

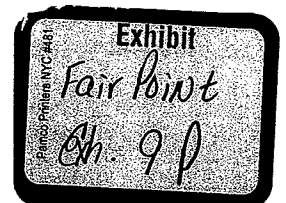
STATE OF NEW HAMPSHIRE
BEFORE THE
PUBLIC UTILITIES COMMISSION

DT 07-011

**Joint Petition by Verizon New England, Inc., et al.
and FairPoint Communications, Inc.
Transfer of New Hampshire Assets of
Verizon New England, Inc. et al.**

**Rebuttal Testimony of Walter E. Leach, Jr.
On Behalf of
FairPoint Communications, Inc.**

SEPTEMBER 10, 2007



Summary: Mr. Leach's testimony discusses the financial characteristics and soundness of the proposed transaction, responding to issues raised by the Commission Staff, the Office of Consumer Advocate and Intervenor witnesses. In particular, Mr. Leach addresses: (i) the purpose for the FairPoint financial model and why the model was not constructed as a tool for third parties to easily conduct multiple high-level scenario analyses, (ii) changes that were made to the projection model between initial testimony and discovery, and why the financial model has evolved over time which is typical in the execution of mergers and acquisitions; (iii) issues related to FairPoint's proposed pro forma capital structure, credit quality, and debt covenants, (iv) questions regarding FairPoint's operating expense projections and ability to generate expected operating cost savings (including why the cost savings should not be excluded from our projections and why the Hawaiian Telcom back office integration situation will not be repeated in this transaction); (v) issues raised regarding projected levels and sufficiency of capital investment; (vi) why FairPoint's business model and history make it an ideal candidate for the acquisition of the Verizon northern New England business; and (vii) FairPoint's assertion that any risks from this transaction will be borne primarily by shareholders and not customers, employees and communities.

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Mr. Leach Supports the Following Exhibits:

Exhibit WL-2	FairPoint Analyst Presentation, January 16, 2007
Exhibit WL-3	New Hampshire Standalone Projections (Highly Confidential)

1 **Introduction & Summary of Testimony**

2 **Q.** Please state your name.

3 **A.** Walter E. Leach, Jr.

4 **Q.** Are you the same Walter E. Leach, Jr., who previously filed testimony on behalf of
5 FairPoint in this proceeding?

6 **A.** Yes.

7 **Q.** What is the purpose of your testimony?

8 **A.** The primary purpose of my testimony is to address issues raised in the direct testimony of
9 the Staff of the Public Utilities Commission of New Hampshire (Staff) (primarily John
10 Antonuk and Randall E. Vickroy, together the "Liberty Witnesses"), the Interveners
11 (primarily Labor witness Randy Barber) and the Office of Consumer Advocate (OCA)
12 (primarily David Brevitz) regarding the financial characteristics and soundness of the
13 proposed transaction. Specifically, I will address: (i) the purpose for the FairPoint
14 financial model and why the model was not constructed as a tool for third party users to
15 conduct multiple high-level scenario analyses, (ii) changes that were made to the
16 FairPoint Communications, Inc. (FairPoint) financial model between initial testimony
17 and discovery, and why FairPoint's model has evolved over time which is typical in the
18 execution of mergers and acquisitions, (iii) issues related to FairPoint's proposed pro
19 forma capital structure, credit quality, and debt covenants, (iv) questions regarding

1 FairPoint's operating expense projections and ability to generate expected operating cost
2 savings (including why the cost savings should not be excluded from our projections and
3 why the Hawaiian Telcom back office integration situation will not be repeated in this
4 transaction), (v) issues raised regarding projected levels and sufficiency of capital
5 investment, (vi) why FairPoint's business model and history make it an ideal candidate
6 for the acquisition of the Verizon northern New England business (Spinco), and (vii) the
7 misconception that any risks from this transaction will be borne primarily by customers,
8 employees and communities. Other financial issues suggested by the and OCA will be
9 addressed by FairPoint witnesses Michael J. Balhoff and William E. King.

10 **Q.** Please summarize your testimony.

11 **A.** Contrary to Mr. Barber's contention that FairPoint's financial case supporting the
12 transaction is "extremely optimistic" (Barber Confidential, p. 42, line 11), I will show (in
13 conjunction with other FairPoint witnesses) that our financial projections in fact reflect
14 reasonable assumptions and contain a substantial "margin of error" to accommodate
15 unforeseen circumstances. In fact, the testimony of Bill King will show the
16 reasonableness and indeed conservatism of our model relative to cash flow margins of
17 other comparable companies.

18 As part of the normal transactional processes, FairPoint's financial projections rationally
19 have evolved over time as we have gained greater knowledge and insight regarding the
20 underlying Spinco operations and financial results and as we advance our plans for

1 operating the combined company. In addition, most of the recent modifications have
2 reflected depreciation and amortization accounting adjustments, with our projected
3 operating results remaining unchanged. The latest iteration of our financial model is the
4 version delivered during discovery in this proceeding. FairPoint is engaged in an
5 exhaustive planning effort prior to the closing of the transaction. As a result of the depth
6 and evolution of our financial projections, FairPoint has provided the Interveners, Staff
7 and the OCA a more developed and accurate picture of the combined company. Far from
8 being a cause for concern, it should be seen as standard operating practice and a positive
9 that FairPoint developed better and better information related to the Spingo operations
10 and proactively reflected the impact of new information in its model (regardless of
11 whether the impact was positive or negative).

12 More specifically, I will demonstrate that FairPoint has a proven track record of
13 delivering improved operating results that exceed the company's projections related to
14 acquisitions. I will discuss how FairPoint is indeed projecting reasonable levels of
15 growth in cash operating expenses, both on an absolute dollar and a per line basis. In a
16 declining access line environment, our decision to model increasing absolute dollar and
17 per line cash operating expense is reasonable.

18 In addition, I will address briefly and other witnesses will address in detail why we
19 believe our assumptions regarding the duration of Transition Services Agreement (TSA)
20 with Verizon are reasonable based on the detailed conversion plan we have described in
21 this proceeding. I will provide a brief explanation of how the conversion planning and

1 process FairPoint is executing is materially different from the Hawaiian Telcom
2 approach, thus making a repeat of the Hawaii experience highly unlikely. Other
3 FairPoint witnesses provide a detailed explanation differentiating our process from the
4 Hawaiian Telcom experience.

5 Also, I will provide greater detail and explanation regarding FairPoint's expected \$60
6 million to \$75 million operating expense savings related to its assuming management of
7 the Spinco operations. This additional detail should provide the Interveners, Staff and the
8 OCA with greater comfort that these avoided costs are reasonable and achievable. I will
9 address specifically the opinion of the Liberty Witnesses that these cost savings should
10 not be included in FairPoint's base case financial projections in this proceeding. Certain
11 costs will be avoided because the allocation of Verizon corporate overhead will cease
12 upon the closing. These avoided costs constitute savings which result in projected cash
13 flows which create a substantial cushion of available cash flow over and above those
14 amounts required to meet all projected operating expenses, capital expenditures, tax
15 payments and debt service requirements. The result is a company which can comfortably
16 meet all of its commitments even if unexpected events occur in the future.

17 Next, I will discuss and address issues related to FairPoint's capital investment plans,
18 demonstrating (even after ignoring the \$200 million spent on back office systems and the
19 \$44 million to be spent soon after closing to increase broadband availability) that we are
20 in fact planning to invest greater amounts on a per line basis than Verizon has in recent
21 years. In addition, FairPoint is committing to hire additional staff to deal with quality of

1 service issues and other recurring items (as described in Mr. Nixon's testimony) which
2 are of concern to the parties. When the data are analyzed properly, it is clear that
3 FairPoint intends to invest sufficiently to provide for its broadband build-out plan, while
4 maintaining and improving the service quality of the Spinco operations.

5 I will explain why it is incorrect to characterize FairPoint's approach to business as based
6 on investing as little as possible in our network. As of March 31, 2007, our company
7 offered broadband to over 92% of its customers and has an industry-leading 26%
8 broadband penetration rate (of voice access lines).¹ It is inconceivable that we could
9 have achieved these successes while serving some of the most rural service territories in
10 the U.S. by starving our networks of investment.

11 Next, I will describe how the FairPoint shareholders will first bear any financial risks
12 from this transaction before any customers, employees and communities, as the
13 projected but discretionary dividend payment would be made available to cover
14 unexpected cash requirements. Contrary to misplaced assumptions regarding how the
15 FairPoint management team would handle any unforeseen financial challenges, it would
16 be irrational for us to take any actions that would risk our relationship with customers and
17 employees or to cease making adequate investment in the operations. To do so would
18 risk the underlying long-term health of the business and value of the assets. In the
19 unlikely event that we are forced to choose between paying the full near-term dividend
20 and taking actions to ensure the long-term health and value of the business, our

¹ *The ILEC Advisor*, June 2007, produced by JSI Capital Advisors.

1 shareholders will understand and support our rational decision to alter the dividend
2 payment if necessary to be able to continue to provide high-quality products and
3 customer service and to maintain investment in our network.

4 Finally, I will discuss and provide additional background regarding FairPoint's
5 discontinued CLEC initiative, highlighting the extenuating circumstances surrounding the
6 decision to no longer pursue that effort. Regardless of what occurred related to the
7 CLEC operations, the proposed transaction with Verizon builds upon FairPoint's existing
8 line of business (the incumbent local exchange carrier business) and falls squarely within
9 FairPoint management's core competency.

10 **Q.** Before we get into the specifics of your testimony, is there anything else you would like
11 to add regarding the transaction in general?

12 **A.** Yes. While much has been made of some of the more minute details regarding financial
13 and operating plans, all of which we will address, I think that it is important that the
14 Commission keep in mind the total picture of the benefits this transaction will offer to
15 numerous constituencies in New Hampshire. As I indicated in my direct testimony, this
16 is an important transaction not only for the companies and their investors, but also for the
17 customers, employees and communities of northern New England. This merger will
18 bring benefits of accelerated and increased broadband availability and other investment to
19 the economies of Maine, New Hampshire, and Vermont. The network being developed
20 to provide such broadband services incorporates newer technology than that being

1 deployed by Verizon, and will better serve the customers of New Hampshire over the
2 long term as explained in other witnesses' testimony. The transaction also will provide
3 stability to existing Verizon employees in the region, with compensation and benefits
4 commensurate with what they currently enjoy. In addition, new job opportunities will be
5 created and employees will see additional opportunities for professional development.
6 The transaction will create a financially stable company with a singular strategic focus in
7 smaller urban and rural communities of providing high-quality advanced communication
8 services that meet the needs of consumers at competitive prices. We are committed to
9 capping existing basic retail rates and CLEC wholesale rates for at least one year and
10 existing special access rates for at least 18 months following the closing. Finally,
11 FairPoint will create and staff a department of community development, reporting to the
12 President and has engaged a nationally recognized leader in connectivity enabled
13 economic transformation in rural and small urban communities to initiate and launch an
14 economic development program across the region (as described in Mr. Nixon's
15 testimony). We believe that it is clear that this transaction is good for our current and
16 future customers, our employees, our company and our communities. As we delve into
17 the minutiae of financial metrics and operating plans, I think it is very important that we
18 not lose sight of all of the tangible benefits the proposed transaction has to offer the
19 citizens of the region. FairPoint is a company that wants to commit substantial capital
20 and operating resources to New Hampshire and to whom the state will be a very
21 important market, whereas the current service provider does not have a strategic plan
22 which focuses primarily on Maine, New Hampshire or Vermont and has no apparent

1 intention to pursue the types of broadband investments and job expansion in New
2 Hampshire to which FairPoint has committed.

3 **Overview of the FairPoint Financial Model**

4 **Q.** Could you provide a brief overview of the creation of the FairPoint financial projection
5 model and its intended use?

6 **A.** The FairPoint financial projection model was created in conjunction with our investment
7 bankers, Lehman Brothers and Morgan Stanley. It was developed as a tool for capturing
8 and presenting the financial data provided to us by Verizon, and then projecting forward
9 our expectations for the operating and financial performance of the combined company
10 based on the assumptions we believed most appropriate. The underlying template for the
11 model was produced by Lehman Brothers, but the form and substance of the model
12 evolved substantially as our work on the transaction progressed over an 18 month period.
13 The model was intended to produce a detailed view of the expected financial
14 performance of the combined company based on assumptions that FairPoint's
15 management deemed reasonable. Quite simply, the purpose was to create a set of
16 comprehensive financial projections.

17 **Q.** OCA witness Brevitz and Labor witness Barber go to great lengths to try to discredit the
18 reliability and functionality of the financial model. Can you address the issues they
19 raise?

1 **A.** Yes. Fundamentally I think that there is a disconnect between what Mr. Brevitz and Mr.
2 Barber would like the financial model to easily do and what it actually was created to do.
3 It is apparent that these witnesses would prefer that the model function more like a high-
4 level acquisition analysis model capable of quickly and easily generating multiple
5 scenario analyses for a first time user. FairPoint's projection model was not created to
6 be, nor was it ever intended to be, such a tool for a third party. As I described above, our
7 projection model evolved over time as we received relevant information from Verizon
8 and factored that information into the model. The modeling team—the FairPoint analysts
9 and the analysts from Lehman Brothers and Morgan Stanley—know the model well
10 enough that they can confidently run different scenarios by assuring all formulas, pages
11 and tabs are correctly changed as different scenarios are considered. A new third party
12 attempting to make such changes would find it difficult to get comfortable with their
13 results because of the lack of familiarity with the model. In fact, in a meeting with OCA
14 and Labor representatives in Washington, DC, on July 12th, we described to Mr. Brevitz
15 and Mr. Barber the process for creating the model, stated its intended internal use, and
16 indicated they would find it somewhat difficult to use the model for creating scenario
17 analyses. So, I think much of the discussion regarding the functionality of our projection
18 model presented by the OCA and Labor witnesses stems from the fact that they want the
19 model to be something that it was never intended to be.

1 **Q.** Do you believe that the fact that the projection model was not created to easily perform
2 the functions desired by the OCA and Labor witnesses makes the model and its outputs
3 unreliable for the purposes of this proceeding as they claim?

4 **A.** No, I do not. In my experience there are numerous, valid types of projection models.
5 The fact that our financial model evolved in such a way that it is not easy for a third party
6 to readily perform scenario analyses should in no way discredit the overall outputs. We
7 are confident that the projections represent a valid and well thought out picture of the
8 likely future financial performance of the combined company. It is hard to believe that a
9 financial model created with substantial input and effort by two of the largest, most-
10 respected global financial institutions would be deemed unreliable and unfit for these
11 regulatory proceedings.

12 **Q.** Beyond their concerns with the functionality of the model, Mr. Barber and Mr. Brevitz
13 also seem concerned that some of the specific detailed assumptions are not what they
14 might have expected. How do you respond to these concerns?

15 **A.** Below I will provide responses to some of their concerns regarding specific assumptions
16 in the financial model. However, I think that it is important that the Commission focus
17 its review on the reasonableness of the overall financial picture presented in the
18 projections. As with any detailed financial modeling exercise, reasonable people can
19 disagree on any number of underlying, discrete assumptions and variables. What is most
20 important is that, regardless of these differences of opinion regarding modeling minutiae,

1 the relevant outputs (income statement, balance sheet and cash flow statement) are
2 reasonable.

3 In this regard, I believe there is substantial evidence that the projections generated by our
4 model are reasonable. FairPoint witnesses King and Balhoff provide detailed support
5 regarding the reasonableness, and in many cases conservative nature, of key projected
6 financial and operating metrics and ratios relative to other comparable companies in our
7 industry. The operating cash flow (or EBITDA) margins that we have projected for
8 Spinco are well below the margins being achieved by a group of comparable or
9 “guideline” companies. Our operating expense per line projections are consistent with
10 what was observed among the guideline companies. However, we are projecting
11 revenues per line that are well below the guideline companies. Therefore, if we are able
12 to increase revenue per line to levels consistent with those being achieved by the
13 comparable company group, there is substantial opportunity for EBITDA margin
14 improvement. The fact that FairPoint has projected Spinco EBITDA margins
15 substantially below the margins being achieved by other companies in our industry
16 should give the Commission confidence that our overall projections are reasonable and
17 reliable. I might reiterate that while these are management’s projections, we developed
18 them while working closely with our financial advisors Lehman Brothers and Morgan
19 Stanley. The projections also have been market-tested in the sense that a number of
20 leading financial institutions have used the projected results in deciding to commit to
21 provide a very substantial portion of the financing required to complete this transaction

1 and operate the business after the merger. The financing commitments are a ringing
2 endorsement of management's work and are tangible evidence to refute all of the other
3 testimony critical of our financial projections and model. If the model and projections
4 are sufficient for these institutions to commit in excess of a billion dollars to this
5 transaction, I firmly believe that the projections should provide a reliable basis for the
6 review required in this proceeding.

7 **Q.** You indicated that you would address some of the more meaningful concerns raised by
8 Mr. Brevitz and Mr. Barber regarding specific assumptions in the model. Could you
9 please do so?

10 **A.** Yes. Below I will address their more relevant concerns regarding specific model
11 assumptions. I will not endeavor to explore all of the assumptions on which they
12 comment, as again I believe that the individual assumptions are not nearly as important
13 for this proceeding as the overall financial picture presented.

- 14 ▪ Cable competition and DSL penetration: Mr. Brevitz indicates in his testimony
15 that the line loss trends incorporated in FairPoint's projections do not properly
16 account for what he believes will be an increase in competition in the region from
17 cable companies (Brevitz, Highly Confidential Level 1, p. 121). He also indicates
18 that he has concerns about the projected rates of assumed growth in DSL
19 penetration and the impact that delayed availability / up-take of FairPoint's DSL
20 product could have on the combined company's ability to fend off the cable

1 competitors (Brevitz, Highly Confidential Level 1, p. 124-125). With regard to
2 Mr. Brevitz's concern, we are confident that our projections reflect reasonable
3 line loss assumptions. As can be seen in FairPoint witness King's Table 2.2, in
4 2005 and 2006, Verizon's decline in average annual access lines in the three-state
5 region was 5.0% and 5.7%, respectively. In our access line projections,

6 *****BEGIN CONFIDENTIAL INFORMATION*****

7
8 *****END CONFIDENTIAL**

9 **INFORMATION***** In total, from 2007 through 2015, we assume a more than
10 29% decline in average annual access lines. We believe it is reasonable to expect
11 that access line losses will plateau and moderate as a result of competitive balance
12 being achieved in the marketplace and our increased focus on providing regional
13 customers the products they desire. A *****BEGIN CONFIDENTIAL**

14 **INFORMATION***** *****END CONFIDENTIAL INFORMATION*****

15 loss of access lines over the projection period is substantial and clearly
16 incorporates the impact of an anticipated increase in cable competition.

17 Mr. Brevitz's concerns regarding our ability to deploy and provide broadband
18 products to our customers in the timeframe we project, and similar concerns
19 expressed by the Liberty Witnesses, seem to be based primarily on the belief that
20 our implementation plans are not sufficiently detailed and developed. Other
21 FairPoint witnesses will address the details and reasonableness of our broadband

1 build-out plans. However, Mr. Brevitz goes on to state that any delay in our
2 execution of the broadband build-out will impact our DSL subscriber projections
3 and our ability to defend against cable competitors. With respect to our projected
4 growth in DSL subscribers, we are not assuming that “DSL customer additions
5 happen quicker rather than slower” as Mr. Brevitz contends (Brevitz, Highly
6 Confidential Level 1, p. 122). ***BEGIN CONFIDENTIAL

7 INFORMATION***

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9
10
11 ***END

12 CONFIDENTIAL INFORMATION*** We believe this level of line loss is
13 sufficient to incorporate any competitive impacts of slight delays in our
14 broadband roll-out (which we do not expect to occur).

- 15 ■ Cash taxes: Mr. Brevitz discusses how FairPoint has historically benefited from
16 Net Operating Loss (NOL) carry forwards to reduce its cash tax obligations and
17 improve cash flows. He indicates that these NOLs will be reduced as a result of
18 the transaction, causing the combined company to pay cash taxes beginning in
19 2009 (Brevitz, Highly Confidential Level 1, p. 66). Since this relates to
20 FairPoint’s cash flows available to cover its capital and financial obligations and
21 discretionary dividends, I think it is important to be clear that our financial

1 projections incorporate the requirement that we begin paying cash taxes.

2 Therefore, when the cash flows in our projections are analyzed, it should be
3 understood that these calculations include the cash taxes referenced by Mr.
4 Brevitz.

5 **Q.** Mr. Barber challenges FairPoint's assumptions for employee levels and related labor
6 costs. Do you maintain that FairPoint's assumptions are reasonable, especially based on
7 recent Verizon trends?

8 **A.** Yes, I continue to believe that our assumptions for employee levels and related
9 compensation expenses are realistic. Following the successful transition off of existing
10 Verizon systems and beginning in 2009, our financial projections assume that natural
11 employee attrition will offset pay increases, which is in some cases guaranteed to
12 employees via a collective bargaining agreement. Assuming that pay increases are in line
13 with recent Verizon trends of 2.4% on average per year, our financial projections imply
14 an attrition rate of *****BEGIN CONFIDENTIAL INFORMATION*****

15 *****END CONFIDENTIAL INFORMATION***** As a
16 point of reference, Verizon's actual rates of attrition for these properties were reported to
17 be 4.7% and 4.1% for 2005 and 2006 respectively. Given that our assumed average pay
18 increases and rate of attrition are in line with actual Verizon results, and considering the
19 fact that our model assumes continued access line erosion, I am confident our projections
20 reflect a strong "base case."

1 Q. Mr. Barber argues that since FairPoint will be serving the same service area and will be
2 performing functions in-house that Verizon provides through NNE affiliated companies,
3 it is “completely unrealistic” to assume the employee levels implied in the financial
4 projections by 2015. How would you respond to this notion?

5 A. While I agree that there must be some “floor” in the level of employees needed to run
6 these properties, I believe our staffing projections remain comfortably above that
7 minimum level. It seems clear that to some degree, work levels are related to customers,
8 or in this case access lines. It is important to note that the percentage decline in
9 employees is less than the percentage decline in access lines. By 2015, given the level of
10 access line losses our model assumes, the number of work orders, customer calls, bills
11 processed, etc. will most certainly be less than it is today. That being said, FairPoint
12 should expect to require fewer employees in seven years than it does today, which it
13 expects to realize via natural attrition.

14 Q. Are there any other issues or clarifications with regard to the financial projections that
15 you would like to address?

16 A. Yes. Staff witness Vickroy in his testimony provides an overview of FairPoint’s
17 projected free cash flows and dividend payout ratios. (Vickroy Confidential, pages 14-15,
18 and Exhibit A) While I agree with his conclusion that FairPoint’s projected cash flow is
19 adequate to support our forecasted levels of interest expense, capital expenditures and
20 dividends, I would like to clarify that his calculations in Exhibit A are not entirely

1 accurate., and substantially understate the levels of projected cash flow. The table below
 2 provides the correct calculation of our free cash flows and payout ratios, with a summary
 3 comparison to Mr. Vickroy's Exhibit A for the most relevant metrics.

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8
	2008	2009	2010	2011	2012	2013	2014	2015
(Dollars in millions)								
Pro Forma Combined Cash Flow Projections								
Pro Forma Combined EBITDA	\$ 435	\$ 546	\$ 541	\$ 525	\$ 510	\$ 497	\$ 486	\$ 478
Pension / OPEB Cash Adjustment	27	29	30	31	33	34	36	37
One-time Opex & TSA Expenses	86	-	-	-	-	-	-	-
Interest Expense	(167)	(168)	(165)	(162)	(159)	(157)	(156)	(155)
Cash Taxes	0	(16)	(20)	(20)	(21)	(26)	(30)	(34)
Cap Ex	(172)	(167)	(164)	(159)	(157)	(156)	(156)	(156)
Change in NWC	(1)	0	(0)	0	0	0	0	0
Free Cash Flow	\$ 208	\$ 224	\$ 222	\$ 216	\$ 205	\$ 191	\$ 180	\$ 170
Dividends	(142)	(142)	(142)	(142)	(142)	(142)	(142)	(142)
Cash Flow after Dividends	\$ 66	\$ 82	\$ 81	\$ 74	\$ 64	\$ 50	\$ 38	\$ 28
Vickroy Exhibit A "Excess Cash Flow"	NA	39	33	26	16	3	(9)	(8)
Variance - Annual		\$ 43	\$ 48	\$ 48	\$ 48	\$ 47	\$ 47	\$ 36
Variance - Cumulative ('09-'15)							\$	\$ 317
Payout Ratio	68%	63%	64%	66%	69%	74%	79%	83%
Vickroy Exhibit A "Dividend Payout %"	NA	78%	81%	85%	90%	98%	107%	106%
Variance - Annual (bps)		1,467	1,731	1,932	2,101	2,402	2,832	2,270

4
 5 As you can see, Mr. Vickroy's calculations understate our Free Cash Flow and Cash
 6 Flow after Dividends by approximately \$317 million over the projection period. As a
 7 result, Mr. Vickroy presents much higher Payout Ratios in his Exhibit. The table
 8 demonstrates that his calculations overstate the Payout Ratio by as much as 2,800 basis
 9 points (28 percentage points), and that in reality our Payout Ratio is expected to remain
 10 well below 100% for the entirety of the projection period. The variance results from the
 11 fact that Mr. Vickroy did not adjust the EBITDA projections in his table to add-back non-
 12 cash pension and OPEB charges, and he used book taxes as opposed to cash taxes in
 13 reducing EBITDA to Free Cash Flow. The table containing the proper calculations
 14 provides even greater support to Mr. Vickroy's conclusion that our projected cash flows
 15 are adequate to fund our cash requirements.

1 **Q.** Are there any other issues regarding the projections that require clarification?

2 **A.** The issue I just raised regarding the need to add-back non-cash pension and OPEB
 3 charges to our EBITDA projections to calculate our Adjusted EBITDA also impacts Mr.
 4 Vickroy's discussion of our projected credit ratios. (Vickroy Confidential, page 17, and
 5 Exhibit B) Again, I totally agree with Mr. Vickroy's ultimate conclusion—that FairPoint
 6 remains in compliance with its debt covenant ratios in each year of the forecast, "with
 7 some room to spare." However, Exhibit B understates the degree of "room to spare" we
 8 actually have in complying with our covenants. The table below provides the more
 9 accurate calculation of the ratios, calculated consistent with our loan agreements.

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8
	2008	2009	2010	2011	2012	2013	2014	2015
(Dollars in millions)								
Pro Forma Credit Ratio Projections								
Interest Coverage								
Pro Forma Combined EBITDA	\$ 435	\$ 546	\$ 541	\$ 525	\$ 510	\$ 497	\$ 486	\$ 478
Pension / OPEB Cash Adjustment	27	29	30	31	33	34	36	37
One-time Opex & TSA Expenses	86	-	-	-	-	-	-	-
Pro Forma Combined Adjusted EBITDA	\$ 548	\$ 575	\$ 571	\$ 557	\$ 543	\$ 531	\$ 522	\$ 515
Interest Expense	167	168	165	162	159	157	156	155
Adjusted EBITDA / Interest Expense	3.28	3.43	3.46	3.43	3.40	3.38	3.35	3.32
Covenant	2.25	2.25	2.25	2.25	2.25	2.25	2.25	2.25
Compliance	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Vickroy Exhibit B "Interest Coverage"	3.08	3.25	3.26	3.22	3.19	3.15	3.12	3.08
Leverage Ratio								
Total Debt	\$ 2,485	\$ 2,406	\$ 2,328	\$ 2,256	\$ 2,196	\$ 2,149	\$ 2,113	\$ 2,088
Less: Cash	3	3	3	3	3	3	3	3
Total Net Debt	2,482	2,403	2,325	2,253	2,193	2,146	2,110	2,085
Pro Forma Combined Adjusted EBITDA	548	575	571	557	543	531	522	515
Total Net Debt / Adjusted EBITDA	4.5	4.2	4.1	4.0	4.0	4.0	4.0	4.1
Covenant	5.8	5.5	5.5	5.5	5.5	5.5	5.5	5.5
Compliance	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Vickroy Exhibit B "Leverage Ratio"	4.8	4.4	4.3	4.3	4.3	4.3	4.4	4.4

10
 11 The primary difference in the calculations is that Adjusted EBITDA should be used in
 12 calculating these ratios. When that is done, our level of compliance with the covenants is
 13 even stronger than represented by Mr. Vickroy, with interest coverage remaining above

1 3.30 times (versus a 2.25 times covenant ratio) and the leverage ratio around 4.1 times by
2 2015 (versus a 5.5 times covenant ratio). In addition, while Mr. Vickroy states that debt
3 pay-downs are relatively modest, per my previous table he underestimates our Cash Flow
4 after Dividends (his "Excess Cash Flow" in Exhibit A and the figure representing funds
5 available for discretionary debt repayments) by approximately \$317 million.

6 So, while Mr. Vickroy's data in Exhibits A and B confirm that FairPoint is projecting
7 sufficient cash flows and remains comfortably in compliance with its debt covenant
8 ratios, the properly calculated data provide even greater support for these conclusions.

9 **Updates to Financial Projections since Direct Testimony**

10 **Q.** Mr. Barber indicates some concern over the fact that the FairPoint financial model
11 continues to evolve (Barber Super Confidential, pages 3 and 10-12). Have FairPoint's
12 projected financial results changed since your direct testimony, and, if so, how?

13 **A.** Yes, as is customary, our financial projections related to the proposed transaction did
14 change from the time my direct testimony (Testimony Model) was submitted to the time
15 we submitted our "FairPoint Financial Information" in discovery (Discovery Model).
16 The Discovery Model is the current complete iteration of our financial projections for the
17 combined company and reflects the culmination of all relevant information we have
18 assembled to-date. FairPoint's Discovery Model was provided as a confidential
19 attachment to FairPoint's responses to several data requests (OCA 1-35, OCA 1-114,
20 OCA 1-115, Staff 1-95, Staff 1-118 and Staff 1-119).

1 The primary changes from the Testimony Model to the Discovery Model relate to an
2 increase in amortization expense for the existing FairPoint operations and a reduction in
3 the beginning shareholders' equity balance for the combined company. I will provide
4 additional detail below highlighting the specific changes to the model and the relevant
5 impacts. Also, I will describe one additional component in the model which has changed
6 in a positive fashion but did not merit a complete reproduction of the model.

7 In general, our approach was to update the financial projection model when meaningful
8 changes to projected cash flows are identified, positive or negative, and to provide the
9 "latest and greatest" view to the Commission and parties once the revised version is
10 available. In this way, we serve the dual purpose of ensuring that our own understanding
11 of the operations at any given point in time is reflected in the model as accurately as
12 possible and of providing the Commission and parties with the latest information as our
13 understanding evolves. It would be the rare case where a company involved in a merger,
14 acquisition, or other significant financial transaction would be able to generate and rely
15 upon a single set of financial projections from early in negotiations until the signing of
16 the transaction. Between signing and closing, some other changes might occur – for
17 example, as a result of application of GAAP to accounting for aspects of the transaction –
18 but they do not affect the validity of the overall underlying model. To assume that no
19 changes will occur reflects either a lack of understanding of transactional work or an
20 attempt at ill-advised oversimplification. In fact, the Interveners, Staff and the OCA
21 should be more concerned if FairPoint was so confident and inflexible that it failed to

1 reflect new and better information in its projection model as that information became
2 available to the company.

3 **Q.** So, what specific changes were made to the Testimony Model that resulted in the
4 Discovery Model version?

5 **A.** The table below compares the specific Income Statement line items that changed from
6 the Testimony Model to the Discovery Model.

7 *****BEGIN CONFIDENTIAL INFORMATION*****

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9 *****END CONFIDENTIAL INFORMATION*****

1 As I stated above, in terms of changes to the projected Income Statement, the principal
2 change was an increase in non-cash Depreciation & Amortization (D&A) expense due to
3 an increase in amortization expense related to existing FairPoint customer lists. The
4 customer list asset is an intangible asset that is amortized over time via an expense on the
5 income statement. Subsequent to submitting my testimony, and as part of the normal S-4
6 preparation and review process, FairPoint obtained a preliminary valuation of our
7 customer list from a third-party appraisal firm. The value placed on our customer list
8 asset was higher than we originally estimated in our Testimony Model. We made a
9 timely update to the model based on the change and provided the latest version in
10 discovery. As indicated in the table, this amortization adjustment resulted in an \$11
11 million per year increase in non-cash D&A expense. Most of the other changes to the
12 projected Income Statement derive from this change in amortization expense. To
13 summarize, there were no changes in revenue between the Discovery Model and the
14 Testimony Model, and the Discovery Model shows only modest annual decreases in Net
15 Income and no change in EBITDA.

16 **Q.** Were the changes between the Discovery Model and the Testimony Model limited to
17 Income Statement impacts?

18 **A.** No, the Income Statement impacts also flowed through to cause modifications to the
19 projected Balance Sheet and Cash Flow Statement. EBITDA was not materially
20 impacted because the amortization adjustment of \$11 million is a non-cash expense that

1 has no cash flow impact.² The table below compares the specific Balance Sheet items
2 that changed from the Testimony Model to the Discovery Model.

3 *****BEGIN CONFIDENTIAL INFORMATION*****

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5 *****END CONFIDENTIAL INFORMATION*****

6 **Q.** It seems, however, that there were other Balance Sheet changes aside from the
7 adjustments related to the increase in D&A. The 2008 beginning balances for Net PP&E

² Note in the Vermont testimony the witness indicated this amortization expense would be deductible for tax purposes but the Company has since determined that in the circumstances of this transaction such is not the case. The resulting cash flows in the Discovery Model are still accurate as the Company has determined certain operating expenses (rents, disaster recovery costs and billing costs) are now lower than originally projected and more than offset the tax savings no longer expected to occur from the customer list amortization expense.

1 and Total LTD appear to be lower versus the beginning balances reflected in the
2 Testimony Model. Can you explain these additional modifications?

3 A. With regard to Net PP&E, the starting balance was reduced in the Discovery Model
4 because the continuing work on integration costs with Capgemini revealed approximately
5 \$30 million of capitalized costs will be expensed instead of capitalized. As evidenced by
6 the constant variance year-over-year between the two models, the only Net PP&E
7 adjustment related to this reduction is the 2008 starting balance. The 2008 Total LTD
8 balance is slightly lower in the Discovery Model because work related to the S-4 filing in
9 April revealed that the opening cash balance would be higher than originally expected as
10 a result of the working capital true-up obligation which Verizon must meet. The increase
11 in cash available at closing reduced the need for financing to the levels reflected in the
12 Discovery Model.

13 Q. *****BEGIN CONFIDENTIAL INFORMATION*****

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17 *****END CONFIDENTIAL**

18 **INFORMATION*****

19 A. Before answering the question it should be noted (as explained in other witnesses'
20 testimony) that Shareholders' Equity is not a relevant measure of financial health or of

1 the inherent value of the company because in the merger Spinco is considered the
2 acquirer under generally accepted accounting principles and a merger-related adjustment
3 results in a low equity number. The change in 2008 Shareholders' Equity relates to
4 modifications in accounting adjustments that are projected as part of the spin-off of the
5 northern New England assets by Verizon into Spinco. The changes to these adjustments
6 and eliminations that are required to create the pro forma balance sheet for the combined
7 company at closing are the result of continuing work with our accountants and Verizon's
8 accountants. These changes specifically came to light as we prepared the S-4 filing for
9 the SEC.

10 The principal cause of the reduction in pro forma Shareholders' Equity was a reduction in
11 the "jumping off point", or the opening balance sheet for the combined business. Half of
12 the difference in the Shareholders' Equity account between the Testimony Model and the
13 Discovery Model is the result of a higher portion of the Employee Benefit Obligation
14 (EBO) transferring with the business than we initially estimated. I should point out that
15 our operating projections for the EBO remain unchanged as this was exclusively a
16 balance sheet item. Of the remaining difference in the Shareholders' Equity account, half
17 was related to working capital and other asset balance refinements, and the remaining
18 portion was the cumulative effect of all the changes above on the deferred tax liability of
19 the merged entity. Again, none of these opening balance sheet changes impacted our
20 operating projections, as revenue and operating cash flow were unaffected.

1 **Q.** Do you believe that this reduction in book Shareholders' Equity, or a negative book
2 equity value generally, is cause for significant concern as some of the witnesses in this
3 proceeding indicate?

4 **A.** I do not, and as demonstrated by other FairPoint witnesses the financial markets do not
5 view it as a major concern. In my opinion, FairPoint's market value of its equity, based
6 on the company's ability to generate and grow cash flows, is much more relevant for our
7 financial future than our book equity. Staff witness Vickroy expresses no concern with
8 this state of facts:

9 While negative equity capital may sound as if a company is insolvent, this is not
10 necessarily the case. Net income and book equity are established and important
11 accounting measures of profitability and net worth, but are not important to
12 investors, bankers, equity analysts and credit analysts. These financial
13 professionals focus on cash flow and cash flow measures, which provide a
14 company's true ability to fund its capital expenditures, interest payments and
15 dividends. A company with negative equity capital can produce very strong
16 operating cash flow that funds capital expenditures, covers interest payments with
17 ample room to spare, and is able to have more than enough cash left over to fund
18 a healthy dividend. (Vickroy, pp. 10-11)

19 In addition, as Vermont Department of Public Service (Vermont DPS) witness Perry
20 Wheaton indicates, "FairPoint's projected cash flows are independent of its book equity
21 position. FairPoint's projected level of free cash flow ensures that it will still have access
22 to equity and debt markets if needed"³ I agree wholeheartedly with Mr. Vickroy's
23 and Mr. Wheaton's assessments.

³ Prefiled Direct Testimony dated May 24, 2007, page 9, lines 15-16.

1 In summary, the Shareholders' Equity account has minimal relevance to the true value of
2 the company. For example, the equity account of FairPoint is higher than the projected
3 level for Spinco prior to the merger despite the fact that Spinco is much larger. As
4 another example, when Embarq was spun off from Sprint its opening equity account was
5 *negative* despite being a profitable business with several million access lines. Embarq
6 currently has book equity of around \$35 million and a market equity capitalization of
7 around \$9 billion—demonstrating vividly the fundamental disconnect that can exist
8 between book equity and true intrinsic value.

9 **Q.** Finally, has FairPoint developed state specific financial projections for New Hampshire?

10 **A.** Yes, these are attached as highly confidential Exhibit WL-3. To generate the projections,
11 as well as similar projections for Maine and Vermont, we took our consolidated model
12 and separated it into three states plus a holding company account. Revenue, expense and
13 cash flow assumptions were made via allocations from the three-state model, and were
14 not built up at the New Hampshire level. While we used the best publicly available
15 information to make such allocations, the model cannot be relied upon for any degree of
16 accuracy and cannot attempt to be reconciled to any ARMIS reports or other public
17 filings by Verizon. For example, the ARMIS reports are not in GAAP format while the
18 model is in such form. Certain expenses such as pension costs and OPEB expenses
19 cannot be allocated readily among states and also will tend to distort the results. Finally,
20 there is no similar publicly available information on non-regulated services by state.

1 Therefore, while the model represents a good faith effort to provide a New Hampshire-
2 only view, it is limited in terms of its usefulness and reliability.

3 **Rationale for Existence of Multiple Versions of Projections**

4 **Q.** Mr. Barber makes much of the fact that he has seen multiple financial projections for the
5 combined company (Barber Confidential, page 10, line 13 through page 12, line 6, and
6 Schedules 13-15). Can you help us understand why these multiple versions of
7 projections exist?

8 **A.** As I discussed above, FairPoint's modeling of the combined company has evolved as we
9 worked internally with our financial advisors and with our accountants. We believe the
10 Discovery Model reflects an accurate and complete, and therefore the best and most
11 reasonable, view today. Let me first address the FairPoint generated models⁴, which
12 include from Mr. Barber's Schedule 16: (i) Leach/Balhoff (this is the Testimony Model),
13 (ii) FairPoint Projections: CFPNH 0001-0019 (financial information) (this is the
14 Discovery Model), (iii) Lehman: New Base Case (FairPoint Board Model), and (iv)
15 Lehman MAC (MAC Case). As discussed above, in a transactional environment it is
16 common for projections and assumptions to evolve and become more accurate as more
17 and better information is assimilated into the models. The FairPoint Board Model, the

⁴ The Lehman models were produced by FairPoint's investment banker, Lehman Brothers, in conjunction with FairPoint. Therefore, these models are considered to be FairPoint generated.

1 Testimony Model and the Discovery Model all reflect this typical evolutionary process.
2 As indicated in FairPoint's response LAB-FDR I-2 (also quoted in footnote D on Mr.
3 Barber's Schedule 16), the MAC Case is a "'worst case' scenario for comparative
4 purposes" requested by FairPoint's Board of Directors. While the MAC Case represents
5 a downside sensitivity, it was not intended to reflect normal course of business operating
6 results as were the other FairPoint generated models. Therefore, in evaluating the
7 evolution of FairPoint's thinking regarding normal course financial results, it is not
8 appropriate to include the MAC Case in such an assessment.

9 **Q.** So, how do you explain the variances in projected cash flows among the three FairPoint
10 generated projections for normal course of business operating results (FairPoint Board
11 Model, the Testimony Model and the Discovery Model) in Mr. Barber's Schedule 16?

12 **A.** First, it is important to recognize that Mr. Barber's table in Schedule 16 does not reflect a
13 consistent methodology for calculating cash flow after dividends. The after-dividend
14 cash flow for Leach/Balhoff (the Testimony Model) should be calculated using the
15 methodology demonstrated in the table below (taken from Leach Direct Testimony
16 Exhibit A). *****BEGIN CONFIDENTIAL INFORMATION*****

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In Mr. Barber's Schedule 16, the data presented for the line labeled FairPoint Projections, CFPNH 0001-0019 (financial information) (the Discovery Model), was taken directly from the Discovery Model cash flow statement, which uses a slightly different methodology. However, the most glaring oversight in terms of the comparability of data in Schedule 16 is the fact that for 2008, one-time capital expenditures are excluded in both the Leach/Balhoff (the Testimony Model) and Lehman New Base Case (FairPoint Board Model) data, but are included in the FairPoint Projections, CFPNH 0001-0019 (financial information) (the Discovery Model) data. It is unclear why Mr. Barber chose not to present these data on a comparable basis using a consistent methodology.

However, the table below presents the projected Cash After Dividends for all three FairPoint generated models calculated on the same basis using the same methodology (in chronological order of development with the oldest model on top). *****BEGIN*****

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5 I have already addressed in some detail the adjustments that impacted our cash flow
6 projections as we moved from the Testimony Model to the Discovery Model. The
7 changes that occurred between the FairPoint Board Model and the Testimony Model
8 were of a similar evolutionary nature. Specifically, as more detailed information became
9 available to us, we determined that the Cash Taxes included in the FairPoint Board
10 Model were too low and the Interest Expense was too high. Again, although making
11 these adjustments resulted in a net reduction in the projected cash flows, we made the
12 changes and provided the updated model to the Commission as part of our direct
13 testimony.

14 The net change in projected Cash After Dividends between the FairPoint Board Model
15 and the most up-to-date Discovery Model is not the result of radical changes in operating

1 assumptions. To the contrary, the changes have been driven by our becoming more
2 informed regarding certain accounting and tax issues that are unrelated to our operating
3 projections. In fact, the EBITDA projections for the combined company for the years
4 2009-2015 have not changed in any meaningful way (nothing more than rounding
5 variances) from the FairPoint Board Model to today.

6 **Q.** Are there any other changes which could be made to the latest model based upon
7 information known to you at this time?

8 **A.** One additional positive development not yet reflected in the model relates to the
9 Transition Services Agreement (TSA). ***BEGIN CONFIDENTIAL

10 INFORMATION***

11 ***END

12 CONFIDENTIAL INFORMATION*** Earlier this year we decided to take advantage
13 of the Schedule C, D and E Services available in the TSA contract, as part of moving to a
14 projected four-month TSA schedule. ***BEGIN CONFIDENTIAL

15 INFORMATION***

16 ***END

17 CONFIDENTIAL INFORMATION*** We have not altered the model and currently
18 have a budget sufficient to cover approximately one month beyond our four-month
19 expectation. Additional refinements have occurred to amortization and depreciation
20 accounts and certain operating expenses but the net impact, while positive, was not
21 deemed to be material enough to warrant an additional run of the model.

1 Q. In light of the discussion above regarding the natural evolution of the FairPoint projection
2 model, how would you address Mr. Barber's Schedule 17 in which he performs a
3 sensitivity analysis on projected 2012 cash flow after dividends using various iterations
4 of the model?

5 A. I will limit my comment to the four FairPoint generated models (excluding the Merrill
6 Lynch models). First of all, I note that Mr. Barber's underlying data for 2012 cash after
7 dividends are slightly inaccurate because he is using numbers calculated based on
8 different methodologies (as discussed above). Next, I think it is important to understand
9 that the MAC Case model was itself an attempt to generate a "worst case" sensitivity.
10 Therefore, applying a sensitivity analysis to the MAC Case model and comparing the
11 results to the three iterations of the normal course operating projections (the FairPoint
12 Board Model, the Testimony Model and the Discovery Model) is comparing apples to
13 oranges. In effect, you would be comparing a sensitivity analysis to another sensitivity
14 analysis, which makes no sense.

15 Finally, as I have described, the three iterations of our normal course projections
16 represent an ongoing evolution, with the latest version (the Discovery Model)
17 representing the most up-to-date and accurate information we have at this time. As a
18 result, and given the explanation above for why changes to the model have occurred, it
19 makes little sense to analyze any version of the model other than the Discovery Model.
20 To do so is to analyze data that we know at this stage are out-of-date, and there is little to
21 be gained by debating information that we know has changed. Therefore, rather than

1 spending our time focusing on old data, I suggest that if analyses are to be performed
2 they should focus on the most up-to-date projected financial data, which is found in the
3 Discovery Model.

4 In terms of the actual results of Mr. Barber's sensitivity analysis in Schedule 17,
5 FairPoint Witness Balhoff will address in detail why the Barber analysis of the relevant
6 data (2012 cash after dividends and cash operating expense assumptions from the
7 Discovery Model) is flawed.

8 **Q.** Can you address the Merrill Lynch models also represented in Mr. Barber's Schedules
9 16, 17 and 18 and how we should view the projected results taken from these models?

10 **A.** As Mr. Barber indicates in Footnote E of his Schedule 16, the Merrill Lynch projections
11 are derived from materials prepared for Verizon's Board of Directors meeting on
12 January 15, 2007 (Verizon, Attachment DPS 101(b)).⁵ As I have described, the modeling
13 of this transaction has evolved since the time the Merrill Lynch estimates were prepared.
14 Therefore, we know that if these projections were prepared today, based on more and
15 better information, the results would be different from those represented in Schedule 16.

16 **Q.** Regardless of the true comparability of the data represented in Mr. Barber's Schedules 16
17 and 17, can you provide any explanation for why the Merrill Lynch – Verizon
18 Management Estimates appear more conservative than FairPoint generated projections
19 and the Merrill Lynch – FairPoint Management Estimates?

⁵ Prefiled Direct Testimony, dated May 24, 2007.

- 1 **A.** Simply stated, FairPoint intends to operate the business differently than Verizon in the
2 future (we will focus on being a broadband company that offers high-quality voice
3 services, not primarily just a voice provider) which will produce far different results.
4 More broadband products create more bundling opportunities which reduces churn and
5 enhances long term revenue prospects. Our newer DSL technology which relies on an
6 Ethernet based system is more capital efficient than the current system used by Verizon.
7 In addition, in a continuing business scenario, Verizon would keep the retiree obligations
8 for all retired employees which represent substantially higher expenses than will exist for
9 the business operated by FairPoint. FairPoint does not inherit any obligations for
10 employees who retire before the merger closes.
- 11 **Q.** Mr. Barber attributes most, if not all, of the discrepancy to differences in cost savings
12 assumptions. How would you address Mr. Barber's contention that Verizon is "in the
13 best position to assess the likelihood of FairPoint achieving the synergies and other cost
14 savings" reflected in the projections (Barber Confidential, page 11, lines 12-14).
- 15 **A.** I disagree. Mr. Barber's statement might have some validity if FairPoint intended to
16 continue to run the operations in the same manner, with the same vision, and with the
17 same cost structure as Verizon. However, that fundamentally is not the case. FairPoint
18 does not intend to operate the Verizon northern New England assets in exactly the same
19 manner as they have been operated in the past. We intend to transition the operating
20 model to one based on broadband as compared to the historical Verizon model which is
21 based primarily on wireline voice services.

1 It is noteworthy that the Verizon management assumptions presented by Merrill appear to
2 calculate operating cost savings with a high-level “percentage of operating expenses”
3 approach, while FairPoint’s cost avoidance assumptions are the result of a detailed, in-
4 depth, bottoms-up pro forma cost build-up that was then compared to Verizon costs. The
5 topic is discussed in greater detail below.

6 The reality is that it is not unusual for buyers in corporate combinations to see
7 opportunities to improve operating performance and value that sellers either cannot or do
8 not recognize (for a variety of reasons). If that were not the case, transactions rarely
9 would occur. Even if Verizon management could have seen opportunities for improving
10 the operating efficiency of the northern New England properties in a manner similar to
11 that proposed by FairPoint, they may not have been able to implement or achieve the
12 savings given the larger company’s operating model and existing infrastructure / cost
13 model.

14 **Capital Structure, Credit Quality and Covenant Issues**

15 **Q.** A number of witnesses raise concerns about the pro forma capital structure and credit
16 quality of the combined company, indicating that the company will be highly leveraged
17 and below investment grade. Can you address these concerns?

18 **A.** FairPoint witness Balhoff will address the capital structure issues in detail. However, it is
19 important that the Commission understand that a high yield credit rating is not indicative
20 of a company that is financially weak, nor is it atypical for our industry or rare among

1 U.S. companies. The size of the non-investment grade bond market has doubled to \$1.2
2 trillion in five years and the non-investment grade loan market is even larger. As of
3 March 31, 2007, approximately 50% of U.S. companies issuing debt had non-investment
4 grade credit ratings. Historically, non-investment grade companies have a strong track
5 record of NOT defaulting on their debt, with the 15-year average default rate as of
6 yearend 2006 at approximately 4.6%. Post-closing, FairPoint is expected to be rated in
7 the BB category, the most conservative part of the high yield market.

8 In addition, it is typical of the incumbent local exchange carrier industry for companies to
9 possess non-investment grade credit ratings. Companies such as Citizens
10 Communications, Windstream Communications, Consolidated Communications, Iowa
11 Telecom, Alaska Communications Systems, Cincinnati Bell, Qwest and Alltel are all
12 rated below investment grade. Therefore, it is an oversimplification merely to look at a
13 non-investment grade credit rating and assume that the company will be in some way
14 financially unstable.

15 **Q.** Mr. Brevitz also indicates a concern that FairPoint is not committing to use excess cash
16 flow to reduce debt. Can you explain?

17 **A.** It is the Company's expectation that we will use our free cash flow after dividends to pay
18 down our outstanding debt, as reflected in our financial projections. In fact, given that
19 we are confident that we can outperform the financial results reflected in the projections,
20 it is possible that we will have more cash available for debt repayment than we have

1 modeled. However, FairPoint has not made a binding commitment to use cash flows
2 after dividends solely for debt repayments as we believe this sort of commitment would
3 unnecessarily constrain the flexibility of management and the Board of Directors to
4 allocate capital to the most productive uses (as conditions might warrant at any given
5 time). Debt reduction clearly would be considered one of the primary potential uses of
6 free cash as those allocation decisions are made. However, if the company needs
7 additional capital for important projects or other investment in the business, we believe it
8 is important that we maintain the flexibility to direct our capital resources appropriately.

9 As reflected in our projections, if cash flow after dividends is used to repay debt, we
10 expect that our debt balance will decline by almost \$400 million over the course of the
11 projection period. Given the expected reduction in principal outstanding, the fact that we
12 should be comfortably in compliance with our debt covenants throughout the projection
13 period, and our historical ability to access the capital markets as needed, we expect to
14 have no difficulty refinancing the remaining debt outstanding prior to maturity.

15 **Q.** Mr. Brevitz believes that FairPoint will be exposed to significant interest rate risk
16 because of the floating rate debt in its pro forma capital structure. Do you agree with this
17 assessment?

18 **A.** No. As Mr. Brevitz notes in his testimony, FairPoint has employed (and expects to
19 employ further) interest rate swaps to convert some of the floating rate debt to a fixed
20 rate. In fact, swaps in place today will continue following the proposed merger and result

1 in a floating rate on only approximately 40%% of the pro forma total debt of the merged
2 company. Additional swaps will be put in place for much of this floating rate debt soon
3 after closing. Purchasing these interest rate swaps serves to hedge a portion of our
4 outstanding debt against fluctuations in interest rates. The market for these interest rate
5 swaps is well-developed and highly liquid, making it quite routine for companies to avail
6 themselves of the benefits of the swaps to manage the interest rate risk on their balance
7 sheets. FairPoint is an experienced participant in this market. In addition, it is also
8 important to note that corporate finance theory generally would not support removing all
9 variable rate debt from the capital structure. There are trade-offs in employing fixed-rate
10 capital and, as a result, it is typically viewed as prudent to retain some variable-rate
11 capital in the capital structure. In doing so, a company is able to benefit from what is
12 typically lower-cost, shorter-term debt and to maintain some potential to reduce costs in a
13 declining rate environment. Therefore, while virtually all companies are exposed to
14 some form of interest rate risk, we feel comfortable that we have the tools and experience
15 necessary to manage these risks in a responsible manner that optimizes our cost of
16 capital.

17 **Q.** Staff witness Vickroy discusses FairPoint's expected debt covenants in relation to ratios
18 in Windstream's new debt securities. (Vickroy Confidential, page 9) Do you agree with
19 his assessment that FairPoint's "more aggressive" covenant levels relative to Windstream
20 should be perceived as a negative?

1 **A.** No. In general, as a borrower, you want to obtain the most flexible covenants possible in
2 order to provide your company with the maximum ability to avoid covenant violations, in
3 good times and in bad. As a result, more lenient covenant ratios (such as FairPoint's 5.5
4 to 1 leverage ratio as compared to Windstream's 4.5 to 1 ratio) generally are perceived as
5 a good thing, as they maximize flexibility in managing through any unanticipated
6 downturns in business or negative external events. As discussed earlier, FairPoint
7 remains comfortably in compliance with its covenant ratios throughout the projection
8 period.

9 **Q.** Mr. Vickroy also seems to be very concerned about the potential ramifications of
10 covenant violations, suggesting that a violation of these ratio tests could cause lenders to
11 take actions that harm service quality. Do you agree with his assessments?

12 **A.** Not entirely. While Mr. Vickroy is correct that repeated, habitual violations of covenant
13 ratios likely will result in lenders taking meaningful action, I believe he overstates the
14 typical consequences of a single technical covenant ratio violation. It is important to
15 remember that there is a significant difference between a technical violation (typically
16 running afoul of a reporting requirement or ratio required in the loan agreements) and a
17 payment default. In the case of a technical violation, it is typical for the lender to notify
18 the company of the violation and to ask that it be remedied. In the absence of a
19 consistent pattern of these types of violations, that is usually the extent of the
20 consequences for the borrower. I believe what Mr. Vickroy describes, with lenders
21 taking aggressive action to control how a company is run and playing an active

1 management role, is much more indicative of a situation in which there has been a
2 payment default (or more likely multiple payment defaults). Importantly, none of our
3 projections, including the MAC case, indicate that FairPoint would even be close to a
4 payment default. Therefore, while the consequences Mr. Vickroy describes are real
5 under certain circumstances, their relevance with respect to the combined company is
6 speculative.

7 **Appropriate Use of 2006 Pro Forma Data**

8 **Q.** A number of Mr. Barber's Schedules (2-5) analyze or depict 2006 pro forma data for the
9 combined company. Are there qualifications that should be made regarding analyses
10 based on the 2006 pro forma data from FairPoint's S-4 filing with the SEC?

11 **A.** There are significant issues with using the pro forma 2006 financial data, which are
12 produced under strict rules imposed by financial accounting standards and SEC practice,
13 to derive insights on the normal course financial characteristics of the combined company
14 going forward. These pro forma data do not, and are not intended to, present an accurate
15 picture of the financial performance of the combined company operating as a single
16 integrated entity. As a result, no expected cost savings or operating efficiencies are
17 included in these data. It is clearly stated in text related to the tables in the Form S-4
18 from which Mr. Barber obtained the pro forma combined company data that he uses in
19 his Schedules:

1 The pro forma amounts in the table below are presented for illustrative purposes
2 only and do not indicate what the financial position or the results of operations of
3 the combined company would have been had the merger occurred as of the date or
4 for the period presented. The pro forma amounts also do not indicate what the
5 financial position or future results of operations of the combined company will be.
6 ... No adjustment has been included in the pro forma amounts for any anticipated
7 cost savings or other synergies that FairPoint expects to result from the merger.

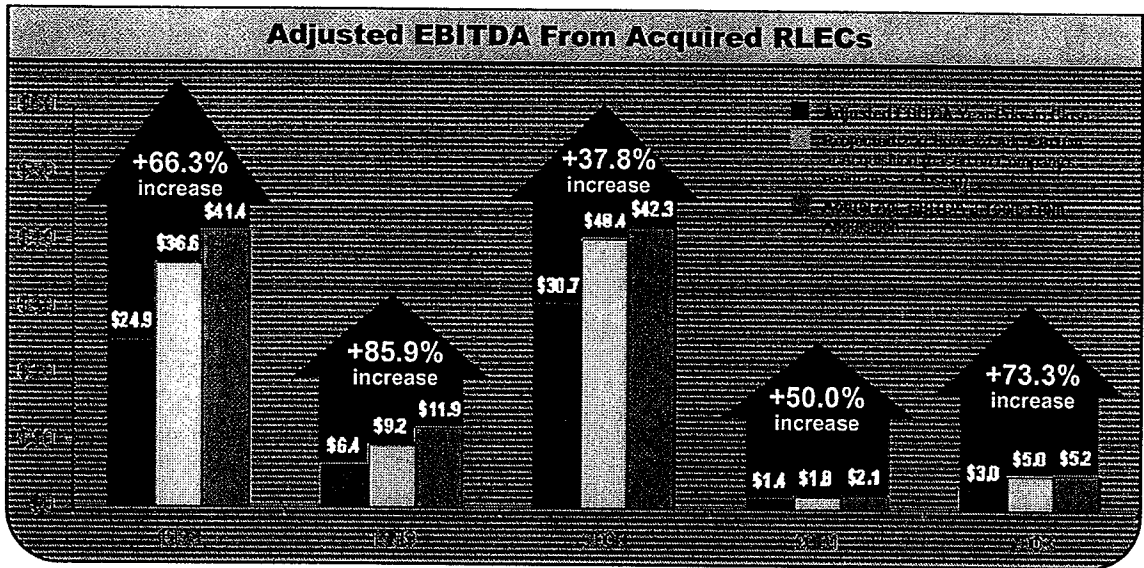
8 In addition, there is a footnote related to the applicable table in our S-4 indicating that the
9 Spinco results utilized to create the pro forma combined data include allocated costs from
10 Verizon and its affiliates. The footnote states that after closing and a transition period
11 FairPoint expects that the combined company will generate \$60 million to \$75 million in
12 annual net cost savings from internalizing or obtaining from third-party providers the
13 functions related to these allocated corporate overhead costs. The 2006 pro forma data
14 Mr. Barber presents include the existing Verizon allocated overhead costs and make no
15 provision for the cost savings expected to be generated as a result of the merger.

16 Therefore, it is clear from the disclaimers in the S-4, the source document for the 2006
17 pro forma combined data, that pro forma 2006 results are for illustrative purposes and do
18 not reflect the expected future performance or financial characteristics of the combined
19 company going forward. I am not sure why Mr. Barber chose to ignore the statements
20 regarding the limitations of the pro forma 2006 data, but the data are not appropriate for
21 his intended use.

1 **FairPoint’s Ability to Deliver Financial Results it has Projected**

2 **Q.** Turning more specifically to the actual consolidated projections, do you agree with Mr.
3 Barber’s contention that FairPoint’s financial case supporting the transaction is
4 “extremely optimistic” (Barber Confidential, p. 42, line 11) with “an extraordinarily
5 small margin of error” (Barber Confidential, p. 2, line 18)?

6 **A.** I do not. In this testimony, I will show (in conjunction with other FairPoint witnesses)
7 that our financial projections in fact reflect reasonable assumptions and contain a
8 substantial “margin of error” to accommodate unforeseen circumstances. Before I
9 discuss more specific details related to the projections, I would like to provide some
10 context for how FairPoint’s acquired properties have performed in the past relative to
11 historical and projected financial results. As the graphic below summarizes, when we
12 look at our acquisition experience, the transactions for every year have exceeded our
13 projection for the group’s Year 2 adjusted EBITDA.



Note: No acquisitions were completed during 2002.

Specifically, for the companies we acquired in 1998-2001 and 2003 (no acquisitions were completed in 2002), the graphic shows adjusted EBITDA the year prior to closing, our projected 2-year forward adjusted EBITDA estimate at closing, and the actual adjusted EBITDA achieved two years from closing. As you consider FairPoint's projections for the proposed transaction, there are two important takeaways: (i) FairPoint always has increased dramatically (by a minimum of 38% for the acquisitions represented in the graphic) the operating cash flow of its acquired companies versus the historical performance of those companies, and (ii) FairPoint in all cases outperformed its own 2-year forward projections.

To quote Mr. Barber, "Watch what someone does, not what they say." I believe our acquisition history speaks for itself. The bottom-line is that, in terms of our acquisition experience, we have always delivered results in excess of past performance and in excess of our own expectations. Our ability to outperform reflects not only our operational

1 acumen, but also is instructive of the way we produce projections for the companies we
2 evaluate for acquisition. It is not our practice to base transactional decisions on
3 “extremely optimistic,” aggressive assumptions regarding the future performance of the
4 to-be-acquired property. To the contrary, our philosophy is to make the financial case for
5 a transaction based on reasonable projections that we are confident we can achieve even
6 if all does not go exactly as planned. In this way, a meaningful margin for error, not an
7 “extraordinarily small margin,” is built into our projections at their core. Rather than any
8 theoretical discussion regarding whether the assumptions contained in our projections for
9 the combined company are conservative or optimistic, I believe that FairPoint’s
10 demonstrated past experience of always outperforming expectations should be the most
11 influential factor in assessing whether we can deliver the operating results we have
12 forecast.

13 **Understanding Projected Operating Expenses**

14 **Q.** In Mr. Barber’s Schedule 6, he makes the point that, “FairPoint’s absolute costs per
15 access line are significantly higher than Verizon NNE’s.” Is this a surprising revelation?

16 **A.** I think that most knowledgeable observers of the incumbent local exchange carrier
17 (ILEC) industry would find this observation about FairPoint’s current business logical
18 and predictable. FairPoint’s existing operations serve some of the most rural, sparsely
19 populated regions in the U.S. As most industry observers will acknowledge, the more
20 rural the region and the lower the population density served, the greater the cost per

1 access line. As indicated on page 14 of the FairPoint Analyst presentation from
2 January 16, 2007, attached as Exhibit WL-2, FairPoint's existing operations serve
3 territories with an average of 13 access lines per square mile, the lowest "teledensity" out
4 of the companies presented (most of which are considered rural operators). Also on this
5 slide, we indicated that pro forma FairPoint (the combined company) will have a
6 "teledensity" of 36 access lines per square mile – significantly higher than FairPoint's
7 current density metric. The increase in access lines per square mile clearly is due to the
8 fact that the Verizon northern New England properties, while somewhat more rural
9 relative to other parts of Verizon's territory, are still more urban and densely populated
10 than FairPoint's operations. Therefore, as a result of the more rural, sparsely populated
11 nature of the FairPoint operations relative to the Spinco operations, it is logical and to be
12 expected that FairPoint would have a higher cost of service reflected in greater per line
13 costs.

14 **Q.** Mr. Barber presents data in his Schedules 6 and 7 indicating that both FairPoint and the
15 Verizon northern New England operations have experienced growth in operating
16 expenses in recent years. Why should we believe that similar growth trends in operating
17 expenses will not continue for the combined company?

18 **A.** Let me point out that Verizon's direct costs for its core business have been declining
19 steadily in recent years. The expense growth Mr. Barber points to is the result of (1)
20 increasing cost allocations to the northern New England region from elsewhere in the
21 vast Verizon organization, none of which FairPoint will inherit, and (2) increases in non-

1 regulated costs that keep pace with non-regulated revenue growth. It is problematic to
2 compare historical stand-alone data and trends for FairPoint existing operations and the
3 Spinco operations to projected results for the combined company. The existing FairPoint
4 operations will benefit from greater purchasing power and economies of scale when
5 combined with the Spinco operations. The Spinco operations should benefit from greater
6 operating efficiencies, as I will describe in more detail below, and the elimination of
7 retiree benefit obligations for all employees who have retired before closing. As a result,
8 historical standalone results are not a satisfactory indicator of likely operating expense
9 levels and trends going forward. However, I would like to address Mr. Barber's
10 contention that FairPoint has not included adequate growth in operating expenses in its
11 projections for the combined company. The table below provides a summary of
12 historical and projected operating costs for the Spinco operations.

13 *****BEGIN CONFIDENTIAL INFORMATION*****

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15 *****END CONFIDENTIAL INFORMATION*****

16 First I will address the change in absolute dollar operating expense. As the table
17 demonstrates, while Total Spinco Operating Expense is projected to decline slightly (at a

1 -0.6% average annual rate) that decline is driven entirely by reductions in non-cash

2 Depreciation & Amortization expense. ***BEGIN CONFIDENTIAL

3 INFORMATION***

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8 ***END CONFIDENTIAL INFORMATION*** Given that we are

9 assuming no reduction in cash operating costs, and in fact are projecting an increase in
10 cash costs, in the face of these significant projected line losses, I feel confident that we
11 are being reasonable in our cash operating cost assumptions.

12 To further emphasize the point, we agree with Mr. Barber that it is important to observe
13 per line data (Barber Confidential, page 18, lines 5-7) to understand the more granular
14 trends that may be masked by only analyzing absolute dollar data. The table below
15 reflects summary historical and projected operating cost data for the Spinco operations on
16 a per line basis.

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*****END CONFIDENTIAL INFORMATION*****

For purposes of calculating per line operating expenses, we have used average annual switched access lines plus UNE-L lines for the denominator, as Mr. Barber advocated. It is somewhat debatable what the appropriate denominator should be for these calculations, switched access lines alone or switched access lines plus UNE-L lines, as operating expenses for a single UNE element (in this case the actual loop) are lower versus the cost of operating a fully-functional switched access line. If we had done the same analysis depicted in the table above using switched access lines as the denominator, per line expenses would have been greater (lower number of switched access lines than switched access lines plus UNE-L lines) and more importantly the growth in per line expenses reflected in the projections would be greater (switched access lines are declining at a more rapid rate than switched access lines plus UNE-L lines, while operating expenses (the numerator) would remain the same). Rather than confuse the issue with any more detail, I will present the analysis using the methodology Mr. Barber prefers, as the ultimate findings remain similar.

1 On this basis, it is apparent that we are assuming significant growth in per line Spinco
2 Cash Operating Expense, which generates some more modest growth in per line Total
3 Spinco Operating Expense. Per line non-cash D&A expense is declining at a 5.1%
4 CAGR from 2009 to 2015; however, per line cash operating expense is increasing at
5 approximately a 2% CAGR, a more rapid rate of annual increase than on an absolute
6 dollar basis. As a result, per line cash expense increases by almost 12% in 2015
7 compared to 2009, or approximately \$59 per line annually. On a per line basis, the
8 magnitude of the projected cash expense increase is sufficient to overcome the decline in
9 per line D&A expense, resulting in a \$22 annual increase (or almost 3.5%) in Total
10 Spinco Operating Expense per line in 2015 versus the estimated 2007 figure.

11 **Q.** You mentioned that it is problematic to compare stand-alone historical expenses to
12 projected combined company costs. In addition to the projected growth in absolute dollar
13 and per line cash operating expense you detailed above, are there other data that give you
14 comfort that FairPoint's per line expense projections are reasonable and contain a margin
15 for change?

16 **A.** There are actually three points that give me comfort that our projected operating expenses
17 are reasonable and that our overall financial projections allow for an acceptable margin
18 for change. First, and most importantly in my opinion, is FairPoint's demonstrated
19 history of modeling the financial case for acquisitions in such a way that we have always
20 outperformed historical results and our projected financial targets. Our philosophy is to
21 model transactions so that we have an acceptable margin for change in order to ensure we

1 are making decisions that will enhance shareholder value and provide high-quality
2 service to all of our customers—existing and prospective. We have been able to do this
3 in the past and our track record makes me confident we are using the same approach in
4 modeling the proposed transaction with Verizon.

5 Second, as I demonstrated in detail above, we are assuming fairly meaningful growth in
6 cash operating expenses on a per line basis over the course of the 2009 to 2015 projection
7 period. In a declining access line environment producing stable-to-declining Spinco
8 revenues over the projection period, our decision to model increasing absolute dollar and
9 per line cash operating expense growth is reasonable, and certainly not overly aggressive.

10 Thirdly, as FairPoint witness Bill King will demonstrate in detail, the operating cash flow
11 (or EBITDA) margins that we have projected for Spinco are well below the margins
12 being achieved by a group of comparable or “guideline” companies. The table below
13 provides a brief summary of Mr. King’s findings regarding how our projected Spinco
14 EBITDA margins compare to the rural ILEC industry in general.

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*****END CONFIDENTIAL INFORMATION***** As Mr. King and FairPoint witness Balhoff discuss, our operating expense per line projections are in line with what was observed among the guideline companies. However, we are projecting revenues per line that are well below the guideline companies. Therefore, if we are able to increase revenue per line to levels consistent with those being achieved by the comparable company group, there is substantial opportunity for EBITDA margin improvement. The fact that FairPoint has projected Spinco EBITDA margins substantially below the margins being achieved by other companies in our industry gives me additional confidence that our projections are reasonable and contain sufficient margin for change. I truly believe that FairPoint will once again be able to achieve and outperform the results we have projected.

Q. Can you provide an explanation for the ongoing decline in non-cash D&A expense?

A. The ongoing decline is related to (1) the continuing drop in equipment costs and (2) the expected declines in access lines. Equipment costs continue to drop in the industry as

1 items such as soft switches replace the far more expensive digital switches of the past.
2 Moving to an Ethernet based system versus the old TDMA system also creates savings
3 opportunities. On the second point, we have explained that FairPoint's capital
4 expenditure projections are based in part on the number of access lines in service. As our
5 projected access lines decrease, the related capital expenditures decrease as well. The
6 projection model assumes 10-year straight-line depreciation for book accounting
7 purposes. So, as the gross amount of capital expenditures related to access lines declines
8 year-over-year in conjunction with the expected year-over-year declines in access lines,
9 our projected depreciation expense also declines as current investment is lower and
10 certain assets become fully depreciated. As I mentioned above, it is this ongoing decline
11 in non-cash D&A expense that is responsible for the appearance that our operating
12 expense projections assume contraction. Once you exclude the declining non-cash D&A,
13 it is apparent that FairPoint is projecting reasonable growth in cash operating expense.

14 **Q.** Before we move on from discussing FairPoint's full operating expense projections, Mr.
15 Vickroy raises the issue that the company's projection of a five-month cutover to the
16 replacement back-office and operations support systems is overly optimistic and any
17 extensions beyond five months become important to the financial case because of the
18 costs under the TSA. How do you respond to this concern?

19 **A.** FairPoint witnesses Haga and Kurtze address this concern in detail. Specifically, they
20 explain the substantial difference in the FairPoint approach to the systems
21 design/integration work and the Hawaiian Telcom approach (upon which Mr. Vickroy

1 bases much of his concern). As the other FairPoint witnesses indicate, the FairPoint
2 transition is being managed very differently from the Hawaiian Telcom transition and, as
3 a result, has a high probability of success within our projected timeframe. At worst, we
4 would not expect any delay beyond a month or so (we have projected one additional
5 month of TSA expense beyond the four month period by which we expect cutover to
6 occur).

7 It should be noted Capgemini was selected as the consultant in the third quarter of 2006,
8 and began the planning process in the fourth quarter of 2006. The June 1, 2008 projected
9 cutover date results in over 19 months of planning for such cutover, which we believe to
10 be a very substantial amount of time for such work.

11 In addition, Verizon witness Steve Smith also addresses the meaningful differences
12 between FairPoint's approach and the approach employed in the Hawaii transaction. As
13 Mr. Smith states, "the difference between working with FairPoint and Capgemini and
14 working with the Hawaii buyer and its consultant is like the difference between night and
15 day." (Smith, page 10). By Mr. Smith's account, we are already achieving milestones in
16 the systems development process that were not achieved in Hawaii until after the close of
17 the transaction and well into the transition service delivery period. Mr. Smith concludes
18 that as a result of Verizon's and FairPoint's greater coordination, communication, and
19 cooperation, the risk of incompatibility between the Verizon data and the new systems at
20 cutover is substantially reduced.

1 Therefore, there is little risk that the TSA period will extend much beyond FairPoint's
2 proposed schedule, as we remain on target to achieve and successfully implement all
3 tasks related to cutover and the initiation of the new systems architecture.

4 **Detailed Explanation of Projected Cost Savings**

5 **Q.** Before getting into details about expected cost savings, please explain at a very "high
6 level" why you expect any of the Verizon expenses to go away.

7 **A.** It is important to remember that Verizon allocates a significant amount of corporate
8 overhead expenses (approximately \$270 million in 2006) to the northern New England
9 operations. These allocations are for costs incurred outside of the three states related to
10 functions which do not come to FairPoint as part of the merger. In addition these
11 allocations include the corporate overhead for Verizon from headquarters and regional
12 locations. Therefore, there is absolute certainty that these costs will go away following
13 the merger. There is no question these costs will be eliminated. The only question is
14 how they compare to the new cost structure which FairPoint is putting in place to
15 replicate such services. Details on that new cost structure are addressed in the following
16 questions.

17 **Q.** There seems to be some confusion or uncertainty regarding the cost savings / operating
18 efficiencies that FairPoint claims it can achieve and how those savings are reflected in the
19 financial projections, even to the extent that the Liberty Witnesses contend that the cost
20 savings should not be included in the financial projections under review in this

1 proceeding. Can you provide additional detail and clarity regarding the sources of
2 operating expense reductions / cost savings and how they are included in the projections
3 going forward?

4 **A.** I will walk you through how FairPoint determined its published cost savings estimates of
5 \$60 million to \$75 million. I believe that once there is better understanding of how we
6 developed these estimates and projections, there will be greater comfort in our ability to
7 deliver the projected operating cost efficiencies and agreement that we are not being
8 unreasonable in including these cost savings in our base case projections for this
9 proceeding.

10 **Q.** Specifically, what are the sources of the \$60 million to \$75 million in operating cost
11 savings and how was this estimate developed?

12 **A.** The table below outlines in detail how the estimated operating efficiency estimates were
13 derived. It is important to know that we did not take the Verizon cost structure and
14 attempt to reproduce it. Instead, we knew that all the allocated overhead costs would go
15 away following the closing and our new cost structure would then replace the Verizon
16 costs. Thus, we merely compared our cost structure to the prior allocated Verizon
17 corporate overhead, and the difference fell out as the cost savings. It should be noted our
18 cost structure assumed in the first year of operation that all the direct costs incurred by
19 the Spinco business in northern New England would continue at pre-merger levels. To
20 that amount we added a detailed build up of all the new back office costs which would be

1 put in place to replace the allocated services historically provided by Verizon from out of
2 state facilities. For purposes of presenting the table below, we estimated how some of
3 the Verizon costs could be allocated across different functions to show a comparison to
4 the FairPoint estimates for those same functions.

5 *****BEGIN CONFIDENTIAL INFORMATION*****

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1 *****END CONFIDENTIAL INFORMATION** The estimated cost savings are
2 primarily the difference between Verizon-allocated costs (for functions performed by
3 other Verizon entities outside of the northern New England operations) and the
4 incremental direct cost that FairPoint must incur post-closing to replace these functions.
5 In creating the estimated cost savings, FairPoint compared Verizon's estimated 2007 cost
6 structure for the to-be-acquired operations to FairPoint's "bottom-up" cost structure
7 derived by quantifying expected costs of all functional operations. In many respects
8 these cost savings are more indicative of avoided costs for the combined company as
9 opposed to what many people typically think of in terms of merger "synergies" (often
10 driven by economies of scale or the elimination of redundant operations). The 2007
11 comparison is reflected in the table above.

12 Based on this methodology, FairPoint expects to eliminate approximately \$118 million of
13 operating expense from the Verizon cost structure (again, principally corporate cost
14 allocations as opposed to actual in-region operating costs), while adding approximately
15 \$46 million in incremental costs to replace the functions represented by the Verizon-
16 allocated costs. Because FairPoint is able to "start with a clean sheet" and tailor its
17 operating model and cost structure specifically to the northern New England operations,
18 and avoid the cost related to many legacy functions no longer required, we are able to
19 reproduce many of the Verizon overhead functions at costs well below the Verizon
20 allocations. As a large corporation with a wide variety of assets, Verizon's cost structure
21 is designed for the entire company, and many lines of business which we are not

1 purchasing, and is not specific to operating regions or companies. Therefore, as FairPoint
2 is demonstrating, when certain assets are removed from the larger corporate entity, it is
3 possible to derive targeted operating cost reductions. This is very typical, as in most
4 RBOC access line sales in the past the acquiring companies have produced similar
5 savings. Mr. Balhoff provides more information about this experience in his testimony.

6 The primary drivers (single category changes in the Verizon cost structure in excess of
7 \$10 million) of expected cost savings and cost increases are highlighted in the table. All
8 other projected cost savings and cost increases (including the impact on existing
9 FairPoint operations) taken together result in a net cost decrease of less than \$1 million.
10 Additional detail on the company's rationale regarding the primary drivers of the
11 estimated avoided costs is provided below.

12 *****BEGIN CONFIDENTIAL INFORMATION*****

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15 *****END CONFIDENTIAL INFORMATION***** The basis for these
16 assumed savings is:

- 17 ▪ Customer Sales & Service: The Verizon allocation for customer sales and service
18 expenses is based upon costs for call centers in the three states, some of which
19 provide service to an area broader than the three states, or for a center providing a
20 service which does not come with the acquired businesses. Otherwise, the cost

1 would be included as a direct expense, not an allocated expense. Verizon has
2 acknowledged they do not operate the three states as a “financial entity” and,
3 therefore, much of the allocated cost information comes from an allocation made
4 to satisfy financial reporting for the three-state market. We believe eliminating
5 the out of state services will result in savings.

- 6 ■ Network & IT: ***BEGIN CONFIDENTIAL INFORMATION***

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8 ***END

9 CONFIDENTIAL INFORMATION*** The allocations represent costs from
10 centralized Verizon workgroups and corporate facilities outside of the Spinco
11 footprint. ***BEGIN CONFIDENTIAL INFORMATION***

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13 ***END CONFIDENTIAL INFORMATION*** These cost allocations will
14 cease at closing. FairPoint has provided for the additional personnel and
15 infrastructure required to replace the functions represented by the Verizon
16 allocation in its estimated cost increases for Engineering & Operations and Land
17 & Building.

- 18 ■ Marketing: Somewhat similar to the allocations for customer sales and service,
19 the Verizon expenses for marketing also represent national or regional costs
20 (expenses incurred outside of the three-state area) which are allocated to the three-
21 state area. We believe that Verizon’s national and regional sponsorship programs

1 have less value to the customer base in northern New England, but the Spinco
2 operations historically were charged an allocation for such costs. After the
3 merger, the three states will be charged only for those expenses related to the
4 three-state area, and we believe that the cost-benefit relationship will be far more
5 efficient than it is today. A perfect example is the fact that FiOS with a video
6 product is advertised in parts of the three-state area, but none of the three states
7 can offer such video service, and there is no benefit to the three states from such
8 advertising.

- 9 ■ Shared Assets: *****BEGIN CONFIDENTIAL INFORMATION*****
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*****END CONFIDENTIAL INFORMATION***** The cost increase for Engineering & Operations (and Legal & Regulatory) reflects, among other things, additional personnel required to replace the centralized Verizon functions that will no longer support the northern New England operations. Other witnesses are attesting to the level of detail and rigor that are being applied with Capgemini to the development of back office functions, and we are very confident we have the necessary dollars budgeted to accomplish all tasks.

Q. Are there any other factors that give you confidence that FairPoint’s projected cost savings are reasonable and achievable?

A. Yes. As part of the company’s ongoing due diligence, we have determined that projected direct operating expenses should be \$15 million lower than previously reflected in our financial projections. The reduction relates to lower expected rent, disaster recovery and billing system costs, expenses and other costs. Therefore, today we are even more

1 confident in achieving the projected cost reductions as our continuing due diligence has
2 actually shown more savings are likely than those reflected in the Discovery Model 1.

3 **Q.** Are there other methodologies for assessing the reasonableness of FairPoint's cost
4 savings estimate?

5 **A.** I think one of the more straight-forward summary methodologies is by utilizing the
6 annual TSA cost. For \$16.5 million per month, or \$198 million per year, Verizon has
7 agreed to provide the combined company with the services (at Verizon's cost) not
8 directly performed within the operations of the assets to be transferred. As I indicated
9 above, Verizon allocated costs in 2006 of approximately \$270 million for service
10 performed outside of the to-be-acquired operations. As a result, the \$72 million
11 difference in the allocated cost and the TSA cost (\$270 million minus \$198 million) is a
12 good proxy for the additional overhead inherent in Verizon's corporate structure, most of
13 which FairPoint will not incur.

14 **Q.** How do you respond to Mr. Vickroy's contention that because FairPoint previously has
15 not built the types of systems it is currently creating, we cannot be certain that the cost
16 savings estimates are accurate?

17 **A.** Our Operations witnesses previously have provided significant detail and will provide
18 substantial additional detail regarding the rigorous and comprehensive development and
19 implementation processes we are undertaking in conjunction with Capgemini. In the end,
20 there are uncertainties with any projections. However, I believe that we have undertaken

1 a best-in-class process and have spared no expense in making sure that the systems we
2 are developing are state-of-the-art and will function at least as effectively as we have
3 projected. In addition, as you have heard from Verizon witnesses, the development and
4 conversion process for these systems, along with the transition process for the rest of the
5 operations, is not being pursued by FairPoint and Capgemini in a vacuum. Verizon is a
6 very active participant in the planning, development and deployment. They know better
7 than anyone what the existing systems do and what it will take to replace them. They
8 also know what functions will need to be replaced as part of the transition. All of this
9 should provide comfort to the Commission that everything possible is being done to
10 ensure that we understand all angles of the conversion and transition processes, and that
11 this understanding forms the detailed basis for the cost savings we expect to achieve.

12 **Q.** So, in response to the Liberty Witnesses, do you believe that FairPoint's estimated cost
13 savings are sufficiently likely to occur such that they should be included in the financial
14 projections being considered by the Commission in assessing the expected financial
15 condition of the company?

16 **A.** Based on the detail I have provided, and the detailed support provided by other FairPoint
17 and Verizon witnesses, I do.

18 **Q.** How will these expected cost savings benefit New Hampshire consumers?

19 **A.** I can address this issue, generally, while other FairPoint witnesses will demonstrate our
20 operational plans in more detail. I see three primary ways in which the operating

1 efficiencies and cost savings I have outlined above will benefit consumers. First, we
2 have indicated that we will not seek increases in Verizon's existing rates for either retail
3 or wholesale customers as a result of the transaction. Second, we intend to tailor our
4 operations to provide improved levels of customer service, and moving back-office
5 functions which are currently performed outside the three states into the three state area
6 should help facilitate that objective. Our operations people will provide greater detail on
7 how this will be achieved, but the cost savings will assist in these efforts. Finally, the
8 money we save in terms of operating costs will be an important source of cash flow for
9 investment in our network. It is this network investment that will enable us to bring
10 broadband more rapidly to significantly more of New Hampshire's residents. Greater
11 broadband availability also will allow FairPoint to provide consumers with a wider array
12 of telecommunications products and services. Again, the details of our broadband build-
13 out plans will be provided by other FairPoint witnesses; but, needless to say, the cost
14 savings described above will enhance our ability to expand broadband availability in New
15 Hampshire faster than would otherwise occur if the merger did not close.

16 So, as a result of this transaction and the projected avoided costs, New Hampshire
17 consumers should expect to see improved customer service, no related increase in prices
18 and, most importantly, greater access to broadband and an array of high-quality,
19 advanced services.

20 Q. Finally, how would you address Mr. Brevitz's statement that the driver of FairPoint's
21 projected cost savings estimates "may be the fact that ***BEGIN CONFIDENTIAL

1 **INFORMATION*****

2 *****END CONFIDENTIAL INFORMATION***** (Brevitz, Highly
3 Confidential, p. 82)

4 **A.** First, I would like to clarify that the statements Mr. Brevitz quotes were made in the
5 context of a review session FairPoint conducted for interested parties to provide
6 additional detail regarding our financial model (although the quote that analysts “love
7 synergies” is not found in his notes from the session, so I am not clear where he got this
8 quote). In any event, while it is true that the vast majority of corporate transactions
9 include some related savings in terms of costs (thus analysts are indeed conditioned to
10 look for the potential costs savings related to transactions), we developed our cost savings
11 estimates using the detailed process I described above. FairPoint did not just pull a cost
12 savings number out of the air to appease investment analysts, as Mr. Brevitz’s statement
13 might suggest.

14 **The MAC Case and Liberty’s Hawaiian Telcom Case**

15 **Q.** The Liberty Witnesses go to great lengths to assert that FairPoint’s base case projections
16 should be disregarded and the company’s MAC case projections should become the de
17 facto base case for the Commission’s consideration of the financial prospects for the
18 combined company. Is the MAC case the most appropriate base case for these
19 proceedings?

1 **A.** No it is not. The Liberty Witnesses are advancing the MAC case, which excludes our
2 projected cost savings because they do not believe the savings should be considered by
3 the Commission. As I stated above, I fundamentally disagree with this position.
4 FairPoint, through me and other witnesses, has presented substantial supporting evidence
5 that the cost savings are reasonable to include in our base case projections for the
6 combined company. Far from being the “most likely” case, as Mr. Vickroy contends, we
7 continue to view the MAC case as a “worst case” scenario. The important message in
8 the MAC case is that it shows all operating expenses, capital expenditures, taxes and debt
9 service payments can still be covered with the likely result being that a lower dividend
10 payment would have to occur. It is also important to note that in this “worst case” view
11 the company is projected to remain in compliance with all its bank agreement covenants.

12 **Q.** Is there anything more you would like to add regarding Mr. Vickroy’s discussion of the
13 MAC case?

14 **A.** I would like to point out that his understanding of the MAC case is less favorable than
15 our actual MAC case projections.

16 As the table below demonstrates, the actual free cash flows and payout ratios generated
17 by the MAC case are more positive than those presented in Mr. Vickroy’s discussion and
18 his Exhibit F.

	Year 1 2008	Year 2 2009	Year 3 2010	Year 4 2011	Year 5 2012	Year 6 2013	Year 7 2014	Year 8 2015
(Dollars in millions)								
Pro Forma Combined Cash Flow Projections								
Pro Forma Combined Adjusted EBITDA	\$ 505	\$ 528	\$ 524	\$ 508	\$ 494	\$ 482	\$ 473	\$ 466
Interest Expense	(185)	(187)	(186)	(185)	(185)	(184)	(185)	(186)
Cash Taxes	(2)	(2)	(2)	(3)	(3)	(2)	(2)	(2)
Cap Ex	(173)	(167)	(163)	(157)	(154)	(152)	(150)	(149)
Change in NWC	-	-	-	1	1	-	-	-
Free Cash Flow	\$ 145	\$ 172	\$ 173	\$ 164	\$ 153	\$ 144	\$ 136	\$ 129
Dividends	(142)	(142)	(142)	(142)	(142)	(142)	(142)	(142)
Cash Flow after Dividends	\$ 3	\$ 30	\$ 31	\$ 22	\$ 11	\$ 2	\$ (6)	\$ (13)
Vickroy Exhibit F "Excess Cash Flow"	NA	24	19	10	(4)	(17)	(29)	(39)
<i>Variance - Annual</i>		\$ 6	\$ 12	\$ 12	\$ 15	\$ 19	\$ 23	\$ 26
<i>Variance - Cumulative ('09-'15)</i>								\$ 115
Payout Ratio	98%	82%	82%	86%	93%	98%	104%	110%
Vickroy Exhibit F "Dividend Payout %"	NA	86%	88%	93%	103%	114%	126%	138%
<i>Variance - Annual (bps)</i>		363	611	661	1,040	1,562	2,183	2,818

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In addition, as the table below demonstrates, the actual debt levels and credit ratios generated by the MAC case are more positive than those presented in Mr. Vickroy's discussion and his Exhibit G.

	Year 1 2008	Year 2 2009	Year 3 2010	Year 4 2011	Year 5 2012	Year 6 2013	Year 7 2014	Year 8 2015
(Dollars in millions)								
Pro Forma Credit Ratio Projections								
Interest Coverage								
Pro Forma Combined Adjusted EBITDA	\$ 505	\$ 528	\$ 524	\$ 508	\$ 494	\$ 482	\$ 473	\$ 466
Interest Expense	185	187	186	185	185	184	185	186
Adjusted EBITDA / Interest Expense	2.73	2.82	2.82	2.75	2.67	2.62	2.56	2.51
Covenant	2.25	2.25	2.25	2.25	2.25	2.25	2.25	2.25
Compliance	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Vickroy Exhibit G "Interest Coverage"	2.63	2.75	2.69	2.59	2.49	2.37	2.26	2.17
Leverage Ratio								
Total Net Debt	\$ 2,561	\$ 2,530	\$ 2,499	\$ 2,477	\$ 2,467	\$ 2,465	\$ 2,470	\$ 2,482
Pro Forma Combined Adjusted EBITDA	505	528	524	508	494	482	473	466
Total Net Debt / Adjusted EBITDA	5.1	4.8	4.8	4.9	5.0	5.1	5.2	5.3
Covenant	5.8	5.5	5.5	5.5	5.5	5.5	5.5	5.5
Compliance	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Vickroy Exhibit G "Leverage Ratio"	5.7	5.3	5.3	5.5	5.6	5.9	6.1	6.3

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As a result, were the MAC case to occur, FairPoint would not be on the "razor's edge of covenant violations" in every year of the projections, as Mr. Vickroy represents, and in no year would we be anywhere near a payment default. In fact, FairPoint remains in compliance with its debt covenant ratios for the entire projection period in the MAC case.

1 Q. Shifting from the MAC case, the Liberty Witnesses also contend that Hawaiian Telcom's
2 experience is actually the most appropriate "worst case" scenario for the Commission to
3 consider. Can you address this contention?

4 A. I think it is very important to consider Staff witness Antonuk's own assessment of the
5 Hawaii experience relative to the proposed transaction—"[w]e do not predict that such
6 results will occur here." (Antonuk, page 18) I agree with Mr. Antonuk that it is highly
7 unlikely that we will repeat the mistakes made in Hawaii. As I indicated above, FairPoint
8 witnesses Haga and Kurtze, and Verizon witness Smith, provide significant detail
9 differentiating our planning and implementation processes versus the Hawaiian Telcom
10 process. Based on their testimonies, it is reasonable to conclude that FairPoint and
11 Verizon are doing everything necessary to ensure that the cutover and transition
12 processes are efficient and effective. As a result, I do not think it is prudent to consider
13 Hawaiian Telcom's experience as indicative of a likely worst case for the proposed
14 transaction.

15 Q. Finally, Liberty prepared and presents a Hawaiian Telcom-type case for the proposed
16 FairPoint-Verizon transaction. Can you address this case, which Liberty claims is a more
17 appropriate "worst case" scenario?

18 A. It is always possible to generate what I would describe as "the perfect storm"—unlikely
19 scenarios in which everything that could go wrong, does go wrong. I would put Liberty's

1 Hawaiian Telcom-based projections for this transaction in that category. We see no
2 evidence that would indicate that this is a realistic downside scenario,

3 **Projected Capital Investment**

4 **Q.** Mr. Barber expresses concern that FairPoint is projecting annual capital expenditures that
5 are less than its annual depreciation. How would you address his concern?

6 **A.** The simple answer is that it is typical for ILECs serving rural and small urban
7 communities at this point in time to have capital expenditures levels that are lower than
8 depreciation. Depreciation is a function of capital spent in prior years when the number
9 of access lines was higher and equipment costs were more expensive, while capital
10 expenditures today are representative of the current needs of the business, and should
11 logically be lower. FairPoint witnesses King and Balhoff will address this issue in more
12 detail, but the reality is that our projected levels of capital expenditures relative to
13 depreciation reflect the industry norm and are not an indicator of abnormal
14 underinvestment as Mr. Barber would have you believe. From 2009 to 2015, FairPoint's
15 median ratio of Spinco capital expenditures to D&A is approximately 65%. As Mr. King
16 demonstrates, over the period from 2004 to first quarter of 2007 the median percentage of
17 capital expenditures to D&A is approximately 62% for the group of guideline companies.
18 Based on this analysis, it seems fair to say that FairPoint's projected level of capital
19 expenditures as a percentage of D&A exceeds current industry standards (this is true on
20 an annual basis for all years except 2009 and 2010). This higher level was deemed

1 appropriate given the need to make network investments in certain areas. It seems
2 inappropriate that it would be counted as a negative factor that our capital investment
3 practices are consistent with other companies in our industry and exceed the investment
4 levels of much of the guideline company group.

5 An interesting side note is that FairPoint's projected Spinco capital expenditures as a
6 percentage of D&A actually are increasing consistently over the projection period to
7 more than 77% by 2015. This trend does not appear typical within the industry and
8 reflects that our capital expenditures and D&A are converging, which should be of some
9 comfort to Mr. Barber.

10 **Q.** Can you address concerns that FairPoint is planning to invest less in the Spinco properties
11 than Verizon has invested in the past?

12 **A.** On an absolute dollar basis, it is accurate that FairPoint is projecting capital expenditures
13 at levels below Verizon's absolute dollar level of investment for the last couple of years.
14 However, in a declining access line environment where revenue growth is difficult to
15 produce, it is rational to reduce capital expenditures (although at a slower rate than the
16 decline in access lines). It is noteworthy that Verizon's normal course capital
17 expenditure budget for 2007 is approximately \$138 million, consistent with our 2008 and
18 2009 projections of \$143 million and \$138 million, respectively. Finally, as Mr. Barber
19 has conceded, it is most appropriate to look at cost and investment levels on a per line or
20 unit basis. This is especially true in a declining line (or unit) environment. As I

1 illustrated in my direct testimony (table on page 30), on a per line basis we are projecting
2 increasing levels of capital expenditures over the entire projection period at levels that
3 exceed Verizon's per line investment levels (excluding FiOS) from 2004 to 2007.

4 **Q.** Can you provide additional detail regarding FairPoint's projected capital expenditures per
5 line that supports your contention that on a per line basis you expect to invest more than
6 Verizon has in the recent past?

7 **A.** First let me address the proper basis for calculating per line capital investment,
8 particularly focusing on the appropriate denominator to use in this calculation. As in my
9 direct testimony, the per line capital expenditures data that I will present use average
10 annual Total Switched Access Lines as the denominator for this calculation. I have
11 excluded UNE-L lines from the calculation because these lines represent only a single
12 UNE element out of the many elements that make up a complete switched access line.
13 As such, the capital investment required of FairPoint for a UNE-L line is significantly
14 lower than it is for a switched access line as the wholesale customer is responsible for
15 capital investment in the remaining elements that compose a functional access line. To
16 include UNE-L lines would depress artificially the per line figures.

17 Likewise, it is not appropriate to use access line equivalents, or ALEs, (that include DSL
18 connections) as the denominator for a per line capital expenditure calculation. In almost
19 all cases, except when a customer purchases only a DSL line from a telephone company
20 and no other voice services (a "naked" DSL line), both telephony and DSL are provided

1 over the same access line to the customer's home. Therefore, except in the unusual case
 2 of a "naked" DSL line, it is double counting to include both the access line and the DSL
 3 line in the denominator of the per line capital expenditure calculation. As with the
 4 inclusion of UNE-L lines, using ALEs (including DSL connections) will depress
 5 artificially the per line investment amount. As such, FairPoint maintains that the proper
 6 basis for these per line calculations is switched access lines.

7 The table below provides the data supporting my contention that FairPoint intends to
 8 invest more in the Spinco properties than Verizon has in the recent past when capital
 9 expenditures are viewed appropriately on a per line basis.

**Spinco Capital Expenditures
 Discovery Model**

(Dollars in millions, lines in thousands, per line data actual dollars)

	Verizon				FairPoint								'08-'15	
	2004	2005	2006	2007	Year 1 2008	Year 2 2009	Year 3 2010	Year 4 2011	Year 5 2012	Year 6 2013	Year 7 2014	Year 8 2015	CAGR	Change
Per Line Calculations (Switched AL Basis)														
Total Capital Expenditures [1]	\$ 172	\$ 145	\$ 147	\$ 138	\$ 143	\$ 138	\$ 134	\$ 130	\$ 128	\$ 127	\$ 127	\$ 127		
Average Total Switched Access Lines	1,739	1,652	1,557	1,453	1,355	1,276	1,213	1,161	1,119	1,083	1,053	1,027	-3.9%	(328)
Total Per Line Capital Expenditures	\$ 99	\$ 88	\$ 94	\$ 95	\$ 105	\$ 108	\$ 111	\$ 112	\$ 115	\$ 117	\$ 120	\$ 123	2.3%	\$ 18
YOY Growth		-11%	8%	0%	11%	3%	2%	1%	2%	2%	2%	3%		

[1] Excludes Verizon FIOS investment for 2004-2006.

11 As you can see, Verizon's annual per line investment (excluding FiOS) for the years
 12 2004 through 2007 (budget) has been in the \$88 to \$99 range. Going forward, from 2008
 13 to 2015, FairPoint intends to invest on average \$114 annually per line (ignoring the \$44
 14 million for the DSL build-out expected in the 18 months following the closing), well
 15 above the range of Verizon per line investment amounts in recent years. In addition,
 16 FairPoint is projecting that per line capital expenditures will grow consistently over the
 17 projection period to \$123 annually per line in 2015—representing a 2.3% CAGR and a

1 per line increase of approximately \$18 in 2015 versus 2008. Therefore, when the data are
2 analyzed properly, it is clear that FairPoint intends to invest sufficiently to maintain and
3 improve the Spinco operations.

4 **Q.** The Liberty Witnesses (Mr. Vickroy in particular) have raised concerns that FairPoint
5 may have underestimated the level of capital expenditures required for its planned
6 broadband build-out and to address the perceived service quality issues for the Verizon
7 New Hampshire operations. How can the Commission feel confident that the capital
8 expenditures FairPoint expects to make in New Hampshire will be adequate to maintain
9 and improve service quality and expand broadband?

10 **A.** In my table above, I outlined FairPoint's projected Spinco capital expenditures on an
11 absolute dollar and a per line basis, indicating that our near-term investment plans are
12 consistent with the last couple of years (2006-2007) of absolute dollar investment by
13 Verizon (excluding FiOS) and that we intend to continue to grow our per line investment
14 every year throughout the projection period. It should also be noted the \$244 million we
15 are spending on back office infrastructure and the upfront broadband build-out is not
16 included in the referenced numbers. FairPoint operating witnesses will testify to the
17 effect that our projected expenditures, particularly the near-term estimates where we have
18 the most visibility, are sufficient to fund our operational plan and our expansion of
19 broadband availability. These witnesses will explain our due diligence efforts regarding
20 the Verizon network and the rationale for our confidence that we have appropriately
21 accounted for the existing state of that network. In addition, they will describe our plans

1 to maintain and improve the core network, our strategy to improve service quality, and
2 the detail behind our broadband build-out plans. Specifically, FairPoint witness Brown,
3 the company's broadband subject matter expert, has been provided continued access to
4 Verizon's detailed engineering records. Mr. Brown's ongoing due diligence has enabled
5 him to achieve a high degree of confidence regarding the budget for our broadband build-
6 out plan across the three state region. Based on this detailed data, I am confident that we
7 have a comprehensive plan in place to achieve the Commission's service quality and
8 broadband goals, and that we have accounted adequately for the investment needed to
9 execute our plan in our capital budget projections.

10 **Q.** Does FairPoint have sufficient capital resources to contend with contingencies that
11 require additional capital?

12 **A.** FairPoint witnesses Balhoff and King address in detail the financial soundness of our
13 company, the significant cash cushion available after all cash obligations have been paid
14 each year, and our ability to access the capital markets as needed (or desired). However,
15 my summary response is that FairPoint is and will continue to be a publicly-traded
16 company that historically has been able to access the public and private debt and equity
17 capital markets when it has deemed appropriate. A good example of our ability to secure
18 capital as needed is the fact that we already have secured commitments for a substantial
19 majority of the financing required to close the acquisition of the Spinco properties upon
20 approval of the transaction. In short, I agree with Vermont DPS witness Perry Wheaton
21 (page 9, lines 15-16) who states, "FairPoint's projected level of free cash flow ensures

1 that it will still have access to equity and debt capital markets if needed to fund capital
2 expenditures.”⁶ Mr. Wheaton goes on to say, “FairPoint has approximately ***BEGIN
3 CONFIDENTIAL INFORMATION*** ***END CONFIDENTIAL
4 INFORMATION*** per year in free cash flow (before dividends) *available to fund*
5 *contingencies*” (emphasis added) (Wheaton, page 9, lines 18-19).⁷ It should also be noted
6 that FairPoint has access to an additional \$200 million via its revolving credit facility
7 which is not projected to be used at any time in our model. Finally, later in his testimony
8 Mr. Wheaton assesses our ability to continue to borrow funds if necessary (i.e., in the
9 case of negative contingencies), concluding that in 2012, “FairPoint will have the
10 capacity to borrow significant additional funds – perhaps as much as \$500 million.”⁸
11 (Wheaton, page 20, lines 10-11). I believe Mr. Wheaton’s assessment is accurate and
12 directly responds to any concern regarding the sufficiency of our capital resources.

13 **FairPoint’s Financial Position if the Transaction is not Approved is not**
14 **Relevant**

15 **Q.** Mr. Brevitz points out that there may be concern in the investment community regarding
16 whether or not FairPoint can sustain its current dividend if the pending transaction is not
17 completed. Is this topic relevant for this proceeding?

6 Prefiled Direct Testimony dated May 24, 2007, page 9, lines 15-16.

7 Id., page 9, lines 18-19.

8 Id., page 20, lines 10-11 (confidential version).

1 **A.** No, it is not relevant. This proceeding concerns whether or not approving the pending
2 transaction is in the best interest of New Hampshire and its residents. The sustainability
3 of FairPoint's current dividend if the transaction is not approved should have no bearing
4 on the approval decision. The analyst reports cited and referred to by Mr. Brevitz say
5 nothing about the ability of the proposed merged entity to be a financially successful
6 company or to pay the proposed dividend. These are the relevant considerations for this
7 proceeding.

8 With regard to the recent report from a Morgan Stanley analyst, it should be made clear
9 that the report purports to be an analysis of FairPoint's financial position if the merger is
10 not approved—a scenario which is not relevant in considering the approval of the merger.
11 Further, the report claims to be based on a new FairPoint standalone forecast; however,
12 no such forecast was ever provided by our company. That being said, nothing the analyst
13 wrote contradicted evidence from FairPoint that we will be financially stronger as a result
14 of the proposed transaction.

15 The discussions regarding how the proposed transaction serves the public interest should
16 be focused on the financial position of the combined company. These discussions and
17 deliberations should not be distracted by side conversations about topics that are
18 irrelevant to the transaction—such as the sustainability of the FairPoint dividend *if the*
19 *transaction is not approved.*

1 **Q.** Along these same lines, Mr. Barber and Mr. Brevitz (to a lesser degree) discuss two
2 projection scenarios, the “Falcon Acquisition Case” and “Falcon Status Quo”, as part of
3 their contention that without the proposed transaction FairPoint is on shaky financial
4 footing. Please explain these scenarios and their intended purpose.

5 **A.** To be clear, Falcon was the code name for FairPoint at one point in the transaction
6 discussions. The Falcon Acquisition Case and Falcon Status Quo case were financial
7 projection scenarios produced by FairPoint management. The Falcon Acquisition Case
8 was intended to be indicative, at a high level, of FairPoint’s projected financial
9 performance were it to continue making small acquisitions (as it had done in the recent
10 past, prior to this transaction) at a similar pace as its historical acquisition activity. The
11 Falcon Status Quo case was a high level projection of FairPoint’s potential financial
12 performance if it continued to operate its existing operations at that time, without further
13 acquisitions or any other operational / financial adjustments. The two scenarios were
14 intended to provide our Board of Directors with some perspective regarding two potential
15 alternative strategic directions as they considered whether or not to pursue the transaction
16 with Verizon. We viewed it as “standard operating procedure” that our Board would not
17 want to consider the Verizon transaction in a vacuum, but would want to have some
18 perspective on alternative strategic directions.

19 **Q.** Are the scenarios truly indicative of how you think FairPoint would have fared
20 financially had it not pursued this transaction with Verizon?

1 A. The scenarios served as a framework for discussion with the Board such that various
2 alternatives could be considered, The Falcon Status Quo case, while instructive to gain
3 some perspective, was somewhat unrealistic. It assumed no continuing acquisitions, but
4 made no other assumptions regarding how management might change its operating model
5 if there truly were a cessation of new transactions. In such an event, management would
6 in all likelihood decide to reduce the operating cost structure of the company and
7 potentially would pursue new directions in terms of new revenue generation (or
8 incremental lines of business). The Falcon Status Quo case did not incorporate any of
9 these fairly predictable actions that likely would accompany any decision for standalone
10 FairPoint to no longer pursue acquisitions.

11 The Falcon Acquisition Case is somewhat more indicative of a realistic strategic
12 direction, but it is still not a likely view of what would have unfolded had we not decided
13 to pursue the Verizon transaction. The scenario assumed only a modest number and size
14 of acquisitions versus what likely would have occurred. The perspective of more robust
15 acquisition opportunities than what was included in the scenario is supported by the
16 number and size of ILEC transactions announced in the marketplace over the last two
17 years. For example, Citizens Communications' acquisition of Commonwealth
18 Communications, CenturyTel's acquisition of Madison River, Quadrangle Group's
19 acquisition of Hargray Communications, Windstream's acquisition of CT
20 Communications, and Consolidated Communications' acquisition of North Pittsburgh, to
21 name a few. Had FairPoint not chosen to commit to the proposed transaction with

1 Verizon, I have no doubt that we would have been an active participant in this robust
2 transactional environment—an environment with much more substantial opportunities
3 than those reflected in the Falcon Acquisition Case.

4 **Q.** Can you address Mr. Barber’s conclusion that “FairPoint management and its Board of
5 Directors believed that they had little alternative to pursuing the Verizon Northern New
6 England acquisition, whatever the risks”?

7 **A.** Mr. Barber’s statement indicates that FairPoint had little alternative but to attempt a
8 transaction with a low chance of success in order to remain viable. This is simply not
9 true. FairPoint had and continues to have strategic alternatives beyond the proposed
10 transaction. As FairPoint witness King has previously stated, he believes that FairPoint
11 would have been a major participant in the RLEC transaction market over the last year or
12 so had it not been for the management focus and resources devoted to this transaction.
13 The size and nature of recent transactions is indicative of the significant alternative
14 opportunities available to FairPoint. Far from believing we had few alternatives,
15 FairPoint’s management and Board made an informed strategic decision that in spite of
16 other opportunities that would likely present themselves, the transaction with Verizon
17 represented a unique opportunity for the company—an opportunity for which, as Mr.
18 King indicates, FairPoint is uniquely qualified.

19 **Q.** Finally, are the scenarios relevant to the current proceeding and to the decision whether
20 or not to approve the transaction?

1 **A.** No they are not. As discussed above regarding the sustainability of FairPoint’s dividend
2 if the transaction is not approved, alternative scenarios of standalone FairPoint prepared
3 to provide perspective for our Board deliberations have no bearing or relevance regarding
4 the financial position of the combined company if the transaction is approved. The
5 discussion of these scenarios is just another attempt to distract the Commission from its
6 consideration of the relevant financial issues.

7 **FairPoint Business Model, Motivations & Management Issues**

8 **Q.** Turning to FairPoint’s general approach to business, Mr. Barber asserts that FairPoint’s
9 approach to business is “to invest as little as possible in capital plant.” (Barber, page 7,
10 lines 6-7). Would you agree with Mr. Barber that part of FairPoint’s strategy in running
11 telephone companies is to invest as little as possible in capital plant?

12 **A.** I could not disagree with Mr. Barber more, and I believe that the facts paint a very
13 different picture from his accusation. FairPoint has a proud history of being a leader in
14 providing advanced communications networks and solutions to its customers. Our
15 company currently offers broadband to over 92% of our customers, and as of June 30,
16 2007, we reported an industry-leading broadband penetration rate of 26% of voice access
17 lines. Our customers understand that we offer high-quality, advanced services over a
18 state-of-the-art, broadband-based network. It is inconceivable to me how we could
19 achieve such high levels of broadband availability and penetration, serving (as I have
20 demonstrated previously in my testimony) some of the most rural service territories in the

1 U.S. (recall our “teledensity” of only 13 lines per square mile), by investing “as little as
2 possible in capital plant.” If FairPoint had discovered a means by which broadband could
3 be provided to high-cost rural areas based on *de minimis* capital investment, there would
4 not be such a clamoring in the U.S. Congress by representatives of rural states looking for
5 ways to offer incentives to carriers to provide these services. I find Mr. Barber’s
6 characterization of our business strategy incorrect, and certainly not supported by the
7 facts.

8 **Q.** Mr. Barber and Mr. Brevitz also go to great lengths to call into question the soundness of
9 FairPoint’s motivations in pursuing this transaction, relying significantly on materials
10 from the FairPoint and Verizon Hart-Scott-Rodino (HSR) filings. Please address the
11 issues they raise.

12 **A.** First, I will address Mr. Barber’s concerns. In terms of FairPoint’s motivations for
13 pursuing the transaction, he draws the conclusions that FairPoint views this transaction as
14 a stepping stone and that the transaction was undertaken out of desperation. Citing
15 “highly confidential” notes from an internal FairPoint conference among top executives
16 and our CEO to discuss the transaction, Mr. Barber draws the conclusion that “FairPoint
17 was already well beyond NNE and its communities.” (Barber, Confidential, p. 35) As
18 support for this conclusion, Mr. Barber cites a statement attributed to our CEO that in
19 planning FairPoint should incorporate “scale and efficiencies so that we truly have an
20 acquisition platform.”

1 We have always been upfront in stating that we do not view the proposed transaction as
2 the terminus of our corporate strategy. However, FairPoint executives have also made it
3 clear that they will not consider additional transactions until they are comfortable that the
4 northern New England operations are operating smoothly and as planned. There is
5 nothing in the material cited by Mr. Barber to contradict this or to indicate that our
6 management team was “looking well beyond NNE and its communities.” To the
7 contrary, we have been and will be laser focused on executing the acquisition and
8 transition until we are 100% confident that the operations are running efficiently and
9 providing high-quality service to our customers. However, once we are comfortable that
10 our plan for the Spinco operations is being executed properly, however long that might
11 take, we think it is prudent to maintain flexibility to pursue additional strategic
12 opportunities (transactional and otherwise) as they arise. The ILEC industry is a
13 consolidating industry. To say we will unequivocally avoid all acquisition activity going
14 forward would unnecessarily restrict our ability to manage the company and its strategic
15 direction.

16 As such, it is important that we build our new systems for the northern New England
17 operations so that they efficiently provide for the needs of that region, but are capable of
18 easily scaling to manage a larger entity in the future, if necessary. Taking this approach
19 in no way harms the combined company and allows it additional flexibility to participate
20 in ongoing industry consolidation down the road, if that is deemed prudent. Therefore,
21 while we certainly want to have the capacity to grow efficiently at some point in the

1 future, should the right opportunities arise, creating the potential for the combined
2 company to serve as a platform for future acquisitions should not be interpreted as
3 diminishing our focus on the northern New England region. Far from serving as a
4 “stepping stone,” we expect the to-be-acquired Verizon operations to form the core of our
5 company for the foreseeable future.

6 **Q.** What about Mr. Barber’s concern that the transaction was undertaken out of desperation?

7 **A.** Again Mr. Barber cites “highly confidential” notes from the internal FairPoint conference
8 among top executives and the CEO to support his conclusion that FairPoint pursued the
9 transaction out of concern for the sustainability of its dividend and because the
10 company’s business strategy had “hit a dead end.” (Barber, Confidential, p. 36) As I
11 discussed above in the section of my testimony regarding FairPoint’s prospects without
12 the acquisition of the Verizon properties, our management and Board of Directors
13 considered a number of scenarios / alternatives to gain a better perspective in assessing
14 whether or not to pursue the transaction. We never believed that our business strategy
15 had “hit a dead end” (Mr. Barber’s interpretation of notes from a meeting he did not
16 attend, not our words). In fact, as I stated above, FairPoint had and continues to have
17 strategic alternatives beyond the proposed transaction. This was not a decision made out
18 of desperation, but an informed strategic decision to pursue what we viewed as a unique
19 opportunity for the company.

1 Q. Turning to Mr. Brevitz, can you address his concerns regarding FairPoint's motivations
2 and objectives in pursuing the transaction with Verizon?

3 A. Mr. Brevitz's concerns are very similar to Mr. Barber's – that without the proposed
4 transaction, FairPoint's standalone prospects were not attractive. Interestingly, he even
5 quotes substantially the same passages from the HSR materials that Mr. Barber cites.
6 (Brevitz, Highly Confidential pp. 24-26) In any event, I believe that my responses above
7 to Mr. Barber's concerns about our motivations sufficiently address the issues raised by
8 Mr. Brevitz, given the similarity.

9 Q. Is there anything that you would like to add regarding the HSR materials?

10 A. Briefly, I would like to set the context for the materials quoted by Mr. Barber and Mr.
11 Brevitz. As stated above, the notes were from a confidential internal meeting of
12 FairPoint executives. This meeting was designed to allow our executives, as is their duty
13 to shareholders, to openly debate the strategic merits of pursuing the proposed transaction
14 with Verizon. We expected the debate to be lively and candid. This type of discussion
15 also involves identifying numerous potential issues, barriers and other concerns that are
16 ultimately agreed to be without merit. We did not attempt to limit the discussion of our
17 options or to stifle any perspectives or opinions. As a result, the notes from this meeting
18 may seem to be a little "raw", or as Mr. Barber put it "amazingly candid", when taken out
19 of context by individuals who were not in attendance at the meeting.

1 At FairPoint, we believe that the best way to arrive at sound decisions is through vibrant,
2 candid debate that allows all opinions and perspectives to be considered. The notes
3 quoted by the Labor and OCA witnesses are a small window into that process. However,
4 one should not assume that they provide (or were ever intended to provide) the full
5 picture. What is important is that FairPoint's Board of Directors made an informed
6 decision to proceed with the transaction after considering its risk and benefits and the
7 recommendations of management.

8 **Q.** How do you address the claim that significant risks will be created as part of this
9 transaction because FairPoint is acquiring a much larger entity?

10 **A.** There are challenges in any corporate combination. To suggest otherwise would be
11 naïve. However, I believe that the structure of this transaction and how the organization
12 will function go a long way to mitigating many traditional risks.

13 When the merger is complete, the combined company will include the existing assets of
14 Verizon related to the businesses to be transferred. The combined company's products
15 and services will be provided to customers in northern New England by the same people,
16 using the same assets they use today. The Verizon employees' institutional knowledge
17 and experience will become assets of the combined company. In addition, the Verizon
18 assets and personnel will be augmented by FairPoint's management expertise and
19 personnel (including new members of the team with extensive industry experience), who
20 have a proven track record serving smaller urban and rural areas. So, while the post-

1 closing company will be larger than FairPoint is today, the operating expertise and assets
2 of the transferred Verizon business will remain within the combined company.

3 From an operating perspective, it is more appropriate to view the proposed transaction as
4 a combination of the Spinco and FairPoint businesses, as opposed to FairPoint trying to
5 absorb Spinco into its own operations (as the characterization that FairPoint is acquiring a
6 much larger entity implies). In many ways, after the Spinco assets are spun-off from
7 Verizon they will function as a standalone business, only with the additional benefit of
8 FairPoint's management experience and expertise. As a result of this complementary
9 approach to running the combined company, I believe that many traditional transactional
10 risks are reduced greatly. In addition, New Hampshire and the other two northern New
11 England states will represent the most important markets for FairPoint (they represent
12 less than 4% of Verizon revenues) and, as a result, will receive enhanced attention and
13 management focus from FairPoint.

14 **Q.** Finally, both Mr. Barber (Barber, Confidential, pp. 40-41) and Mr. Brevitz (Brevitz,
15 Highly Confidential, pp. 139-142) question FairPoint's candor in this proceeding. Do
16 you agree with their contention that FairPoint has been less than candid or cooperative in
17 the process of trying to gain approval for the transaction?

18 **A.** To be honest, I find it amazing that Mr. Barber, who states that "[i]n my experience, it is
19 exceedingly rare for a company to publicly disclose transaction-related financial
20 projections with the level of detail or over the period of time included in these filings,"

1 would in any way question our forthrightness in pursuing this transaction. (Barber,
2 Public, p. 26) Our approach from day one has been to be as open as possible with parties
3 to this proceeding, while still keeping in mind that a number of the parties are openly
4 hostile to our efforts. We have made ourselves available for face-to-face meetings,
5 answered thousands upon thousands of discovery requests, and tried to provide as much
6 detail as we feel we responsibly can at any given point in time. Anyone who knows this
7 management team will vouch for the fact that we say what we mean and we mean what
8 we say, regardless of what adversarial parties in a contested proceeding may want the
9 Commission to believe.

10 I also think it is somewhat ironic that Mr. Brevitz is taking us to task for revealing certain
11 confidential information to the public when we believed it was appropriate to do so.
12 (Brevitz, Highly Confidential, p. 139) In my opinion, making more information public is
13 an indication of our intention to be as transparent and forthcoming as possible. In
14 addition, Mr. Brevitz seems to be irritated by the fact that we availed ourselves of our
15 right to object to certain discovery requests. (Brevitz, Highly Confidential, pp. 140-141)
16 It is unclear to me how following proper procedural process should be interpreted as
17 FairPoint not being transparent or forthcoming.

18
19 In the end, the
20 commissions in northern New England have had direct experience dealing with FairPoint
21 on any number of issues over the years we have operated in the region. We believe it is

1 more prudent for the Commission to rely on those experiences, over an extended period
2 of time and under normal operating conditions, in assessing the likelihood that FairPoint
3 will be a “good ‘regulatory citizen’”, rather than rely on Mr. Brevitz’s opinion developed
4 solely as part of this proceeding.

5 **Allocation of Risks from the Transaction**

6 **Q.** Mr. Barber seems to have a very definite perspective on how he believes FairPoint will
7 react if operating expenses are higher than the company’s current expectations. If that
8 should occur, he believes that FairPoint will raise prices, reduce service, lower wages and
9 other operating expenses, outsource operations, and cut capital expenditures in order to
10 protect its high dividend. He states that FairPoint will “reduce employment, increase
11 customers’ rates, or scale back plans to implement new services before it cuts its
12 dividend.” Do you agree with Mr. Barber’s assessment?

13 **A.** I do not agree. To begin with, Mr. Barber completely ignores the possibility that the
14 combined company could outperform its expectations regarding revenues (in the absence
15 of any rate increase). As FairPoint witness King points out, we have projected per line
16 revenues that are well below the guideline company metrics. If we were to outperform
17 our revenue projections (as we expect we will), that would provide a margin for change
18 (or “cushion”) for operating expenses to come in higher than we have projected while
19 cash flows and profits could be equal to or greater than projected. The revenue increases
20 could come in the form of higher than expected sales of broadband, long distance and

1 bundled service offerings, among other things. So, it is important to recognize that in his
2 assessment of the financial prospects of the combined company, Mr. Barber completely
3 ignores the possibility that increasing revenues per line (not due to rate hikes) could allow
4 us to absorb unforeseen cost increases without materially impacting our profits or cash
5 flows.

6 **Q.** In the event that unforeseen financial pressures—beyond the margin for change we have
7 included in our projections—should unfold (which we do not expect to happen in the
8 ordinary course of business), FairPoint would act like any other well-run company and
9 take all reasonable actions to stabilize operations while not harming the long-term
10 prospects for the business and its access to capital. This means that the company would
11 look at all options to address the source of the financial stress—be it a drop in revenues, a
12 sharp rise in costs, or something else—while placing a primary focus on causing no harm
13 to its core operations (which are the source of long-term value for its employees,
14 customers, and financial stakeholders).

15 **Q.** If, however, unforeseen circumstances result in the need for extraordinary near-term
16 corrective action, FairPoint's management believes that protecting and maximizing the
17 long-term health and value of its operations is its primary mission. If the short-term
18 choice must be made between doing what is right for the long-term health of the business
19 and paying discretionary, near-term consistent dividend amounts, management would
20 recommend that our board of directors choose to invest in operations and maintain
21 quality service to customers. We would not, as Mr. Barber suggests, prioritize actions

1 that potentially could sour the company's relationship with critical constituencies (such
2 as requesting large rate increases from our customers, dramatically reducing employment,
3 or ceasing to invest in our network).

4 **Q.** FairPoint management would assess the situation and formulate a strategy based on
5 rational and prudent steps, crafted to protect our business, its customers, and employees,
6 while addressing the root cause of any unexpected financial pressure. We would also
7 consider measures related to the company's capital structure that could alleviate financial
8 strain. These sorts of corrective actions could include taking steps to minimize near-term
9 debt service via the use of our \$200 million revolving credit facility and reducing our
10 discretionary dividends.

11 **Q.** I want to be clear, however, that FairPoint's management team believes that if any
12 actions taken do not place the highest priority on maintaining the quality of operations,
13 network and service, there will be no business in the future to pay dividends. To
14 prioritize near-term dividends at the expense of the underlying business (including its
15 customers, employees and assets) clearly would be foolish.

16 Ultimately, our management team believes that making the appropriate capital allocation
17 decisions for the long-term health of the business will serve the long-term best interest of
18 its shareholders, even if short-term share price fluctuations result. As a result, in the face
19 of unforeseen financial stress FairPoint will take actions primarily designed to protect its
20 relationship with customers, employees and the communities it serves, while also taking

1 into account the long-term (not short-term) impact on financial stakeholders. Our
2 dividend will remain important, but not more important than ensuring the health of the
3 business that facilitates the dividend.

4 **Q.** Mr. Barber expresses concern related to FairPoint's past experience with its CLEC
5 operations (Barber Public, pp. 40-42). He states that the CLEC business represents the
6 "only time that FairPoint has attempted to develop a business on such a large scale." In
7 addition, he states, "The simple truth is that FairPoint's management was not able to
8 manage the scope and complexity of the operation." Can you address FairPoint's CLEC
9 experience and Mr. Barber's concerns and assertions?

10 **A.** There are a number of problems with Mr. Barber's understanding and assessment of
11 FairPoint's past experience with its CLEC operations. First of all, our current ILEC
12 operations are larger in scale than the CLEC business that we discontinued. As of March
13 31, 2007, FairPoint currently serves approximately 310,000 access line equivalents
14 (switched access lines plus high-speed data connections), with full-year 2007 revenues
15 expected to be \$281 million to \$284 million. At the time that we discontinued our
16 previous CLEC business, those operations served less than 100,000 access line
17 equivalents and were generating approximately \$50 million in annual revenues.
18 Therefore, it is inaccurate to state that the CLEC operations represent the "only time that
19 FairPoint has attempted to develop a business on such a large scale." We have, in fact,
20 developed a very successful ILEC business that is substantially larger than the CLEC
21 initiative.

1 In addition, I think that it is important to distinguish the CLEC initiative from the
2 proposed transaction with Verizon. The CLEC initiative was an attempt by our company
3 and management team to enter into a new line of business. While a CLEC business
4 clearly is similar to an ILEC business in many respects, it also has many characteristics in
5 terms of assets and operations that are quite different from running an ILEC business.
6 So, the CLEC opportunity was tangential to our ILEC operations, but was not an
7 expansion of our core operations. In fact, the CLEC business represented going into new
8 markets on a *de novo* basis with no existing assets or customer base at all. By contrast,
9 the combination with Spinco represents an ILEC transaction that is squarely within
10 FairPoint's core competency and expands upon our successful history of acquiring and
11 running existing ILEC operations. As opposed to an effort to enter a new line of
12 business, the proposed transaction builds upon our existing line of business.

13 FairPoint's CLEC business did not fail or go bankrupt. In fact we were building revenues
14 and cash flows steadily, but determined it would take a considerable amount of time and
15 additional capital to generate a reasonable return on the business. Therefore, we
16 concluded it was not an attractive long-term business.

17 In addition, the "bursting of the Internet bubble" in late 2000-early 2001, signaling the
18 end of the "dot-com boom," had a significant negative impact on all telecom investing at
19 that time. Demand for communications bandwidth contracted, while capital available for
20 investment in telecom networks became scarce. Needless to say, contracting demand and
21 scarcity of capital do not foster the growth of developing businesses, such as our CLEC

1 initiative. In fact, the majority of CLECs founded at the same time as our initiative have
2 since ceased operations, as the regulatory structure at that time, in addition to other
3 factors, resulted in most CLEC business plans not proving to be viable over the long
4 term. The fact that FairPoint was able to recover and now operate as the 14th largest
5 telecom company in the U.S. is a testament to the capabilities of the existing management
6 team.

7 So, as you can see, there were numerous external factors for why we ultimately chose to
8 discontinue the CLEC operations and this was not because management was unable “to
9 manage the scope and complexity of the operation,”

10 **Proposed Financial Conditions**

11 **Q.** Before addressing specific recommended conditions for approval, are there any general
12 comments you would like regarding how this portion of your testimony should be viewed
13 in light of ongoing settlement negotiations and discussions with Commission staff and
14 parties to the proceeding?

15 **A.** The positions outlined below, whether indicating FairPoint’s willingness to accept a
16 condition, our belief that a condition is inappropriate, or that further discussion is
17 required, must be considered in the context of a global settlement of issues in order to
18 gain approval for the transaction. Therefore, especially regarding conditions that
19 currently we believe we could accept, our ultimate position on any individual condition

1 will be influenced significantly by how that specific requirement fits within the
2 framework of a comprehensive settlement agreement or approval order.

3 **Q.** Mr. Vickroy recommends, as part of a series of conditions, that there be a substantial
4 reduction in the initial debt financing for the transaction. Is that feasible at this stage?

5 **A.** The structure and financing components of the transaction were negotiated over a
6 substantial period of time by FairPoint and Verizon, and are documented in the Merger
7 Agreements. The transaction structure has already been approved by FairPoint's
8 shareholders and was the basis for the IRS tax opinion requested by Verizon several
9 months ago. In addition, any change in the debt would likely have a negative
10 consequence for Verizon and therefore not represent the deal they expected. Thus, while
11 nothing is impossible, I would think any proposed change in the debt structure would
12 substantially slow down the process, require a complete renegotiation of the deal
13 economics and therefore significantly increase the probability that the transaction would
14 not close.

15 **Q.** Mr. Vickroy also suggests that there be a condition requiring a reduction of or maximum
16 level of TSA costs. Can FairPoint agree to this sort of condition?

17 **A.** Again, the TSA is a document that was negotiated as part of the overall transaction
18 agreement between FairPoint and Verizon. FairPoint cannot unilaterally agree to the type
19 of condition suggested by Mr. Vickroy. For reasons explained earlier as well as addressed
20 by other witnesses, there does not appear to be any reason to expect a substantial increase

1 in the TSA period. If higher costs related to an extended TSA period did occur, the
2 company will have a \$200 million credit facility available to cover such incremental
3 costs.

4 **Q.** Mr. Brevitz suggests that FairPoint be required to notify the Commission and all parties
5 in this proceeding of the downgrade of its debt within seven days of such downgrade, and
6 that the company should report on whether the conditions driving the downgrade are
7 anticipated to result in short-term or long-term deterioration in credit quality, among
8 other things?

9 **A.** FairPoint would consider providing such information to the Commission but is
10 uncomfortable making such a commitment to all other parties in this proceeding given
11 the changing nature of competition in the telecommunications business. Sufficient
12 sources of financial information about the company are expected to be available to such
13 other parties that including them as recipients in such a reporting requirement should not
14 be required.

15 **Q.** Mr. Brevitz also recommends that FairPoint be required to provide the Commission and
16 all parties to this proceeding with copies of all reports regarding the company (issued
17 after closing) from credit ratings agencies within 15 days of their issuance—is this
18 necessary?

19 **A.** FairPoint will agree to this condition for a limited time, such as 12 to 24 months
20 following closing of the transaction. Any extension of the condition beyond such a time

1 period is simply putting an administrative burden on FairPoint that is not justified. As
2 discussed in my previous answer, there are publicly available resources for monitoring
3 changes in the company's credit quality. The company would also object to making
4 these reports available to all parties to this proceeding for the same reasons mentioned in
5 the prior response.

6 **Q.** Regarding the financing of the transaction, Mr. Vickroy proposes that the Commission
7 have the ability to review and approve the final debt agreements prior to their signing. In
8 addition, he would require a relaxation of the debt financial covenants until completion of
9 the conversion project. How do you respond?

10 **A.** FairPoint believes it is unnecessary for the Commission to approve the final debt
11 agreements prior to their signing. FairPoint will not execute the debt agreement unless
12 and until the transaction has been approved by the Commission. The Commission has
13 the opportunity to review the form of those agreements, including the principal terms, as
14 part of this proceeding. In addition, the impact of the expected pricing and terms of the
15 financing is reflected in our financial projections. We negotiated these principal terms
16 with our bank group and underwriters prior to announcing the transaction. As part of
17 those negotiations, we were able to achieve a relaxation of the covenants for the first year
18 after closing. It is our expectation that the conversion project will be completed well
19 within this time period. Therefore, we believe there is no need for Mr. Vickroy's
20 proposed condition.

1 **Q.** Will FairPoint be willing to accept Mr. Brevitz's proposed condition that FairPoint's
2 New England subsidiaries not assume responsibility for the liabilities of FairPoint as
3 guarantor, endorser, surety, through pledging of assets or stock, or otherwise? Similarly,
4 is the company comfortable with Mr. Barber's suggestions that the acquisition financing
5 not be secured by the New England subsidiaries' assets, that those assets not be pledged
6 in the future and that the subsidiaries will not provide guarantees to facilitate this or any
7 other acquisition?

8 **A.** FairPoint does not intend to encumber any of the New Hampshire assets to support any
9 financing agreements, or require the guarantee of parent company liabilities by the New
10 Hampshire operations. Therefore, a condition to this effect could be acceptable.

11 In response to Mr. Brevitz's proposed condition that stock pledges be prohibited, it is
12 important to note providing collateral security is standard practice in the utility industry.
13 This practice lowers cost of capital by granting lenders priority over other creditors, such
14 as trade creditors, in the event of severe financial crisis. Prohibiting the stock pledge
15 would destroy the financial balance provided by the proposed capital structure and
16 eliminate all of the benefits I describe below. Therefore, we do not believe the stock
17 pledge should be prohibited, and such prohibition would not be allowed under the
18 financing commitments already put in place.

19 **Q.** Mr. Barber recommends a prohibition on transferring cash from FairPoint's existing
20 operations in New Hampshire and the to-be-acquired northern New England operations

1 to the parent company (or any affiliate) through loans, advances, investments or other
2 means if the operations fail to meet or exceed a majority of certain service quality
3 measures. Is this sort of condition financially feasible or beneficial?

4 A. Any limitation on the ability to transfer funds to the parent from the existing and to-be-
5 acquired New Hampshire operations (as well as the other to-be-acquired New England
6 operations) would not be acceptable under the financing agreements already in place nor
7 in the best interest of New Hampshire customers. The three-state operations provide
8 operational and regulatory diversity that would cushion the New Hampshire operations
9 from a disruptive, unexpected event (such as a natural disaster or economic depression).
10 The scale and scope of the three-state operations also provides economies of scale and
11 operational efficiencies.

12 FairPoint's proposed capital structure results in all company debt residing at the parent
13 company level, not at the operating ILEC level in each state. This corporate structure
14 avoids the need for the ILEC to either guarantee the debt or pledge any assets to secure
15 such debt. The ILEC also benefits from a lower cost of capital than it would otherwise
16 enjoy if it attempted to access capital on its own. Any restriction on the ability to transfer
17 funds from the New Hampshire operations to the parent to service such debt would not be
18 acceptable to FairPoint or the company's lenders, and would not support the current
19 capital structure or any capital structure that incorporates the use of debt at the parent
20 company. Therefore, the benefits from such a structure would not be available to New
21 Hampshire.

1 The proposed structure provides the “best of all worlds” to New Hampshire, as the
2 individual state-level ILEC operations benefit from the cost of capital perspective but
3 pledge none of their assets. In a worst case scenario (bankruptcy for example), the New
4 Hampshire operations would be lien-free and could not be foreclosed on a piece-meal
5 basis as they could be, hypothetically, under a general mortgage. Thus, any limitation on
6 the transfer of funds would be detrimental to the customers in New Hampshire.

7 **Q.** Mr. Brevitz suggests that as a condition to approval the Commission require FairPoint to
8 reduce its dividend payouts. In addition, Mr. Vickroy recommends that FairPoint be
9 required to reduce or eliminate its dividend in certain financial situations. Are these
10 types of conditions appropriate?

11 **A.** No. FairPoint intends to be responsive to the needs of its customers, its employees and to
12 its stockholders. It is the responsibility of management to balance and meet the needs of
13 all of the company’s stakeholder groups. FairPoint cannot reasonably balance and meet
14 the needs of all of its stakeholders if it has artificial limits placed on its ability to pay
15 dividends. As I have stated previously, we are confident based on our planned operating
16 model and resulting financial projections that the company will generate sufficient cash
17 flows to cover all of its capital investment plans, required debt service, and expected
18 discretionary dividends, with additional cash available after dividends as a “cushion.”
19 Therefore, we do not believe that restricting our flexibility with regard to capital
20 allocation decisions, which include dividend payments, is appropriate.

1 With regard to Mr. Vickroy's suggestion that dividends might be limited in certain
2 situations, it should be noted that our new Credit Agreement contains covenants which
3 require FairPoint to cease making dividend payments if debt exceeds predetermined
4 levels. Thus, there is no need for additional protection at the state level, as the interests
5 of the lenders generally will be consistent with those of the customers and the states, i.e.,
6 ensuring the company meets its obligations before paying dividends and maintains a
7 sound financial condition.

8 **Q.** Similarly, Mr. Barber recommends that FairPoint's northern New England operations be
9 required to maintain a consolidated common equity-to-capitalization ratio of at least 40%
10 before paying any dividends on common stock and that no dividend can be declared that
11 would cause this ratio to fall below 40%. Is this condition appropriate?

12 **A.** FairPoint believes it is inappropriate to restrict the company's flexibility regarding
13 critical capital allocation decisions. However, FairPoint would consider a limitation on
14 dividends from the parent corporation if excessive levels of debt were incurred. As
15 stated above, the Credit Agreement with FairPoint's bank group limits dividends in such
16 instances. However, we would be willing to discuss a similar condition, if deemed
17 necessary, as part of a global settlement agreement.

18 In addition, FairPoint and its lenders focus on a net debt-to-adjusted EBITDA leverage
19 ratio, not a book equity-based ratio.. To the extent Mr. Barber is suggesting a book
20 equity-to-capitalization test, we do not believe that is a suitable leverage measure for the

1 company. An adjusted EBITDA-based metric is most appropriate and is standard in the
2 financial markets for telecommunications companies.

3 **Q.** Mr. Brevitz believes that prior to approval FairPoint should be required to provide the
4 Commission with updated financial projections reflecting a “current view” and
5 incorporating what he might consider more reliable data. As part of the process for
6 developing this “current view” Mr. Brevitz believes the company should review
7 additional detailed plant and engineering records (from Verizon), revise its capital
8 expenditure budgets and projections based on the findings of this review, and incorporate
9 the revised capex amounts into the new projections. What is FairPoint’s position on
10 these suggestions?

11 **A.** FairPoint would find it reasonable to provide updated financial projections reflecting a
12 “current view” if more reliable data or information resulted in a material change to the
13 cash flows in such projections. With regard to additional due diligence on the Verizon
14 network, we certainly will review and analyze any additional information and data
15 provided to us by Verizon. However, it is our belief that, as described by FairPoint’s
16 Operations witnesses, the network due diligence processes we employed in assessing this
17 transaction were sound and comprehensive, and nothing we have learned since the
18 execution of the Merger Agreement causes us to now believe otherwise. Our prior due
19 diligence, coupled with the ongoing exchange of information with Verizon regarding the
20 to-be-acquired assets, gives us comfort that our understanding of the network is sound.
21 Therefore, we would be surprised if the review suggested by Mr. Brevitz leads to our

1 discovering material new information that significantly impacts the company's existing
2 capital expenditure plans and our overall financial projections.

3 **Q.** Mr. Vickroy suggests as a general condition that FairPoint be required to maintain capital
4 expenditure levels at forecasted amounts or above. In addition, Mr. Barber presents a
5 very detailed condition that attempts to require the company to make annual capital
6 investments equal to its annual depreciation for any given year. What are your thoughts
7 on requiring FairPoint to make some minimum annual level of capital investment?

8 **A.** FairPoint would be willing to agree to a commitment for a reasonable amount of annual
9 capital expenditures for a period of time until the Commission has evidence that the
10 company is meeting its service quality criteria. In addition, FairPoint would agree to
11 keep a specified amount of its credit facilities available for use in New Hampshire, as a
12 way to assure liquidity would be available for investment at all times. However, I believe
13 Mr. Barber's suggestion that our annual capital expenditures should equal our annual
14 depreciation is not suitable for the industry in which we operate. As discussed previously
15 in this testimony and as demonstrated by FairPoint witness King, over the period from
16 2004 to first quarter of 2007 the median percentage of capital expenditures to D&A for
17 the group of guideline companies is approximately 62%. Our median projected capex-to-
18 depreciation ratio compares favorably to the guideline group median. As such, it would
19 not be appropriate to require FairPoint to automatically invest at levels not deemed
20 appropriate by the rest of our industry, in all likelihood harming the way our company is
21 viewed by the financial markets.

1 **Q.** Mr. Brevitz would require that no additional capital costs resulting from the company's
2 non-investment grade credit rating be recovered from ratepayers. Is this condition
3 necessary to protect New Hampshire consumers?

4 **A.** FairPoint sees no need for the proposed condition. In any rate proceeding, all parties are
5 free to present their positions regarding the cost of capital. The Commission will have
6 the authority and discretion at the time of any subsequent rate proceeding to determine
7 how FairPoint's cost of capital should be calculated. Further, Mr. Brevitz's proposal fails
8 to reflect the favorable impact of including a lower equity component in FairPoint's
9 WACC, and is therefore not coherent.

10 **Q.** Mr. Brevitz also suggests as a condition to approval that ratepayers not be required to
11 bear (directly or indirectly) any costs, liabilities or obligations incurred in connection
12 with the spin-off and merger transactions. OCA witness Susan Baldwin recommends a
13 similar condition barring FairPoint from seeking recovery of transaction-related
14 expenses. What is FairPoint's position regarding this type of proposed condition?

15 **A.** FairPoint agrees not to attempt to recover transaction-related expenses in rates, including
16 all one-time expenses associated with the transaction. FairPoint reserves the right to
17 attempt to recover costs associated with new systems which are replacing existing
18 Verizon systems. The transaction will result in the elimination of costs associated with
19 Verizon's existing systems and the introduction of replacement costs associated with
20 FairPoint's new systems. These new systems are used and useful in the provision of

1 retail and wholesale services, and FairPoint expects to be able to include these costs in
2 any future rate proceeding. This is no different than if FairPoint were to replace vehicles
3 used by installation and repair technicians. In that circumstance the company would
4 expect to eliminate the cost of the retired vehicles and include the cost of the new
5 vehicles in any rate-setting proceeding.

6 **Q.** OCA witness Baldwin believes that FairPoint should commit to maintaining separate
7 financial books in order to provide an accounting trail for transaction-related expenses,
8 and should report on such expenses at six and 18 months after closing. Is this condition
9 acceptable to FairPoint?

10 **A.** FairPoint would be willing to provide the Commission with updates at reasonable
11 intervals regarding its transaction related expenditures. However, the company does not
12 believe it is appropriate to require separate financial books (beyond the reports required
13 to meet existing state regulatory reporting requirements) for this purpose. The
14 administrative costs of this obligation are not justified.

15 **Q.** More generally, Mr. Vickroy recommends a moratorium on rate increases for a specified
16 period of time. How would you respond to this potential condition?

17 **A.** It is difficult to address Mr. Vickroy's recommendation given its high level of generality.
18 However, FairPoint has stated on numerous occasions that it has no intention of raising
19 rates as a result of this transaction. FairPoint has also acknowledged it would consider a
20 mutual two or three year "stay out" whereby the company commits to making no requests

1 for any price increases in conjunction with the NHPUC agreeing to also not require any
2 rate case activity during the same period. As stated above, FairPoint agrees not to
3 attempt to recover transaction-related expenses in rates, including all one-time expenses
4 associated with the transaction. However, we do not believe it is prudent to restrict
5 indefinitely the company's ability to recover demonstrable costs that are verifiable
6 components in the provision of retail and wholesale services in future rate proceedings.
7 Without additional detail on what Mr. Vickroy specifically has in mind, I cannot respond
8 further.

9 **Q.** Mr. Brevitz also believes that FairPoint should agree that the management, billing, and
10 operational support systems developed as part of this transaction should be owned by the
11 combined company's New Hampshire, Maine and Vermont subsidiaries, with the
12 benefits of this ownership flowing to the ratepayers in these states. Does FairPoint agree
13 with Mr. Brevitz's suggested approach?

14 **A.** No. As the company grows over time the operational support systems developed as part
15 of this transaction will be utilized to support other operations and the costs will be
16 allocated accordingly resulting in lower costs automatically accruing to the northern New
17 England operations. Therefore, there is no reason to create such an agreement.

18 **Q.** Finally, Mr. Brevitz recommends that any compensation, remuneration or other payment
19 to any officer, executive or Board member of FairPoint as a consequence of, or related to
20 the consummation of, this transaction, should be paid only with stock or stock option

1 redeemable no sooner than 2012. What is your opinion of this possible requirement for
2 approval?

3 **A.** FairPoint expects all of its stakeholders (retail and wholesale customers, the Commission,
4 its employees and its stockholders) to benefit from its flexibility to meet market
5 conditions for compensation of any sort to its officers, executives and Board members.
6 As such, we believe it is inappropriate to artificially restrict the company's flexibility and
7 discretion in determining appropriate forms of compensation and compensation
8 structures. It should also be noted that at this time the total amount of potential bonuses
9 based upon the successful completion of the transaction for the entire employee group
10 approximates only \$300,000. FairPoint has no current intention to grant additional
11 bonuses (except possibly in the context of certain high-level new hires).

12 **Conclusion**

13 **Q.** Are there any concluding remarks you would like to make regarding the proposed
14 transaction?

15 **A.** In conclusion, I think that, while much of the detail discussed in my testimony provides
16 important insights for the Commission, it is important to remain focused on the bigger
17 picture of whether or not the proposed transaction is good for New Hampshire and its
18 citizens. FairPoint believes that there is no question this transaction provides tangible
19 benefits to the combined company's customers and employees, and the communities it
20 serves.

1 I have demonstrated in my testimony that the financial case for the transaction is sound
2 and that FairPoint will be financially strong after the transaction. FairPoint's projections
3 include reasonable assumptions regarding cash operating expenses (at levels comparable
4 to the guideline companies) and (based on Mr. King's testimony) potentially conservative
5 assumptions regarding per line revenues. As a result, our projected EBITDA margins fall
6 well below the margins achieved by the guideline company group, again indicating a
7 conservative approach to the model. If our per line revenues exceed what we have
8 modeled (which we intend to be the case and which is reasonable to assume given the
9 experience of comparable companies), our cash flows and cash "cushion" may increase
10 significantly. In any event, we believe the FairPoint Discovery Model is reasonable-to-
11 conservative and contains a sufficient "margin for change" to allow the company to
12 weather any unforeseen financial or operating pressures. We believe these projections
13 fully reflect our planned investment in broadband expansion and will permit us to drive
14 expanded services.

15 We have provided sufficient detail supporting our expected cost savings in combining
16 FairPoint with the Verizon operations in New Hampshire, Vermont and Maine. As
17 demonstrated, these cost savings are not speculative and it is reasonable for them to be
18 included in assessing the financial case for the transaction. In addition, with regard to the
19 TSA costs and the Hawaiian Telcom transaction, FairPoint Operations witnesses, along
20 with Verizon witness Smith, provide substantial detail establishing the clear

1 differentiation between this transaction and the prior Hawaii experience. We have
2 learned from the mistakes made there and will not repeat them.

3 In addition, our projections provide for capital investment on a per line basis that exceeds
4 Verizon's investment levels (excluding FiOS) in recent years. More importantly, our
5 capital budgets were developed through careful due diligence and comprehensive
6 planning (as detailed by FairPoint's Operations witnesses) on the basis of improving
7 customer service, enhancing service quality, and, critically, accelerating and expanding
8 the deployment of broadband. Our plan involves providing tangible benefits to our
9 customers and the communities we serve, making approval of the transaction clearly in
10 the public interest.

11 The transaction also will provide stability to existing Verizon employees in the region,
12 with compensation and benefits commensurate with what they currently enjoy. In
13 addition, new job opportunities will be created, and employees will see additional
14 opportunities for professional development. We have committed to adopt Verizon's rates
15 as of closing and cap those rates for specified periods.

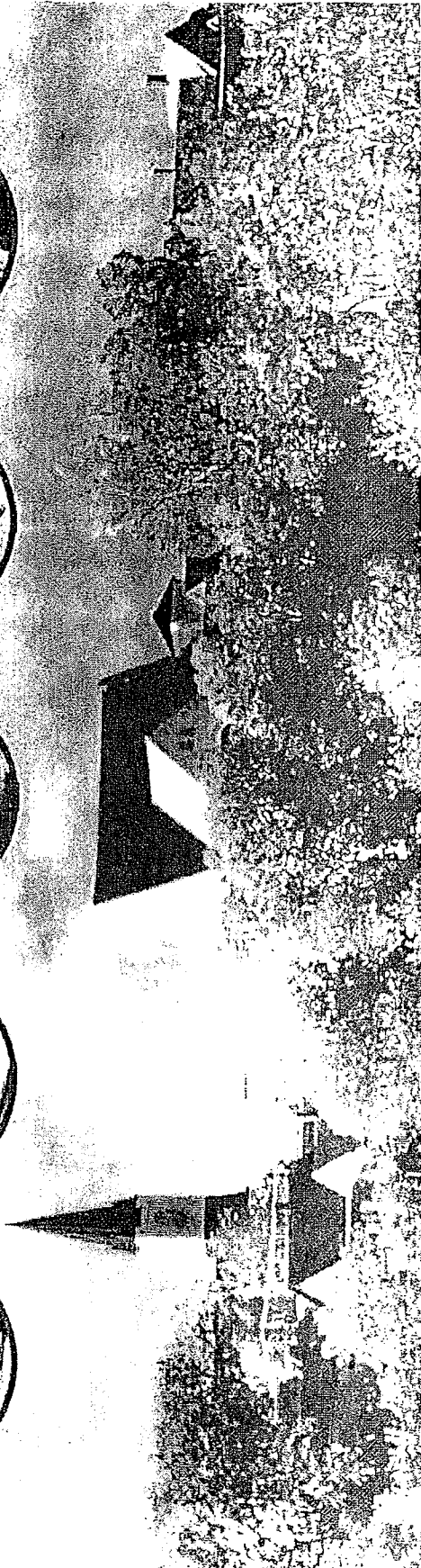
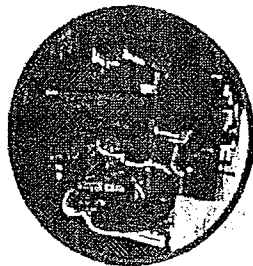
16 FairPoint is committed to being a leader in economic and community development in the
17 communities we will serve. We are creating a connectivity-enabled economic
18 development initiative based upon community, region and state collaboration. This
19 initiative is designed to work with the existing economic development agencies,
20 providing resources, expertise and tools to assist them in establishing and meeting

1 measurable objectives for economic growth based upon broadband connectivity and
2 collaboration. FairPoint will create and staff a department of community development,
3 reporting to the President and has engaged a nationally recognized leader in connectivity
4 enable economic transformation in rural and small urban communities to initiate and
5 launch the program.

6 Finally, the transaction will create a company with a singular strategic focus in smaller
7 urban and rural communities of providing high-quality advanced communication services
8 that meet the needs of consumers at competitive prices. The company will be run with a
9 focus on broadband services which will put it on a different growth track than if it
10 continued to be operated primarily as a voice service provider. We believe that it is clear
11 that this transaction is good for our current and future customers, all employees, our
12 communities, and our company and its shareholders. FairPoint is a company that will
13 commit substantial capital and operating resources to New Hampshire and to whom the
14 state will be a very important market, whereas the current service provider has a strategic
15 plan which does not focus on New Hampshire. When viewed in that light, we believe
16 there is a clear and convincing case for the decision to approve the proposed transaction.

17 **Q.** Does this conclude your testimony?

18 **A.** Yes it does.



Presenters

Eugene B. Johnson – Chairman and Chief Executive Officer
Walker E. Leach, Jr. – Executive Vice President, Corporate Development
John P. Crowley – Executive Vice President and Chief Financial Officer

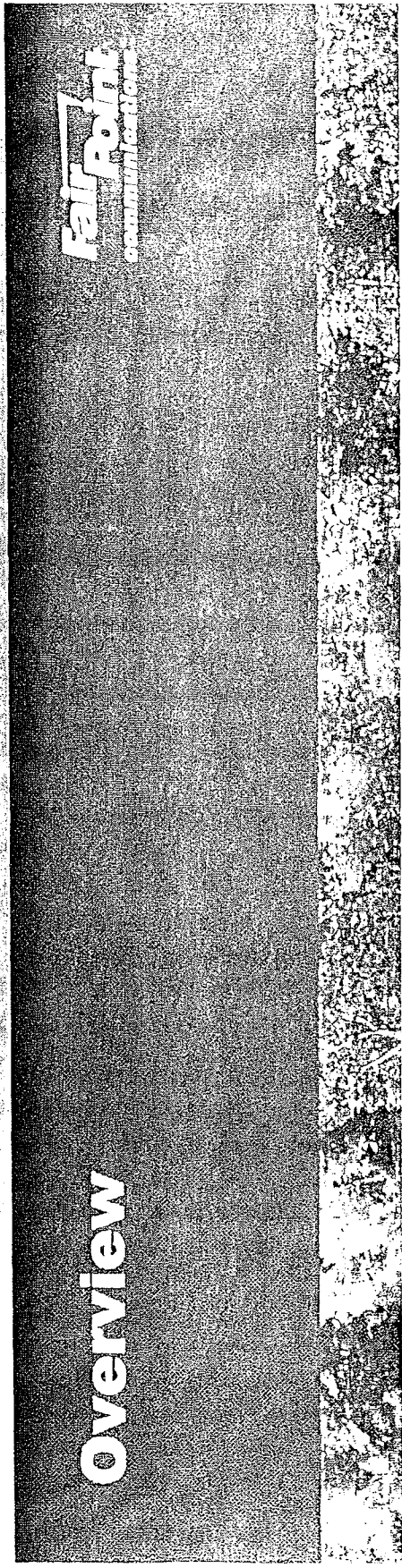


Forward-Looking Statement

This presentation may contain forward-looking statements that are not based on historical fact, including, without limitation, statements containing the words "expects," "anticipates," "intends," "plans," "believes," "seeks," "estimates" and similar expressions and statements relating to potential cost savings and synergies expected to be realized in the proposed merger with the wireline operations of Verizon Communications Inc. in Maine, New Hampshire and Vermont. Because these forward-looking statements involve known and unknown risks and uncertainties, there are important factors that could cause actual results, events or developments to differ materially from those expressed or implied by these forward-looking statements. Such factors include those risks described from time to time in FairPoint Communications, Inc.'s filings with the Securities and Exchange Commission, including, without limitation, the risks described in FairPoint's most recent Annual Report on Form 10-K on file with the Securities and Exchange Commission. These factors should be considered carefully and you are cautioned not to place undue reliance on such forward-looking statements. All information is current as of the date of this presentation, and FairPoint Communications, Inc. undertakes no duty to update this information.

FairPoint intends to file a registration statement, including a proxy statement, and other materials with the Securities and Exchange Commission ("SEC") in connection with the proposed merger. We urge investors to read these documents when they become available because they will contain important information. Investors will be able to obtain copies of the registration statement and proxy statement, as well as other filed documents containing information about FairPoint and the merger, at www.sec.gov, the SEC's website, or at www.fairpoint.com/investor, when they are available. Investors may also obtain free copies of these documents and the Company's SEC filings at www.fairpoint.com under the Investor Relations section, or by written request to FairPoint Communications, Inc., 521 E. Morehead Street, Suite 250, Charlotte, NC 28202, Attention: Investor Relations.

FairPoint, Verizon, and FairPoint's directors, executive officers, and other employees may be deemed to be participants in the solicitation of proxies from FairPoint stockholders with respect to the proposed transaction. Information about FairPoint's directors and executive officers is available in FairPoint's proxy statement for its 2006 annual meeting of shareholders, dated April 24, 2006. Additional information about the interests of potential participants will be included in the registration statement and proxy statement and other materials to be filed by FairPoint with the SEC.



Transaction Overview

Accelerates FairPoint's strategy

> **FairPoint growing through merger with Verizon's Maine, New Hampshire and Vermont operations**

- Accelerates FairPoint's strategy to acquire / improve local telecom operations
- Attractive valuation at 6.3x 2005 EBITDA⁽¹⁾; less than 6.0x⁽²⁾ after synergies
- \$60 - \$75 million in expected cost savings and synergies
- Results in meaningful free cash flow accretion
- Substantially increases scale

> **Transaction Mechanics**

- Tax-free spin-off of VZ operations, then tax-free merger with/into FairPoint
- \$2.715 billion valuation—\$1.7 billion in assumed debt, \$1.015 billion in FairPoint stock to be issued to Verizon shareholders
- FairPoint shareholders will own approximately 40%, Verizon shareholders approximately 60%
- Combined company will trade under FairPoint's ticker symbol (NYSE: FRP)
- Committed financing in place for a substantial portion of this debt
- Post-closing board to consist of 3 current FairPoint Board members and Verizon will nominate 6 directors who are independent of Verizon

(1) Based on 2005 audited financial results, net of adjustments to pension and other postretirement benefit expenses and certain one time items. 2005-*unadjusted* EBITDA was \$395 million but included certain expenses that were not included in the merger.

(2) Based on 2005 EBITDA assuming post-closing synergies and cost-savings expected to be achieved 12 months after closing.

Rationale For The Merger

Compelling benefits for shareholders, customers and employees

> **Benefits shareholders**

- Improves dividend sustainability (FairPoint intends to maintain its dividend at \$1.59 per share annually⁽¹⁾)
- Pro forma leverage improves to approximately 4.1 times EBITDA⁽²⁾
- Improves financial flexibility
- Pro forma dividend payout ratio improves to 60%–70% after anticipated cost-savings
- Improves revenue mix

> **Benefits customers and employees**

- Stronger competitive operations
- Increased focus on customers
- Significant DSL / broadband expansion in region
- Expanded employee-base enhances core capabilities
- Opening three scalable service centers in the region
- Constructive relationships with employees, unions, policymakers

(1) Subject to declaration by the board of directors and compliance with Delaware law and covenants in agreements governing indebtedness.

(2) Estimate at closing of merger. Calculated using combined EBITDA for 2005 and combined net debt at closing.

Long-term Strategic Flexibility

Increased opportunities to generate shareholder value

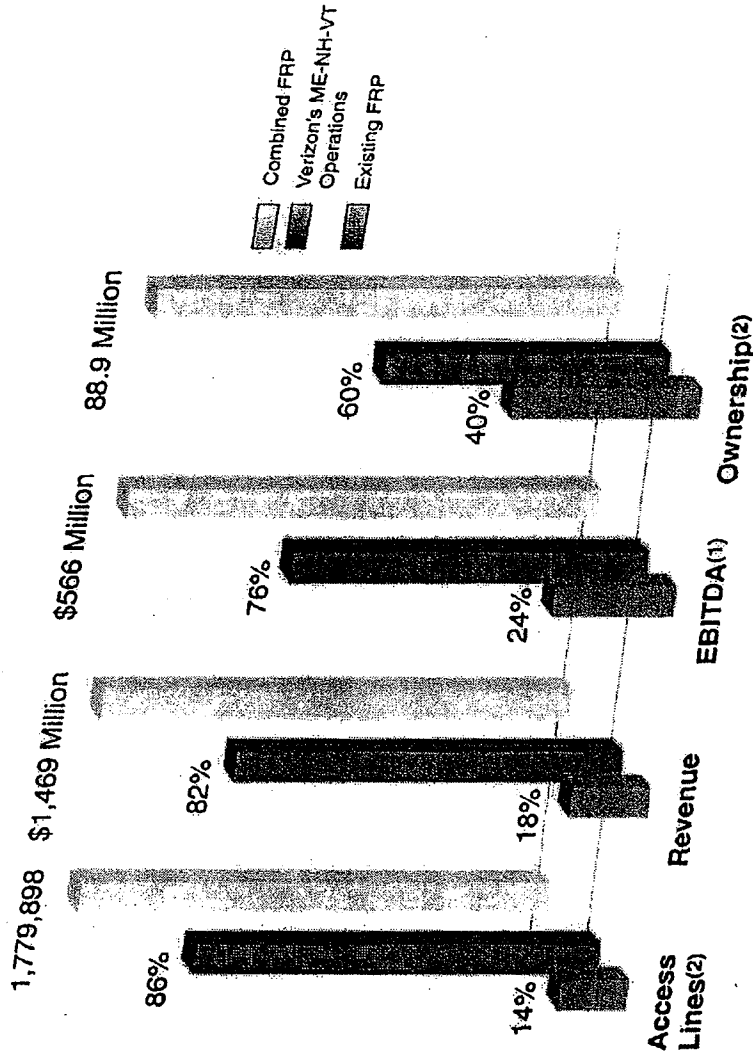
Provides multiple opportunities for value creation

- Improves revenue opportunities
 - New product bundles
 - Increased broadband availability
 - Increased focus on local sales and marketing
- Enhances operational efficiencies
 - Economies of scale
 - Investment in state-of-the-art systems
 - Greater operating flexibility
- Improves financial strength
 - De-leverages balance sheet
 - Improves access to capital / lowers cost of capital
 - Increases liquidity for shareholders
 - Increases free cash flow per share
 - Reduces reliance on access and USF revenues
- Creates a scalable platform for further acquisitions

Favorable Contribution Metrics

Shareholders receive significant stake in combined entity

- > **FRP shareholders own approximately 40% of total merged company**
- > **FRP contribution**
 - 14% of total access lines
 - 18% of total revenue
 - 24% of total EBITDA



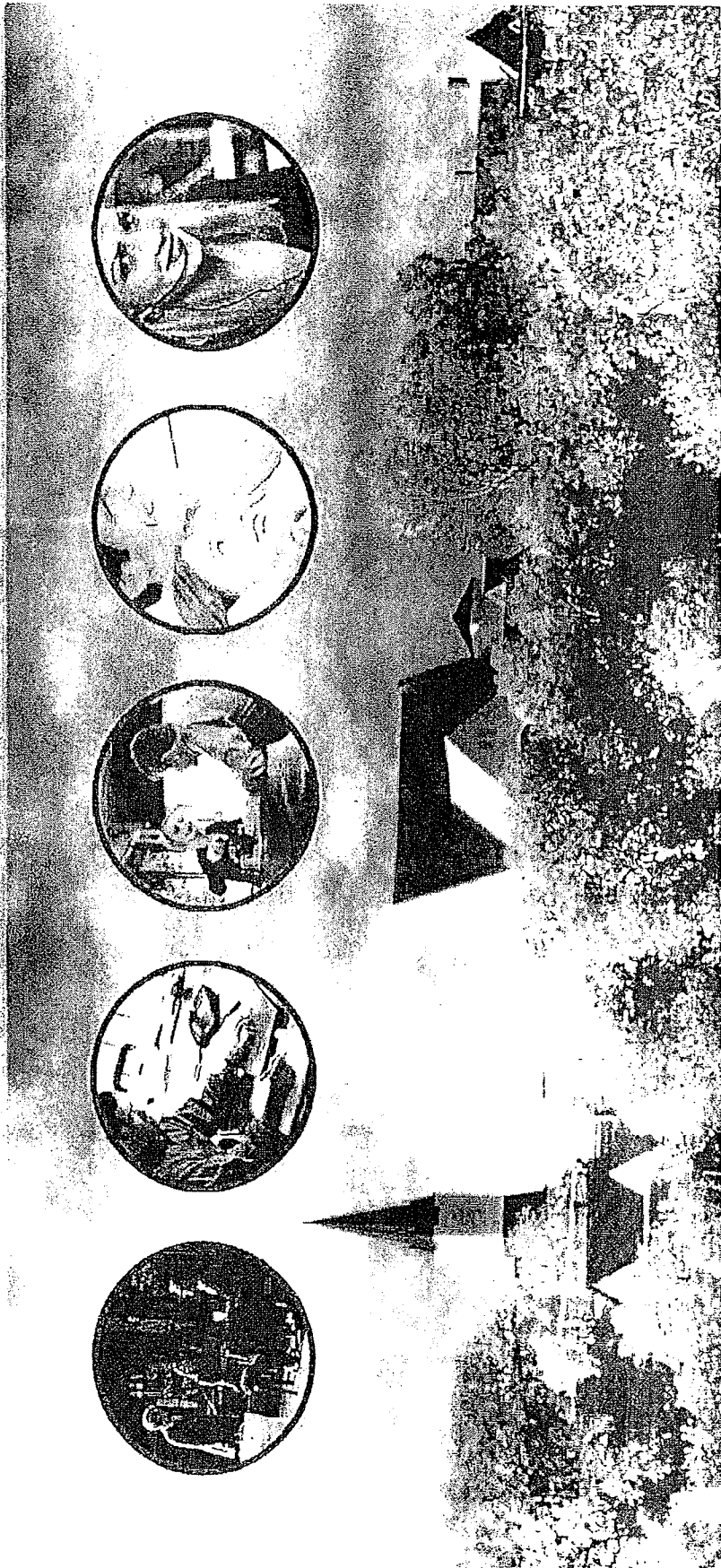
(1) Based on 2005 audited financial results, net of adjustments to pension and other postretirement benefit expenses and certain one time items.
 (2) Based on access lines and outstanding shares at September 30, 2006.

Transition Services & Integration

Ensuring an efficient and successful transition

- > **Getting ahead – execution begins now**
 - Seasoned FairPoint management team with extensive operating experience
 - Previous experience in executing and integrating acquisitions
 - Transition execution has already begun
 - Integration plan based on investing \$200 million on systems development and integration (of which, approximately \$95 - \$110 million invested before closing)
 - Verizon to pay for up to \$40 million of these pre-closing transition costs
 - FRP expects to generate \$55 million in cash from sale of its investment in Orange County – Poughkeepsie to Verizon Wireless
 - FairPoint has engaged experienced consultants
 - Detailed transition plan with incentives for an accelerated transition

- > **Investment in systems**
 - Systems are scalable
 - Maximize and accelerate efficiencies
 - Benefits this transaction, legacy FairPoint and future acquisitions



FairPoint
COMMUNITY CONNECTION

Transaction Details

Attractive Financial Characteristics

With defined opportunities for improvement

53.8 Million FairPoint Shares issued to Verizon Stockholders
Implied Equity Value (@ \$18.88 per share) \$1,015M
Plus Assumed Debt \$1,700M
Total Transaction Value \$2,715M
EBITDA multiple (based on 2005 EBITDA)⁽¹⁾⁽²⁾ 6.3x

- > **Expected cost savings and synergies of \$60 - \$75 million annually**
- > **Full effect of synergies begins 12 months after closing**
- > **Planned investment of \$200 million in strategic systems**

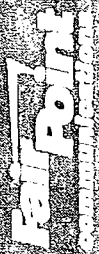
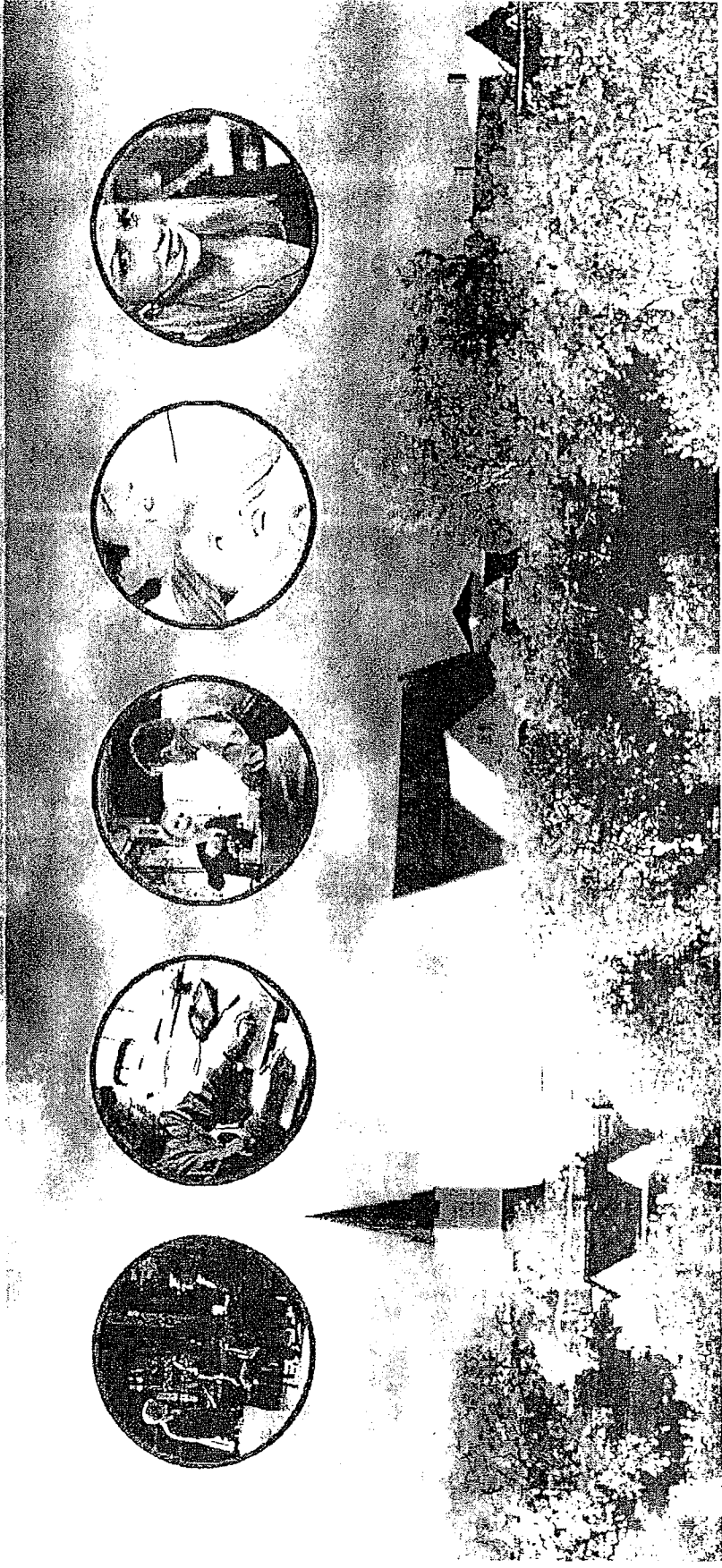
Verizon's Maine, New Hampshire and Vermont operations ⁽²⁾:

Revenue	\$1,206 million
Operating expenses ⁽³⁾	\$775 million
EBITDA	\$431 million

(1) Earnings before interest, taxes, depreciation and amortization.

(2) Based on 2005 audited financial results, net of adjustments to pension and other postretirement benefit expenses and certain one time items.

(3) Excludes depreciation and amortization.



Financial & Operational Overview

Summary Financial Comparison

Enhanced financial strength

Pro forma FairPoint Consolidated:	
Revenue ⁽²⁾	\$1,469 million
EBITDA ⁽²⁾	\$566 million
Net Debt ⁽³⁾	\$2,334 million
Dividend	\$1.59 per share
Shares Outstanding	88.9 million
Leverage ⁽⁷⁾	4.1x (at closing)
Payout ratio ⁽⁶⁾	60 - 70%

FairPoint (pre-merger):	
Revenue ⁽¹⁾	\$263 million
EBITDA ⁽¹⁾	\$135 million
Net Debt ⁽³⁾	\$602 million
Dividend	\$1.59 per share
Shares Outstanding ⁽⁴⁾	35.1 million
Leverage ^{(1)/(5)}	4.5x
Payout ratio ⁽¹⁾	87%

- > Expected cost savings/synergies of \$60 - \$75 million per year
- > Full effect of synergies begins 12 months after closing
- > Planned investment of \$200 million in state-of-the-art systems

(1) Based on 2005 results which are the most recent full year audited financial statements available for both companies.
 (2) Based on 2005 audited financial results, net of adjustments to pension and other postretirement benefit expenses and certain one time items.
 (3) Long-term debt net of cash and cash equivalents.
 (4) As of September 30, 2006.
 (5) Defined as net debt/EBITDA.
 (6) Pro-forma payout ratio after realization of anticipated cost savings and synergies of \$60-75 million.
 (7) Calculated using 2005 combined EBITDA and estimated net debt at closing.

Additional Transaction Information

Value based on strong partnerships

- > **Related agreements with Verizon**
 - Transition Services Agreement (TSA) ensures back office support through final conversion
 - Verizon to contribute \$40 million in pre-closing transition costs
 - FairPoint to sell Orange County – Poughkeepsie investment to Verizon Wireless for \$55 million

- > **FairPoint to assume all existing collective bargaining agreements with union employees**
 - Pension and OPEB
 - Receives pension assets / obligations for all active, transferred employees
 - Pension obligations to be fully-funded at closing
 - Verizon will retain the obligation to provide retirement benefits for employees that are retired prior to closing of the merger
 - FairPoint will accept OPEB obligations for all active, continuing employees
 - New Hiring
 - FairPoint expects to hire approximately 600 new employees in the Northeast
 - New employees to provide support and services currently provided by Verizon corporate services

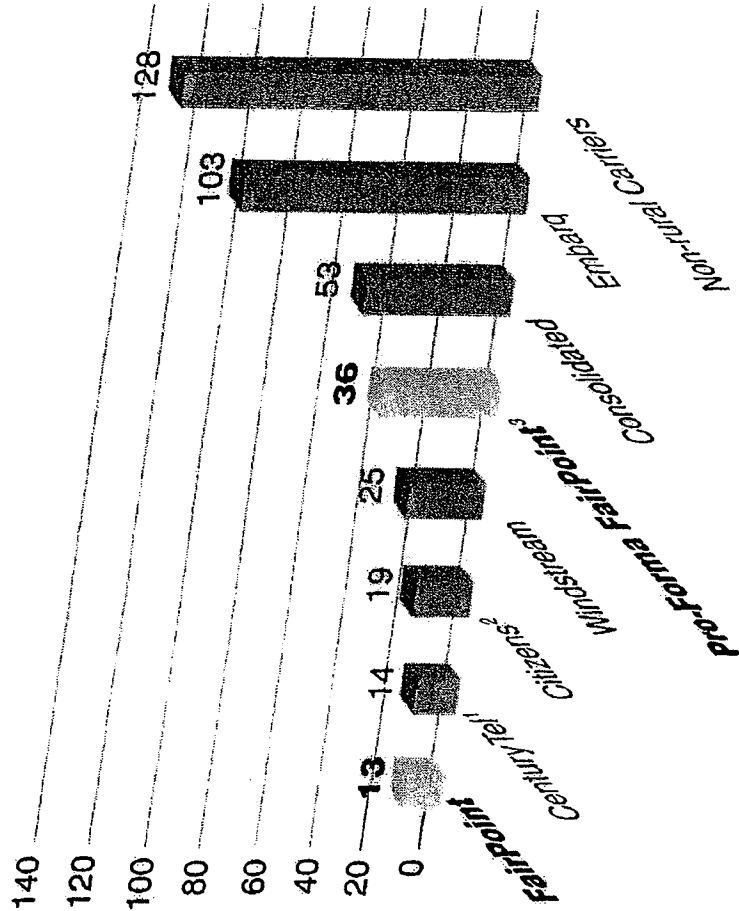
Favorable Rural Characteristics

Focus on rural/smaller urban markets

> Continuing focus on lower-density markets after transaction

- 36 lines / sq. mile
- More than 80% of local exchanges will serve 5,000 customers or less

Access Lines/Square Mile



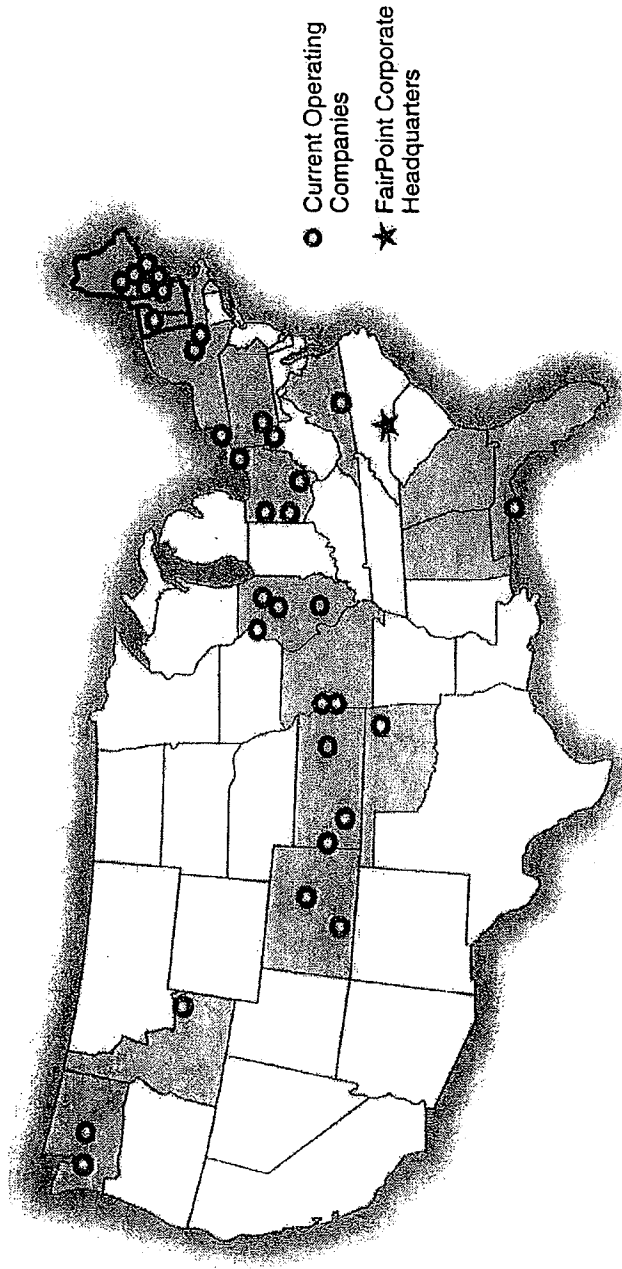
Source
SEC filings and
investor presentations

Notes

1. Pro forma for CenturyTel's acquisition of Madison River
2. Pro forma for Citizens' acquisition of Commonwealth
3. Pro forma for FairPoint's acquisition of Verizon's New England access lines

Overview of FairPoint

Significantly greater scope and scale



Pre-merger FairPoint⁽¹⁾

- 308,858 total access line equivalents
- 194,002 residential voice access lines
- 57,761 business voice
- 57,095 HSD subscribers (including DSL, cable modem and WBB)

Post-merger⁽¹⁾

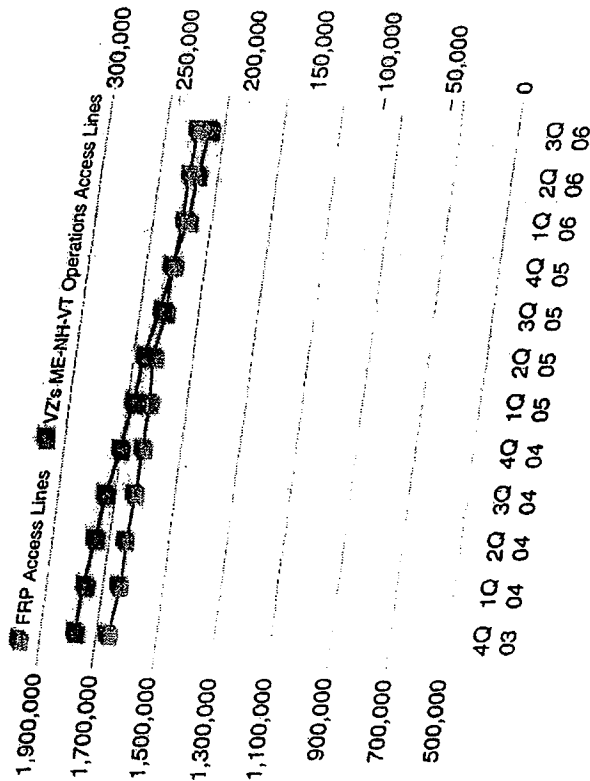
- 2,022,109 total access line equivalents
- 1,176,955 residential voice access lines
- 451,368 business voice lines
- 159,722 wholesale access lines
- 234,064 HSD subscribers (including DSL, cable modem and WBB)

(1) As of September 30, 2006.

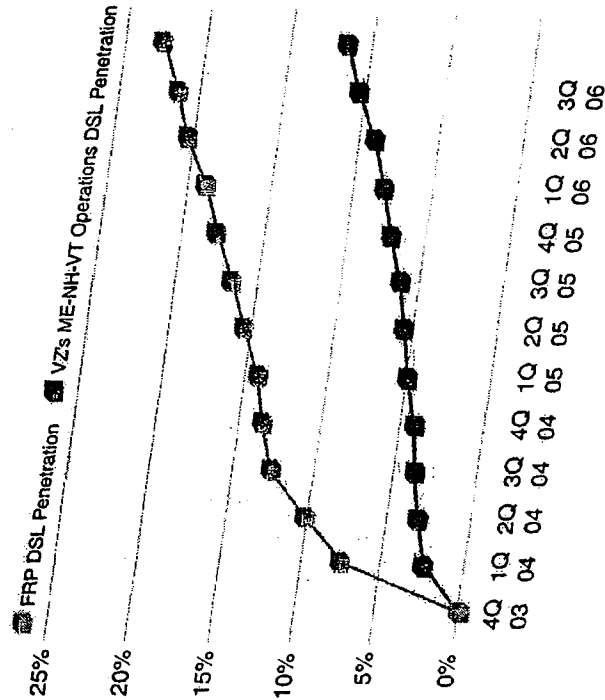
Access Line Trends

Opportunity for Improvement

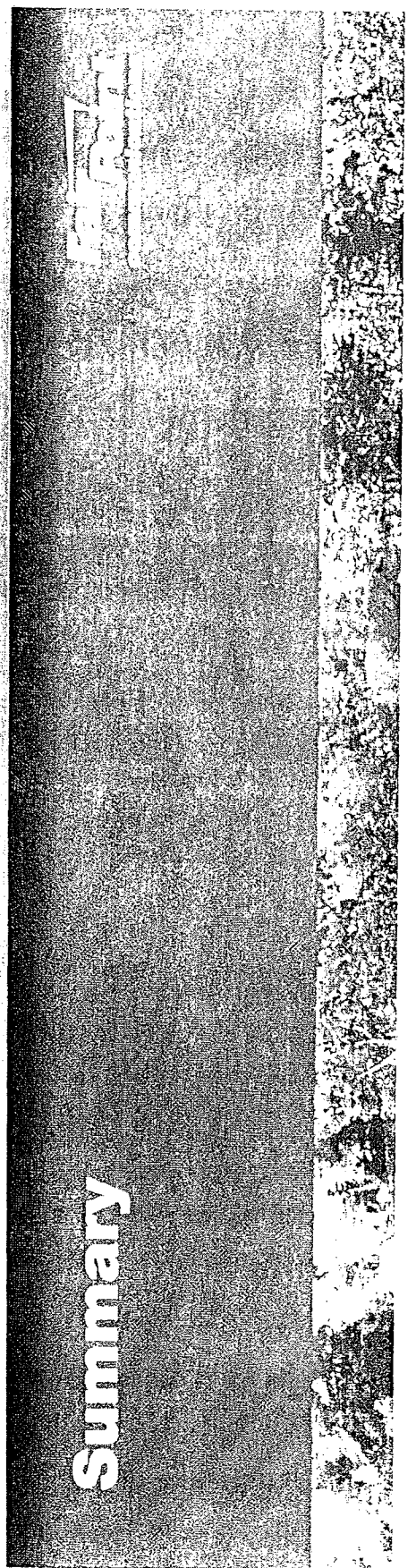
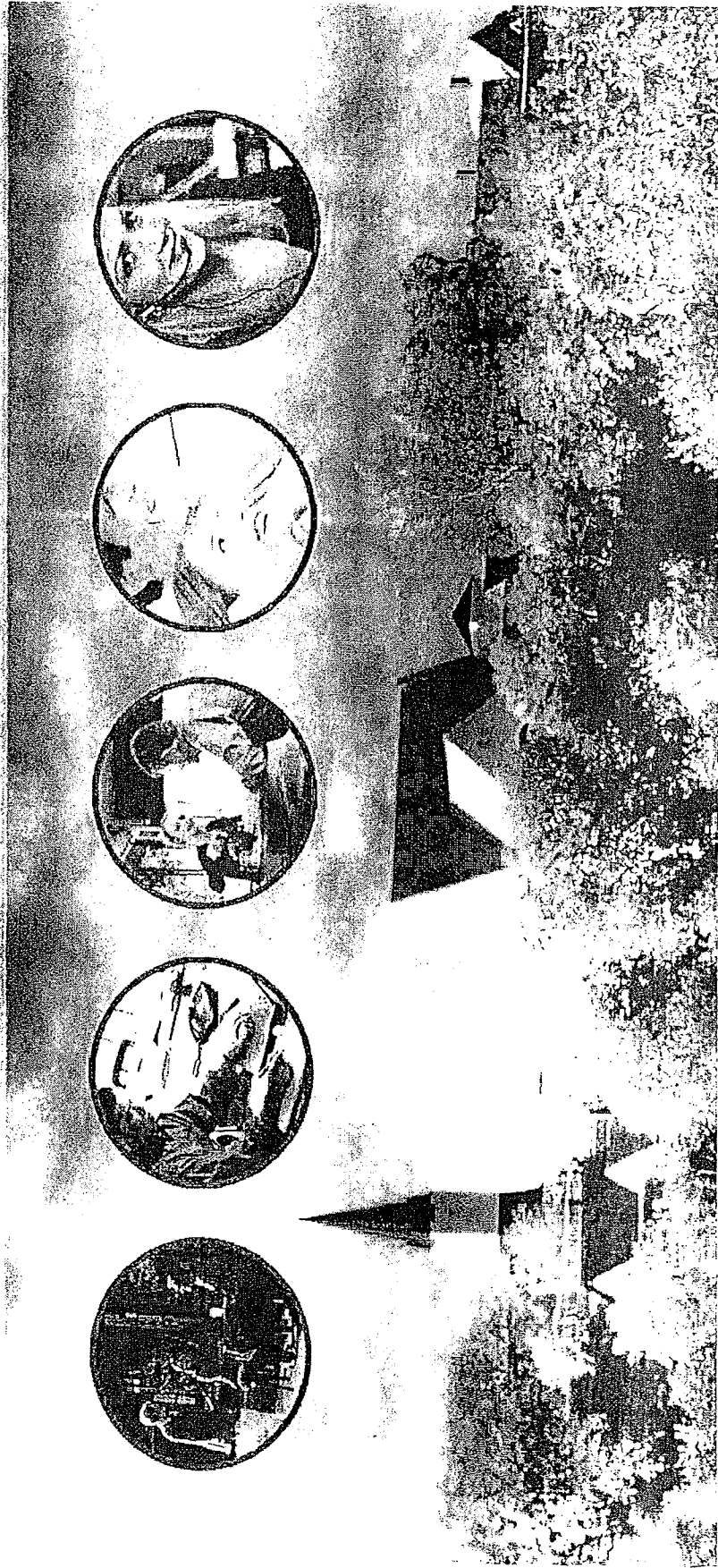
Access Line Trends



DSL Growth



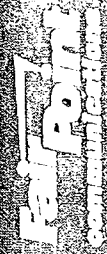
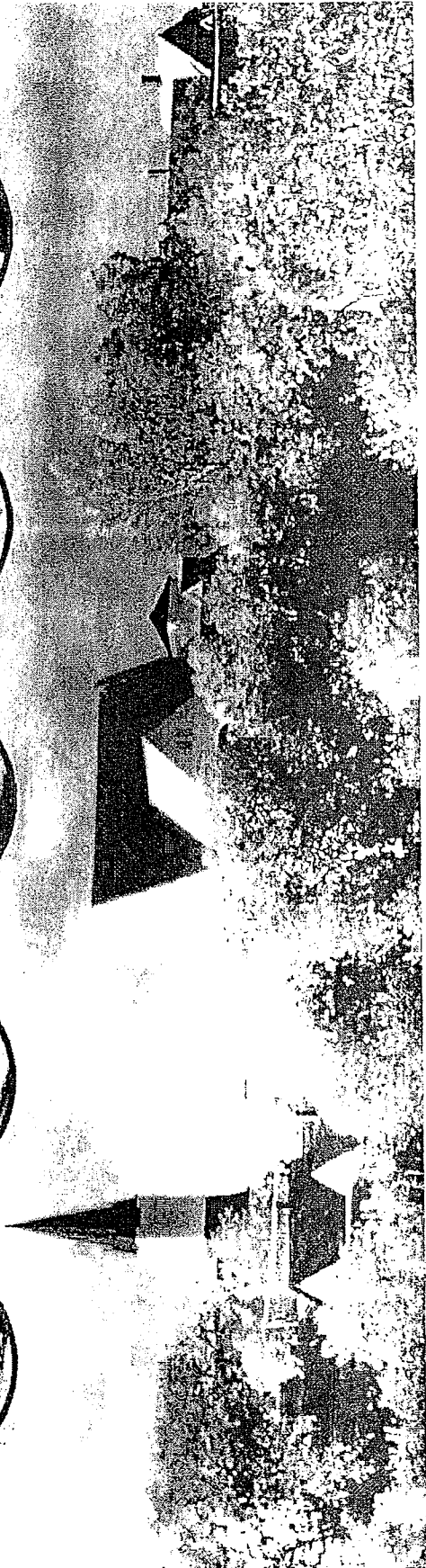
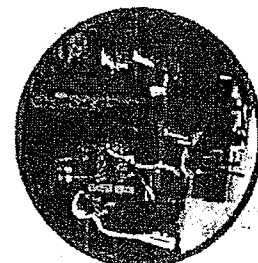
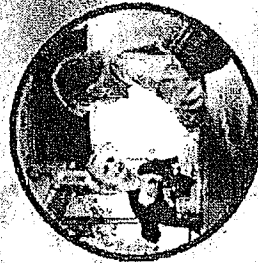
- > Verizon's Maine, New Hampshire and Vermont operations broadband addressability is over 80%
- > Existing FairPoint broadband addressability is 62%
- > Top cable competitors in region are Comcast and Time Warner



Summary

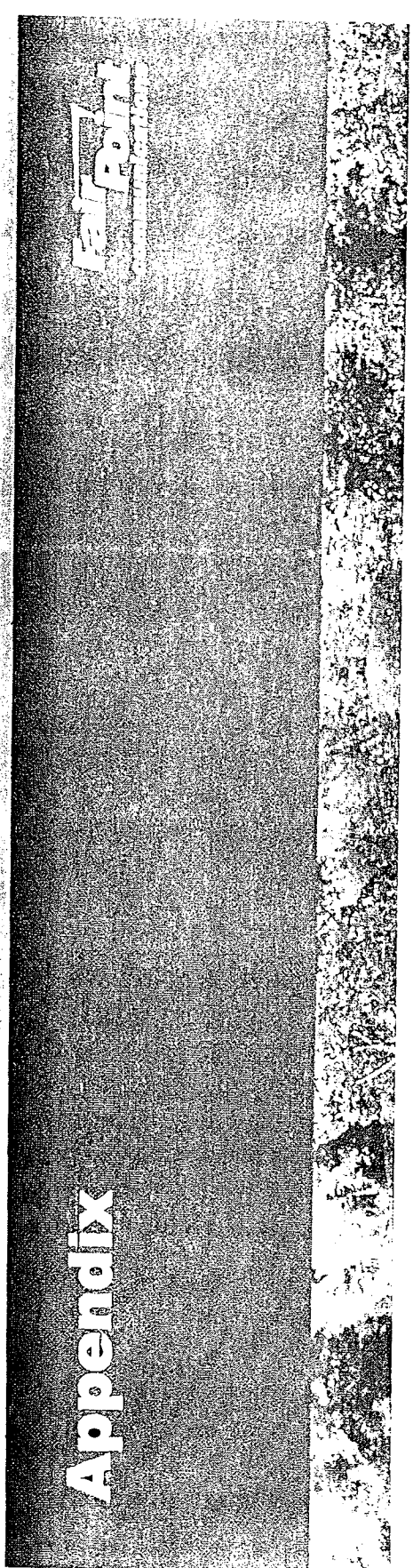
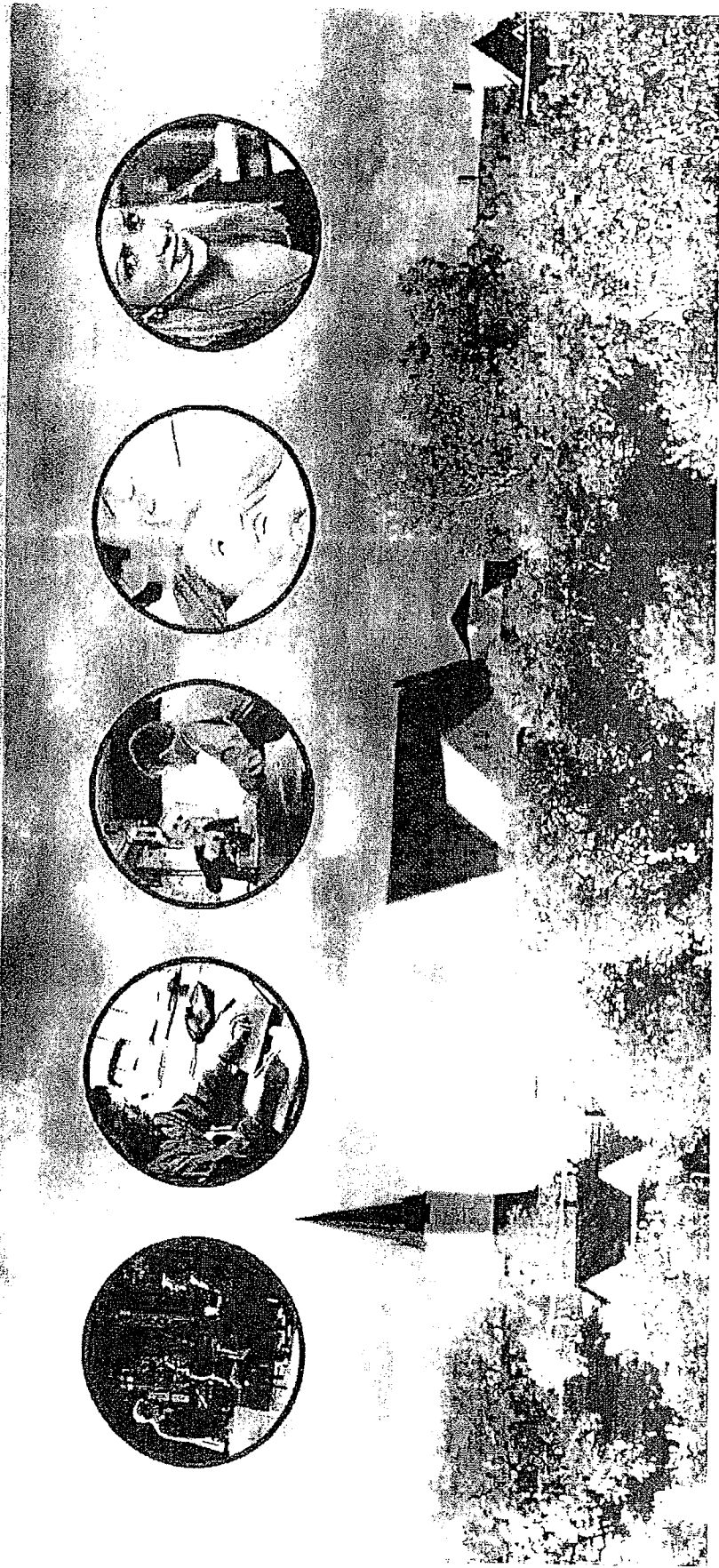
Strategic win for shareholders, employees and customers

- > **Accelerates FairPoint's strategy**
- > **Leverages FairPoint's operating expertise**
- > **Benefits shareholders**
 - Attractive valuation
 - Results in cash flow accretion
 - Enhances financial strength
- > **Benefits customers and employees**
- > **Creates multiple opportunities for ongoing value creation**
 - Improves revenue opportunities
 - Enhances operating efficiencies
 - Improves financial flexibility
 - Creates scalable platform for future acquisitions



Questions and Answers FairPoint Communications, Inc.

January 16, 2007



FairPoint

Appendix

Experienced Management Team

Average of 23 years of industry experience

Name	Position	Experience
Gene Johnson	Co-Founder, Chairman of the Board & Chief Executive Officer	31 years corporate and operating experience; company co-founder and director since 1991; CEO since January 2002
Peter Nixon	Chief Operating Officer	28 years experience; COO since November 2002
John Crowley	Executive Vice President, Chief Financial Officer	28 years finance and investment banking experience for telecom clients; Joined FairPoint in May 2005 and became CFO in June 2005
Walt Leach	Executive Vice President, Corporate Development	32 years finance, mergers and acquisitions experience
Shirley Linn	Executive Vice President, General Counsel and Secretary	31 years experience; Joined FairPoint in 2000
Lisa Hood	Senior Vice President, Corporate Controller	18 years experience; Corporate Controller since 1993
Pat Morse	Senior Vice President, Government Affairs	30 years experience; Joined FairPoint in 1979
Mike Haga	Director of Billing and OSS and Transition Team Lead	17 years experience; Joined FairPoint in 2005

**CONFIDENTIAL EXHIBIT TO
PREFILED TESTIMONY OF
WALTER LEACH**

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EXHIBIT WL-3

**FairPoint Communications, Inc.
Financial Information
Table of Contents**

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Section I - Combined Financials

The combined financial information reflects projections for the merged entity beginning 2008.

Combined Summary Financials	Page 1
Combined Balance Sheet	Page 2
Combined Income Statement	Page 3
Combined Cash Flows	Page 4

Section II - Standalone Spinco Projections

The standalone projections reflect the operations to be acquired from Verizon as part of this transaction.

Summary Projections	Pages 1-2
Detailed Projections	Pages 3-9
Capital Expenditure Forecast	Page 10

Section III - Synergies Detail

The synergies detail reflects the cost for FairPoint to replace those functions that are currently performed by Verizon outside of the territory.

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Section I - Combined Financials

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FairPoint Communications, Inc.
Combined Financials
Summary
(\$ in millions)

	2008 ¹	2009	2010	2011	2012	2013	2014	2015
FairPoint Revenues	\$275	\$274	\$272	\$269	\$266	\$263	\$260	\$257
% Y-o-Y Growth		(0.5%)	(0.5%)	(1.2%)	(1.2%)	(1.1%)	(1.2%)	(1.2%)
Spinco Revenues	1,151	1,145	1,150	1,144	1,138	1,135	1,136	1,136
% Y-o-Y Growth		(0.5%)	0.4%	(0.5%)	(0.5%)	(0.2%)	0.1%	0.0%
Pro Forma Revenue	\$1,426	\$1,419	\$1,422	\$1,413	\$1,404	\$1,398	\$1,396	\$1,393
% Y-o-Y Growth		(0.5%)	0.2%	(0.6%)	(0.7%)	(0.4%)	(0.2%)	(0.2%)
FairPoint Operating Expenses	162	164	167	167	167	168	168	168
% Y-o-Y Growth		1.6%	1.5%	0.2%	0.2%	0.2%	0.0%	0.0%
Spinco Operating Expenses	830	709	714	721	727	734	742	748
% Y-o-Y Growth		(14.6%)	0.8%	1.0%	0.8%	0.9%	1.1%	0.8%
Pro Forma EBITDA	\$435	\$546	\$541	\$525	\$510	\$497	\$486	\$478
FairPoint Capital Expenditures	\$29	\$29	\$29	\$29	\$29	\$29	\$29	\$29
% Y-o-Y Growth		(0.4%)	0.1%	(0.0%)	(0.0%)	0.0%	0.0%	0.0%
Spinco Capital Expenditures	296	138	134	130	128	127	127	127
% Y-o-Y Growth		(53.3%)	(2.7%)	(3.3%)	(1.4%)	(0.9%)	(0.4%)	0.1%
Pro Forma Capital Expenditures	\$325	\$167	\$164	\$159	\$157	\$156	\$156	\$156
% Y-o-Y Growth		(48.5%)	(2.2%)	(2.7%)	(1.2%)	(0.7%)	(0.3%)	0.1%

1. ¹ials include one-time operating expenses of \$56 million.

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FairPoint Communications, Inc.
Combined Financials
Income Statement
(\$ in millions)

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	2008 ⁽¹⁾	2009	2010	2011	2012	2013	2014	2015
FairPoint Revenues								
Local	\$69	\$69	\$69	\$69	\$68	\$68	\$68	\$68
% Y-o-Y Growth		(0.0%)	0.1%	(0.0%)	(1.5%)	0.0%	(0.0%)	(0.1%)
Access	119	112	105	101	96	92	89	86
% Y-o-Y Growth		(6.1%)	(6.5%)	(3.4%)	(5.4%)	(3.5%)	(3.5%)	(3.3%)
Long Distance	27	28	29	29	29	29	29	29
% Y-o-Y Growth		3.1%	2.9%	(0.0%)	(0.2%)	0.0%	(0.0%)	(0.1%)
Data / Internet	40	45	50	50	50	50	50	50
% Y-o-Y Growth		12.2%	11.1%	0.4%	(0.4%)	0.4%	(0.0%)	(0.1%)
Other	21	21	21	21	24	25	25	24
% Y-o-Y Growth		0.6%	0.7%	0.5%	17.0%	0.3%	(0.0%)	(0.1%)
Subtotal FairPoint	\$275	\$274	\$272	\$269	\$266	\$263	\$260	\$257
% Y-o-Y Growth		(0.5%)	(0.5%)	(1.2%)	(1.2%)	(1.1%)	(1.2%)	(1.2%)
Spinco Revenues								
Local	609	580	557	537	521	507	496	484
% Y-o-Y Growth		(4.8%)	(4.1%)	(3.5%)	(3.0%)	(2.6%)	(2.2%)	(2.4%)
Access	458	473	490	503	516	531	548	566
% Y-o-Y Growth		3.2%	3.6%	2.6%	2.6%	2.9%	3.2%	3.2%
Other	18	17	15	14	13	12	11	10
% Y-o-Y Growth		(9.1%)	(8.7%)	(8.3%)	(7.9%)	(7.4%)	(7.1%)	(6.7%)
Long Distance	89	90	91	92	91	90	90	89
% Y-o-Y Growth		1.2%	1.7%	0.4%	(0.8%)	(0.8%)	(0.8%)	(0.8%)
Data / Internet	99	121	142	147	146	146	144	143
% Y-o-Y Growth		22.2%	17.8%	3.1%	(0.3%)	(0.5%)	(0.8%)	(1.1%)
MVNO	0	1	6	11	15	19	22	25
% Y-o-Y Growth		N/A	276.6%	87.8%	41.0%	25.7%	18.2%	13.8%
Eliminations	(122)	(137)	(151)	(159)	(164)	(170)	(175)	(181)
% Y-o-Y Growth		12.2%	10.4%	5.0%	3.2%	3.3%	3.3%	3.3%
Subtotal Spinco	\$1,151	\$1,145	\$1,150	\$1,144	\$1,138	\$1,135	\$1,136	\$1,136
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% Y-o-Y Growth		(0.5%)	0.2%	(0.6%)	(0.7%)	(0.4%)	(0.2%)	(0.2%)
FairPoint Operating Expenses	162	164	167	167	167	168	168	168
% Y-o-Y Growth		1.6%	1.5%	0.2%	0.2%	0.2%	0.0%	0.0%
Spinco Operating Expenses	830	709	714	721	727	734	742	748
% Y-o-Y Growth		(14.6%)	0.8%	1.0%	0.8%	0.9%	1.1%	0.8%
Pro Forma EBITDA	\$435	\$546	\$541	\$525	\$510	\$497	\$486	\$478
Depreciation and Amortization	312	302	282	270	258	239	226	214
Stock-based Comp and Other	2	0	0	0	0	0	0	0
Operating Income	\$121	\$244	\$259	\$255	\$252	\$257	\$260	\$263
Interest / Dividend Income	1	0	0	0	0	0	0	0
Interest Expense	(168)	(168)	(166)	(163)	(160)	(158)	(156)	(155)
Total Other Income / (Expense)	(\$167)	(\$168)	(\$165)	(\$162)	(\$159)	(\$157)	(\$156)	(\$155)
Pre-Tax Income / (Loss)	(\$46)	\$76	\$94	\$93	\$92	\$100	\$105	\$108
Income Tax Benefit / (Expense)	18	(30)	(37)	(36)	(36)	(39)	(41)	(42)
Net Income / (Loss)	(\$28)	\$47	\$57	\$57	\$56	\$61	\$64	\$66

1. 2008 financials include one-time operating expenses of \$56 million.

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FairPoint Communications, Inc.
Combined Financials
Balance Sheet
(\$ in millions)

	PF 12/31/07	2008	2009	2010	2011	2012	2013	2014	2015
Current Assets:									
Cash	\$37	\$3	\$3	\$3	\$3	\$3	\$3	\$3	\$3
Other Current Assets	\$28	\$20	\$14	\$10	\$04	\$98	\$97	\$97	\$96
Total Current Assets	\$65	\$23	\$17	\$13	\$07	\$101	\$100	\$100	\$99
FairPoint Net PP&E	\$230	\$216	\$201	\$187	\$177	\$167	\$160	\$155	\$150
Spinco Net PP&E	\$1,701	\$1,749	\$1,650	\$1,567	\$1,487	\$1,417	\$1,358	\$1,309	\$1,272
Goodwill									
Customer List	\$861	\$861	\$861	\$861	\$861	\$861	\$861	\$861	\$861
Other Assets	170	154	138	121	105	89	73	57	40
	97	97	97	97	97	97	97	97	97
Total Assets	\$3,424	\$3,399	\$3,263	\$3,146	\$3,034	\$2,932	\$2,848	\$2,778	\$2,719
Total Current Liabilities	\$263	\$258	\$257	\$257	\$256	\$255	\$254	\$254	\$253
Long-Term Liabilities:									
Spinco Credit Facility	\$1,550	\$1,550	\$1,550	\$1,533	\$1,462	\$1,401	\$1,354	\$1,319	\$1,294
Revolver	0	0	0	0	0	0	0	0	0
Delayed Draw Term Loan	0	138	58	0	0	0	0	0	0
Total Secured Debt	\$1,550	\$1,688	\$1,608	\$1,533	\$1,462	\$1,401	\$1,354	\$1,319	\$1,294
Remaining FairPoint Bonds:									
2010 Senior Notes, 11.875%	\$2	\$2	\$2	\$0	\$0	\$0	\$0	\$0	\$0
Taconic Fixed/Berkshire RTFC after 5/1/05	1	1	1	1	1	1	1	1	1
UI - RTFC	1	1	1	1	1	0	0	0	0
Demand Note Payable	0	0	0	0	0	0	0	0	0
Debt-for-Debt Exchange Securities	\$793	\$793	\$793	\$793	\$793	\$793	\$793	\$793	\$793
Long-Term Debt	\$2,348	\$2,485	\$2,406	\$2,328	\$2,256	\$2,196	\$2,149	\$2,113	\$2,088
Deferred Tax Liability	\$253	\$238	\$250	\$264	\$277	\$290	\$300	\$307	\$312
Total Other Long Term Liabilities	\$260	\$287	\$316	\$346	\$377	\$410	\$444	\$480	\$517
Total Long Term Liabilities	\$2,863	\$3,011	\$2,971	\$2,957	\$2,911	\$2,895	\$2,893	\$2,900	\$2,917
Minority Interest	0	0	0	0	0	0	0	0	0
Total Shareholder's Equity / (Deficit)	\$298	\$130	\$36	(\$18)	(\$133)	(\$218)	(\$298)	(\$376)	(\$452)
Total Liabilities & Shareholders Equity	\$3,424	\$3,399	\$3,263	\$3,146	\$3,034	\$2,932	\$2,848	\$2,778	\$2,719

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FairPoint Communications, Inc.
 Combined Financials
 Cash Flow
 (\$ in millions)

	2008	2009	2010	2011	2012	2013	2014	2015
Cash Flows from Operations								
Net Income / (Loss)	(\$28)	\$47	\$57	\$57	\$56	\$61	\$64	\$66
Amortization of Financing Fees	4	4	4	4	4	0	0	0
Amortization of Customer List	16	16	16	16	16	16	16	16
Depreciation and Amortization	292	281	261	249	237	223	210	198
Deferred Income Taxes	(17)	11	14	14	13	10	7	5
Pension / OPEB Cash Adjustment	27	29	30	31	33	34	36	37
Stock-based compensation	2	0	0	0	0	0	0	0
Other	0	0	0	0	0	0	0	0
As in Working Capital	(1)	0	(0)	0	0	0	0	0
Net Cash Provided by Operating Activities	\$295	\$389	\$383	\$372	\$360	\$345	\$333	\$323
Cash Flows from Investing								
Acquisition of PP&E (Capital Expenditures)	(325)	(167)	(164)	(159)	(157)	(156)	(156)	(156)
Net Cash Provided by Investing Activities	(\$325)	(\$167)	(\$164)	(\$159)	(\$157)	(\$156)	(\$156)	(\$156)
Cash Flows from Financing								
Proceeds from Issuance of Long-Term Debt	0	0	0	0	0	0	0	0
Mandatory Repayment of Long-Term Debt	0	(0)	(2)	(0)	(0)	(0)	(0)	0
Dividends Paid to Common Stockholders	(142)	(142)	(142)	(142)	(142)	(142)	(142)	(142)
Net Cash Provided by Investing Activities	(\$142)	(\$142)	(\$144)	(\$142)	(\$142)	(\$142)	(\$142)	(\$142)
Net Increase / Decrease in Cash Balance	(\$171)	\$80	\$76	\$71	\$61	\$47	\$35	\$25
Cash Balance, Beginning	\$37	\$3	\$3	\$3	\$3	\$3	\$3	\$3
Revolver / DDTL	138	(80)	(58)	0	0	0	0	0
Optional Debt Repayment	0	0	(17)	(71)	(61)	(47)	(35)	(25)
Cash Balance, Ending	\$3	\$3	\$3	\$3	\$3	\$3	\$3	\$3

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Section II - Standalone Spinco Projections

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FairPoint Communications, Inc.
Standalone Spinco
Summary Projections
(\$ in 000s except per line)

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	2008	2009	2010	2011	2012	2013	2014	2015
Switched Access Lines								
Consumer	853,149	808,358	769,961	737,238	709,592	686,530	667,650	650,959
Small Business	180,784	172,197	164,878	158,695	153,538	149,316	145,583	141,943
Enterprise	134,381	127,998	122,558	117,962	114,128	110,989	108,215	105,509
Wholesale	108,848	99,468	94,809	93,071	92,137	90,521	89,660	89,182
Official	27,218	26,946	26,677	26,410	26,146	25,884	25,626	25,369
Public	7,334	6,307	5,361	4,503	3,738	3,065	2,483	1,986
Total Switched Access Lines	1,311,713	1,241,274	1,184,244	1,137,880	1,099,278	1,066,306	1,039,216	1,014,949
% Change	-6.2%	-5.4%	-4.6%	-3.9%	-3.4%	-3.0%	-2.5%	-2.1%
Retail DSL								
Consumer	237,494	258,023	277,434	284,741	292,940	301,958	311,833	321,845
Business	39,982	56,344	72,096	77,373	82,468	87,265	92,052	96,670
Total Retail DSL	277,476	314,367	349,530	362,113	375,408	389,222	403,885	418,515
% Change	16.8%	13.3%	11.2%	3.6%	3.7%	3.7%	3.8%	3.6%
Penetration of Retail Lines	23.8%	28.4%	33.1%	35.7%	38.4%	41.1%	43.8%	46.6%
Access Line Equivalents								
% Change	-2.9%	-2.1%	-1.4%	-2.2%	-1.7%	-1.3%	-0.9%	-0.7%
Long Distance								
Consumer	524,686	524,686	524,686	524,686	524,686	524,686	524,686	524,686
Business	107,424	117,331	126,716	126,716	126,716	126,716	126,716	126,716
Total Long Distance	632,110	642,017	651,402	651,402	651,402	651,402	651,402	651,402
% Change	0.2%	1.6%	1.5%	0.0%	0.0%	0.0%	0.0%	0.0%
Penetration of Retail Lines	54.1%	57.9%	61.6%	64.2%	66.7%	68.8%	70.7%	72.5%
LEC Revenue								
Consumer	\$361,218	\$338,832	\$321,394	\$306,460	\$293,750	\$283,036	\$274,127	\$266,531
Small Business	121,033	115,101	110,093	106,194	103,004	100,546	98,550	96,385
Enterprise	127,102	126,403	125,133	124,685	124,429	123,867	123,548	121,443
Partner Solutions (Carrier & CLEC)	309,500	310,525	314,242	320,379	328,929	339,150	350,881	363,339
Fiduciary	148,659	162,467	175,728	182,536	186,961	191,722	196,873	202,176
Public	4,505	3,523	2,730	2,095	1,592	1,199	893	659
LiveSource	13,815	13,124	12,468	11,845	11,252	10,690	10,155	9,647
Total LEC Revenues	\$1,085,832	\$1,069,975	\$1,061,788	\$1,054,193	\$1,049,918	\$1,050,210	\$1,055,029	\$1,060,181
% Change	-2.5%	-1.5%	-0.8%	-0.7%	-0.4%	0.0%	0.5%	0.5%
Non-Reg Revenues								
ISP Revenue	\$98,870	\$120,827	\$142,366	\$146,779	\$146,324	\$145,606	\$144,495	\$142,838
Long Distance Revenue	88,887	89,978	91,487	91,862	91,169	90,474	89,779	89,083
VSSI - CPE	0	0	0	0	0	0	0	0
MVNO Revenue	0	1,490	5,609	10,536	14,857	18,675	22,080	25,118
Total Non-Reg Revenues	\$187,757	\$212,294	\$239,462	\$249,177	\$252,349	\$254,755	\$256,354	\$257,039
% Change	11.8%	13.1%	12.8%	4.1%	1.3%	1.0%	0.6%	0.3%
Eliminations								
	(122,302)	(137,220)	(151,433)	(159,054)	(164,166)	(169,502)	(175,133)	(180,851)
Consolidated Spinco Revenue	\$1,151,286	\$1,145,049	\$1,149,818	\$1,144,317	\$1,138,101	\$1,135,463	\$1,136,250	\$1,136,369
% Change	-2.1%	-0.5%	0.4%	-0.5%	-0.5%	-0.2%	0.1%	0.0%

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FairPoint Communications, Inc.
Standalone Spinco
Summary Projections
(\$ in 000s except per line)

	2008	2009	2010	2011	2012	2013	2014	2015
LEC Cash Operating Expense								
Recurring Overhead	\$600,637	\$644,560	\$640,603	\$637,905	\$635,780	\$635,210	\$636,239	\$638,856
Transition Services Agreement ("TSA")	115,200	0	0	0	0	0	0	0
Capgemini / Integration Expense	32,565	0	0	0	0	0	0	0
Non-recurring (Branding/Recruiting/etc.)	23,709	0	0	0	0	0	0	0
Total LEC Cash Expense	\$772,111	\$644,560	\$640,603	\$637,905	\$635,780	\$635,210	\$636,239	\$638,856
% Change	15.9%	-16.5%	-0.6%	-0.4%	-0.3%	-0.1%	0.2%	0.4%
Non-Reg Cash Operating Expense								
ISP Expense	126,475	145,826	165,241	178,072	187,368	196,629	206,047	211,985
LD Expense	53,814	54,230	54,984	55,298	55,188	55,069	54,940	54,804
MVNO Expense	0	1,266	4,824	9,166	13,074	16,621	19,872	22,858
Total Non-Reg Operating Expense	\$180,290	\$201,323	\$225,049	\$242,536	\$255,630	\$268,319	\$280,859	\$289,646
% Change	13.8%	11.7%	11.8%	7.8%	5.4%	5.0%	4.7%	3.1%
Eliminations	(122,302)	(137,220)	(151,433)	(159,054)	(164,166)	(169,502)	(175,133)	(180,851)
Consolidated Spinco Cash Expense	\$830,099	\$708,663	\$714,219	\$721,387	\$727,245	\$734,026	\$741,964	\$747,651
% Change	15.4%	-14.6%	0.8%	1.0%	0.8%	0.9%	1.1%	0.8%
LEC Operating EBITDA	\$313,720	\$425,415	\$421,185	\$416,289	\$414,138	\$415,001	\$418,790	\$421,324
Plus: Non-recurring Adjustments	0	0	0	0	0	0	0	0
Plus: Fully-funded Pension Adjustment	0	0	0	0	0	0	0	0
Plus: Actives-only Adjustment	0	0	0	0	0	0	0	0
Fully Adjusted LEC EBITDA	\$313,720	\$425,415	\$421,185	\$416,289	\$414,138	\$415,001	\$418,790	\$421,324
% Change	-34.0%	35.6%	-1.0%	-1.2%	-0.5%	0.2%	0.9%	0.6%
Margin	28.9%	39.8%	39.7%	39.5%	39.4%	39.5%	39.7%	39.7%
Non-Reg Operating EBITDA	\$7,467	\$10,972	\$14,414	\$6,641	(\$3,281)	(\$13,564)	(\$24,505)	(\$32,607)
% Change	-21.9%	46.9%	31.4%	-53.9%	-149.4%	313.4%	80.7%	33.1%
Margin	4.0%	5.2%	6.0%	2.7%	-1.3%	-5.3%	-9.6%	-12.7%
Consolidated Spinco Operating EBITDA	\$321,187	\$436,387	\$435,599	\$422,930	\$410,857	\$401,436	\$394,285	\$388,717
Plus: Non-recurring Adjustments	0	0	0	0	0	0	0	0
Plus: Fully-funded Pension Adjustment	0	0	0	0	0	0	0	0
Plus: Actives-only Adjustment	0	0	0	0	0	0	0	0
Fully Adjusted Spinco EBITDA	\$321,187	\$436,387	\$435,599	\$422,930	\$410,857	\$401,436	\$394,285	\$388,717
% Change	-33.7%	35.9%	-0.2%	-2.9%	-2.9%	-2.3%	-1.8%	-1.4%
Margin	27.9%	38.1%	37.9%	37.0%	36.1%	35.4%	34.7%	34.2%
Less: Higher Classic FRP Labor Cost	(\$3,800)	(\$3,724)	(\$3,650)	(\$3,577)	(\$3,505)	(\$3,444)	(\$3,392)	(\$3,350)
Less: FPNE DSL ARPU Impact	(1,860)	(2,108)	(2,336)	(2,410)	(2,486)	(2,566)	(2,651)	(2,743)
Incremental EBITDA	\$315,527	\$430,555	\$429,614	\$416,943	\$404,865	\$395,427	\$388,242	\$382,625
Plus: Pension & OPEB Cash Adjustment	\$26,971	\$28,928	\$29,923	\$31,449	\$32,838	\$34,257	\$35,698	\$37,151
Incremental Cash EBITDA	\$342,498	\$459,483	\$459,537	\$448,392	\$437,704	\$429,683	\$423,940	\$419,776
% Change	-32.7%	34.2%	0.0%	-2.4%	-2.4%	-1.8%	-1.3%	-1.0%
Capital Expenditures:								
Recurring	\$142,934	\$138,192	\$134,463	\$130,036	\$128,170	\$127,078	\$126,593	\$126,767
DSL Buildout	43,800	0	0	0	0	0	0	0
Conversion	109,045	0	0	0	0	0	0	0
Total Capital Expenditure:	\$295,779	\$138,192	\$134,463	\$130,036	\$128,170	\$127,078	\$126,593	\$126,767
Recurring per Avg. Switched Loop	\$105	\$108	\$111	\$112	\$115	\$117	\$120	\$123
Total per Avg. Switched Loop	\$218	\$108	\$111	\$112	\$115	\$117	\$120	\$123

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