

**STATE OF NEW HAMPSHIRE
PUBLIC UTILITIES COMMISSION**

Docket No. DT 07-011

**POST HEARING BRIEF
OF
NEW HAMPSHIRE OFFICE OF CONSUMER ADVOCATE**

November 21, 2007

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I. INTRODUCTION, SUMMARY OF ARGUMENT AND OVERVIEW OF TRANSACTION

A. Introduction

This docket involves the most important telecommunications case in New Hampshire in at least the last decade. The proposed transaction in this case will impact every person in the state who has landline service from Verizon, as well as many others, including those who rely on the Verizon network for other services, including competitive providers, emergency responders, businesses, municipalities, and state government.

The proposed transaction also stands to impact the economy of the state, as our telecommunications network is a vital asset, managed on our behalf by a public utility. The case presents a wide array of issues of utmost importance to the state, including affordable access to reliable telephone service, consumer protection, high speed internet access, labor and employment, the maintenance of utility poles, competition, and access to new technologies, among others.

In a statement at the close of the hearings, Chairman Getz characterized the case as “fundamentally different from the situation the Commission faces when a . . . larger company with more resources seeks to acquire a smaller company and it can be relatively assured that there are the financial, technical and managerial capabilities within that new entity to address any outstanding operating concerns or any other issues of risk.”¹

The Chairman went on to describe what the OCA believes is a useful characterization of the central issues in this case:

Is it in the public interest for Verizon to discontinue service in New Hampshire and to be relieved of all of its statutory obligations, and is it in the public interest for FairPoint to assume control of the Verizon franchise[?] With respect to FairPoint, we must determine, among other things, whether it has the financial, managerial and technical capabilities to operate as a telecommunications public utility in New Hampshire. A related inquiry goes to the question of what does the public interest

¹ Hearing Transcript (TR) Day 9 11/01/07 p. 96 lines 22 through p. 97 line 4.

require of Verizon. For instance, does the public interest and do the facts in this case require that Verizon provide assurances that its successor in interest is in a position to meet all its statutory obligations, and what form would such assurances take[?]²

With respect to the first question, we believe, after careful consideration of the full record in the case, that the Commission should find that Verizon and FairPoint have not met their burden of proof that the transaction, as proposed, is for the public good. As proposed, it is our belief that the transaction presents enough serious risks that it will result in net harm to consumers and therefore it should be rejected by the Commission. We believe that if the Commission nonetheless approves the transaction, the last question raised by the Chairman must be answered in the affirmative – Verizon must be required to provide concrete assurances that FairPoint will be a position to meet all its statutory obligations, especially in light of the state of the network that Verizon seeks to abandon. We offer proposed conditions on what form those might take at the end of this brief.

B. Parties to the Case

1. The Office of Consumer Advocate

The Office of Consumer Advocate (“OCA”) is an independent state agency pursuant to RSA 363:28. The statute authorizes the OCA to represent the rights and interests of residential customers of New Hampshire regulated utilities in proceedings before the Public Utilities Commission (“Commission”).³

Pursuant to special statutory authority, the OCA contracted with two consultants, David Brevitz and Susan M. Baldwin, to assist it with these proceedings.⁴ Mr. Brevitz and Ms. Baldwin prefiled direct testimony and testified at the hearing on behalf of the OCA.⁵

² Id. at p. 97 line 11 through p. 98 line 2.

³ See RSA 363:28, II.

⁴ See Ch. 25:10 (HB 361, 2007).

⁵ See OCA Exh. 1P, 1C, and 1HC (Brevitz testimony) and OCA Exh. 2P, 2C and 2HC (Baldwin testimony).

Mr. Brevitz has substantial experience in the field of telecommunications regulation.⁶ Mr. Brevitz's recent experience includes the evaluation of proposed telecommunications spin offs and mergers, designed to be "tax free," including under a Reverse Morris Trust framework.⁷ Mr. Brevitz holds an MBA in finance,⁸ and is a Chartered Financial Analyst.⁹ Mr. Brevitz is very familiar with Verizon New England (Verizon NE) regulatory issues from participating in numerous cases on behalf of the Maine Office of Public Advocate and Vermont Department of Public Service. Mr. Brevitz served as the OCA's expert on financial and transactional issues, and recommended that the Commission deny the Joint Petition, or if it approved the transaction, urged the Commission to do so with conditions.¹⁰

Ms. Baldwin also has substantial experience in the field of telecommunications regulation, and has participated in numerous state and federal proceedings concerning the regulation of many different aspects of Verizon and its predecessor companies (New England Telephone and Telegraph Company ("NET"), NYNEX Corporation ("NYNEX"), and Bell Atlantic), including such issues as its mergers, retail and wholesale rate design, retail and wholesale cost studies, service quality, regulatory framework, affiliate transactions, and consumer protection.¹¹ She also has significant experience with service quality issues in many state proceedings, as well as during her service as Director of Telecommunications for the Massachusetts Department of Public Utilities.¹² Ms. Baldwin served as the OCA's expert on a range of issues, including broadband expansion, service

⁶ OCA Exh. 1HC, pp. 1-3 and p. 233-243 (exhibit DB-P-1).

⁷ OCA Exh. 1HC, p. 1, line 19 through p. 2, line 2, and p. 4, line 1 through p. 5, line 2.

⁸ OCA Exh. 1HC, p. 2, line 9.

⁹ OCA Exh. 1HC, p. 5, lines 3-9.

¹⁰ OCA Exh. 1HC, p. 8, line 4 through p. 14, line 8.

¹¹ OCA Exh. 2P, p. 2, lines 5-11.

¹² OCA Exh. C, p. 4 lines 1-9.

quality, and rate design.¹³ She recommended that the Commission deny the Joint Petition, or if the Commission approved the transaction, to do so with conditions.¹⁴

2. Verizon

The Verizon entities directly involved in the proposed transaction include Verizon New England, Inc. (“Verizon NE”), Bell Atlantic Communications, Inc. (“BACI”), NYNEX Long Distance Company (“NYNEX Long Distance”), and Verizon Select Services Inc. (“VSSI”) (collectively “Verizon”).¹⁵ The parties to the Agreement and Plan of Merger are Verizon Communications, Inc. (“Verizon Communications”), Northern New England Spinco, Inc. (“Spinco”) and FairPoint.

Verizon NE is a wholly owned, direct Subsidiary of NYNEX Corporation (“NYNEX”).¹⁶ NYNEX is a wholly owned, direct subsidiary of Verizon Communications, Inc. (“Verizon Communications”).¹⁷ Verizon has an investment grade credit rating.¹⁸

Verizon NE is part of a regional Bell operating company (“RBOC”).¹⁹ RBOCs typically serve 80-85% of a state’s population and comprise the technical hub in the state for network services and Enhanced 911.²⁰ Verizon NE “currently serves a territory addressing approximately 87% of the households and approximately 73% of the geography of Maine, New Hampshire, and Vermont.”²¹ Verizon NE serves 1,713,251 access lines in the three states.²² Of this total, 982,953 are residential

¹³ OCA Exh. 2HC.

¹⁴ OCA Exh. 2HC p. 9 line 9, and p. 11 lines 15-21.

¹⁵ FairPoint Exh. 20, p. 2.

¹⁶ FairPoint Exh. 21, p. 1.

¹⁷ FairPoint Exh. 21, p. 1.

¹⁸ OCA Exh. 1HC, p. 55, lines 15-16.

¹⁹ Transcript, October 24, 2007, p. 100, lines 17-19.

²⁰ OCA Exh. 1HC, p. 27, lines 9-10.

²¹ OCA Exh. 1HC, p. 17 and p. 247 (exhibit DB-P-2, p. 24).

²² OCA Exh. 1HC, p. 18 and pp. 295-296 (exhibit DB-P-3, pp. 12 and 15).

access lines.²³ The net book value of the Verizon northern New England properties is \$1.6 billion.²⁴ Verizon's current debt:EBITDA ratio is 2.5x.²⁵

Verizon seeks approval of the proposed transaction with FairPoint in order to abandon service in order to stop deploying capital and other resources in New Hampshire, Maine and Vermont,²⁶ and "to focus more intently on its operations in other markets," especially its fiber to the premises offering ("FiOS") in other states, and on wireless services.²⁷ New Hampshire, Maine and Vermont are not a priority to Verizon Communications from an operational and financial standpoint, and probably have not been for some time, as indicated by the lack of significant deployment of FiOS and recurrent service quality problems over the past several years.²⁸ Verizon's rural Northern New England operations are considered to be expensive to maintain and difficult to serve.²⁹

3. FairPoint

FairPoint Communications, Inc. ("FairPoint") was incorporated in 1991, and made its first acquisition in 1993.³⁰ FairPoint became a publicly-traded company in 2005.³¹ FairPoint characterizes itself as an "acquisition company," and focuses on "small and mid-size, privately and publicly owned local exchange carriers, as well as properties sold by the regional Bell operating companies."³² Since 1993, FairPoint has acquired 35 small, rural local exchange carriers ("LECs").³³ FairPoint continues to operate only 31 of those exchange properties in 18 states.³⁴

²³ OCA Exh. 1HC, p. 18 and pp. 295-296 (exhibit DB-P-3, pp. 12 and 15).

²⁴ TR Day 2 10/23/07 p. 138, line 23 through p. 139, line 2.

²⁵ Verizon Exh. 5P. EBITDA is earnings before interest, taxes, depreciation and amortization.

²⁶ OCA Exh. 1HC, p. 29, lines 12-14.

²⁷ Verizon Exh. 1HC, p. 2, line 21.

²⁸ OCA Exh. 1HC, p. 29, lines 7-12.

²⁹ OCA Exh. 1HC, pp. 28-29.

³⁰ OCA Exh. 1HC, p. 21, line 18.

³¹ FairPoint Exh. 20, p. 5. OCA Exh. 1HC, p. 22, lines 15-16.

³² OCA Exh. 1HC, p. 21, line 18 through p. 22, line 2.

³³ OCA Exh. 1HC, p. 22, lines 2-3, and p. 27, lines 5-6.

³⁴ OCA Exh. 1HC, p. 22, lines 2-3 and p. 27, lines 5-7. FairPoint Exh. 20, p. 11. and.

All of FairPoint's prior acquisitions were smaller and more rural than Verizon's Northern New England operations, which makes this transaction unique for FairPoint.³⁵ Only its first acquisition, involving approximately 20,000 to 25,000 access lines, required the development of operating systems.³⁶ The majority of communities that FairPoint serves have fewer than 2,500 access lines.³⁷ Because the companies acquired by FairPoint thus far are rural in nature, FairPoint's revenue stream includes significant amounts of federal universal service funds.³⁸

FairPoint serves only 308,858 access lines in its entire service territory, including 194,002 residential access lines.³⁹ Also, these operations do not include large business customers. In these respects, FairPoint's existing operations are one-fifth the size of Verizon NE's operations.⁴⁰

FairPoint's subsidiary, Northland Telephone Company of Maine, Inc. d/b/a FairPoint Communications, provides service to the New Hampshire exchanges of East Conway and Chatham.⁴¹ FairPoint serves approximately 384 access lines in these New Hampshire exchanges.⁴²

FairPoint is a "high debt/high dividend" local exchange carrier (LEC).⁴³ FairPoint's overall risk profile is high.⁴⁴ Interest payments associated with the high debt are a very significant outflow of cash for FairPoint, as are dividend payments.⁴⁵ Without the merger, FairPoint's dividend payout ratio is projected to go *****BEGIN CONFIDENTIAL***** *****END**

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³⁵ TR Day 2 1023/07, p. 129, line 23 through p. 130, line 2, and p. 130, lines 3-5.

³⁶ TR Day 2 1023/07, p. 130, lines 8-24.

³⁷ OCA Exh. 1HC, p. 22, lines 8-9.

³⁸ OCA Exh. 1HC, p. 22, lines 9-10.

³⁹ OCA Exh. 1HC, p. 18 and p. 295-296 (exhibit DB-P-3, pp. 12 and 15).

⁴⁰ OCA Exh. 1HC, p. 18 and p. 295-296 (exhibit DB-P-3, pp. 12 and 15).

⁴¹ FairPoint Exh. 20, p. 5.

⁴² OCA Exh. 1HC, p. 22, lines 11-13.

⁴³ OCA Exh. 1HC, p. 8, line 15, and p. 23, line 9.

⁴⁴ OCA Exh. 1HC, p. 23, lines 9-10.

⁴⁵ OCA Exh. 1HC, p. 23, lines 10-11.

⁴⁶ OCA Exh. 1HC, p. 24, lines 9-10; p. 25, line 4, and OCA Exh. 56HC.

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As a “high debt/high dividend” rural LEC, FairPoint is at the upper end of the risk spectrum for both equity and debt components of its capital structure.⁴⁸ FairPoint’s dividend yield is at the top of comparable companies (8.4%), as is its dividend payout ratio (91%).⁴⁹ FairPoint’s debt leverage (net Debt/EBITDA) is ***BEGIN HIGHLY CONFIDENTIAL***

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Higher debt leverage increases the risk that fixed payments of principal and interest cannot be paid, and higher dividend yield increases the risk that indicated dividend levels cannot be paid, all other things being equal.⁵¹ The landline business of “high debt/high dividend” rural LECs is declining in nature, so reductions in dividends are expected.⁵² If that happens, there would be a substantial decline in the valuation of a firm with substantial debt levels.⁵³

FairPoint’s high debt leverage causes it to have a non-investment grade or “junk bond” credit rating.⁵⁴ FairPoint has never been an investment grade company and has no plans of becoming investment grade.⁵⁵ Investors demand a higher return on non-investment grade investments than investment grade investments.⁵⁶

⁴⁷ OCA Exh. 1HC, p. 24, lines 10-11. See also OCA Exh. 1HC, p. 23, lines 11-15; p. 211 (exhibit DB-C-1); pp. 213-215 (exhibit DB-C-2, pp. CFPNH 0948, 0974, 0989); pp. 217-223 (exhibit DB-C-2, p. CFPNH 1050, 1051, 1062-1066); p. 225 (exhibit DB-C-2, p. CFPNH 1428); and p. 227 (exhibit DB-C-2, p. CFPNH 2579). OCA Exh. 1HC, p. 58, lines 9-11.

⁴⁸ OCA Exh. 1HC, p. 51, lines 6-7, and pp. 174-177 (exhibit DB-HCL2-7).

⁴⁹ OCA Exh. 1HC, page 51, line 1, citing FairPoint S4.

⁵⁰ OCA Exh. 1HC, p. 177 (exhibit DB-HCL2-7, p. 28).

⁵¹ OCA Exh. 1HC, p. 51, lines 7-10.

⁵² OCA Exh. 1HC, p. 52, lines 3-4.

⁵³ OCA Exh. 1HC, p. 52, lines 9-10.

⁵⁴ OCA Exh. 1HC, p. 55, lines 13-14. See also TR Day 2 1023/07, p. 97, lines 4-9.

⁵⁵ TR Day 2 1023/07, p. 97, lines 10-15.

⁵⁶ OCA Exh. 1HC, p. 55, lines 14-15.

Without the proposed transaction, FairPoint's prospects are dire: *****BEGIN HIGHLY**

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Through the proposed transaction, FairPoint seeks to improve its financial position by augmenting its "free" cash flow.⁵⁹ FairPoint projects that its leverage ratio will decline from approximately 4.5x to 4.1x (net debt as a multiple of net EBITDA), and that its dividend payout ratio will decline from 87% to 60-70%.⁶⁰

4. Other Intervenors

In addition to the Staff of the Commission, more than twenty parties, including combined groups that formed single parties, participated in the docket. The parties represent a wide range of interests, including Labor groups who are the existing workforce of Verizon; low-income customers; municipalities; Independent Telephone Companies; Competitive Local Exchange Companies; Cable and internet service providers; and the state's electric utilities.

C. Timeline

After filing their Joint Petition on January 31, 2007 and their prefiled direct testimony in the case on March 23, 2007, the parties and Staff engaged in discovery and technical sessions throughout the spring and summer. Public Statement hearings were held by the Commission in four locations around the state during the month of May, in Merrimack, Exeter, Newport and Littleton to receive public comment. The intervenors and Staff filed direct testimony on August 1, 2007 followed by a round of discovery and technical sessions. The Joint Petitioners then filed rebuttal

⁵⁷ OCA Exh. 56HC, and OCA Exh. 1HC, p. 25, lines 6-9 and line 13.

⁵⁸ OCA Exh. 1HC, p. 25, line 26 through p. 26, line 1.

⁵⁹ OCA Exh. 1HC, p. 26, lines 2-3.

⁶⁰ OCA Exh. 1HC, p. 26, lines 3-6, and p. 295 (exhibit DB-P-3, p. 12).

testimony on September 10, 2007, which was also subject to discovery. Finally, after a final public statement hearing in Concord on October 19, 2007, the final adjudicative hearings in the case were held at the Public Utilities Commission between October 22 and November 1, 2007.

II. SUMMARY OF THE ARGUMENT

The Joint Petitioners have failed to meet their burden of proof that it is for the public good for Verizon to transfer its New Hampshire franchise to FairPoint, and for FairPoint to exercise that franchise following transfer. Specifically, the Joint Petitioners failed to prove that FairPoint possesses the requisite financial, technical or managerial expertise to undertake the proposed transaction in a manner consistent with the public good.

The risks by far outweigh any of the purported benefits of the proposed transaction. FairPoint's financial weakness, its lack of due diligence and understanding of the state of Verizon's network, the difficulty of enforcing service quality standards and other commitments upon FairPoint, as well as the recent history of disinvestment by Verizon, the potential loss of Yellow Pages revenues for customers which could result in rate increases, among other factors, all combine to present serious risks to consumers that require that the proposed transaction be denied.

The Joint Petitioners have also failed to meet their burden of proof that the public good does not require the further continuance of Verizon's local and long distance service, as proposed in the Joint Petition. The fact that Verizon has neglected the state, has been uncooperative with regulators, and has no interest in rectifying the problems that it has created does not justify approval of the proposed transaction, especially when FairPoint lacks the requisite abilities to undertake the proposed transaction in a manner consistent with the public interest.

III. OVERVIEW OF PROPOSED TRANSACTION

A. FairPoint and Verizon's Joint Petition

On January 31, 2007, Verizon and FairPoint (collectively, "Joint Petitioners") filed with the Commission a Joint Application for Approvals Related to Verizon's Transfer of Property and Customer Relations to Company to be Merged with and into FairPoint Communications, Inc. ("Joint Petition").⁶¹ Along with the Joint Petition, the Joint Petitioners filed several key transaction documents including the Agreement and Plan of Merger ("Merger Agreement"),⁶² and the Transition Services Agreement ("TSA").⁶³

In pertinent part, the Joint Petitioners request a determination by the Commission that the proposed transactions are for the public good pursuant to RSA 374:30 and RSA 374:26.⁶⁴ The Joint Petitioners also request that the Commission authorize Verizon to discontinue service as a public utility in New Hampshire pursuant to RSA 374:28.⁶⁵

B. Mechanics of the Proposed Transaction

Generally, the proposed transaction entails the transfer of Verizon's local and long-distance business in New Hampshire, Maine and Vermont to companies to be controlled by FairPoint.⁶⁶ The transactions that are the subject of the Joint Petition would establish a separate entity, "Spinco," as the holding company for Verizon's local exchange, long distance and related business activities in Maine, New Hampshire and Vermont, then distribute the stock of that new entity to stockholders, and then immediately merge the new entity with and into FairPoint.⁶⁷ The projected closing date is January 31, 2008.

⁶¹ FairPoint Exh. 20.

⁶² FairPoint Exh. 21.

⁶³ FairPoint Exh. 25.

⁶⁴ FairPoint Exh. 20, pp. 3-4.

⁶⁵ FairPoint Exh. 20, p. 4.

⁶⁶ FairPoint Exh. 20, pp. 5-8.

⁶⁷ FairPoint Exh. 20, pp 2, and 5-7.

The proposed transaction, if approved, will increase FairPoint by between four to six times its current size.⁶⁸ If approved, the Spinco operation will represent more than 80 percent of FairPoint's customers and 80 percent of FairPoint's revenues.⁶⁹ FairPoint today has 308,000 access lines, and that would increase to include Verizon's 1.713 million; its annual revenues would increase from approximately \$263 million to \$1.2 billion.⁷⁰

C. Reverse Morris Trust Structure

The proposed transaction is structured as a Reverse Morris Trust ("RMT").⁷¹ As such, Verizon Communications and its shareholders will not be taxed on capital gains resulting from the transaction.⁷² "In order to qualify as a tax-free event under the Internal Revenue Code and regulations, the merger must result in shareholders of Verizon [Communications] owning a majority of FairPoint."⁷³ Immediately following the consummation of the proposed transaction, Verizon Communications shareholders will own approximately 60% of the surviving company.⁷⁴ The value of the tax-free nature of the RMT structure has been estimated to be \$400-500 per line, for a total value of approximately \$600 million.⁷⁵

Besides its tax-free nature, another salient characteristic of a RMT transaction is that the acquiring entity must be smaller from a valuation standpoint than the operations that are being spun off.⁷⁶ Consequently, only a handful of smaller entities, including FairPoint, met this size limitation for Verizon's landlines in Northern New England.⁷⁷ Of these, *****BEGIN HIGHLY CONFIDENTIAL HSR (Hart-Scott-Rodino SEC filing) INFORMATION*****

⁶⁸ TR Day 2 1023/07, p. 90, lines 15-18.

⁶⁹ TR Day 2 1023/07, p. 125, lines 20-23.

⁷⁰ OCA Exh. 1HC, p. 18, line 1.

⁷¹ OCA Exh. 1HC, p. 37, line 12.

⁷² Verizon Exh. 1HC, p. 3, lines 11-13.

⁷³ Verizon Exh. 1HC, p. 16, line 22 through p. 17, line 1. See also OCA Exh. 1HC, p. 332 (exhibit DB-P-14, p. 3).

⁷⁴ Verizon Exh. 1HC, p. 17, lines 1-3.

⁷⁵ TR Day 3 10/24/07, p. 92 lines 1-8.

⁷⁶ OCA Exh. 1HC, p. 39, lines 11-12.

*****END HIGHLY CONFIDENTIAL HSR INFORMATION***.**⁷⁸

Fundamentally, “the ‘pool’ of potential buyers under [the RMT] limitation is too small, and consists of already highly leveraged companies, without existing back office systems robust enough to operate the three states operations to be acquired.”⁷⁹ Due to Verizon’s desire to maximize profit in the sale of the Northern New England landlines, any potential purchaser presents significant risks for customers.

D. Remuneration to Verizon Communications

Verizon Communications, Inc. (“Verizon Communications”) or its shareholders will receive at total of \$2.715 billion as a result of the proposed transaction.⁸⁰ This amount is comprised of \$1.015 billion in FairPoint equity value received by Verizon Communications’ shareholders, and \$1.7 billion in proceeds received by Verizon Communications by a combination of the special cash dividend (approximately \$900 million) and the exchange of FairPoint debt for Verizon Communications debt (approximately \$800 million).⁸¹ FairPoint will issue approximately 53.8 million shares of its common stock to Verizon Communications’ shareholders.⁸²

⁷⁷ OCA Exh. 1HC, p. 39, line 19 through p. 40, line 3. Staff Exh. 2HC, p. 7, lines 12-14.

⁷⁸ OCA Exh. 1HC, p. 43, lines 2-4, and p. 167 (exhibit DB-HCL2-4, p. 3).

⁷⁹ OCA Exh. 1HC, p. 49, lines 11-13.

OCA Exh. 1HC, p. 17 and p. 294 (exhibit DB-P-3, p. 10). FairPoint Exh. 8C, p. 16, lines 1-2.

OCA Exh. 1HC, p. 17 and p. 294 (exhibit DB-P-3, p. 10); FairPoint Exh. 8C, p. 16, lines 2-7.

⁸² OCA Exh. 1HC, p. 17 and p. 294 (exhibit DB-P-3, p. 10).

E. FairPoint's funding of the Transaction Price

FairPoint proposes to fund the transaction price with 37% common equity (\$1.015 billion of \$2.715 billion) and 63% debt (\$1.7 billion of \$2.715 billion).⁸³ This is the parent company capital structure, and FairPoint has stated that it does not necessarily represent FairPoint's view of what the appropriate capital structure ought to be in New Hampshire in the event of a rate case for the company.⁸⁴

1. Bank Loans

FairPoint has secured bank commitments for a total of \$2.08 billion in long term debt.⁸⁵ The loan agreements, however, have not yet been finalized.⁸⁶ This raises a significant risk that the interest rates will be much higher than expected, given the changes in the markets over the past year.⁸⁷

The bank loan total is comprised of three components: \$200 million in a six-year revolving credit facility, \$1.68 billion in a "Term loan B" facility, and a \$200 million delayed draw term loan facility which is available to be drawn until the first anniversary of the merger closing date.⁸⁸ Both of the latter loans mature in eight years.⁸⁹ FairPoint will also refinance its existing debt as part of this transaction.⁹⁰ The proposed new bank debt for the holding company is to be carried at a variable interest rate.⁹¹ The bank debt bears interest at a variable rate based on a chosen short term interest period (i.e., 1, 2, 3, or 6 months as selected by the borrower, or 9 or 12 months if agreed to by the lender) based on Adjusted LIBOR (London Interbank Rate) plus an additive margin, or an interest

⁸³ TR Day 2 10/23/07, p. 89, lines 7-10.

⁸⁴ TR Day 2 10/23/07, p. 90, lines 7-10.

⁸⁵ OCA Exh. 1HC, p. 58, line 18-19. TR Day 2 10/23/07, p. 82, lines 1-4. See also Labor Exh. 4C.

⁸⁶ TR Day 2 10/23/07, p. 15, lines 20-22, and OCA Exh. 52. See also TR Day 2 10/23/07, p. 152, lines 14-15.

⁸⁷ Staff Exh. 43.

⁸⁸ OCA Exh. 1HC, p. 58, line 19 through p. 59, line 1.

⁸⁹ OCA Exh. 1HC, p. 59, lines 1-2.

⁹⁰ OCA Exh. 1HC, p. 59, lines 14-16.

⁹¹ OCA Exh. 1HC, p. 60, lines 6-7.

rate that appears to be fixed based on a “prime rate” plus an additive margin.⁹² The applicable margin over LIBOR is not yet fixed for the revolving facility.⁹³

FairPoint’s financial model assumes that the bank loans are priced at *****BEGIN HIGHLY CONFIDENTIAL***** *****END HIGHLY CONFIDENTIAL***** the LIBOR base rate.⁹⁴ However, as noted above, the bank loan agreements and documents have not yet been negotiated or finalized. FairPoint’s financial model also assumes that *****BEGIN HIGHLY CONFIDENTIAL***** *****END HIGHLY CONFIDENTIAL*****⁹⁵ FairPoint’s financial projections indicate that they will not be able to pay down debt since it consumes almost all of its cash for interest payments, dividend payments, operating expenses, taxes and capital expenditures.⁹⁶ FairPoint has interest rate hedges for some limited period of for some portion of the debt.

2. FairPoint’s Spinco Bonds

Outside of the bank commitment letter, FairPoint intends to issue approximately \$800 million in senior unsecured notes that Verizon will be able to take and “swap” for its own debt.⁹⁷ There is no loan commitment for these notes yet either, and the bond debt arrangement will be negotiated much closer to the closing date.⁹⁸ The interest cost for the proposed Spinco bonds is not yet set, and will be determined by market conditions much closer to closing of the proposed transactions, which as noted above, are much different from 2006 when the deal was structured, and remain very difficult and higher cost.⁹⁹

⁹² OCA Exh. 1HC, p. 60, lines 7-11, and p. 287 (exhibit DB-P-2, p. 135).

⁹³ OCA Exh. 1HC, p. 63, lines 9-15 and p. 287 (exhibit DB-P-8, p. 135). See OCA Exh. 1HC, p. 63, line 19 through p. 64, line 2

⁹⁴ OCA Exh. 1HC, p. 64, lines 5-6.

⁹⁵ OCA Exh. 1HC, p. 54, lines 9-14.

⁹⁶ OCA Exh. 1HC, p. 100, lines 2-5.

⁹⁷ OCA Exh. 1HC, p. 9, lines 8-11, and p. 320 (exhibit DB-P-8, p. 211).

⁹⁸ TR Day 2 1023/07 p. 110, lines 8-11. See also OCA Exh. 1HC, p. 61, lines 1-2, and p. 320 (exhibit DB-P-8, p. 211).

⁹⁹ OCA Exh. 1HC, p. 66, lines 7-9, and pp. 317 and 319 (exhibit DB-P-8, pp. 110 and 137).

There is currently substantial unease in the credit markets such that risk premiums are increasing.¹⁰⁰ Conditions in the credit markets remain challenging to unfavorable for borrowers today.¹⁰¹ “FairPoint is subject to much higher interest cost than that which is included in the model projections.”¹⁰²

3. FairPoint’s debt level following closing

FairPoint’s debt level is indicated to be approximately \$2.35 billion, following closing of the proposed transaction,¹⁰³ and is projected *****BEGIN HIGHLY CONFIDENTIAL*****

*****END HIGHLY CONFIDENTIAL*****.¹⁰⁴ Following the closing of the proposed transaction, FairPoint’s net debt leverage is projected to be 5.1x in 2008, and 4.5x EBITDA in 2009.¹⁰⁵ When compared to FairPoint’s six “comparable” companies, FairPoint is proposing to have the highest debt: EBITDA ratio of any of those companies.¹⁰⁶ In addition, FairPoint has paid high dividends since it became a publicly traded company in 2005, and therefore is a “high debt/high dividend” company, unlike a traditional public utility.¹⁰⁷ The debt that FairPoint proposes to incur is not related to the operating needs in New Hampshire, Maine and Vermont.¹⁰⁸ Instead, the proposed debt is primarily related to the desire of Verizon Communications to reduce its own debt, and does not take into account the impact of the sustained high debt level on FairPoint.¹⁰⁹

¹⁰⁰ OCA Exh. 1HC, pp. 64-66.

¹⁰¹ TR Day 2 1023/07 p. 110, lines 12-20.

¹⁰² OCA Exh. 1HC, p. 66, lines 9-10.

¹⁰³ OCA Exh. 1HC, p. 53, lines 14 and pp. 310 and 311 (exhibit DB-P-8, pp. 76 and 78),

¹⁰⁴ Staff Exh. 2HC, p. 5, lines 19-23.

¹⁰⁵ OCA Exh. 1HC, p. 53, lines 15-16 and pp. 310 and 311 (exhibit DB-P-8, pp. 76 and 78).

¹⁰⁶ OCA Exh. 1HC p. 52 line 1

¹⁰⁷ OCA Exh. 1HC p.23 line 9.

¹⁰⁸ OCA Exh. 1HC, p. 36, lines 3-4.

¹⁰⁹ OCA Exh. 1HC, p. 36, lines 5-7. OCA Exh. 1HC, p. 9, lines 10-12, and p. 320 (exhibit DB-P-8, p. 320). OCA Exh. 1HC, p. 36, lines 12-13, and p. 181 (exhibit DB-HCL2-9, p. 6).

According to FairPoint, *****BEGIN HIGHLY CONFIDENTIAL*****

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4. Transition Services Agreement

“Verizon delivers many administrative and operating support services to its local exchange and non-LEC affiliates from centralized Verizon support service groups and systems.”¹¹¹ These support service groups and systems will not be conveyed to FRP as part of the transaction, and in fact many, if not most of these services are provided from outside the Northern New England region.¹¹² Instead, pursuant to the Transition Services Agreement (“TSA”), Verizon will provide FairPoint “with major support services until such time as [FairPoint] develops its own support systems and groups to provide these services.”¹¹³

The cost to FairPoint for these transition services is in the tens of millions of dollar per month.¹¹⁴ Although FairPoint contemplates the TSA being available for 15 months, FairPoint’s financial model incorporates an assumption that FairPoint relies on the TSA for only six months.¹¹⁵ However, if the TSA lasts beyond twelve months, in the 13th month the cost of transition services will rise to \$14,700,000 per month.¹¹⁶ Every month thereafter, until termination of Schedule A services, the cost rises by an additional \$500,000 each month.¹¹⁷ FairPoint ran sensitivity analyses for retail access line projections and for operating expenses.¹¹⁸ However, FairPoint did not run any

¹¹⁰ OCA Exh. 1HC, p. 36, lines 13-14, and p. 181 (exhibit DB-HCL2-9, p. 6).

¹¹¹ VZ Exh. 1P, p. 21, lines 19-21.

¹¹² VZ Exh. 1P, p. 23, lines 6-7.

¹¹³ VZ Exh. 1P, p. 23, lines 7-9.

¹¹⁴ VZ Exh. 1P, pp. 29-30.

¹¹⁵ See OCA Exh. 2P, Exhibit SMB-P-12, FairPoint response to OCA GII 2-24.

¹¹⁶ FairPoint Exh. 20, Exhibit 5, at Article II, 2.1 Transition Services and Fees.

¹¹⁷ Id.

¹¹⁸ FairPoint Exh. 12P, at 24.

sensitivity analyses for factors such as the duration of the TSA, among other costs.¹¹⁹ FairPoint has committed to not recovering the costs of transition services from ratepayers.¹²⁰

IV. APPLICABLE LAW

A. Standard of Review

RSA 374:26 authorizes the Commission to grant permission to a public utility to engage in business in New Hampshire upon a finding “that such engaging in business... or exercise of right, privilege or franchise would be for the public good, and not otherwise.” RSA 374:26 also authorizes the Commission to “prescribe such terms and conditions for the exercise of the privilege granted under such permission as it shall consider for the public interest.”

Pursuant to RSA 374:28, the Commission may authorize any public utility to permanently discontinue serving customers in New Hampshire. Such authorization must be based upon a finding that “the public good does not require the further continuance of such service.”

RSA 374:30 pertains to the transfer of a New Hampshire “franchise, works or system” from one public utility to another. As with RSA 374:26 and RSA 374:28, the Commission may only approve such a transfer upon a finding “that it will be for the public good ... but not otherwise.”

What is for the public good is not easy to define.¹²¹ Generally, “public good” includes the needs of particular persons directly affected by a proposed transaction as well as the needs of the public at large and the general welfare of the utility involved.¹²² In determining whether a proposed franchise transfer is consistent with the “public good,” the Commission assesses, among other things, the financial, managerial, and technical expertise of the petitioners.¹²³ The controlling case

¹¹⁹ See OCA Exh. 2P, Exhibit SMB-P-14.

¹²⁰ TR Day 4 10/25/07, p. 137, lines 12-23, and OCA Exh. 10.

¹²¹ See Appeal of Legislative Utility Consumers' Council, 120 N.H. 173, 412 A.2d 738 (1980).

¹²² See Re Northern Utilities, Inc. - Pelham Division, DG 06-143. Order No. 24,689 (2006); and Boston & Maine R. v. State, 102 NH 9, 10 (1959).

¹²³ Re Riverside Water Works, Inc., DW 06-023, Order No. 24,713 (2006); and Lower Bartlett Water Precinct, 85 NH PUC 635, 641 (2000).

on the public good standard is Grafton County Electric Light and Power Co. v. State, 77 N.H. 539, 94 A. 193 (1915). There, the Court stated that “the public good” is

equivalent to a declaration that the proposed action must be one not forbidden by law, and that it must be a thing reasonably to be permitted under all the circumstances of the case. If it is reasonable that a person or a corporation have liberty to take a certain course with his or its property, it is also for the public good. It is the essence of free government that liberty be not restricted save for sound reason. Stated conversely: it is not for the public good that public utilities be unreasonably restrained of liberty of action, or unreasonably denied the rights as corporations which are given to corporations not engaged in the public service.¹²⁴

“The above language, which speaks in terms of the liberty of public utilities to act as other corporations if the action is not forbidden by law and warranted under the circumstances, supports a ‘no harm’ test.”¹²⁵

When applying the “no harm” test, the Commission grants the petition so long as it concludes that the acquisition does not adversely affect the public’s interests.¹²⁶ The “no harm” test is distinguished from the “net benefit” test, which imposes a greater burden on the petitioners to demonstrate that the acquisition benefits the public.¹²⁷

B. Burden of Proof

The Joint Applicants bear the burden of proof.¹²⁸ They must prove that the proposed transaction is for the public good by a preponderance of the evidence.¹²⁹

Id. at 194.

¹²⁵ Re Eastern Utilities Associates, DF 89-085, Order No. 20,094, April 1, 1991, 1991 WL 420183 (N.H.P.U.C.). Cf. Parker-Young Co. v. State, 83 N.H. 551 (1929) (application of “net benefits” test where there are competing offers to acquire). But see Re New Hampshire Electric Cooperative, Inc., 84 N.H. P.U.C. 266, 1999 WL 477155 (N.H.P.U.C.) (commission approved transfer of NHEC franchise upon finding of “net benefits”).

Re Eastern Utilities Associates, DF 89-085, Order No. 20,094, April 1, 1991, 1991 WL 420183 (N.H.P.U.C.).

¹²⁷ Id.

¹²⁸ Jus 801.02(b) and 812.02.

¹²⁹ Id.

V. ARGUMENT

As discussed in detail below, the OCA believes that the transaction as proposed must be denied because the Joint Petitioners have not shown by a preponderance of the evidence that the transaction is in the public interest, or that FairPoint has the requisite financial, technical and managerial expertise or capacity to become the state's largest telecommunications provider.

A. The Purported "Benefits" of the Proposed Transaction Are Illusory, Difficult to Enforce, and Will Be Paid For by Customers

The Joint Petitioners contend that the proposed transaction will result in benefits to the public in New Hampshire, Maine and Vermont.¹³⁰ These purported benefits can be distilled down to the following: network improvements to facilitate broadband deployment; "an increased selection of competitively priced communications service bundles;" new operating systems; new local service centers; and some additional jobs.¹³¹ All other purported benefits claimed by FairPoint are fundamentally the continuation of present obligations of Verizon.¹³² Most of the benefits touted by FairPoint are also speculative and are not backed by strong financial, technical or managerial plans or resources. Equally as important, many are unenforceable or unverifiable.

1. Broadband Deployment

FairPoint has described its Broadband Plan ("BB Plan") as "the cornerstone" of its proposal to purchase the landline assets of Verizon in Northern New England.¹³³ The State of New Hampshire has indeed identified the need for action to "promote access to affordable and reliable broadband service to all state citizens and businesses" as an important policy goal.¹³⁴ The statute

¹³⁰ See, e.g., FairPoint Exh. 8C, p. 6-14.

¹³¹ See, e.g., FairPoint Exh. 8C, p. 6-14.

¹³² See, e.g., FairPoint Exh. 8C, p. 6, lines 20-22 (FairPoint proposes to continue to provide to wholesale customers the same services under the same rates, terms and conditions as Verizon); p. 8, lines 21-22 (FairPoint proposes to assume Verizon's inter-carrier contracts and concur in or adopt Verizon's tariffs); p. 9, lines 10-23 (FairPoint proposes to honor Verizon's commitments to Spinco employees including Verizon's unexpired collective bargaining agreements).

¹³³ Nixon Transcript Day 6 10/29/07 p. 250, lines 9-14.

¹³⁴ NH RSA 12-A:46 V(a).

charges the Department of Resources and Economic Development and a Telecommunications Planning and Development Advisory Committee with collecting information, developing an inventory of resources and services, and working with providers to increase coordination and collaboration in order to increase the deployment of broadband services in the state.¹³⁵ This is based in part on the realization “that a robust, well-utilized communications infrastructure is essential for economic development,” as well as for education, “telehealth,” tourism, and public safety, among other issues.¹³⁶

According to the FCC, as of June 30, 2006, 59% of all New Hampshire customers where an ILEC (Verizon NH and all others) offered telephone service had xDSL services available to them.¹³⁷ This compares to a nationwide estimate that in 2006, 79% of U.S. residential consumers had xDSL available to them where ILECs offer local telephone service.¹³⁸ According to Verizon NH’s December 2006 FCC Form 477, broadband service is available to *****BEGIN CONFIDENTIAL END CONFIDENTIAL***** of all New Hampshire households it serves.¹³⁹ Today, according to FairPoint, broadband is available to approximately 61% of Verizon customers.¹⁴⁰ In addition,

¹³⁵ *Id.* at Sec. IV.

¹³⁶ Master Plan of the Telecommunications Advisory Board, “100% by the Year 2010,” October 2006, pp. 7-9.

¹³⁷ FCC, Industry Analysis and Technology Division, Wireline Competition Bureau, *High-Speed Services for Internet Access: Status as of June 30, 2006*, rel. January 2007, at Table 14, available at http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-270128A1.doc. In addition, the report indicates that 67% of residential consumers in Maine and 60% of residential consumers in Vermont have xDSL services available to them where an ILEC offers telephone service as of June 30, 2006. *Id.* The Commission typically releases new high-speed services reports in January and July. The most recent report available as of mid-July was the report released January 2007. See also Staff Exh. 63P.

¹³⁸ OCA Exh. 2P lines 1-3. FCC, Industry Analysis and Technology Division, Wireline Competition Bureau, *High-Speed Services for Internet Access: Status as of June 30, 2006*, rel. January 2007) at Table 14. On October 31, 2007, the FCC released a report with data as of December 31, 2006. Based on these data, the percentage of residential customers who have DSL available to them in New Hampshire, Maine, and Vermont, are 61%, 67%, and 64%. The nationwide average is still 79%.

¹³⁹ OCA Exh. 2C p. 103 lines 4-6, citing Exhibit SMB-C-52 Verizon NH response to OCA GI 1-34, sections (l) and (o). OCA Exh. 2P p. 102 lines 14-15 – p. 103 line 1. As discussed below, FairPoint is now using a current “addressability” number of 72% for Verizon as opposed to the 58% “availability” figure reported to the FCC by Verizon. A discussion of the difference between these two terms appears below.

¹⁴⁰ FairPoint Exh. 14C, p. 28, lines 3-5. As discussed further in this section, this number has been described as between 61% - 63% depending upon the source and how it was developed.

Maine and Vermont also ranked low nationally at 67% and 60%, respectively.¹⁴¹

Leach asserts in his direct prefiled testimony that one of the primary benefits of the proposed transaction is “access for more customers to advanced telecommunications and information services such as broadband Internet . . .”¹⁴² He also explains that FairPoint's intends to primarily use DSL technology.¹⁴³ FairPoint repeatedly points to the fact that 92% of its customers in the three-state region of northern New England have access to broadband, as compared to 62% of Verizon’s customers, though it does not propose to reach those levels in New Hampshire.¹⁴⁴ In addition, Mr. Harrington states in his prefiled direct testimony that “one of FairPoint’s top priorities will be to deploy broadband network infrastructure and provide broadband-enabled services to customers who do not have high-speed access and broadband-enabled services today.”¹⁴⁵

The latest version of the BB plan (the third update), which is undated but was prepared in August or September,¹⁴⁶ proposes “a multi-year Network Enhancement plan . . . with a major kick-off investment of approximately \$16.4 million dollars during the first 18-24 months following closing.”¹⁴⁷ According to this most recent BB Plan, FairPoint proposes providing broadband services to “an additional 57,700 access lines in the State of New Hampshire, the majority of which currently do not have access to Verizon broadband.”¹⁴⁸ This means that, according to FairPoint,

¹⁴¹ See *id.*

¹⁴² Leach (FairPoint) Direct, at 6.

¹⁴³ *Id.*, at 7.

¹⁴⁴ *Id.*, at 7. See also, Nixon (FairPoint) Direct, at 7. With respect to the 92% addressability rate for the FairPoint classic companies, there are two important distinctions to make. First, FairPoint has not presented a plan to reach more than 83% of the current Verizon NH customers. Second, it is important to note that the 92% addressability number for FairPoint “classic” companies is likely due in large part to the federal USF “high cost” support received by FairPoint’s rural ILECs, which is at a level much higher than Verizon currently receives as a non-rural ILEC. The rural ILECs have much more flexibility over the use of those funding, including for DSL build out.

¹⁴⁵ Harrington (FairPoint) Direct, at 3.

¹⁴⁶ Mr. Brown testified that it was prepared during “the first week of August” TR, Day 8 10/31/07 p. 13 lines 3-5; this was later corrected to be early September by Mr. McHugh and Mr. Brown, TR Day 8 10/31/07, p.28 lines 14-24.

¹⁴⁷ FRP Exh. 59P, p. 1.

¹⁴⁸ *Id.*

“within 12 to 18 months this will bring the broadband addressability rate from its present 72% to approximately 75% and within 24 months from closing to approximately 83%.”¹⁴⁹

FairPoint’s second broadband plan update provided in June, shows a price tag of \$13.7 million, yet in that plan they proposed serving 108,103 lines.¹⁵⁰ The new updated plan shows a higher price tag of \$16.4 million, yet it only serves about half the original number of lines, or 57,700. Apparently this substantial change results from inaccurate or incomplete data provided by Verizon, *****BEGIN CONFIDENTIAL*****

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In assessing FairPoint’s plan, it is important to first understand the distinction between broadband “availability” and “addressability,” and the differences between Verizon’s current availability rate and FairPoint’s proposed addressability rate. In its prior BB plan, provided to the parties on July 27, 2007, FairPoint stated that “within 12 to 18 months this will bring the broadband addressability rate from its present 63% to approximately 75% and within 24 months from closing to approximately 80%.”¹⁵¹

According to Mr. Brown

a ‘qualified loop’ means it has been pretested to be able to support broadband services ‘Addressable’ means the equipment is in place that can address that line to be able to provide broadband service. And, that means additional conditioning may be required for that line, but yet there is equipment there.¹⁵²

¹⁴⁹ Staff Exh.60P, emphasis added.

¹⁵⁰ OCA Exh. 2HC, see SMB-HCL3-66b.

¹⁵¹ FRP Exh. 60C.

¹⁵² TR Day 8, 10/31/07 p. 17 lines 13-14, and p. 18 lines 1-3. In his rebuttal testimony, Mr. Brown stated that “addressable” to FairPoint “means that a wire center (central office or remote terminal) has been equipped with the capability to offer DSL service, i.e., that it has the requisite digital access multiplexing equipment . . . this definition does not mean that every access line served by that wire center can be immediately connected to provide DSL service (although the vast majority of lines would have immediate access to DSL. FairPoint Exh. 14C, 32 lines 17-20, and p. 33 lines 1-2.

Mr. Brown explained that the change from 63% to 72% resulted from the company's discovery that Verizon was reporting the number of lines that are qualified (pre-tested) for DSL within 18,000 feet from a central office.¹⁵³ FairPoint, however, intends to use additional technologies in order to extend DSL beyond 18,000 feet out to 22,000 feet, and therefore is now using the "addressable" number rather than the "qualified" number.¹⁵⁴

As a result, under FairPoint's most recently updated plan, the company expects to be able to increase the DSL addressability rate to between 72-75% of customers within 12 to 18 months after close, an increase of approximately 11-14%.¹⁵⁵ In addition, the company seems to propose reaching 83% addressability within 24 months from close, which at this time is estimated to be February 2010 if the closing takes place as scheduled. However, during the hearing Mr. Brown stated "our goal is to reach the 80 percent mark."¹⁵⁶ He also stated, with respect to the 83% (or 80%) goal, that the company is using what he called a "book end approach . . . It will be 71 percent up to the 82 to 83 percent. It will be somewhere in between that number that will actually be qualified at that time."¹⁵⁷ Therefore, FairPoint has not made clear how many customers will receive broadband, or when.

Staff experts Falcone and King have testified that they have two main concerns with FairPoint's BB Plan: "First, we believe that FairPoint's broadband expansion plan is based on too many unsupported assumptions. Second, we believe that, as a result, it is very likely that FairPoint's estimate of the capital it will need to implement its plan is significantly understated."¹⁵⁸ At the hearings, almost three months after filing their prefiled testimony, they testified that they still had these concerns:

¹⁵³ TR Day 6 10/29/07 p. 37 lines 14-21.

¹⁵⁴ TR Day 8 10/31/07 p. 15 lines 24 and p. 16 lines 1-7.

¹⁵⁵ FairPoint Exh. 59P, p. 1.

¹⁵⁶ TR Day 8 10/31/07 p. 18, lines 17-18.

¹⁵⁷ TR Day 6 10/29/07 p. 42 lines 19-22.

¹⁵⁸ Staff Exh. 3P, p. 11 lines 1-4.

Well, based on what we've seen so far from FairPoint's revisions to its plan, it seems to lend credence to our concerns here, that . . . they were with merit. FairPoint has, as we've heard from Mr. Brown yesterday, drastically reduced the number of lines that it's going to make available for broadband service and, at the same time, the costs of the plan have gone up. And when questioned, Mr. Brown stated . . . what prompted those changes -- and one of the bits of information that he gave us was that the change was prompted by additional information that he received from Verizon on assumptions that they were making, which proved that their assumptions were not valid with relation to power, cabinet size, room in the cabinet. So to use Mr. Brown's words, as FairPoint comes down from the 15,000 feet down to the 5,000 feet, down to the ground, they still may be making assumptions . . . and I believe Mr. Brown did say that until they get access to the network after close, that they still have to make some assumptions because they don't have all the information that they need to make concrete decisions, without a doubt, from Verizon. Until they get to that point, I have to say, yes, there are still some concerns.¹⁵⁹

FairPoint has acknowledged that while it has reviewed the information provided by Verizon and conducted limited site visits of the physical plant, it does not have access to all of the buildings and cabinets in order to determine the extent of investment necessary to achieve the BB plan. Despite this, FairPoint nonetheless assumes that building renovations will not be required and that only minor power augmentations will be required.¹⁶⁰ FairPoint states that these assumptions were made "due to the fact that detailed plant and engineering records and resources relating to the to-be-acquired properties will not be available until after the transaction closes."¹⁶¹

FairPoint indicates that it relied upon four types of information that Verizon provided:

- A list of network elements, including CLLI codes (which FairPoint states enabled it to designate where the equipment is located);
- An interoffice facilities map outlining where fiber connectivity between central offices exists;
- A database showing digital loop carrier information (CLLI codes and indication of whether fiber or copper fed as well as number of working access and DSL lines); and

¹⁵⁹ TR Day 7 10/30/07 p. 101 lines 12-24, and p. 102 lines 1-12.

¹⁶⁰ See OCA Exh. 2HC, Exhibit SMB-HCL3-66a. This exhibit to Ms. Baldwin's testimony is the "first" broadband plan, provided in the second supplemental rely to Staff 2-35. Note that Exhibit SMB-HCL3-66b is the "second" broadband plan, which we received just before filing Ms. Baldwin's testimony but did not have time to analyze. We now understand that the first few pages of each of these exhibits are public, but these exhibits have remained designated as "Highly Confidential" by the company.

¹⁶¹ Id.

- A list of central offices and the number of working access lines per central office.¹⁶²

FairPoint has assumed that information provided by Verizon is up to date and accurate; that fiber is available at sites and is in good repair; that equipment rack space is available or easily obtainable; that necessary power requirements can be obtained; that a limited amount of fiber splicing will be required; and that existing labor rates and comparable time to install similar networks will be consistent.¹⁶³

FairPoint performed limited due diligence of outside plant facilities, including visits to five central offices sites in New Hampshire: Portsmouth, Dover, Concord, Newmarket and Hanover.¹⁶⁴

FairPoint also conducted “visual inspections of eight locations.”¹⁶⁵ Mr. Brown explained that a visual inspection

means I would find the central office in town, and then I would look at the routes leaving that central office and continuing out of town, inspecting it, looking at the closures, looking at the cable, looking at the poles. Pretty much everything that's involved in the outside plant, so I just do a visual inspection of it.¹⁶⁶

By way of further explanation, Mr. Brown stated that by visual inspection he meant that

whenever I was driving through the area, and I did take a few side trips on some side roads as far as -- and I also stayed on the main routes So, whenever I ride through an area, I'm constantly looking at it. So, I made an effort to ride specifically through the North Country so I could look at some of these areas, just do a visual inspection.¹⁶⁷

Staff's experts testified that this was insufficient, and that “they [FairPoint] were only able to observe what you and I could observe driving by in our car and looking at the wires on the line, looking at the telephone poles, looking at the boxes. They did not actually kick the tires, if you will.

¹⁶² Id.

¹⁶³ See Exhibit SMB-HCL3-66a.

¹⁶⁴ FairPoint Exh. 55P.

¹⁶⁵ OCA Exhibit 105, TR Day 6 10/29/07 p. 69 lines 19-22.

¹⁶⁶ TR Day 6, 10/29/07 p. 70 lines 20-24, p. 71 lines 1-2.

¹⁶⁷ TR Day 6 10/29/07, p. 70 lines 7-17.

They didn't open up any of the boxes to see what it looked like inside or anything of that nature.”¹⁶⁸

In addition, Verizon did not accompany FairPoint on those reviews. Therefore, Staff's expert stated that his concerns remained at the time of the final hearings in the case.¹⁶⁹ As a result, the OCA believes that FairPoint's BB Plan is not based on sound data on Verizon's network, may not take into account necessary investments to plant and other additional costs, and therefore may not provide the benefits claimed by FairPoint.

FairPoint's BB Plan projections include the expectation that in addition to increasing the availability of DSL to customers, FairPoint will also*****BEGIN CONFIDENTIAL**

*****END CONFIDENTIAL*****¹⁷⁰ Mr. Leach states that FairPoint's broadband penetration levels for FairPoint's existing companies are *****BEGIN CONFIDENTIAL**

*****END CONFIDENTIAL***** of voice access lines, as compared to *****BEGIN CONFIDENTIAL***** *****END CONFIDENTIAL>>>** for Verizon.¹⁷¹ FairPoint intends to expand broadband penetration in northern New England through the expansion of availability and through the provision of “competitively priced broadband service offerings.”¹⁷² In his testimony, Mr. Balhoff states that the model projects that broadband penetration *****BEGIN CONFIDENTIAL*****

*****END CONFIDENTIAL***** FairPoint expects *****BEGIN CONFIDENTIAL*****¹⁷³

¹⁶⁸ TR Day 7 10/30/07 p. 164 lines 7-16.

¹⁶⁹ See, e.g. TR Day 7 10/30/07 p. 164 lines 9-18.

¹⁷⁰ FairPoint Exh. 8C at 24-25.

¹⁷¹ Id. at 24-25.

¹⁷² Id. at 24.

¹⁷³ FairPoint Exh. 11P at 20.

*****END CONFIDENTIAL*****¹⁷⁴

The OCA suggests caution regarding any projected take rates for DSL.¹⁷⁵ FairPoint cannot be certain of either the costs to deploy DSL, or the pace at which DSL take up by consumers can reasonably take place. FairPoint's projected financial modeling *****BEGIN HIGHLY**

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HIGHLY CONFIDENTIAL***. To the extent that this assumption is not valid, the financial projections must be *****BEGIN HIGHLY CONFIDENTIAL*****

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broadband projections that assume that DSL customer additions happen quickly do not recognize any significant difficulties that FairPoint may encounter due to poor plant conditions and needed plant upgrades. The fact that service quality problems have been significant in the three states over past years is indicative that DSL take-up by consumers will not necessarily be able to occur promptly and on a broad scale.¹⁷⁶

New Hampshire consumers expect access to affordable broadband services. FairPoint should be required to provide just that for several reasons. First, the cost of the local loop, which provides the platform for DSL, is already recovered through intrastate and interstate regulated rates that consumers pay for basic telephone services. However, FairPoint's incentive will be to maximize its DSL revenue stream as DSL rates are not regulated, which conflicts with consumers' interest in obtaining DSL at reasonable rates.¹⁷⁷ In any rate case, FairPoint likely would seek recover of at least

¹⁷⁴ FairPoint Exh. 8C p. 25. See also OCA Exh. 1C at p. 112 line 19 through p. 15 line 10 for further discussion.

¹⁷⁵ OCA Exh. 1HC, pages 122-123.

¹⁷⁶ OCA Exh. 1HC, page 120, line 13.

¹⁷⁷ OCA Exh. 2P p. 126-127.

BEGIN CONFIDENTIAL ***END CONFIDENTIAL*** from New Hampshire consumers.¹⁷⁸

FairPoint has also indicated that it will provide the same services at the same rates, terms and conditions that Verizon currently offers its customers at the time of the merger.¹⁷⁹ In the only reference to pricing of broadband in the company's rebuttal testimony, Mr. Brown states that "pricing will mirror the pricing offered by Verizon today."¹⁸⁰ However, on cross examination to explore the meaning of this commitment, Mr. Brown testified that "by 'mirror' I'm dealing with the engineering side of it I do not deal with pricing."¹⁸¹ Therefore, despite the fact the Mr. Brown's testimony clearly referenced pricing and seemed to indicate that FairPoint would continue Verizon's pricing of broadband, the company has made no such commitment.

One important aspect of broadband offerings for consumers is that they include the option to purchase broadband from FairPoint, without being require to purchase voice local exchange service. When pressed, FairPoint has stated that it will provide stand-alone DSL.¹⁸² However, FairPoint did not make any commitment regarding the duration of time that it will make any particular services available, including stand-alone DSL, in its petition. Mr. Nixon recognized in his direct testimony that Verizon is subject to several conditions that the FCC placed upon its approval of the Verizon/MCI merger, and notes that to the extent some conditions remain in effect (many are set to expire by January 2008) such as stand-alone DSL, "FairPoint would expect to review with regulators whether such conditions are merited in the context of the present transaction."¹⁸³ During the hearing, Mr. Nixon testified that FairPoint "would continue that [stand-alone DSL] for one year from

¹⁷⁸ FairPoint Exhibit 52C.

¹⁷⁹ See Exhibit SMB-P-74, FairPoint response to OCA GII 2-38.

¹⁸⁰ FairPoint Exh. 14P p. 40 line 1.

¹⁸¹ TR Day 6 10/29/07 p. 44 lines 23 & 24, p. 45 lines 1-3.

¹⁸² See Exhibit SMB-P-74, FairPoint response to OCA GII 2-38.

¹⁸³ FairPoint Exh. 6 at 29.

closing . . . that's the maximum we'd commit to.”¹⁸⁴ Therefore, customers who rely upon standalone DSL will only be able to do so for one year if the transaction is approved.

In its BB Plan, FairPoint proposes to spend approximately \$16.4 million on broadband and network improvements.¹⁸⁵ Any of this investment that also benefits voice services will be considered part of the common-line revenue requirement and intrastate expenses.¹⁸⁶ FairPoint estimates that *****BEGIN CONFIDENTIAL***** *****END CONFIDENTIAL***** of its investment in broadband, or about *****BEGIN CONFIDENTIAL***** *****END CONFIDENTIAL***** will be assigned to and recovered through rates from New Hampshire ratepayers.¹⁸⁷

DSL revenues, however, will not be booked as intrastate regulated revenues because as an “internet service,” broadband (or DSL) is not regulated by the Commission.¹⁸⁸ Rather, DSL revenues will flow to FairPoint and, to the extent that creates a profitable revenue stream, to shareholders.¹⁸⁹ This illustrates an important cost allocation issue for the Commission, as voice service customers should not subsidize DSL investment which is not regulated by the Commission.

FairPoint utilizes an extensive array of affiliates and subsidiaries, which makes cost allocation all the more important to protect customers from cost-shifting and over-allocations.¹⁹⁰ FairPoint affiliates provide some operating functions for FairPoint's local operations at a cost.¹⁹¹ For FairPoint's existing operations, the cost is addressed generically under various management

¹⁸⁴ TR Day 6 10/29/07 p. 246 lines 1-4.

¹⁸⁵ FairPoint Exh. 59P.

¹⁸⁶ TR Day 4 10/25/07 p. 161, lines 13-23; p. 162, line 20 through p. 163, line 8; and p. 167, line 7-19.

¹⁸⁷ FairPoint Exh. 52C, and TR 10/25/07 p. 169, lines 12-19. See also Transcript, October 23, 2007, p. 75, lines 6-9, and TR Day 3 10/25/07 p. 172, lines 2-3; and TR Day 3 10/25/07 p. 172, lines 5-14.

¹⁸⁸ TR Day 2 10/23/07 p. 62, lines 6-10, and OCA Exh. 44P; and TR Day 3 10/25/07 p. 161, line 24 through p. 162, line 4.

¹⁸⁹ TR Day 2 10/23/07 p. 62, lines 11-16.

¹⁹⁰ OCA Exh. 1HC, p. 67, line 15 through p. 68, line 3.

¹⁹¹ OCA Exh. 1HC, p. 68, line 6.

services agreements between the affiliates.¹⁹² However, FairPoint “has not yet determined the management fee structure to be applied to the acquired [New England] properties.”¹⁹³ FairPoint has not specified any details of how it will allocate costs between and among FairPoint affiliates.¹⁹⁴ Because the intertwining of affiliates obscures source cost information from the Commission’s view, FairPoint’s allocations of costs is a critical component of their ratemaking structure and must be determined prior to any approval of the transaction.¹⁹⁵

FairPoint’s DSL subsidiary and FairPoint’s Spinco operations have the same parent.¹⁹⁶ FairPoint’s Spinco operations will provide wholesale services to its DSL affiliate.¹⁹⁷ However, it appears that any compensation will only be in the form of “paper” transactions on an intercompany basis, so that there is no assurance that this transaction will be properly calculated absent a condition that the Commission review and approve these transactions.¹⁹⁸ DSL services require the use of the local loop to be provided, and in fact require enhancements to the local loop. Local loop plant is the most capital-intensive portion of the local exchange network, and therefore represents a large portion of rates for basic exchange service. It is therefore imperative from the ratepayer’s perspective that compensatory contribution from DSL services be properly attributed and recognized for ratemaking purposes, especially with FairPoint’s proposed emphasis on DLS deployment, and its lack of willingness to accept caps on local rates after the transaction. FairPoint has committed, for financial reporting purposes, that the Spinco operations will not bill the DSL affiliate the costs of DSL

¹⁹² OCA Exh. 1HC, p. 68, lines 6-8.

¹⁹³ OCA Exh. 1HC, p. 68, lines 8-9.

¹⁹⁴ TR Day 2 10/23/07 p. 58, line 23 through p. 59, line 3; and TR Day 4 10/25/07 p. 153, lines 6-7, and lines 8-12.

¹⁹⁵ OCA Exh. 1HC, p. 68, lines 18-19.

¹⁹⁶ TR Day 4 10/25/07 p. 163, line 9 through p. 165, line 18.

¹⁹⁷ TR Day 4 10/25/07 p. 171, lines 13-18.

¹⁹⁸ TR Day 4 10/25/07 p. 163 line 9 through p. 165 line 18.

provided by the Spinco operations.¹⁹⁹ The Commission should therefore ensure that a cost allocation process is in place if it approves the transaction.

In sum, although its BB Plan is FairPoint's "cornerstone" of the proposed transaction,²⁰⁰ it falls far short of what New Hampshire customers require. And although increased broadband access is claimed by the company as a key benefit to customers, the Plan has more weaknesses than strengths, and therefore is closer to a risk than a benefit. It is clear that FairPoint does not have the information necessary about the network to have a concrete Plan that it can implement. The company also has not made a commitment about broadband pricing. In addition, while increased broadband access would certainly be a benefit to some customers, any customer who orders DSL service will pay for it, so it is a benefit with a cost. Lastly, there is a risk that voice customers will subsidize the DSL services that FairPoint plans to offer without a fair cost allocation method in place. Therefore, in light of the many risks posed by the transaction, as well as in the Plan itself, the Broadband Plan does not justify approval of the transaction.

2. "New and Improved" Bundles

FairPoint offered no specific information about the purported new and improved bundles that it proposes to offer if the transaction is approved, which the company claims is a benefit of the proposed transaction. There is also no specific information in the record about the bundles currently offered by Verizon. In some instances FairPoint claims that it will simply step into Verizon's shoes, but in many cases it will not commit to either the length of time a service or package will be offered, or to the pricing for services or packages. Therefore, the parties and the Commission are not able to determine whether this is actually a benefit which would result from the proposed transaction, or if it will result in business as usual.

¹⁹⁹ TR Day 4 10/25/07 p. 163, line 9 through p. 165, line 18.

²⁰⁰ TR Day 6 10/29/07 p. 250, lines 9-14.

3. New operating systems

In its previous rural LEC acquisitions, FairPoint could integrate the new company into existing FairPoint operations and systems, or maintain stand-alone functions of the existing company depending upon the circumstances.²⁰¹ In prior acquisitions, FairPoint also likely could have realized savings from the combination of two companies.²⁰²

In this transaction, however, FairPoint cannot integrate the three state operations into existing back office operational and management systems.²⁰³ Instead, FairPoint must “identify, acquire or develop, test, implement, maintain and manage systems and processes which provide the functionality currently performed for the Northern New England business by over 600 systems of Verizon.”²⁰⁴ There is no off the shelf integrated system option.²⁰⁵ These systems must function properly together in order to provide all aspects of Verizon’s operations.²⁰⁶ They must successfully replicate a complicated network made up of hundreds of legacy Verizon and New England Telephone systems that are highly integrated with the rest of Verizon New England and beyond. FairPoint has not undertaken this type of system creation in any of its prior acquisitions, nor could it think of an example where a project of this scale had been completed.

FairPoint initially contracted with Capgemini for systems development and integration, and conversion work pertaining to most systems except for billing, which was directed to another vendor.²⁰⁷ In July 2007, FairPoint changed its approach and also contracted with Capgemini for the billing systems work.²⁰⁸

²⁰¹ OCA Exh. 1HC, p. 28, lines 4-5.

²⁰² OCA Exh. 1HC, p. 28, lines 8-10.

²⁰³ OCA Exh. 1HC, p. 28, lines 6-8.

²⁰⁴ OCA Exh. 1HC, exhibit DB-P-2, p. 249; OCA Exh. 1HC, p. 28, lines 6-8, and p. 48, lines 8-10.

²⁰⁵ OCA Exh. 1HC, p. 89, line 13.

²⁰⁶ OCA Exh. 1HC, p. 89, lines 11-12.

²⁰⁷ OCA Exh. 1HC, p. 77, lines 1-3.

²⁰⁸ OCA Exh. 1HC, p. 77, lines 10-13.

FairPoint proposes to spend a total of \$200 million for systems development and integration.²⁰⁹ FairPoint's financial model projects total transition cost payments to Capgemini in 2007 and 2008 in the amounts of *****BEGIN HIGHLY CONFIDENTIAL*****

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FairPoint states that the majority of the costs of the new operations systems will be capitalized.²¹² As such, FairPoint will include them in rate base in future rate cases.²¹³ If FairPoint were not purchasing the northern New England properties of Verizon, ratepayers would not have to pay any of these costs as these services are currently included in the rates that Verizon customers pay today.²¹⁴ Therefore, it is likely that the capitalization of these new costs will increase rates for customers when FairPoint has a rate case – which it has not committed to undertake, within any time frame, prior to possibly seeking an Alternative Form of Regulation (AFOR, or price deregulation).

4. New local service centers

Verizon currently provides back-office functions to Northern New England through service centers located outside of Northern New England.²¹⁵ FairPoint proposes to open three new local service centers within Northern New England to replace those functions.²¹⁶ As with the new operating systems, the majority of the costs of these new local service centers will be capitalized,

²⁰⁹ TR Day 2 10/23/07 p. 88, line 24 through p. 89, line 6.

²¹⁰ OCA Exh. 1HC, p. 77, lines 14-17.

²¹¹ OCA Exh. 1HC, p. 77, lines 17-19.

²¹² TR Day 2 10/23/07 p. 126, lines 17-20; and TR Day 4 10/25/07 p. 133, line 24 through p. 134, line 6.

²¹³ TR Day 2 10/23/07 p. 126, 21-24.

²¹⁴ TR Day 4 10/25/07 p. 134, lines 7-13.

²¹⁵ FairPoint Exh. 8C, p. 7, line 11.

²¹⁶ FairPoint Exh. 8C, p. 7, lines 12-13.

and FairPoint will seek to recover them from ratepayers.²¹⁷ Therefore, while having local service centers may provide benefits to customers, as with new operating systems, customers will pay for any possible benefits in rates.

5. New Hires

FairPoint proposes to hire an additional 675 employees “to perform [the] back-office functions that are currently provided by Verizon.”²¹⁸ These positions are necessary in order to replace the back-office functions and support provided by Verizon outside of the region today.

FairPoint has no active pension plans today.²¹⁹ FairPoint’s model projections *****BEGIN
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FairPoint recognizes the difficulties it may face filling these positions with qualified individuals.²²¹ The OCA shares this concern and urges the Commission to require FairPoint to provide detailed plans on how they intend to hire and train these key employees in time for cut-over, which the company currently plans for May 30, 2008, just over 6 months from now.

B. The Risks of the Proposed Transaction Greatly Outweigh the Purported Benefits

While Consumers will pay for any benefits, though unlikely, that might result from the transaction, they would bear most of the risks associated with it. Shareholders can sell their stock, lenders have protections against default, and employees could seek other employment. However, both residential and business customers who rely on telephone services for their economic and personal well being are dependent upon a system that provides adequate and reasonably priced

²¹⁷ TR Day 2 10/23/07 p. 106, lines 6-19.

²¹⁸ TR Day 2 10/23/07 p. 127, lines 6-9.

²¹⁹ TR Day 2 10/23/07 p. 35, lines 14-16. See also OCA Exh. 1HC, p. 102, lines 3-4.

²²⁰ OCA Exh. 1HC, p. 102, lines 4-5. See also TR Day 2 10/23/07 p. 178, line 1 through p. 179, line 3; and p. 208, line 9 through p. 209, line 7.

²²¹ See, e.g., OCA Exh. 1HC, p. 248 (exhibit DB-P-2, p. 25) and p. 264 (exhibit DB-P-2, p. 41); and OCA Exh. 1HC, p. 104, lines 6-8, and p. 160, (exhibit DB-HCL2-2, p. CFPNH HSR 0216).

services. Many of these risks stem from the company's precarious financial position and overly optimistic financial projections, which create a broad set of risks that could impact rates, service quality, the company's ability to deliver on its BB Plan promises, and even the very health of FairPoint as a public utility.

1. FairPoint's financial projections show that it lacks the financial resources to undertake the transaction and as a result, faces severe financial risks

The threshold issue in this case is whether FairPoint has the financial resources, over the long term, to undertake this transaction. FairPoint proposes to serve as a public utility while also being a "high debt/high dividend" entity. FairPoint is at the very highest end of the scale on these two financial parameter, where high ranking is not positive for a public utility. FairPoint's dividend yield is at the top of comparable companies (8.4%), as is its dividend payout ratio (91%).²²²

FairPoint's a debt leverage, or debt:EBITDA ratio of *****BEGIN HIGHLY CONFIDENTIAL*****

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FairPoint used a complex financial model to project the results of the proposed transaction.²²⁴

The financial model is built on information received from Verizon.²²⁵ Although its model extends to 2015, FairPoint focused on years 2008 through 2012.²²⁶ The financial projections are "on a

²²² OCA Exh. 1HC, page 51 line 1.

²²³ OCA Exh. 1HC, Exhibit HC 2-7, p. 177. "EBITDA" stands for earnings (or net income) before subtraction of interest expense, taxes, depreciation and amortization. EBITDA is an accounting-related measure based on the income statement that is used to compare profitability, assess operating profitability, and eliminates the effects of how a business is financed.

²²⁴ FairPoint Exh. 8C, p. 19, lines 4-5; and FairPoint Exh. 8C, p. 20, lines 6-7.

²²⁵ FairPoint Exh. 8C, p. 19, lines 8-12.

²²⁶ FairPoint Exh. 8C, p. 20, lines 6-8; and TR Day 2 10/23/07, p. 38, line 24 through p. 40, line 5.

consolidated basis representing all three states, the existing FairPoint operations today and all related corporate overhead.”²²⁷

FairPoint’s financial model and the model results are estimations that are based upon assumptions, data and mathematical formulas.²²⁸ Neither is innately correct or accurate.²²⁹ As aptly observed by FairPoint, its financial projections “**should not be considered a reliable predictor of future operating results.**”²³⁰

The validity and reliability of FairPoint’s financial model is undermined by the fact that much of the data does not trace back to verifiable external data or calculations.²³¹ Much of the data is “hard coded,” or placed into the model without back-up calculations or sources.²³² The fact that FairPoint has not updated its financial model during the course of these proceedings further reduces its value to the Commission.²³³

2. FairPoint faces the risk of receiving insufficient assets from Verizon in the transfer

If Verizon transfers insufficient network assets to Spinco by Verizon, FairPoint’s business, financial condition and results of operations could be adversely affected.²³⁴ For example, Verizon’s assets associated with interoffice fiber optic networking may not be sufficient to support DSL networking and expansion. Similarly, rights of way and buildings for placement of DSL terminals may be insufficient, placing more costs on FairPoint in order to achieve its broadband expansion

²²⁷ TR Day 2 10/23/07 p. 40, lines 11-15.

²²⁸ OCA Exh. 1HC, p. 106, lines 17-18.

²²⁹ OCA Exh. 1HC, p. 106, lines 16-17.

²³⁰ OCA Exh. 1HC, p. 112, lines 14-15, and p. 278 (exhibit DB-P-2, p. 74) (emphasis in original).

²³¹ OCA Exh. 1HC, p. 108, lines 8-18; OCA Exh. 1HC, p. 114, line 3 through p. 115, line 7; and OCA Exh. 1HC, p. 118, lines 2-7.

²³² OCA Exh. 1HC, p. 109, lines 4-7, and p. 110, lines 30-32. See also OCA Exh. 1HC, p. 83, lines 7-18; OCA Exh. 1HC, p. 111, lines 6-7; and OCA Exh. 1HC, line 8 through p. 117, line 16.

²³³ OCA Exh. 1HC, p. 112, lines 18-22, and p. 113, lines 4-8. See also OCA Exh. 43P.

²³⁴ OCA Exh. 1HC, p. 250 (exhibit DB-P-2, p. 27).

plans. In addition, FairPoint's financial model does not account for the risk that Verizon transfers insufficient assets and additional investments are necessary.²³⁵

3. FairPoint faces several significant risks associated with high debt leverage

FairPoint's public projections for long term liabilities from 2007-2015 show a flat trend: \$2.590 million in 2007, and \$2.549 million in 2015.²³⁶ FairPoint's financial model projects

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Shareholders equity declines almost \$900 million dollars over the same period, to a negative \$218 million in 2015.²⁴⁰ FairPoint's financial model projects ***BEGIN HIGHLY

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Debt leverage is a "two-edged sword," in that when times are good, leverage can be beneficial financially, but when times are bad due to economic conditions, unexpected revenue or operating losses, or greater than expected need for cash, leverage becomes a problem.²⁴² Leverage

²³⁵ OCA Exh. 1HC, p. 74, lines 2-3.

²³⁶ OCA Exh. 1HC, p. 125, lines 4-5, and p. 313 (exhibit DB-P-8, p. 78).

²³⁷ TR Day 2 10/23/07 p. 196, line 19 through p. 197, line 8.

²³⁸ TR Day 2 10/23/07 p. 197, lines 13-16,

²³⁹ TR Day 2 10/23/07 p. 197, line 17 through p. 198, line 15.

²⁴⁰ OCA Exh. 1HC, p. 125, lines 4-5, and p. 313 (exhibit DB-P-8, p. 78).

²⁴¹ OCA Exh. 1HC, p. 126, lines 2-3.

²⁴² OCA Exh. 1HC, p. 55, lines 4-6.

magnifies financial problems since higher fixed costs (debt interest and principal payments) are associated with higher leverage.²⁴³

Under the proposed transaction, FairPoint is also significantly exposed to interest rate risk.²⁴⁴ Interest rates are time dependent.²⁴⁵ FairPoint projected a blended cost of debt in the range of

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The risk exists that interest rates will continue to rise, or that risk premium margins will continue to rise, causing FairPoint to bear increased fixed charges associated with higher interest for the debt which is carried at the variable rate.²⁴⁷ These higher interest expenses must be paid, and would preempt cash use that had been planned or is necessary for other purposes (e.g., dividends, capital investment or operating expenses).²⁴⁸

FairPoint's stock price is also exposed to additional risk from higher interest rates.²⁴⁹

FairPoint's stock is a "yield based" investment due to the high payout dividend level.²⁵⁰ As a yield based investment, the stock price will therefore be affected negatively by rising interest rates—the stock price will tend to decline with increasing interest rates.²⁵¹

Through the use of interest rate swap agreements, FairPoint has fixed approximately 60 to 65% of its floating rate debt.²⁵² Interest rate swap agreements, however, cannot eliminate the interest rate risk that would exist for FairPoint given its heavy debt leverage, and use of variable

²⁴³ OCA Exh. 1HC, p. 55, lines 7-8.

²⁴⁴ OCA Exh. 1HC, p. 60, lines 5-6.

²⁴⁵ OCA Exh. 1HC, p. 61, lines 2-8.

²⁴⁶ TR Day 2 10/23/07 p. 200, lines 5-9, and p. 201, line 2.

²⁴⁷ OCA Exh. 1HC, p. 60, lines 11-13; p. 63, lines 17-19; p. 63, line 19 through p. 64, line 2; and OCA Exh. 1HC, p. 64, line 8, through, p. 65, line 26, and pp. 346-353 (exhibits DB-P-20 through DB-P-24).

²⁴⁸ OCA Exh. 1HC, p. 60, lines 13-15.

²⁴⁹ OCA Exh. 1HC, p. 61, lines 9-11.

²⁵⁰ OCA Exh. 1HC, p. 61, lines 11-12.

²⁵¹ OCA Exh. 1HC, p. 61, lines 12-13.

²⁵² TR Day 2 10/23/07 p. 113, lines 8-9. See also TR Day 2 10/23/07 p. 111, lines 11-21 (\$900 million at varied rates below 8%). Compare OCA Exh. 1HC, p. 61, line 17 through p. 62, line 2, and p. 320 (exhibit DB-P-8, p. 211) (FairPoint expects to fix "\$550 million at a blended rate of 6.3%").

interest rates for large portions of that debt.²⁵³ If there is a prolonged rising of interest rates over time, the higher rates will get built into the baseline for future swaps and future arrangements.²⁵⁴

FairPoint did not include in its projections *****END HIGHLY CONFIDENTIAL*****

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“[T]o the extent interest rates increase in the future, [FairPoint] may not be able to enter into a new interest rate swap or purchase an interest rate cap or other interest rate hedge on acceptable terms.”²⁵⁶ This is particularly critical in light of the fact that FairPoint will continue to have

significant long term debt, and will have to refinance most if not all of that debt, *****BEGIN**

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or before maturity.²⁵⁷ Refinancing that debt at higher interest rates will result in *****BEGIN**

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net cash flow than projected.²⁵⁸

Due to its weak financial position, FairPoint cannot weather these increased interest costs by making other changes.²⁵⁹ Cash is necessary for dividends, capital expenditures, cash expenses and taxes.²⁶⁰ FairPoint’s exposure to increased interest expenses creates the substantial likelihood of a distressed public utility if the Commission approves the proposed transaction.²⁶¹

4. FairPoint faces the risk that it will have insufficient revenues to operate the business

To operate its business, service its indebtedness, and pay out a significant portion of its cash flow to its stockholders in the form of quarterly dividends, FairPoint will require a significant

²⁵³ OCA Exh. 1HC, p. 62, lines 5-6, and lines 18-20. See also OCA Exh. 1HC, p. 63, lines 4-7 and pp. 344-345 (exhibit DB-P-19).

²⁵⁴ TR Day 2 10/23/07 p. 114, lines 9-14.

²⁵⁵ TR Day 2 10/23/07 p. 199, lines 13-14.

²⁵⁶ OCA Exh. 1HC, p. 62, lines 13-16, and p. 341 (exhibit DB-P-18, p. 18).

²⁵⁷ OCA Exh. 1HC, p. 62, line 21 through p. 63, line 2. See also TR Day 2 10/23/07 p. 199, line 20 through p. 200, line 4.

²⁵⁸ OCA Exh. 1HC, p. 66, lines 2-5.

²⁵⁹ OCA Exh. 1HC, p. 66, lines 12-13.

²⁶⁰ OCA Exh. 1HC, p. 66, lines 13-14.

amount of cash.²⁶² Yet, FairPoint's ability to generate cash will depend on many factors beyond its control.²⁶³ These include general economic, financial, competitive, legislative, and regulatory factors.²⁶⁴ As a result, FairPoint may not be able to generate sufficient cash flow from operations or borrow sufficient funds to service or pay its indebtedness.²⁶⁵

FairPoint projects *****BEGIN HIGHLY CONFIDENTIAL*****

. *****END HIGHLY CONFIDENTIAL*****²⁶⁶ The projections assume no change in rates.²⁶⁷ FairPoint's revenue from existing operations is projected to be approximately *****BEGIN HIGHLY CONFIDENTIAL***** *****END HIGHLY CONFIDENTIAL***** of combined revenue.²⁶⁸

Average revenue per unit (ARPU) is assumed to be flat or increasing.²⁶⁹ This assumption is optimistic in light of competition from cable modem and telephony, as well as from Verizon entities that will continue to exist in the state and will compete with FairPoint for some customers.²⁷⁰

FairPoint projects slower access line losses than Verizon.²⁷¹ This is contrary to industry trends.²⁷² Such projections do not take into account the full effect of cable telephony offerings in the former Adelpia areas in northern New England, recently acquired by Time Warner and Comcast.²⁷³ As well, *****BEGIN HIGHLY CONFIDENTIAL*****

²⁶¹ OCA Exh. 1HC, p. 66, lines 14-16.

²⁶² OCA Exh. 1HC, p. 257 (exhibit DB-P-2, p. 34).

²⁶³ OCA Exh. 1HC, p. 257 (exhibit DB-P-2, p. 34).

²⁶⁴ OCA Exh. 1HC, p. 257 (exhibit DB-P-2, p. 34).

²⁶⁵ OCA Exh. 1HC, p. 257 (exhibit DB-P-2, p. 34).

²⁶⁶ OCA Exh. 1HC, p. 111, lines 7-8, and p. 310 (exhibit DB-P-8, p. 76). See also OCA Exh. 1HC, p. 309.

²⁶⁷ OCA Exh. 1HC, p. 120, line 1; and TR Day 2 10/23/07 p. 39, lines 6-10, and p. 109, lines 2-6.

²⁶⁸ OCA Exh. 1HC, p. 111, lines 12-13.

²⁶⁹ OCA Exh. 1HC, p. 121, line 14 through p. 122, line 2.

²⁷⁰ OCA Exh. 1HC, p. 122, lines 1-2, and pp. 314-316 (exhibit DB-P-8, pp. 79-81).

²⁷¹ OCA Exh. 1HC, p. 93, lines 11-14.

²⁷² OCA Exh. 1HC, p. 120, lines 1-3.

²⁷³ OCA Exh. 1HC, p. 107, lines 18-19.

. *****END HIGHLY CONFIDENTIAL*****²⁷⁴ In addition, poor service quality may lead to additional line loss.²⁷⁵

FairPoint projects *****BEGIN HIGHLY CONFIDENTIAL*****

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FairPoint's financial projections *****BEGIN HIGHLY CONFIDENTIAL*****

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FairPoint's DSL projections assume no significant difficulties due to poor plant conditions and needed plant upgrades.²⁸⁰ FairPoint, however, will not have access to detailed plant records until following the closing of the proposed transaction.²⁸¹ The fact that service quality problems have been significant in the three states over past years is indicative that DSL take-up by consumers will not necessarily be able to occur promptly and on a broad scale.²⁸²

Following the consummation of the merger, FairPoint will face more competition than it has historically.²⁸³ FairPoint sees New Hampshire as a competitive environment,²⁸⁴ and many of FairPoint's future competitors "have brand recognition, offer online content services and have

²⁷⁴ OCA Exh. 1HC, p. 111, lines 11-12.

²⁷⁵ OCA Exh. 1HC, p. 120, lines 18-19.

²⁷⁶ OCA Exh. 1HC, p. 120, lines 9-11.

²⁷⁷ OCA Exh. 1HC, p. 124, line 4 through p. 125, line 1, and OCA Exh. 1HC, p. 134, line 7, and lines 9-10.

²⁷⁸ OCA Exh. 1HC, p. 120, lines 9-11.

²⁷⁹ OCA Exh. 1HC, p. 120, lines 13-14; and OCA Exh. 1HC, p. 123, lines 13-14.

²⁸⁰ OCA Exh. 1HC, p. 122, lines 13-14, and p. 151 (exhibit DB-HCL1-2).

²⁸¹ Exh. 1HC, p. 120, lines 14-16.

²⁸² OCA Exh. 1HC, p. 120, lines 16-18.

²⁸³ OCA Exh. 1HC, p. 94, lines 7-11, and pp. 255-256 (exhibit DB-P-2, pp. 32-33).

²⁸⁴ TR Day 2 10/23/07 p. 52, line 22 through p. 53, line 1

financial, personnel, marketing and other resources” that may be greater than those of FairPoint.²⁸⁵

These competitors will include Verizon entities, including Verizon’s Voice over Internet Protocol services and Verizon wireless services.²⁸⁶ This competition may lead to loss of revenues and profitability.²⁸⁷

Competition from Verizon and cable telephony could impact FairPoint’s access line loss projection.²⁸⁸ Full roll out and marketing of cable telephony by these other facilities based carriers in the Verizon territory can be expected to have a significant impact, based on experience from other jurisdictions.²⁸⁹

Verizon’s competition could impact FairPoint’s Enterprise Revenue assumption.²⁹⁰ Over that time, Verizon will likely seek to sell all services to Enterprise accounts, rather than sharing with FairPoint, and FairPoint, given its lack of historical experience with Enterprise level customers, will likely face difficulty retaining these customers and revenues.²⁹¹ However, FairPoint “assumed total average revenue per unit for the Spinco business would increase 26% versus 2006 levels by 2012 as the Spinco business captured a greater percentage of the overall spending by Enterprise customers.”²⁹²

5. FairPoint faces the risk of higher than projected operating expenses, higher capital expenditures and network systems costs

FairPoint’s financial model projects capital expenditures of *****BEGIN HIGHLY**

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²⁸⁵ OCA Exh. 1HC, p. 94, lines 22-25, and pp. 255-256 (exhibit DB-P-2, pp. 32-33).

²⁸⁶ OCA Exh. 1HC, p. 94, line 26 through p. 95, line 19, and pp. 255-256 (exhibit DB-P-2, pp. 32-33); and p. 96, line 15 through p. 98, line 15.

²⁸⁷ OCA Exh. 1HC, p. 95, lines 30-38.

²⁸⁸ OCA Exh. 1HC, p. 99, lines 11-13.

²⁸⁹ OCA Exh. 1HC, p. 107, line 19 through p. 108, line 3.

²⁹⁰ OCA Exh. 1HC, p. 98, line 17 through p. 99, line 1.

²⁹¹ OCA Exh. 1HC, p. 99, lines 4-7.

²⁹² OCA Exh. 1HC p. 99 lines 1-4 and p. 315 (exhibit DB-P-8, p. 80).

. *****END HIGHLY CONFIDENTIAL*****²⁹³ Except for 2007, FairPoint projects to spend less and less on capital investment than Verizon did in 2004, 2005 or 2006 on non-FiOS investment.²⁹⁴

FairPoint expects to spend approximately \$200 million on infrastructure and network systems integration and planning in connection with the proposed transaction.²⁹⁵ FairPoint's financial model does not account for the risk that FairPoint will be required to expend higher than projected amounts on capital expenditures and network systems costs.²⁹⁶

For the Spinco operations, which are located primarily in rural areas and are expensive and difficult to serve,²⁹⁷ FairPoint assumed that expenses would remain relatively flat or increase slightly over the projection period."²⁹⁸ This assumption is in absolute terms, so that costs per line would be slightly increasing.²⁹⁹

FairPoint's projected expenses are contrary to the operating expense pattern shown in recent actual FairPoint data.³⁰⁰ According to FairPoint's data, operating expenses have increased an average of 11% over the past three years, on a per line basis.³⁰¹ Moreover, the operations that it will acquire are in rural areas, expensive to maintain and difficult to service.³⁰² A less than average rate of 9% average annual operating expense growth per access line results in *****BEGIN HIGHLY**

²⁹³ OCA Exh. 1HC, p. 133, lines 7-8.

²⁹⁴ TR Day 2 10/23/07 p. 85, lines 3 through p. 86, line 15, and OCA Exh. 47HC. See also OCA Exh. 2P, p. 67-69 for further analysis of capital expenditure data.

²⁹⁵ OCA Exh. 1HC, p. 251 (exhibit DB-P-2, p. 28).

²⁹⁶ OCA Exh. 1HC, p. 74, lines 2-3.

²⁹⁷ OCA Exh. 1HC, pp. 28-29

²⁹⁸ OCA Exh. 1HC, p. 129, lines 10-11, and OCA Exh. 1HC, p. 130, lines 1-4. See also OCA Exh. 1HC, p. 111, lines 7-8.

²⁹⁹ OCA Exh. 1HC, p. 129, lines 12-13.

³⁰⁰ OCA Exh. 1HC, p. 129, lines 13-14, and p. 342 (exhibit DB-P-18, p. 44).

³⁰¹ OCA Exh. 1HC, p. 131, lines 9-10.

³⁰² OCA Exh. 1HC, pp. 28-29.

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6. FairPoint faces the risk of having insufficient cash flow

Cash flow is essential, as it is cash that pays expenses, taxes, capital expenditures, interest and principal, and dividends.³⁰⁴ Free cash flow is the cash available after payment of these cash obligations.³⁰⁵ A key factor for the Commission's determination is whether FairPoint after the merger will have enough cash flow to cover its obligations to the many rural areas served by Verizon, which are expensive to maintain and difficult to service.³⁰⁶

FairPoint's financial model projected cash flow. Specifically, FairPoint projected annual free cash flow after dividends *****BEGIN HIGHLY CONFIDENTIAL*****

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FairPoint's cash flow projections would be most materially affected by changes to its projections for cash expenses, subscriber volumes and revenues, interest on debt, capital expenditures, and dividends.³⁰⁸ It is reasonable to consider changes to these projections and the severe impact such changes would have on FairPoint.³⁰⁹

Individually, changes to these projections would result in *****BEGIN HIGHLY CONFIDENTIAL*****

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³⁰³ OCA Exh. 1HC, p. 131, lines 13-14.

³⁰⁴ OCA Exh. 1HC, p. 127, lines 21-22.

³⁰⁵ OCA Exh. 1HC, p. 127, lines 11-12.

³⁰⁶ OCA Exh. 1HC, p. 127, lines 14-15, and OCA Exh. 1HC, pages 28-29.

³⁰⁷ TR Day 2 10/23/07 p. 198, lines 17-20, and FairPoint Exh. 9HC, exhibit WL-3, p. 6 ("4 of 4").

³⁰⁸ OCA Exh. 1HC, p. 128, lines 11-17.

³⁰⁹ OCA Exh. 1HC, p. 135, line 10 through p. 136, line 8.

³¹⁰ OCA Exh. 1HC, p. 131, line 1 through p. 132, line 2; OCA Exh. 1HC, p. 134, line 4-11; and OCA Exh. 1HC, p. 133, lines 7-8.

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FairPoint has also historically derived substantial benefits from Net Operating Loss (NOL) carryforwards, which are the application of previous years' net operating losses to reduce current year's tax liabilities.³¹² FairPoint has paid little to no cash taxes in previous years due to NOL carryforwards.³¹³ The fact that cash is not paid for taxes enhances cash availability for dividends and interest payments.³¹⁴ This has been one contributor to FairPoint's ability to make interest and dividend payments as a "high debt/high dividend" ILEC.³¹⁵

Consummation of the proposed transaction will accelerate the absorption of the NOL carryforwards, such that FairPoint is projected to pay cash taxes beginning in 2009.³¹⁶ Limitations on FairPoint's ability to use net operating loss carryforwards may affect its ability to pay dividends to its stockholders.³¹⁷

7. Synergies and Cost Savings Risks

FairPoint defines synergies as "essentially the difference between the allocated costs [of Verizon Communications to Verizon NE] that go away upon close and the incremental direct cost that FairPoint must incur post-close."³¹⁸ In essence, FairPoint claims that it can provide the services currently provided by Verizon to the three-state region more efficiently and at a lower cost.

³¹¹ OCA Exh. 1HC, p. 135, lines 5-6.

³¹² OCA Exh. 1HC, p. 67, lines 3-5.

³¹³ OCA Exh. 1HC, p. 67, lines 5-6.

³¹⁴ OCA Exh. 1HC, p. 67, lines 6-7.

³¹⁵ OCA Exh. 1HC, p. 67, lines 7-9.

³¹⁶ OCA Exh. 1HC, p. 67, lines 12-14, and pp. 281-282 (exhibit DB-P-2, p. 77).

³¹⁷ OCA Exh. 1HC, p. 91, lines 27-30.

³¹⁸ OCA Exh. 1HC, p. 359.

Generally, all of the services that are needed today across the three states that are provided by Verizon will have to be replaced and provided by FairPoint.³¹⁹ Some of the costs that are allocated by Verizon, which FairPoint proposes will be eliminated, are analogous to FairPoint's projected costs.³²⁰ However, in its due diligence, FairPoint did not determine the benefits and value associated with the costs currently allocated by Verizon to Northern New England, in order to estimate potential synergies or savings.³²¹

FairPoint expects to realize approximately \$60 to \$75 million in synergies (or savings) following the merger.³²² FairPoint's financial projections assume these full synergy estimates as well as growth opportunities.³²³ FairPoint's synergies calculation is entirely dependent on FairPoint's estimation of the eliminated allocations compared to its estimation of the costs it will incur, and there is not sufficient data to validate that these synergies will actually occur. The realization of these asserted synergies is dependent on the extent to which estimated Verizon allocations are correct, and the extent to which estimated FairPoint costs materialize as projected.³²⁴ FairPoint's success in realizing the projected synergies and cost savings depends largely upon the successful integration of Spincos' and FairPoint's businesses and operations.³²⁵ However, even if FairPoint is able to integrate the Spincos business operations successfully, it may not realize the projected synergies and cost savings at all.³²⁶ FairPoint may not realize the projected synergies and

³¹⁹ TR Day 2 10/23/07 p. 69, lines 2-7.

³²⁰ TR Day 2 10/23/07 p. 120, line 20 through p. 121, line 4.

³²¹ TR Day 2 10/23/07 p. 61, lines 4-6.

³²² OCA Exh. 1HC, p. 359.

³²³ OCA Exh. 1HC, p. 84, line 3-4. But see OCA Exh. 1HC, p. 84, lines 4-6 and OCA Exh. 51HC (FairPoint "Material Adverse Change" ("MAC") scenario, designed essentially to assume no synergies).

³²⁴ OCA Exh. 1HC p. 81 line 14 to p. 82 line 21.

³²⁵ OCA Exh. 1HC, p. 250 (exhibit DB-P-2, p. 27).

³²⁶ OCA Exh. 1HC, p. 250 (exhibit DB-P-2, p. 27).

cost savings, and in fact has not made a showing that it will.³²⁷ However, the financial success of the merger depends on these projections.³²⁸

The substantial risk that the synergies will not be attained is heightened by the fact that this proposed transaction is a complete shift for FairPoint, from acquiring a small company and simply eliminating expenses by integration into existing operations, to acquiring a large geographic operation with a required development, integration and implementation of a complete “back office” for management and operational systems support.³²⁹ Despite this, FairPoint’s financial model does not account for the risk that FairPoint may not realize the projected synergies, cost savings and growth opportunities in this much more complex transaction.³³⁰

Staff witness Antonuk also testified that the likelihood is high that FairPoint will not attain its high projected synergies.³³¹ He also stated that not only is it unlikely that a company like FairPoint, that must develop an entire suite of back-office systems, could find the level of savings it expects, but that it also has not made a strong enough showing that those savings are possible: “You can’t accept on faith that a company that, I think was pointed out, is about maybe one or less percent the size of Verizon is going to come in and save that kind of money.”³³²

If FairPoint does not realize its projected synergies, it will have less cash flow available over and above the amounts required to meet all operating expenses.³³³ Failure to realize projected synergies will also leave less cash to meet capital expenditures and debt service requirements as well.³³⁴

³²⁷ OCA Exh. 1HC, p. 249 (exhibit DB-P-2, p. 26).

³²⁸ OCA Exh. 1HC, p. 249 (exhibit DB-P-2, p. 26).

³²⁹ OCA Exh. 1HC, p. 82, line 23 through p. 83, line 3.

³³⁰ OCA Exh. 1HC, p. 74, lines 2-3.

³³¹ TR Day 4 10/25/07 at 78-80.

³³² Tr. 10/25/07 at 78-80.

³³³ Transcript, October 23, 2007, p. 121, lines 5-9.

³³⁴ Transcript, October 23, 2007, p. 121, lines 10-22.

Therefore, in its analysis the Commission should not place great weight on FairPoint's synergies projections. Instead, it should do what Staff proposed in its Supplemental testimony, and assume that no synergies occur from the merger.³³⁵

8. FairPoint faces significant business integration risks

"The integration of FairPoint's and Spincos' businesses may not be successful."³³⁶ "[T]he proposed transaction directly involves the transfer of the assets and customers of the state's largest incumbent local exchange carrier," an RBOC.³³⁷ It is completely different from any of FairPoint's previous acquisitions of small, rural LECs.³³⁸ The acquisition of the Verizon operations in New Hampshire, Maine and Vermont "is the largest and most significant acquisition FairPoint has undertaken."³³⁹

Integration of smaller independent LECs is accomplished in a much different fashion than the integration necessary of an RBOC. The nature and quality of a smaller rural LEC's operations would tend to be more visible, while RBOC operations and quality are less transparent due to the national scale of the company, allocations from centralized service organizations, and variations in allocations of capital to different lines of business and jurisdictions.³⁴⁰

"Due to the size and complexity of the Northern New England business and the activities required to separate Spincos' operations from Verizon's, FairPoint may be unable to integrate the Spincos business into its operations in an efficient, timely and effective manner."³⁴¹ FairPoint's

³³⁵ Staff Exh. 4, Attachment A, p. 1.

³³⁶ OCA Exh. 1HC, exhibit DB-P-2, p. 248.

³³⁷ FairPoint Exh. 20, p. 9, fn. 5.

³³⁸ OCA Exh. 1HC, p. 27, lines 4-7.

³³⁹ OCA Exh. 1HC, p. 248 (exhibit DB-P-2, p. 25).

³⁴⁰ OCA Exh. 1HC, p. 27, lines 15-19.

³⁴¹ OCA Exh. 1HC, p. 248 (exhibit DB-P-2, p. 25).

failure “to complete this integration successfully could have a material adverse effect on the combined company’s business, financial condition and results of operations.”³⁴²

Securities analysts, including one of FairPoint’s investment advisors, recognize the integration risk faced by FairPoint in undertaking the proposed transaction.³⁴³ Despite this, FairPoint’s financial model does not account for business integration risks.³⁴⁴

9. FairPoint faces significant systems integration risks

“The integration of FairPoint’s and Spincor’s businesses may present significant systems integration risks, including risks associated with the ability to integrate Spincor’s customer sales, service and support operations into FairPoint’ customer care, service delivery and network monitoring and maintenance platforms.”³⁴⁵ The proposed transaction represents a complete shift in thinking and approach for FairPoint, and thus heightens execution risk.³⁴⁶

There are numerous unknowns regarding the development of back office systems including the length of time to develop, the cost to develop, training and productivity of employees with the newly developed systems, the extent to which existing Verizon data will be able to be managed effectively and in an integrated fashion on the new systems, the extent to which developed systems effectively replicate or improve upon existing Verizon systems, the extent to which FairPoint will be able to effectively develop and operate systems in areas where it has no previous experience (e.g., CLEC and wholesale services), and the extent to which customer-affecting business activities will suffer significant interruption or not.³⁴⁷ System problems can be detrimental financially, and FairPoint has first-hand experience with financial loss associated with its billing systems

³⁴² OCA Exh. 1HC, p. 248 (exhibit DB-P-2, p. 25).

³⁴³ OCA Exh. 1HC, p. 79, line 3 through p. 80, line 17, and pp. 211-228 (exhibits DB-C-1 and DB-C-2).

³⁴⁴ OCA Exh. 1HC, p. 74, lines 2-3.

³⁴⁵ OCA Exh. 1HC, p. 248 (exhibit DB-P-2, p. 26).

³⁴⁶ OCA Exh. 1HC, p. 28, lines 10-12.

³⁴⁷ OCA Exh. 1HC, p. 75, lines 4-12.

problems.³⁴⁸ As observed by one industry analyst, without existing management, back office and other required infrastructure to run the combined company, the value the Verizon operations may be destroyed in creating such corporate infrastructure.³⁴⁹

The failure of any of the new systems “could result in [FairPoint’s] inability to adequately bill and provide service to its customers or meet its financial and regulatory reporting operations.”³⁵⁰ To the extent that systems failure impacts FairPoint’s customers, rate of access line loss to competitors, especially cable telephony, will be higher than it otherwise would be.³⁵¹ In turn, FairPoint’s financial condition could be adversely affected.³⁵²

The risk of this adverse affect on FairPoint is heightened by the fact that Verizon’s operations in New Hampshire, Maine and Vermont have experienced notable service quality problems in the years leading up to this proposed transaction.³⁵³ Despite this, FairPoint’s financial model does not account for system integration risks.³⁵⁴

FairPoint has underestimated the complexity, cost and time for the tasks of developing and integrating new systems, especially with the need for a rapid and successful cutover.³⁵⁵ Staff experts Falcone and King testified that the cutover target dates are unrealistically short.³⁵⁶ As a result, FairPoint may still be exposed to time and cost increases which are not reflected in the proposed transaction or the proposed financing of it.³⁵⁷

On the sixth day of hearings, the Commission Staff announced that the Staffs of the three state Commissions had reached an agreement on Statement of Scope for a “FairPoint Cutover

³⁴⁸ OCA Exh. 1HC, p. 75, lines 14-18 and p. 343.

³⁴⁹ OCA Exh. 1HC, p. 48, lines 14-18, and p. 331 (exhibit DB-P-14).

³⁵⁰ OCA Exh. 1HC, p. 249 (exhibit DB-P-2, p. 26). See also OCA Exh. 1HC, p. 80, line 19 through p. 81, line 6.

³⁵¹ OCA Exh. 1HC, p. 81, lines 8-10.

³⁵² OCA Exh. 1HC, p. 249 (exhibit DB-P-2, p. 26).

³⁵³ OCA Exh. 1HC, p. 81, lines 10-12.

³⁵⁴ OCA Exh. 1HC, p. 74, lines 2-3.

³⁵⁵ OCA Exh. 1HC, p. 89, lines 15-16.

³⁵⁶ TR Day 7 10/30/07 p. 98 lines 22-24 and p. 99 lines 1-4. See also Staff Exh. 39, p. 110-111.

Monitoring” program.³⁵⁸ When the document was first presented at the hearing, both companies stated that they were reviewing the document and did not yet have a position.³⁵⁹ FairPoint later stated that it consented to the work being done and intended to cooperate with Liberty.³⁶⁰

The Statement of Scope describes a detailed series of steps that will be taken by Liberty Consulting on behalf of the three state’s Staffs. These steps include:

- Reviewing and assessing FairPoint’s planned testing and cutover readiness process;
- Monitoring of testing and cutover readiness process, including staffing and training;
- Pre-cutover readiness review and final report;
- Regular telephone conferences with state regulators to review progress; and
- Post-cutover review and report.³⁶¹

Throughout the process, Liberty will provide reports to the three state Commissions in a “collaborative inter-jurisdictional process.”³⁶² Some of those reports will be available for review by the parties in the case. The intent of the monitoring plan is for the Staffs to go forward with it prior to Commission action in any of the three states because it is necessary to get work underway immediately.³⁶³ In fact, Mr. King testified that “the first part of the work, which is the review and assessment of FairPoint’s plan testing and cutover readiness process is contemplated to take place before -- potentially before such approval, so that it might inform such approvals.”³⁶⁴ However, there is nothing in the scope document, or the contemplated process, that would allow Liberty to prevent cutover from taking place even if they had reservations about FairPoint’s readiness.³⁶⁵ It is also not clear what role the Commissions in the three states could play in preventing premature

³⁵⁷ OCA Exh. 1HC, p. 89, line 16 through p. 90, line 1.

³⁵⁸ Staff Exh. 61. The budget for the scope of work is estimated to be \$616,800. Staff Exh. 62.

³⁵⁹ TR Day 6 10/29/07 p. 183 lines 20-23, and p. 184 lines 2-3.

³⁶⁰ TR Day 7 10/30/07 p. 172 lines 14-20.

³⁶¹ See id.

³⁶² Staff Exh. 61 p. 5.

³⁶³ TR Day 7 10/30/07 p. 113 lines 3-9.

³⁶⁴ TR Day 7 10/30/07 p. 113 lines 9-14.

³⁶⁵ TR Day 7 10/30/07 p. 139 lines 15-20.

cutover. Mr. King testified that Liberty “would not have authority one way or the other about stopping or not stopping the cutover. All we can do is recommend . . . our recommendation goes to the three staffs.”³⁶⁶

The OCA finds troubling that the three state Staffs believe that there is a need for this level of oversight of FairPoint’s planning and execution of cutover at this point in the process. In addition, to have this level of oversight without the ability to delay cutover if serious problems exist makes the exercise seem futile. Therefore, the OCA urges the Commission to make a condition of approval of the transaction that FairPoint may only cutover if Liberty believes that the company is ready. We also urge the Commission to clarify how Liberty’s reports and findings will be used in the Commission’s deliberations and decision, if at all.

11. FairPoint faces risks arising from labor relations and the August 2008 contract negotiations

Following the merger, approximately 67% of FairPoint’s employees will be members of unions.³⁶⁷ Two of Verizon’s existing seven collective bargaining agreements with its unionized workforce expire in August 2008.³⁶⁸ At that time, FairPoint may experience difficulty negotiating new agreements on favorable terms or at all, and any labor disputes could negatively impact FairPoint’s operations and financial condition.³⁶⁹ In these proceedings, both of the labor unions representing Spinco employees have objected to the merger.³⁷⁰ FairPoint’s financial model does not account for this risk. Instead, FairPoint projects the status quo going forward with regard to labor relations.³⁷¹ This lack of consideration for the impact of renegotiating union contracts mere months

³⁶⁶ TR Day 7 10/30/07 p. 158 lines 6-11.

³⁶⁷ OCA Exh. 1HC, p. 262, (exhibit DB-P-2, p. 39).

³⁶⁸ OCA Exh. 1HC, p. 262, (exhibit DB-P-2, p. 39).

³⁶⁹ OCA Exh. 1HC, p. 262, (exhibit DB-P-2, p. 39).

³⁷⁰ OCA Exh. 1HC, p. 262, (exhibit DB-P-2, p. 39).

³⁷¹ OCA Exh. 1HC, p. 101, lines 19-20.

after cutover seems imprudent and the impacts of any delay should be considered before the transaction is approved.

12. FairPoint faces risks if it can not attract and retain a qualified workforce

A key risk in this transaction is that FairPoint may not have a sufficient number of employees to integrate FairPoint's and Spinco's businesses, or to operate the combined company's business. FairPoint recognizes that its success depends upon its ability to retain and attract qualified technical and management personnel,³⁷² yet it has not taken steps sufficient to ensure a qualified, skilled workforce is in place upon close.

In the Joint Petition, Verizon and FairPoint contend that approximately 3,000 employees of Verizon whose primary jobs at the close of the transaction would be to support the local phone business will continue employment with FairPoint after the proposed transaction.³⁷³ However, as of the time of the hearing, that amount had decreased to between 2,750 and 2,800.³⁷⁴

FairPoint's financial model indicates that there will be *****BEGIN HIGHLY CONFIDENTIAL***** *****END HIGHLY CONFIDENTIAL***** employees for the three-state operation.³⁷⁵ However, FairPoint does not know the minimum number of employees needed to run the Spinco operations.³⁷⁶

Employees in the three states *****BEGIN HIGHLY CONFIDENTIAL***** *****END HIGHLY CONFIDENTIAL***** over the period in which this transaction has been considered.³⁷⁷ In mid-2006, the three state operation had *****BEGIN HIGHLY CONFIDENTIAL***** *****END HIGHLY CONFIDENTIAL***** employees.³⁷⁸ As of May

³⁷² OCA Exh. 1HC, p. 248 (exhibit DB-P-2, p. 25) and p. 264 (exhibit DB-P-2, p. 41).

³⁷³ FairPoint Exh. 20, p. 12.

³⁷⁴ TR Day 2 10/23/07 p. 127, lines 1-6.

³⁷⁵ OCA Exh. 1HC, p. 104, lines 4-6.

³⁷⁶ Transcript, October 23, 2007, p. 127, lines 20-23.

³⁷⁷ OCA Exh. 1HC, p. 103, lines 4-6.

³⁷⁸ OCA Exh. 1HC, p. 103, lines 6-8, and p. 198 (exhibit DB-HCL2-16, p. CFPNH HSR 0082).

2007, the employee count was 2,700 to 2,800 employees.³⁷⁹ This is a *****BEGIN HIGHLY**

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percent of the employee base.³⁸⁰ Moreover, FairPoint *****BEGIN HIGHLY CONFIDENTIAL*****

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13. Wholesale Customers face risks due to FairPoint's inexperience serving CLECs

FairPoint faces risks related to its assumption of major wholesale operations and responsibilities. "Spinco offers services that FairPoint has no experience in providing, the most significant of which are competitive local exchange carrier wholesale services."³⁸³ This risk is compounded by the fact that FairPoint must develop CLEC operations and systems from scratch.³⁸⁴ As such, the OCA recommends that the Commission consider the recommendations of CLEC parties to the case, with special attention to providing opportunities for CLECs to participate in the cutover monitoring process that Liberty Consulting will be undertaking on behalf of the three state Commissions.

³⁷⁹ OCA Exh. 1HC, p. 103, lines 8-9, and Rebuttal Testimony of Peter G. Nixon, Docket No. 7270 before the Vermont Public Service Board, page 14, line 6.

³⁸⁰ OCA Exh. 1HC, page 103, line 10.

³⁸¹ OCA Exh. 1HC, p. 104, lines 6-8, and p. 160, (exhibit DB-HCL2-2, p. CFPNH HSR 0216).

³⁸² See OCA Exh. 2C at p. 47-56 regarding the loss of experienced personnel. See also Verizon Exh. 34C and 35C, which were requested by the Commission.

³⁸³ OCA Exh. 1HC, p. 248 (exhibit DB-P-2, p. 25). OCA Exh. 1HC, p. 105, lines 1-3.

³⁸⁴ OCA Exh. 1HC, p. 105, lines 3-4.

14. There is a strong risk that FairPoint will need transition services for a period longer than projected, resulting in increased costs

The cost to FairPoint for these transition services is in the tens of millions of dollar per month.³⁸⁵ For the first eight months after the closing date, the fee for “Schedule A” services is \$14.2 million per month.³⁸⁶ In months nine through twelve, the fee is reduce by \$500,000 per month.³⁸⁷ In the thirteenth month, however, the cost of transition services will rise to \$14.7 million per month, and continue to rise each month thereafter by \$500,000.³⁸⁸

Although FairPoint contemplates the TSA being available for 15 months, FairPoint’s financial model incorporates an assumption that FairPoint relies on the TSA for only six months.³⁸⁹ However, if the TSA lasts beyond twelve months, FairPoint will be paying the higher monthly rate described above. Every month thereafter, until termination of Schedule A services, the cost rises by an additional \$500,000 each month. FairPoint ran sensitivity analyses for retail access line projections and for operating expenses.³⁹⁰ However, FairPoint did not run any sensitivity analyses for factors such as the duration of the TSA, among other costs.³⁹¹ FairPoint has committed to not recovering the costs of transition services from ratepayers.³⁹²

If FairPoint continues to require services from Verizon under the TSA longer than twelve months, the increased fees could have a material adverse effect of the combined company’s business, financial condition and results of operations.”³⁹³

³⁸⁵ VZ Exh. 1P, pp. 29-30.

³⁸⁶ Id. There are additional monthly fees for other services that vary depending on timing.

³⁸⁷ Id.

³⁸⁸ FairPoint Exh. 20, Exhibit 5, at Article II, 2.1 Transition Services and Fees.

³⁸⁹ See OCA Exh. 2P, Exhibit SMB-P-12.

³⁹⁰ FairPoint Exh. 12P, at 24.

³⁹¹ See OCA Exh. 2P, Exhibit SMB-P-14.

³⁹² TR Day 4 10/25/07, p. 137, lines 12-23, and OCA Exh. 10.

³⁹³ OCA Exh. 1HC, p. 249 (exhibit DB-P-2, p. 26).

15. Customers face the risk of increased rates

a. FairPoint will only commit to a one-year rate cap

FairPoint proposes to cap rates for basic local exchange service for only one year following the closing.³⁹⁴ FairPoint views the telecommunications industry as “quick-changing” and considered a rate cap of more than one year as “imprudent.”³⁹⁵ With only a one-year rate cap, however, FairPoint could request a rate increase as early as February 2009.³⁹⁶ If FairPoint seeks a rate increase in February 2009, it will seek to recover capitalized costs associated with its new operating systems, new local service centers, and broadband deployment to date.³⁹⁷

In the other two Northern New England States involved in the proposed transaction Maine and Vermont, Verizon operates under an alternative form of regulation (“AFOR”).³⁹⁸ Vermont’s AFOR controls rates until 2010.³⁹⁹ A renewal process is currently underway for Maine’s AFOR.⁴⁰⁰ If FairPoint is unable to raise rates in Vermont and Maine because of their respective AFORs or other conditions on the approval of the proposed transaction in those jurisdictions, the likelihood and pressure for a rate increase in New Hampshire would increase.⁴⁰¹

Despite FairPoint’s reluctance to provide rate stability to customers, a cap on basic local exchange service for a period of more than three years would not conflict with FairPoint’s financial

³⁹⁴ TR Day 2 10/23/07 p. 48, lines 1-13, and OCA Exh. 40P, subsection (b). But see FairPoint Exh. 9HC, pp. 105-106; and TR Day 2 10/23/07 p. 51, lines 1-6, and lines 8-12 (FairPoint willing to consider as part of “global settlement” a cap on basic local exchange rates for a period of up to three years). See also OCA Exh. 12P (one-year rate cap for discretionary services and directory assistance).

³⁹⁵ TR Day 2 10/23/07 p. 67, lines 10-14.

³⁹⁶ TR Day 2 10/23/07 p. 51, lines 13-18; and p. 51, line 22 through p. 52, line 3.

³⁹⁷ TR Day 2 10/23/07 p. 126, lines 17-20 (operating system costs); TR Day 4 10/25/07 p. 133, line 24 through p. 134, line 6 (operating system costs); TR Day 2 10/23/07 p. 126, 21-24 (operating system costs); TR Day 2 10/23/07 p. 75, lines 6-9 (broadband costs).

³⁹⁸ TR Day 2 10/23/07 p. 67, lines 16-18; and TR Day 4 10/25/07 p. 151, lines 12-19.

³⁹⁹ TR Day 2 10/23/07 p. 67, lines 19-22; and Transcript, October 25, 2007, p. 148, lines 5-8.

⁴⁰⁰ TR Day 2 10/23/07 p. 67, line 23 through p. 68, line 3; and TR Day 4 10/25/07 p. 151, lines 19-24.

⁴⁰¹ TR Day 2 10/23/07 p. 133, line 24 through p. 134, line 12; and TR Day 4 10/25/07 p. 145, lines 12-24, and p. 147, lines 1-4.

projections.⁴⁰² Based on FairPoint's own projections, a rate increase is not needed; as a result, FairPoint should be required to commit to its model projections through a five year rate freeze for basic local rates. A cap on basic local exchange service for a period of more than three years is also consistent with FairPoint's statements that it will not increase Verizon's existing rates for retail customers as a result of the proposed transaction.⁴⁰³

FairPoint has stated that "it would consider a two or three year stay-out, where by the company commits to making no requests for price increases in conjunction with the New Hampshire PUC agreeing also to not require any rate case activity [i.e. a rate reduction] during the same period . . . as part of a global settlement, FairPoint would certainly consider a two to three year stay-out."⁴⁰⁴

b. Customers face the risk of losing the hard-won Yellow Pages revenues under the proposed transaction

Directory revenues are included in Verizon's current rates, as they were established in its last rate case in 1989.⁴⁰⁵ Subsequently, Verizon spun off the directory assistance business without Commission approval, despite the fact that the directory assistance business was funded by ratepayers. As a result of litigation in 2004 and 2005, Verizon now imputes directory revenues of at least \$23 million dollars annually.⁴⁰⁶ That case was a significant victory for ratepayers, but will be a hollow victory under the parties' proposal in this transaction.

If the proposed transaction is approved, despite taking on Verizon's regulatory responsibilities, FairPoint has stated that it will not impute any amount for directory revenues.⁴⁰⁷ In

⁴⁰² Transcript, October 23, 2007, p. 54, line 18 through p. 55, line 1.

⁴⁰³ TR Day 2 10/23/07 p. 54, lines 2-7.

⁴⁰⁴ TR Day 2 10/23/07 p. 55.

⁴⁰⁵ See DR 89-10.

⁴⁰⁶ In re Verizon New Hampshire, 89 N.H. P.U.C. 382 (2004) (requiring imputation of at least \$23.3 million for ratemaking purposes), *rehearing denied by In re Verizon New Hampshire*, 89 N.H. P.U.C. 582 (2004), *affirmed by In re Appeal of Verizon New England, Inc.*, 153 N.H. 50, 889 A.2d 1027 (2005).

⁴⁰⁷ TR Day 2 10/23/07 p. 55, lines 8-22, and OCA Exh. 40P, subsection (e). See also TR Day 4 10/25/07 p. 134, line 18 through p. 135, line 8, and OCA Exh. 11P; and TR Day 2 10/23/07 p. 55, line 23 through p. 56, line 17; and OCA Exh. 50P (FairPoint did not include Yellow Pages imputation in its projections).

a rate case, this will amount to a revenue requirement of at least \$23 million more than it would be if Verizon remained in the state.⁴⁰⁸ The higher the revenue requirement, the higher the rates charged to customers.

Therefore, in order for ratepayers to realize the benefits granted to them by the New Hampshire Supreme Court, Verizon must either make a one-time payment for the benefit of customers that represents the equivalent value of the imputation, or FairPoint must agree to continue the imputation into the future. This must take place in this case in order to protect ratepayers from the risk of losing the benefit of the imputation forever.

c. Customers face the risk that FairPoint will file for an AFOR without a rate case, when the last rate case was in 1989

FairPoint has not ruled out seeking an alternative form of rate regulation (AFOR) in New Hampshire between 2008 and 2012.⁴⁰⁹ FairPoint also refused to commit to undergoing a full rate case prior to the implementation of an alternative form of regulation.⁴¹⁰ Verizon is currently under AFOR plans in both Maine and Vermont, so that New Hampshire is currently the only rate of return state of the three.

A full rate case is absolutely necessary prior to granting any company the pricing flexibility that comes from an AFOR, and is particularly important in this case, whether for Verizon or FairPoint. This is true because the last time Verizon, or in reality its predecessor New England Telephone Company, had a full rate case in which all of its costs, as well as costs by service offering were examined, was in 1989. Clearly, because nearly 20 years have passed and compounded by ownership changes, the cost structure in total and by service offering may have changed dramatically as has the telecommunications industry, mandating the need for a rate case in order to establish the

⁴⁰⁸ TR Day 4 10/25/07 p. 135, lines 17-20.

⁴⁰⁹ TR Day 4 10/23/07 p. 42, lines 1-13.

⁴¹⁰ TR Day 4 10/25/07007, p. 172, lines 15-23.

proper starting point for an AFOR. It is equally important that FairPoint “stay out” for some period of time to allow for a test year for ratemaking purposes to occur after the end of the transition period, which could last into 2010 or beyond. Therefore, the Commission must require that first FairPoint must commit that it will not file for an AFOR to go into effect prior to that time, and secondly that FairPoint agree to a full rate case prior to requesting an AFOR.

16. Customers face risks of continued service quality violations, and further decline in service quality

Service quality is an important issue for consumers. They expect that they will receive reliable service in exchanges for the rates they pay, and that the utility will be responsive to problems with service.

A complicating factor in this case with respect to service quality is that despite concerns expressed by Staff, the OCA and others over the last several years, Verizon’s quality of basic local exchange service in New Hampshire has been deteriorating, and Verizon NH demonstrates no intention of achieving PUC-established service quality standards before selling its landline assets to FairPoint.⁴¹¹ Neither Staff concerns, existing Commission standards, open dockets, nor purported competition have provided sufficient economic incentives for Verizon NH to improve and maintain its service quality.

Today Verizon is subject to service quality standards that were established in 1997, during the Bell Atlantic/NYNEX merger.⁴¹² In 2004, the Staff of the Commission requested that the

⁴¹¹ OCA Exh. 2p. See also, *Verizon’s Quality of Service Performance*, New Hampshire Public Utilities Commission DT 04-019, *Order Establishing Status Conference*, Order No. 24,551, December 1, 2005 (“Order No. 24,551”) and *Report on Initial Analysis for the Staff of the New Hampshire Public Utilities Commission*, by Curry & Associates, Docket No. 04-019, February 4, 2005 (“Curry Report”).

⁴¹² In re New England Telephone and Telegraph Company dba NYNEX, 82 N.H. P.U.C. 30 (1997) (approving the merger contingent upon the merged entity (now Verizon) meeting certain service quality standards).

Commission open a docket to investigate Verizon's service quality.⁴¹³ According to Staff, Verizon's service quality had been declining over the previous two and a half years, in part due to work force and capital expenditure reductions.⁴¹⁴ That docket is still pending, with no activity since September 2006, and Verizon continues to violate certain service quality standards. If the proposed transaction is not approved, the OCA will urge the Commission to turn its attention back to that docket immediately.

Another issue related to service quality is that today, Verizon files its service quality information on a confidential basis, claiming that it deserves confidential protection under RSA 378:43. As a result, New Hampshire customers do not have access to information on whether Verizon is meeting service quality standards. In Maine, customers can access this information on the Maine Public Utilities Commission website.⁴¹⁵ When asked, a FairPoint witness stated that he didn't "see any immediate reason why we wouldn't be willing to discuss" developing a public reporting mechanism similar to the Maine report.⁴¹⁶ If it approves the transaction, the Commission should include a condition requiring FairPoint to follow through on this commitment. There is no reason why New Hampshire customers should receive less information than customers in a neighboring state.

FairPoint has acknowledged that Verizon is not meeting certain service quality standards. Mr. Harrington testified in his prefiled direct testimony: "I am generally aware of issues that have been raised by some regarding Verizon's service quality in New Hampshire, to the extent those issues relate to network infrastructure. However, as the Commission is aware, there remains

⁴¹³ See DT 04-019, *Staff Memorandum to the Commissioners Regarding Verizon Service Quality*, February 24, 200. The Commission took administrative notice of certain documents in that docket in the present case.

⁴¹⁴ *In re Verizon New Hampshire*, 89 N.H. P.U.C. 382 (2004) (requiring imputation of at least \$23.3 million for ratemaking purposes).

⁴¹⁵ See OCA Exh. 100P.

⁴¹⁶ TR Day 6 10/29/07 p. 54 line 24, and p. 55 lines 1-2.

considerable debate and discourse regarding the service quality standards, if and how Verizon has met these standards, and what standards should be adopted by the Commission going forward.”⁴¹⁷

The Commission should pay close attention to Mr. Harrington’s statement that questions the standards. This is the exact approach taken by Verizon: criticize the standards generally in order to avoid complying with them, yet do not offer an alternative. This is compelling evidence of the need to have enforceable accountability to ensure that FairPoint will meet service quality standards regardless of any philosophical differences it may have with these standards. FairPoint should not be allowed to continue the status quo as it relates to the service quality consumers of Verizon are currently experiencing.⁴¹⁸

This is especially true in light of the fact that New Hampshire customers do not enjoy the protections that Verizon customers in Maine and Vermont currently have. Those states use similar systems to assign penalties to Verizon Vermont and Verizon Maine in the event of service quality shortfalls, which are returned to customers as refunds.⁴¹⁹ In both states, calculation of the penalty is based on the percentage deviation from the benchmark, summed over all benchmarks.⁴²⁰ For example, if the benchmark for Metric Alpha is 16, and the actual performance is 18, then percentage deviation is $(18-16)/16$, or 12.5%. In almost every case in both states, the performance areas are

⁴¹⁷ FairPoint Exh. 13, at p. 15, emphasis added.

⁴¹⁸ The Commission should also review FairPoint’s service quality record in its existing service territories,
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⁴¹⁹ See OCA Exh. 2P, p. 91-94. Specifically, for Maine, see *Maine Public Utilities Commission Investigation into Bell Atlantic-Maine’s Alternative Form of Regulation*, State of Maine Public Utilities Commission Docket No. 99-851, Order (Part 2), June 25, 2001; *Investigation into Verizon Maine’s Alternative Form of Regulation*, Docket No. 1999-851, NOTICE OF CONSIDERATION OF CHANGES TO SQI REBATE STRUCTURE, Investigation into Verizon Maine’s Service Performance, Docket No. 2005-24, NOTICE OF INVESTIGATION, January 13, 2005. For Vermont, see *Investigation into a Successor Incentive Regulation Plan for Verizon New England Inc., d/b/a Verizon Vermont*, Docket No. 6959, *Investigation into Tariff Filing of Verizon New England Inc., d/b/a Verizon Vermont*, in re: Compliance Filing in Docket 6959, Docket No. 7141, Order Adopting Amended Plan, April 27, 2006.

(APPENDIX B — 2005-2010 AMENDED RETAIL SERVICE QUALITY PLAN FOR VERIZON - Effective January 1, 2005).

⁴²⁰ Id.

measured monthly and averaged over 12 months, resulting in the annual performance measure.⁴²¹ In both states, the total annual service quality refund is capped – at \$10,515,650 in Vermont, and at \$12,500,000 in Maine. In New Hampshire, in contrast, New Hampshire customers lack these protections.

Several FairPoint witnesses acknowledged that Verizon currently has service quality problems. Mr. Nixon testified:

It's going to take us, as Mr. Smee said, a couple years for us to turn a couple of areas around. By and large, the services from a statewide-level basis, the network trouble report rate is pretty good. There are surveillance-level areas, some wire center areas that need remediation. I think Mr. Smee was extremely correct. We can't come in here and promise we're going to fix something overnight and then take two years to do it.⁴²²

Mr. Nixon also stated that “FairPoint is willing to work with Staff and the parties to identify service quality issues and to establish metrics that FairPoint will achieve, as well as reporting procedures by which FairPoint's performance can be monitored.”⁴²³ If the transaction is approved, the Commission sure include conditions to ensure that FairPoint follows through on this commitment.

In his Rebuttal Testimony, Mr. Smee, who joined FairPoint in April of 2006, also acknowledges the existing problems with Verizon’s service quality. He stated that the company “has no dispute with those metrics,” referring to the standards that apply to Verizon today.⁴²⁴

Mr. Smee also provided an estimate of the costs for remediation work to address existing service quality problems, while noting that as with the broadband plan, “it’s the 30,000-foot, 15,000-foot, 10,000-foot view. We will need to get into the analysis with the staff, the Verizon staff, when

⁴²¹ Id. One difference is how the percentage deviations are translated into actual dollar amount penalties. In Vermont, the percentage deviations are converted to “points,” with each point representing a specific dollar amount penalty. The penalty structure is such that as more points are accumulated (i.e. – service is worse), the points become more “expensive.” In Maine, each percentage deviation “costs” the same amount - \$7,500. In the Metric Alpha example above, the 12.5% deviation would result in a penalty of \$93,750.

⁴²² TR Day 6 10/29/07, p. 254 lines 2-10.

⁴²³ OCA Exhibit 93P.

they become FairPoint staff, and the data, in order to understand exactly what it will cost in each individual wire center. But we've made an estimate based on the size of the wire centers . . . [of] approximately 5 to \$6 million in the state of New Hampshire for the first year, and a similar number for the second year.⁴²⁵

Mr. Smee also testified that FairPoint will not commit to meeting the existing standards until two years after the planned cutover date of May 30, 2008, stating “we will be working to achieve full on-target performance with progress coming in phases over the 2 years post cutover.”⁴²⁶ As a result, FairPoint proposes to be exempted from the existing service quality standards until June 2010 – if the cutover takes place as scheduled on FairPoint’s aggressive schedule. Mr. Peres, an expert for the Labor Intervenors, aptly described this as “a regulatory holiday,” and pointed out that service quality could actually decline during that period.⁴²⁷

Mr. Smee also testified that FairPoint is only willing to commit to refraining from challenging the existing service quality standards for six months after they become effective, under the company’s 24 month plan. As a result, the company is proposing that it be subject to the existing standards for a six month period that could take place in 2010.⁴²⁸

FairPoint also opposed penalties for failure to meet service quality standards. There are currently no financial penalties in New Hampshire for service quality metrics.⁴²⁹ However, Mr. Nestor, Verizon’s Vice President for Government Relations for New Hampshire, stated that with respect to service penalties, “service penalties in a regulatory environment are but one factor Verizon utilizes in putting together service delivery plans.”⁴³⁰ If the transaction is approved, the Commission

⁴²⁴ TR Day 6 10/29/07, p. 53 lines 21-22.

⁴²⁵ TR Day 6 10/29/07, p. 93 lines 14-22, and p. 94 lines 1-3.

⁴²⁶ TR Day 6 10/29/07, p. 57, lines 20-22, and p. 200 line 24 through p. 210 lines 1-2.

⁴²⁷ TR Day 8 10/31/07, p. 200, lines 4-5.

⁴²⁸ TR Day 6 10/29/07 p. 59 line 24 through p. 60 lines 1-18. See OCA Exh. 109P.

⁴²⁹ TR Day 6 10/29/07 p. 57, lines 6-8.

⁴³⁰ TR Day 8 10/31/07 174 10-13.

should require a condition that FairPoint agree to service quality penalties, as they are necessary in order to ensure that the standards are met, and to provide the company with an economic incentive to abide by them. In fact, if New Hampshire is the only state of the three Northern New England states that does not have such penalties, it seems likely that our customers would be the last to see service quality improvements.

17. Customers of FairPoint “Classic” operations also face risks in this transaction

FairPoint refers to its existing operations as its “classic” operations or companies.⁴³¹ One of FairPoint’s classic companies Northland Telephone Company of Maine, Inc. d/b/a FairPoint Communications, provides service to the New Hampshire exchanges of East Conway and Chatham.⁴³² FairPoint serves approximately 384 customers in these New Hampshire exchanges. Due to the lack of transparency of FairPoint’s affiliate transactions, there is a possibility that FairPoint could pass along additional costs of the proposed transaction to its existing operations.⁴³³ The Commission should take steps to ensure that this cost shifting does not take place.

18. Customers face the risk that FairPoint will continue in acquisitions mode, transferring resources and attention out of the region

FairPoint intends to continue with acquisitions after this transaction.⁴³⁴ FairPoint contends that it will not consider additional acquisitions until the Northern New England operations are operating “smoothly and as planned,” and “efficiently and providing high-quality service to [its] customers.”⁴³⁵ However, FairPoint could not provide details about this assurance or how it might be

⁴³¹ See, e.g., TR Day 4 10/25/07, p. 176, lines 21-22.

⁴³² FairPoint Exh. 20, p. 5.

⁴³³ OCA Exh. 1HC, pp. 67-68.

⁴³⁴ OCA Exh. 1HC, p. 26, line 9, and p. 309 (exhibit DB-P-8, p. 40). TR Day 2 10/23/07 p. 122, line 24 through p. 123, line 11.

⁴³⁵ TR Day 2 10/23/07 p. 123, line 20 through p. 124, line 6.

implemented.⁴³⁶ In addition, FairPoint does not intend to seek Commission permission for additional acquisitions.⁴³⁷

Given the serious nature of these eighteen risks, especially those related to the financial condition of FairPoint, the Commission should not approve the proposed transaction. In addition, the few benefits claimed by the company are too vague, difficult to enforce, or may increase rates.

VI. IF THE COMMISSION APPROVES THE TRANSACTION, IT MUST IMPOSE CONDITIONS TO AVOID NET HARM TO CONSUMERS AND TO THE STATE AS A WHOLE RESULTING FROM THE PROPOSED TRANSACTION.

RSA 374:26 authorizes the Commission to grant permission to a public utility to engage in business in New Hampshire upon a finding “that such engaging in business... or exercise of right, privilege or franchise would be for the public good, and not otherwise.” RSA 374:26 also authorizes the Commission to “prescribe such terms and conditions for the exercise of the privilege granted under such permission as it shall consider for the public interest.”

While the OCA believes that the transaction as proposed should be rejected, we proposed the following conditions in the event that the transaction is approved. Each of these conditions is supported by the record. We note that the enforceability of each conditions is critical, as Verizon is currently not complying with conditions established in the NYNEX/Bell Atlantic merger in 1997, as discussed above.

A. Financial Conditions:⁴³⁸

1. FairPoint’s debt upon closing must be reduced by \$200 million by Verizon, without contingencies or limitations. Verizon is realizing a benefit in the order of \$600 million from the Reverse Morris Trust tax treatment alone.

⁴³⁶ TR Day 2 10/23/07 p. 124, line 19 through p. 125, line 12.

⁴³⁷ TR Day 2 10/23/07 p. 126, lines 14-16.

⁴³⁸ As a starting point, FairPoint must commit to accepting its own financial projections as conditions of approval.

2. FairPoint must reduce its dividend by 30% effective prior to close, and use the cash to pay down debt.
3. FairPoint must commit to an annual reduction in long term debt in the amount of at least \$50 million per year (equivalent to average debt reduction in its financial model).
4. FairPoint must agree to a dividend restriction that it may not pay dividends if its Debt/EBITDA ratio exceeds 4.75x in the first year or 4.4x thereafter.
5. TSA payments by FairPoint should be limited to the amount modeled of \$110M. The parties must restructure the TSA to ensure that FairPoint does not have an incentive to stay on the TSA longer than necessary.
6. Verizon shall fund to FairPoint for completion of the Raymond Central Office relocation and the Pinkham Notch project.

Verizon shall also provide funds to FairPoint to expeditiously remove the approximately 6400 double poles in the state (Verizon Exh. 32P).

8. Verizon shall pay amounts owed for tree trimming/pole maintenance as requested by Public Service Company of New Hampshire and Unital.
9. Verizon must place \$200 million in an escrow account for use by FairPoint for capital expenditures, efforts necessary to address system problems, and/or Broadband plan build out necessary due to Verizon's lack of investment. The NH Supreme Court decision affirming a PUC order requiring Verizon NH to impute for ratemaking purposes at least \$23.3 million annually earned by a Verizon directory affiliate, pre-dates the 2006 spin-off. Based on the present value of the annual \$23.3 million (or \$340 per line), Verizon owes New Hampshire ratepayers \$200 million.
10. FairPoint's New England subsidiaries shall not assume responsibility for the liabilities of FairPoint or its successor directly or indirectly as guarantor, endorser, surety, through pledging of assets or stock, or otherwise.
11. FairPoint shall make no further material acquisitions (i.e., those exceeding \$50 million) until and unless it experiences four consecutive preceding quarters with a debt-to-EBITDA ratio of 4.0 times or less, and meets the service quality objectives outline below.
12. FairPoint shall continue to provide the same state level FCC ARMIS reports as Verizon currently files at the FCC until such time as the Commission, after an opportunity for comment, determines that such reports are no longer necessary.
13. The management, billing and operational support systems platform developed for this transaction will be funded by FairPoint's New Hampshire, Maine and Vermont subsidiaries or their successors. FairPoint shall agree that any regulated operations in New Hampshire, Maine or Vermont shall not be charged any markup for margin over

cost for allocated costs of development or use of this system. FairPoint shall agree that charges for use of the system by any existing or future company operation in any other state shall inure to the benefit of the regulated entities in Vermont, New Hampshire and Maine and offset or reduce costs charged to any FairPoint regulated operation in these three states.

14. Any compensation, remuneration, or other payment to any officer, executive or board member of FairPoint as a consequence of, or related to the consummation of this transaction, shall be paid only in stock or stock options redeemable no sooner than 2012.
15. FairPoint must notify the Commission and parties to this docket of any downgrading of FairPoint's or any subsidiary's debt within seven days business days of such downgrade, and include with such notice the complete report of the issuing bond rating agency. FairPoint must also report whether the conditions driving the change in credit rating are anticipated to result in a short-term or long-term deterioration of credit metrics, and shall address FairPoint's liquidity and provide an explanation of FairPoint's financial condition that is verified and attested to by a corporate officer.

B. Service Quality:

16. FairPoint must provide a preliminary network improvement plan prior to close, and a detailed plan on how FairPoint will achieve Service Quality standards within 3 months after cutover but not later than Nov 1, 2008.
17. FRP will create a customer communication plan for Commission review 3 months prior to close.
18. FairPoint must agree to standards and financial consequences, including penalties and/or automatic customer credits, if PUC-established service quality benchmarks are not met. If standards are not met for 12 consecutive months, penalties are doubled. FairPoint must agree to a penalties scheme in line with the Maine and Vermont SQIs; details to be developed by FairPoint, Staff and OCA within 60 days of the Commission's final order. (See OCA Attachment A).
19. To be included in penalties/SQI plan:
 - a. FairPoint will meet call center standards within 6 months of cutover or not less than 6 months from Aug 1, 2008. (no later than Feb 1, 2009).
 - b. FairPoint must meet SQ standards at the statewide level beginning 9 months after cutover, but not later than May 1, 2009.
 - c. FairPoint must meet SQ standards at the Central Office (CO) level beginning 12 months after cutover, but not later than September 1, 2009.

20. FairPoint will work with Staff and the OCA to make service quality information and reports available to the public as is the case for the ILECs in Vermont and Maine.⁴³⁹ FairPoint should file service quality reports, on a monthly basis and in a web-based format which can be made available directly to consumers on the PUC website.
21. FairPoint agrees to provide same sales and service options as Verizon (with exception of Verizon “One Bill” including wireless). FairPoint will redirect calls to FairPoint 800 numbers.
22. FairPoint will provide for Commission review a copy of bill format 60 days prior to cutover.
23. FairPoint will negotiate contracts with the same payment agencies used by Verizon for in-person bill payment.
24. FairPoint should agree that it shall employ and continue to employ adequate resources to meet the quality of service standards established by the Commission.
25. FairPoint must provide monthly reports to the Commission beginning immediately to provide the staffing status for the Northern New England service area, with detailed information on the adequacy of technical skills of workers placed in new positions (new hires and transfers) as compared to departed employees. The report must include training plans and progress. These reports should continue until at least 6 months after cutover.
26. FairPoint should develop a profit-sharing plan to provide stock options based on longevity of employment as a way to retain Verizon’s skilled workforce. The program should provide stock options annually for the first 5 years post-close.

C. Broadband deployment

27. FairPoint must commit in New Hampshire to provide 75% BB available in 18 months, 85% BB available in 24 months, 95% in 60 months. BB is defined as 1.5M downstream out to 22,000 feet (not less than 764kb after 22k ft). FairPoint must agree to a penalty, i.e. \$1m for each percentage point under goal; monies go to state broadband fund.
28. FairPoint should commit to offering DSL at the rates presently charged by Verizon for at least three years.
29. FairPoint will offer unbundled (stand-alone) DSL so that consumers can obtain access to DSL without subscribing to the Incumbent Local Exchange Carrier’s (“ILEC’s”) voice service. The rates for unbundled DSL should be less than that for “bundled” DSL/voice.

⁴³⁹ / See OCA Exh. 100P.

30. FairPoint will establish specific broadband deployment dates and locations, with clearly delineated plans that set forth not only when and where broadband *will* be deployed but also where it *will not* be deployed so that consumers' expectations are not unnecessarily raised and so that policy makers and industry know where alternative technologies such as WiFi may be necessary.
31. FairPoint will work with NH policy makers and the Telecommunications Advisory Board to develop plans to reach 100% of customers in the state with high speed internet access, and should make funds available to deploy alternative technology to serve underserved or unserved regions of New Hampshire.
32. FairPoint will agree to not oppose municipalities' wireless broadband efforts to improve the chances of unserved areas gaining broadband access.
33. FairPoint will agree to provide comprehensive, clear and frequent customer education (and customer service representative education) about the deployment, pricing, rates, terms, conditions, and availability of unbundled DSL and stand-alone service.
34. FairPoint will make broadband deployment data public and should regularly provide it, at a minimum, to the Governor's office, the PUC, the Telecommunications Advisory Board, and to the OCA to assist policy makers in designing and implementing broadband policy tailored to the specific needs of New Hampshire. As part of that effort, FairPoint will provide the information necessary to identify unserved and underserved areas of the state.
35. FairPoint will commit to abide by the net neutrality commitment as set forth in the FCC's set of conditions that apply to AT&T, as a result of its acquisition of BellSouth for at least five years.

D. Rate Design

36. FairPoint must offer unbundled (i.e., a la carte or stand alone) basic local exchange service indefinitely, or at the very least, until the Commission makes an affirmative finding that such a requirement is no longer in the public interest. The availability of such service should be well-publicized and well-explained to customers by customer service representatives. FairPoint may not discontinue or grandfather basic "barebones" local service.
37. FairPoint will cap basic local exchange service rates in New Hampshire at present rates for at least five years (through 2012).
38. FairPoint must commit to filing a rate case prior to seeking an alternative form of regulation (AFOR) in New Hampshire.
39. FairPoint must agree that in future rate cases in the next ten years, the cost of capital will be based upon an investment-grade bond rating if FairPoint is still non-investment grade.

40. In any future rate proceeding, FairPoint rates will reflect Yellow Pages directory revenues foregone by FairPoint when it agreed not to compete with Verizon's former directory business for thirty years.
41. FairPoint must propose a cost allocation manual, to be approved by the Commission, to ensure that there is no subsidy from its regulated operations to any of its unregulated operations, including broadband and any future video business. FairPoint must pay the regulated entity the fair share of any joint and common costs attributable to regulated facilities, including the loop.
42. FairPoint's marketing scripts and customer education for bundled packages, discretionary features, and inside wiring maintenance are subject to Commission review and approval, to ensure that consumers make informed decisions.
43. FairPoint will participate in efforts to increase Lifeline participation, as outlined in the MOU between FairPoint and New Hampshire Legal Assistance on behalf of Ms. Schmitt, and will include Staff and the OCA in those efforts.

E. Transaction costs

44. Consumers should not bear the costs associated with developing or implementing the proposed transaction. FairPoint must commit to refrain from seeking recovery of any transaction, regulatory, branding, integration, legal, and other transaction-related expenses in regulated rates, including TSA and Cap Gemini costs.
45. FairPoint should commit to maintain separate books to create an accounting trail for transaction-related expenses, and should provide a report of such expenses within six months and 18 months of closing.

F. Other issues

46. FairPoint must agree to apply conditions imposed in Maine and Vermont so that New Hampshire customers realize at least equivalent benefits.
47. Regarding post-transaction commitments, at a minimum FairPoint must submit a monthly report to the PUC and to the OCA regarding progress met, and there should be an enforcement mechanism in place for each commitment (i.e. SQ, BB, etc.) in the event that commitments are not met
48. The state's E-911 system is of utmost importance to the public safety and well-being of its citizens. The PUC should assess FairPoint's ability to operate and provision E911. In doing so, it may be prudent for the Commission to seek input from the E911 Emergency Bureau.⁴⁴⁰

^{440/} See RSA 363:18 "Cooperation With Other Agencies – The commission may confer and cooperate with any other state, federal, or local agency in any matter relating to its duties."

VII. Conclusion

For the reasons set forth above, the OCA recommends that the Commission reject the transaction as proposed because the parties have not met their burden of showing that the transaction is in the public interest. In fact, if the transaction is approved as proposed, it will result in net harm to customers. If the Commission does approve the transaction, it should only do so with the conditions discussed above, as well as other appropriate conditions proposed by other parties.

Respectfully submitted,
OFFICE OF CONSUMER ADVOCATE



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Certificate of Service

I certify that on this date a copy of this document was provided to all persons on the service list in this docket.

Date: November 21, 2007



Meredith A. Hatfield, Esq.

Service Quality Incentives in Maine and Vermont

Vermont's SQI

The Service Quality Index covers these metrics:

Vermont SQI	
Performance Metric	Benchmark
1. Network Trouble Report Rate-Vermont: reports per 100 lines	1.4
2. Troubles Not Cleared within 24 hours-Residence	30%
3. Troubles Not Cleared within 24 hours-Business	10%
4. Calls Not Answered within 20 seconds-Residence Offices	25%
5. Calls Not Answered within 20 seconds-Business Offices	25%
6. Repair Centers:	
a. Busy Rate	3.0%
b. Calls Not Answered Within 20 seconds	20%
7. Installation Commitments Not Met for Company Reasons-Residence and Business Total	2.5%
8. Installation Held Orders Residence and Business Combined:	
a. Missed Installation Rate	0.70%
b. Average Delay Days for Missed Installations (days)	14
9. Service Reliability:	
a. Service Outage (5,000 lines over 30 minutes): number of events	1
b. Interoffice Facility Failure (30,000 lines over 30 minutes): number of events	1
c. Signaling System Failure (outages over 30 minutes): number of events	1
10. Umbilical Blockage:	
a. Units greater than .11% Blocking	7%
b. Units greater than .11% Blocking for longer than 3 consecutive months	0%
c. Units greater than 0.0% blocking	35%
11. Dial Tone Speed:	
a. Switch modules with dial tone delay greater than .20%	7%
b. Switch modules at greater than .25% dial tone consecutive months: number of modules	0

- Verizon must make an annual Retail Service Quality filing. In this filing, Verizon must calculate the service quality compensation to be paid to consumers. The service quality compensation is paid as a one-time rebate each year.
- In calculating the service quality compensation, each metric is evaluated separately. One metric cannot offset another.
- Each metric is evaluated monthly. Monthly results are averaged to determine the annual performance.

OCA Attachment A

- For each metric, the deviation of the actual annual performance from the Baseline Standard is expressed as a percentage, and then multiplied by 100, yielding the number of “service quality compensation points” for that metric.
- The total of the points over all performance areas yields the total “service quality compensation points” for the year.
- The Service quality compensation points are translated to dollars using a tiered system of equivalence. The first 25 points “cost” \$10,000 each in service quality compensation. The next 75 points results in a penalty of \$15,000 for each point. The table below summarizes the penalty structure.

Points Over Benchmark	Rebate Dollars per Point	Maximum Cumulative Rebate
up to 25	\$10,000	\$250,000
26 to 100	\$15,000	\$1,375,000
101 to 150	\$22,500	\$2,500,000
151 to 200	\$33,750	\$4,187,500
201 to 250	\$50,625	\$6,718,750
251 to 300	\$75,938	\$10,515,650
Example: 163 Service Quality Compensation Points = \$2,938,750.		

- The maximum annual rebate is \$10,515,650.
- There are additional details. OCA could recommend that within 1 month of the Commission’s order, FairPoint submit a specific SQI that corresponds with the Vermont SQI.

Source: *Investigation into a Successor Incentive Regulation Plan for Verizon New England Inc., d/b/a Verizon Vermont, Docket No. 6959, Investigation into Tariff Filing of Verizon New England Inc., d/b/a Verizon Vermont, in re: Compliance Filing in Docket 6959, Docket No. 7141, Order Adopting Amended Plan, April 27, 2006. (APPENDIX B — 2005-2010 AMENDED RETAIL SERVICE QUALITY PLAN FOR VERIZON - Effective January 1, 2005)*

Maine SQI

The current SQI contains 15 performance benchmarks. The benchmarks for two criteria, “Major Service Outages” and “PUC Complaint Ratio,” are based on annual totals. The other benchmarks are based on the average of 12 monthly results.

The following table lists the current performance measures, as well as modifications recommended by the Hearing Examiner on May 7, 2007.

Maine SQI - Current and Recommended Benchmarks		
Performance Metric	Current Benchmarks	Recommended Benchmarks
CUSTOMER SERVICE		
1. Premise Installations: % Appointments Not Met – Company Reasons	12.64%	12.64%
2. Mechanized Installations: % Appointments Not Met – Company Reasons	0.10%	0.10%
3. Premise Repairs:- % Appointments Not Met – Company Reasons	16.11%	16.11%
4. Mechanized Repairs: % Appointments Not Met – Company Reasons	7.21%	7.21%
5. Held Orders - Average Delay Days	6.21	6.21
6. Business Office calls: % Answered over 20 seconds	31.00%	31.00%
7. Repair Service Calls: % Answered over 20 seconds	23.10%	23.10%
SERVICE RELIABILITY		
8. Customer Trouble Reports Rate per 100 lines	1.08	1.08
9. Repeat Trouble Reports Rate per 100 lines	0.12	0.12
10. % Troubles not cleared within 24 hrs – Residential Customers	21.10%	21.10%
11. % Troubles Not Cleared within 24 hours - Business Customers	9.00%	9.00%
12. Duration of Residential Outages (hours)	None	17.5
13. Dial Tone Speed % over 3 seconds	0.36%	Remove
14. % Blocked Calls	0.03%	Remove
15. Major Service Outage	614	614
CUSTOMER SATISFACTION		
16. PUC Complaint Ratio (complaints per 1000 customers)	0.52	0.52

Under the current SQI:

- The customer rebate for each benchmark is calculated by finding the percentage deviation of the actual performance from the benchmark and multiplying this number by \$750,000.
- The rebate for each performance benchmark is \$1.135M annually, except for the “Major Service Outage” metric, which is capped at \$2.27M. The annual SQI rebate is capped at \$12.5M.

Under the Hearing Examiner’s proposed revisions to the SQI, Verizon Maine’s total service quality rebate would no longer be capped annually, nor would individual elements be capped.

The Hearing Examiner’s recommendation for revising the SQI involves a plan similar to Vermont’s SQI – i.e., assigning a “service compensation point” for each 1% in excess of the benchmark, for each benchmark. The points would then be totaled and assigned values, with the values increasing, as shown in the table below.

Points Over Baseline	Rebate Dollars per Point	Maximum Cumulative Rebate
0 to 25	\$15,000	\$375,000
26 to 100	\$20,000	\$1,875,000
101 to 150	\$25,000	\$3,125,000
151 to 200	\$35,000	\$4,875,000
201 to 250	\$50,000	\$7,375,000
251 to 300	\$75,000	\$11,125,000

In addition, under the Hearing Examiner’s proposal, if Verizon Maine misses an individual benchmark for two or more years, it must pay an additional annual customer rebate equal to the base rebate for the metric times the number of years missed.

Sources: *Maine Public Utilities Commission Investigation into Bell Atlantic-Maine’s Alternative Form of Regulation, State of Maine Public Utilities Commission Docket No. 99-851, Order (Part 2), June 25, 2001; Investigation into Verizon Maine’s Alternative Form of Regulation, Docket No. 1999-851, NOTICE OF CONSIDERATION OF CHANGES TO SQI REBATE STRUCTURE, Investigation into Verizon Maine’s Service Performance, Docket No. 2005-24, NOTICE OF INVESTIGATION, January 13, 2005; Maine Public Utilities Commission Investigation into New Alternative Form of Regulation for Verizon Maine Pursuant to 35-A M.R.S.A. Sections 9102-9103, State of Maine Public Utilities Commission Docket No. 2005-155, HEARING EXAMINER’S REPORT (REVENUE REQUIREMENT AND SERVICE QUALITY ISSUES), May 9, 2007.*