as of December 31, 2008. As of December 31, 2007, pension plan assets stood at \$822.2 million and those assets declined to \$598.8 million at the end of 2008.<sup>94</sup> The value of the pension plan has decreased further based upon Frontier's 10Q for the quarter ending June 30, 2009.<sup>95</sup> Frontier estimates that its 2009

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<sup>93</sup> See Frontier's 10Q for the quarter ending June 30, 2009 at 16-17 for a complete list of risks to Frontier including those related to the integration of the Verizon lines.

<sup>94</sup> See Frontier's 10K for year ending December 31, 2008 at pages 34-35.

<sup>95</sup> See Frontier's 10Q for the quarter ending June 30, 2009 at page 14.

pension and other post retirement benefit expenses will be between \$50 million and \$55 million, as compared to \$11.2 million in 2008.<sup>96</sup>

In view of the foregoing, State Advocates submit that the Commission should, as a part of its analysis of the financial impacts of the transaction, determine an appropriate period to remedy the under-funding issue. This will lessen the risk to the public, which includes a large number of Frontier retirees.

#### **H. SUMMARY OF COMMITMENTS AND CONDITIONS**

The Commission should require Verizon to commit to 100% broadband penetration in its remaining territories using the proceeds from the merger with Frontier. The Commission should require Frontier to to commit to 100% broadband deployment in its current territory and the acquired Verizon territories.

The *pro forma* Frontier should have a third party accounting firm test their operating systems to make sure that their wholesale systems are functioning properly.

Both Verizon and Frontier should be required to report on the progress of the merger and these conditions, including reinstating many of the ARMIS reports.

The Commission should determine how Frontier should be require to cure the current under-funding of its pension and other benefit plans.

In addition, as discussed above, the Commission should not approve this transaction prior to full disclosure and review of the financial prospects of the merged entity.

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<sup>96</sup> *Id.*



## VII. CONCLUSION

State Advocates submit that the proposed transaction must be thoroughly reviewed by the Commission to address whether the proposed transaction would serve the public interest, convenience and necessity. In this regard, the Commission and parties to this proceeding must have access to all books of account, documents, data and records pertaining to the transaction in order to assess whether the transaction is likely to generate verifiable, merger-specific public interest benefits. The impositions of the conditions discussed above are the minimum conditions necessary to have the transaction found to be in the public interest. Based upon further review of the transaction, including the comments filed by other parties, State Advocates may recommend further conditions be imposed. State Advocates appreciate the opportunity to provide these initial comments on this matter.

Respectfully submitted,

/s/

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