BEFORE THE NEW HAMPSHIRE
PUBLIC UTILITIES COMMISSION

Verizon New England Inc., Bell Atlantic	)	
Communications Inc., NYNEX Long Distance	)	
Company, Verizon Select Services Inc. and	)	
FairPoint Communications, Inc.	)	Docket No. DT 07-011
Joint Petition for Authority to Transfer Assets	)	
and Franchise to FairPoint Communications, Inc.	)	

PREFILED DIRECT TESTIMONY OF SUSAN M. BALDWIN

ON BEHALF OF THE OFFICE OF CONSUMER ADVOCATE

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I. INTRODUCTION

A. Qualifications

Q: Please state your name, position, and business address.

A: My name is Susan M. Baldwin. I am a consultant, and my business address is 17 Arlington Street, Newburyport, MA, 01950. I specialize in telecommunications economics, regulation, and public policy consulting for public sector agencies.

Q: Please summarize your educational background and professional experience.

A: I have prepared a Statement of Qualifications, which is included as Attachment A.

Q: Have you previously testified before the New Hampshire Public Utilities Commission ("Commission" or "PUC")?

A: No. However, in 2006, I provided technical assistance to the Office of Consumer Advocate ("OCA") in its participation in the Commission's investigation of a proposed alternative regulation plan ("AFOR") for Verizon New Hampshire ("Verizon NH").[1] However, the docket has had no activity since September 2006.

Q: Have you testified before other State Commissions?

A: Yes. As Attachment A to my testimony shows, I have testified before sixteen state commissions on diverse telecommunications issues encompassing such matters as alternative regulation, revenue requirement, service quality, local competition, mergers, infrastructure deployment, universal service, cost studies, rate design, telephone numbering, and unbundled network elements.

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[1] / Docket No. DT 06-072, Verizon New Hampshire Flexible Pricing Regulation/Verizon New Hampshire Alternative Regulation Plan.

Q: Have you analyzed major transactions concerning telecommunications carriers in other regulatory proceedings?

A: Yes. As my statement of qualifications indicates, I have participated in numerous state and federal merger and spin-off proceedings.

Q: Have you participated in other proceedings concerning Verizon companies' operations?

A: Yes. I have participated in numerous state and federal proceedings concerning the regulation of many different aspects of Verizon and its predecessor companies (New England Telephone and Telegraph Company ("NET"), NYNEX Corporation ("NYNEX"), and Bell Atlantic), including such issues as its mergers with its potential and actual competitors, deployment and pricing of new services, revenue requirement, retail and wholesale rate design, retail and wholesale cost studies, service quality, regulatory framework, affiliate transactions, and consumer protection.

Q: Deployment of advanced services is one of the issues that the proposed transaction raises. Have you addressed this issue previously?

A: Yes. Among my recent work in this area is the preparation of comments, submitted in Federal Communications Commission ("FCC) proceedings, on behalf of consumer advocates regarding various aspects of broadband services: deployment, industry practices, competition, consumer protection, and data collection and analysis.[2]

[2] / *In the Matter of Broadband Industry Practices*, WC Docket No. 07-52, Notice of Inquiry ("Broadband Industry Practices NoI"), FCC 07-31 (rel. April 16, 2007); *In the Matter of Development of Nationwide Broadband Data to Evaluate Reasonable and Timely Deployment of Advanced Services to All Americans, Improvement of Wireless Broadband Subscribership Data, and Development of Data on Interconnected Voice over Internet Protocol (VoIP) Subscribership*, WC Docket No. 07-38, Notice of Proposed Rulemaking, rel. April 16, 2007 ("Broadband Data NPRM"); *In the Matter of Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996*, GN Docket No. 07-45, Notice of Inquiry, FCC 07-21, rel. April 16, 2007 ("Broadband Deployment Notice"); *In the Matter of Consumer Protection in a Broadband Era*, WC Docket No. 05-271. I also participated in several merger proceedings, in

Also, when I served as the Director of Telecommunications for the Massachusetts Department of Public Utilities ("DPU") (subsequently the Department of Telecommunications and Energy, and now the Department of Telecommunications and Cable), NET's roll-out of then-advanced infrastructure in the more sparsely populated parts of Massachusetts was just as much an issue to consumers as roll-out of broadband services in New England's rural areas is today. While I was the Director of Telecommunications, the DPU directed NET to accelerate its replacement of electromechanical switches in the Berkshires,[3] and in another proceeding, directed NET to set more affordable rates for and accelerate the deployment of its then state-of-the-art Integrated Services Digital Network ("ISDN") service.[4] Although technology has evolved since the late 1980s and early 1990s, public policy concerns about consumers' disparate levels of access to advanced telecommunications services and incumbent carriers' seemingly unilateral ability to control the deployment and prices of advanced services seem largely unchanged.

Q: Service quality is another concern in this proceeding. Have you analyzed service quality in other regulatory proceedings?

A: Yes. I have examined service quality data and the regulation of service quality in numerous proceedings. When I was the Director of Telecommunications for the Massachusetts DPU, our

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which the FCC addressed net neutrality.

[3] / State regulators directed NET (now Verizon) to accelerate its replacement of outdated electromechanical central office switches in rural Massachusetts so that some communities would not be left behind, lacking access to touch tone, while NET advertised then-new features, such as call waiting, in urban and suburban communities. State regulators also directed NET to improve service quality in specific regions of the state where aging outside plant yielded inferior service quality. Massachusetts D.P.U. 89-300, *New England Telephone Company*, June 29, 1990.

[4] / The Massachusetts DPU found that ISDN is a "monopoly, basic service that has a potentially far- reaching and significant role in the telecommunications infrastructure of the Commonwealth" and directed NET to deploy ISDN more broadly so that consumers could avail themselves of this then "advanced" technology. *ISDN Basic Service*, Mass. D.P.U. 91-63-B, February 7, 1992, p. 34.

division conducted a comprehensive analysis of voluminous service quality data submitted by NET,[5] and later, on behalf of the Massachusetts Attorney General, I analyzed service quality indices and productivity offsets as part of my analysis of the proposed price cap plan submitted by NYNEX – Massachusetts.[6] I have also addressed service quality in various alternative regulation plans in numerous states including in the context of a general rate case in which CenturyTel of Northwest Arkansas, LLC requested a revenue increase in Arkansas;[7] and in the preparation of a detailed report on service quality and price cap plans on behalf of the Utah Division of Public Utilities.[8]

B. <u>Purpose of Testimony</u>

Q: On whose behalf is this testimony submitted?

A: This testimony is submitted on behalf of the Office of Consumer Advocate ("OCA").

Q: What is the purpose of your testimony at this time?

A: The OCA asked me to analyze the proposed sale by Verizon New England, Inc. ("Verizon New England") of its New Hampshire operations to FairPoint Communications, Inc. ("FairPoint") (collectively, "Joint Petitioners") to assess the impact of the proposed transaction on consumers. The OCA also asked me to consider whether and how the risks of the proposed transaction, if approved, could be mitigated and the probability of consumers benefiting could be increased.

5/ D.P.U. 89-300 (in the context of a traditional rate of return proceeding).

6/ D.P.U. 94-50.

7/ Arkansas Public Service Commission Docket No. 03-041-U.

8 / "Price Cap Plan for USWC: Establishing Appropriate Price and Service Quality Incentives for Utah" (Patricia D. Kravtin, Scott C. Lundquist, and Susan M. Baldwin). Prepared for the Utah Division of Public Utilities, March 22, 2000.

David Brevitz addresses financial aspects of the proposed transaction on behalf of the OCA.

C. Organization of Testimony

Q: Ms. Baldwin, how is your testimony organized?

A: This section introduces my testimony. Section II summarizes the major aspects of the proposed transaction and the Joint Petitioners' testimony. Section III sets forth my understanding of the standards for review of the transaction and Section IV compares the Joint Petitioners' economic incentives with those of consumers. Section V discusses the managerial and operational aspects of the transaction. In Section VI, I discuss pre-transaction and post-transaction service quality issues. In Section VII, I analyze the status of broadband deployment in New Hampshire, analyze broadband as it relates to the proposed transaction, and discuss affirmative recommendations for broadband that I support regardless of whether the transaction occurs. Section VIII analyzes the potential impact of the proposed transaction on FairPoint's rates and service offerings. Sections IX and X discuss directory publishing, and wholesale operations, respectively. Section XI addresses the impact of the proposed transaction on employment and the New Hampshire economy and the implication of the transaction for E-911. Section XII concludes my testimony.

Q. MS. BALDWIN, PLEASE EXPLAIN THE FOUR LEVELS OF REDACTION IN YOUR TESTIMONY.

A: The text and exhibits that are flagged as "confidential" correspond with information that the Joint Petitioners consider "confidential" and which the Joint Petitioners made available only to each other, the Commission Staff ("Staff") and those parties who have signed protective agreements with the Joint Petitioners ,including the OCA and the OCA's consultants. The text that is flagged as "highly confidential" corresponds with information that the Joint Petitioners have designated as either "highly confidential" or "proprietary" and requires, as a result of conditions imposed upon disclosure by the Joint Petitioners during the discovery phase of this docket, three separate levels of redaction The "highly confidential" designation in my testimony denotes a higher level of protection than that afforded the information that I designate as "confidential." "Highly Confidential – Level 1" corresponds to information and documents which the Joint Petitioners made available only to each other, Staff and its consultants, and the OCA and its consultants. "Highly Confidential – Level 2" corresponds to information and documents which the Joint Petitioners made available only to each other, Staff, Scott Rubin, Esq., an attorney for the Labor intervenors, Randall Barber, a consultant to the Labor intervenors, the OCA and the OCA's consultants. "Highly Confidential – Level 3" corresponds to information and documents which the Joint Petitioners made available only to each other, Staff, the OCA and its consultants, and the attorneys for each of the following intervenors: Labor, the electric utilities, and New Hampshire Legal Assistance. In addition to the above-mentioned four confidential/highly-confidential versions of testimony, the OCA is filing a non-redacted, "Public" version of my testimony.

D. <u>Summary of Testimony</u>

Q: Please describe your view of the timing of the Commission's review of the proposed transaction.

A: The Commission's review of the proposed major transaction is premature and has been rushed unreasonably by the Joint Petitioners. Among other things:

- On June 11, July 2, and July 10, 2007 FairPoint filed major amendments to its S-4, which provide new information about analyses and projections of cash flows, prospective merger synergies, and other information that FairPoint had neglected to provide previously in response to data requests.[9]

- The Internal Revenue Service ("IRS") has not yet issued the tax ruling that Verizon Communications ("Verizon") seeks in order to utilize a Reverse Morris Trust, which appears to be the only mechanism which renders the transaction be achievable for FairPoint while still being sufficiently attractive to Verizon shareholders.[10]
- Information that is critically important to the Commission's assessment of the transaction has been filed late in the proceeding, often as a result of protracted follow-up discussions and motions to compel,[11] and, in many important aspects, *after* the completion of technical sessions, which precluded parties' ability to raise technical questions about the recently filed materials during those sessions.[12] For example, Verizon NH did not provide its final cutover plan until June 22, 2007.[13]

[9]/ FairPoint Communications, Inc., Amendment No. 2 to Form S-4 Registration Statement Under the Securities Act of 1933, filed with the United States Securities and Exchange Commission on June 11, 2007 ("Amendment No. 2 to S-4"); FairPoint Communications, Inc., Amendment No. 3 to Form S-4 Registration Statement Under the Securities Act of 1933, filed with the United States Securities and Exchange Commission on July 2, 2007 ("Amendment No. 3 to S-4"); and FairPoint Communications, Inc., Amendment No. 4 to Form S-4 Registration Statement Under the Securities Act of 1933, filed with the United States Securities and Exchange Commission on July 10, 2007 ("Amendment No. 4 to S-4").

[10]/ Smith (Verizon) Direct, at 3; Leach Direct (FairPoint), at 15.

[11]/ In an order issued on June 22, 2007, the Commission granted the OCA's Second Motion to Compel Verizon's Responses to Data Requests (which, the OCA submitted on June 8, 2007, after attempts to resolve the dispute informally did not succeed), and specifically directed Verizon to provide the business plans sought by OCA in OCA 1-5, a request which was originally directed to Verizon NH on April 27. Following the Commission's Order, Verizon and the OCA reached an agreement to resolve this dispute. See Letter from Sarah B. Knowlton to Debra A. Howland, Executive Director and Secretary, N.H. Public Utilities Commission, dated June 29, 2007.

[12]/ For example, FairPoint's first supplemental reply to Staff 2-35 was received on June 12, 2007. This response addresses information originally sought by OCA in OCA II 2-33, the response to which was that FairPoint indicated that: it was "performing the initial assessments to identify the locations for new or expanded broadband service, although that assessment is not complete at this time." Because FairPoint did not file its initial assessment until June 12, 2007, parties were precluded from asking questions about the plan during the technical session. FairPoint stated its intention to further

- Verizon NH's contract with its non-salaried work force, which represents the vast majority of its employees, expires in August 2008.[14] The impact of the contract renewal on employees' decisions regarding continuing employment with SpinCo is unknown, but it potentially could deplete human resources, further jeopardizing consumers.
- The information provided regarding SpinCo employees (both those in the present work force and those that have departed since the Joint Petitioners' announcement of the transaction) spans only the months January 16 through May 31, 2007. As a preliminary recommendation, I urge the Commission, before rendering any final decision in this proceeding (in late 2007 or early 2008), to seek up-to-date information on the composition of the SpinCo work force because of the inherently dynamic nature of this critically important information. The composition of the post-transaction work force directly affects FairPoint's ability to deliver basic telephone service at affordable rates and reasonable service quality, while also making significant investments in broadband roll-out.
- Beginning in May 2007, FairPoint began to receive monthly reports regarding employees assigned to the properties involved in the FairPoint transaction, which suggests that FairPoint's analysis thus far of the SpinCo work force has been superficial and cursory.[15]

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supplement its reply, but had not done so prior to the filing of this testimony.

[13] / Verizon NH's final cutover plan was provided in its supplemental response to OCA FDR GI 1-13 on June 22, 2007, which related to Verizon's response to OCA GI 1-124 (propounded on April 27).

[14]/ "FairPoint Purchase of Verizon ME, NH and Vermont Properties," January 16, 2007, http://ibew2326.com/html/purchase.htm.

[15] / See Exhibit SMB-P-1, Verizon response to OCA FDR V 1-7, which indicates that the reports will include the information contained in Verizon response to Staff FDR 1-1b.

- There has not yet been a regulatory proceeding in which the Commission could determine the appropriate level of compensation that Verizon NH should make to consumers for its late 2006 spin-off of its directory publishing operations.[16] Therefore, this issue must be addressed in this proceeding.
- FairPoint has not yet provided a plan to meet PUC service quality standards, despite the fact that the system it proposes to purchase, under Verizon's ownership, has not met those standards for some time, and those violations are the subject of a pending docket.[17]

Q: Please summarize your major findings and recommendations.

A: My testimony demonstrates that the Commission should deny Verizon NH's proposed sale of its New Hampshire operations to FairPoint. Although serious problems exist with Verizon NH's present operations, acquisition by FairPoint would be yet worse for New Hampshire's consumers. The risks to consumers of FairPoint acquiring Verizon NH's operations are high; the benefits are speculative; the magnitude of the proposed transaction is substantial; the transaction itself would be irreversible; and FairPoint's plans are vague, still evolving, not based on full and complete due diligence, and reliant on a highly leveraged capital structure.

Q: Is there a set of conditions that would render the transaction acceptable, in your view, for the Commission's approval?

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[16] / *See, e.g.*, Exhibit SMB-C-2 Verizon's objection to OCA FDR I 1-20, *see also* Exhibit SMB-P-2, Verizon's objections to OCA FDR I 1-12, 1-21, and 1-22. See also Appeal of Verizon New England, Inc. d/b/a Verizon New Hampshire, 153 N.H. 50 (2005) (affirming PUC order requiring the imputation of at least $23.3 million earned by Verizon's directory affiliate for ratemaking purposes).

[17] / The last activity in DT 04-019, opened on March 19, 2004, was on September 5, 2006 when the Commission issued a letter to Verizon reiterating its intent to issue an RFP to independently evaluate service quality concerns.

A: No. Under the current proposal, I am unaware of any set of conditions that could render the transaction in the public interest.

Q: Does the proposed transaction raise other overarching concerns?

A: Yes. Consumers' interests are being held hostage to this transaction: regulatory attention is being diverted away from pressing issues (such as unacceptable service quality and long-standing pole attachment issues). The Commission has been investigating Verizon NH's service quality for several years now, but its attention and resources have been diverted to the FairPoint transaction. Meanwhile Verizon NH continues to flout the Commission's service quality standards and has fallen woefully behind in poles repairs and replacement while it focuses on selling off its Northern New England operations.

My testimony demonstrates, among other things, that:

- The transaction poses serious risks to consumers, not just financially, but also serious managerial and operational risks (e.g., brain drain, cutover challenges, etc.).
- The transaction has caused regulatory "water-treading" as key consumer issues are held hostage to this investigation.
- FairPoint would like to sweep key issues such as Yellow Pages profits under the rug.
- FairPoint has failed to acquaint itself adequately with the operations it intends to take over.
- "Business as usual" is simply not an acceptable starting point for FairPoint's performance. However, FairPoint appears to lack benchmarks and criteria to even assess whether the SpinCo it inherits will really be maintained at "business as usual" levels – that staffing will remain relatively the same or stable, for example.[18]

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[18] / As stated elsewhere in my testimony, my review of materials submitted in this proceeding indicates that Verizon NH's current staffing levels may not be appropriate as indicated by its inability to meet PUC-established service quality benchmarks and the problems under investigation in the PUC's poles docket (DT 05-172). However, in addition to

- The Joint Petitioners' interests and those of consumers, and the State as a whole, diverge in ways that are critical to the Commission's analysis: Verizon seeks to shed itself of rural areas in order to focus on bundled packages and on its FiOS-based services in more densely populated states, and seeks to do so through a complex tax-free transaction. Although FairPoint asserts that its interests are more closely aligned with New Hampshire consumers than are those of Verizon NH, it has not yet demonstrated its ability and willingness to manage the system to provide public benefits, or even to follow through on promises made in the pre-transaction regulatory context.

Q: If the Commission, contrary to your recommendation, approves the transaction, should conditions apply?

A: Absolutely. As proposed, this transaction poses too many risks to be approved. Although I oppose the transaction, I describe throughout my testimony critical issues that must be addressed, to at least partially offset the risks of this transaction to consumers.[19] If, contrary to my recommendation, the Commission approves the transaction, it should condition such approval on clear, enforceable commitments that I discuss in this testimony.[20] However, it is my position that conditions cannot entirely offset the significant risks that consumers will bear, and will not result in the proposed transaction being in the public interest.

Q: Please summarize the issues that you believe must be addressed.

A: I have prepared a preliminary list of nine major issues areas that must be addressed. Based on

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the problem that Verizon's "business as usual" or status quo staffing and investment levels pose, I am also concerned that FairPoint does not have the resources to determine whether SpinCo will even be in the same state that is was at the time of the merger agreement. I discuss in further detail below why "business as usual" is also not sufficient as a starting point for FairPoint for many other reasons.

[19] / It is my recommendation that many of the measures and conditions that I discuss in this testimony are equally applicable to Verizon NH's operations and that the Commission (or Legislature) should pursue the problems I address and pursue these matters in a separate proceeding with Verizon NH if the transaction is not approved.

[20] / Other witnesses may also identify possible conditions. Until such time as I am aware of these other proposals, however, I cannot comment on their merits.

my continuing review of information recently filed by the Joint Petitioners, and of other parties' testimony, the OCA may seek leave to revise my recommendations further in the future.[21]

1. Service quality/infrastructure investment

Principle/Concern: Competitive forces do not yet discipline the rates or quality of basic telephone service. Verizon NH and FairPoint, in the course of this proceeding, have referred to the failure of Verizon NH to meet service quality standards and the apparent ongoing "debate" regarding the applicability of the PUC's service quality standards to Verizon NH's operations.[22] Verizon NH's overall service quality has been deteriorating for many years, and FairPoint has made no commitments to improve it.[23] If Joint Petitioners obtain approval for the transaction, consumers must be assured that service quality problems will be addressed.

- Verizon NH should not be permitted to transfer its local operations until the proposal includes a detailed plan with a time table, budget, and sanctions for non-compliance to ensure that (1) PUC-established service quality standards are met or exceeded upon transfer; and (2) service quality is raised in those communities that are receiving sub-par service quality.

- FairPoint should agree to financial consequences, including penalties and/or automatic customer credits, if PUC-established service quality benchmarks are not met.

- FairPoint should make service quality information and reports available to the public (i.e., not filed confidentially) as is the case for the ILECs in Vermont and Maine.[24] Also,

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21/ Many of the following preliminary suggested conditions should be pursued by the Commission (including seeking any required change in law with the Legislature) *regardless* of whether the transaction occurs.

22/ Harrington (FairPoint) Direct, at 15.

23 / See Section VI and Exhibit SMB-3-P, Service Quality Metrics for Verizon New Hampshire 1996-2006, in which I analyze public information regarding Verizon's service quality. See, also, *Verizon's Quality of Service Performance*, New Hampshire Public Utilities Commission DT 04-019, *Order Establishing Status Conference*, Order No. 24,551, December 1, 2005 ("Order No. 24,551") and *Report on Initial Analysis for the Staff of the New Hampshire Public Utilities Commission*, by Curry & Associates, Docket No. 04-019, February 4, 2005 ("Curry Report").

24 / See, http://www.maine.gov/cgi-bin/mpuc/scorecard.pl; In Vermont, a consumer can obtain service quality

FairPoint should file service quality reports, on a monthly basis and in a web-based format which can be made available directly to consumers on the PUC website.

2. Broadband deployment/practices[25]

Principle/Concern: Access to advanced telecommunication services is essential so that New Hampshire households and businesses can participate in economic, medical, educational, and other societal activities. However, approximately four in ten of New Hampshire's households do not have the option to subscribe to digital subscriber line ("DSL") service.[26]

- New Hampshire consumers should have access to affordable retail DSL service. The cost of the local loop, which provides the platform for DSL, is already recovered through intrastate and interstate regulated rates that consumers pay. DSL "rides over" this network and therefore, if the broadband market were competitive, the rates for DSL would be aligned closely with the incremental cost of adding DSL capability. Therefore, FairPoint should commit to offering DSL at rates that are aligned closely with the incremental cost of adding DSL capability.

- FairPoint should offer unbundled (stand-alone) DSL so that consumers can obtain access to DSL without subscribing to the Incumbent Local Exchange Carrier's ("ILEC's") voice service. The rates for unbundled DSL should be less than that for "bundled" DSL/voice.

- FairPoint should establish specific broadband deployment dates and locations, with clearly delineated plans that set forth not only when and where broadband *will* be deployed but also where it *will not* be deployed so that consumers' expectations are not unnecessarily raised and so that policy makers and industry know where alternative technologies such as WiFi may be necessary.

- FairPoint should make funds available to deploy alternative technology to serve underserved or unserved regions of New Hampshire.

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data by calling the Department of Public Service.

[25]/ I discuss the PUC's limited authority regarding broadband deployment in Section VII of my testimony.

[26] / The FCC's most recent high-speed services report indicates that as of June 30, 2006, 59% of all end-user premises in New Hampshire where ILECs (not just Verizon NH) offered telephone service had xDSL services available to them. FCC, Industry Analysis and Technology Division, Wireline Competition Bureau, *High-Speed Services for Internet Access: Status as of June 30, 2006*, rel. January 2007, at Table 14.

- FairPoint should agree to not oppose municipalities' wireless broadband efforts to improve the chances of unserved areas gaining broadband access.

- FairPoint should agree to provide comprehensive, clear and frequent customer education (and customer service representative education) about the deployment, pricing, rates, terms, conditions, and availability of unbundled DSL and stand-alone service.

- FairPoint should make broadband deployment data public and should regularly provide it, at a minimum, to the Governor's office, the PUC, the Telecommunications Advisory Board, and to the OCA to assist policy makers in designing and implementing broadband policy tailored to the specific needs of New Hampshire.

- FairPoint should commit to abide by the net neutrality commitment as set forth in the FCC's set of conditions that apply to AT&T, as a result of its acquisition of BellSouth.

- Verizon NH should provide an across-the-board credit to customers for its spin off of its directory operations of at least $200 million, and should fund a broadband program that would provide for reduced broadband rates for Lifeline customers and broadband deployment in unserved areas.[27]

3. Rate Design/Tariffs

Principle/Concern: ILECs' interest in selling telecommunications "packages" and discretionary features should not create pressure on consumers to purchase features they do not want. In addition, FairPoint should not be allowed to discontinue or grandfather basic "barebones" local service.[28]

- Because many customers do not subscribe to bundled packages and many consumers order "barebones" basic local exchange service,[29] FairPoint should commit to offer unbundled (i.e., a la carte or stand alone) basic local exchange service indefinitely, or at

[27]/ See Section IX for a discussion of the basis for this recommended condition.

[28] / To grandfather a service would be to provide the service under a "grandfather clause" or a "clause creating an exemption based on circumstances previously existing." See Merriam-Webster Dictionary Online, www.m-w.com. To grandfather a service generally means to allow current customers of the service to continue to use the service but no longer offer the service to new customers.

[29] / See confidential Exhibit SMB-C-4, December 2006 Snapshot of Verizon NH basic customers.

the very least, until the Commission makes an affirmative finding that such a requirement is no longer in the public interest. Furthermore, the availability of such service should be well-publicized and well-explained to customers by customer service representatives.

- FairPoint should agree that its marketing scripts and customer education for bundled packages, discretionary features, and inside wiring maintenance are subject to Commission review and approval, to ensure that consumers make informed decisions.

- FairPoint should commit to cap basic local exchange service rates at present rates for at least five years.

- FairPoint should commit to participate in efforts to increase Lifeline participation.

4. Yellow pages compensation

Principle/Concern: Consumers are entitled to a fair share of the proceeds associated with Verizon's spin-off in 2006 of its directory publishing operations. As years pass, particularly if the proposed transaction is approved, regulators' ability to obtain that fair share may fade.

- The NH Supreme Court decision, affirming a PUC order requiring Verizon NH to impute for ratemaking purposes at least $23.3 million annually earned by a Verizon directory affiliate, pre-dates the 2006 spin-off.[30] Therefore, Verizon NH should agree to provide consumers with a one-time customer credit relating to Verizon's spin-off of its directory publishing.

- Based on the present value of the annual $23.3 million imputation consumers are entitled to per-line credits of at least $340, and on an aggregate basis are entitled to at least $200 million as a result of the spin-off.[31]

5. Transaction costs (legal, overhead, branding, regulatory, financial fees, etc.)

Principle/Concern: Consumers should not bear the costs associated with developing or

[30]/ Appeal of Verizon New England, Inc. d/b/a Verizon New Hampshire, 153 N.H. 50 (2005). The PUC's order arose in a case concerning Verizon's change to its directory publishing agreement with its affiliate, which eliminated the directory company's requirement to pay any fees to or to share revenues from directory advertising sales with Verizon. Id.

[31]/ See Section IX for discussion.

implementing the proposed transaction.

- FairPoint should commit to refraining from seeking recovery of any transaction, regulatory, branding, integration, legal, and other transaction-related expenses from consumers.

- FairPoint should commit to maintain separate books to create an accounting trail for transaction-related expenses, and should provide a report of such expenses within six months and 18 months of closing.

6. Wholesale Issues

Principle/Concern: Taking over Verizon NH's wholesale operations is a complex, resource-intensive endeavor.

- The Commission should consider carefully FairPoint's ability to take over wholesale operations.

7. E-911

Principle/Concern: The state's E-911 system is of utmost importance to the public safety and well-being of its citizens. At the same time, accountability for the cost of running an efficient operation is important so that citizens and consumers do not pay excessive charges for E-911.

- The PUC should assess FairPoint's ability to operate and provision E911. In doing so, it may be prudent for the Commission to seek input from the E911 Emergency Bureau.[32]

8. Employment and Economy

Principle/Concern: The state of New Hampshire's telecommunications infrastructure and the quality of local service bear directly on its economy. Furthermore, any new positions should be distributed fairly throughout New Hampshire, Maine and Vermont.

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

- FairPoint should commit to work with policy makers to ensure that all regions of the state have access to advanced telecommunications services, because such access directly affects the economy of the state.

9. Consequences

Principle/Concern: Transaction-related promises are meaningless without accountability and adequate economic incentives.

- Ensuring follow-through on commitments after approval is inherently difficult and places the burden on regulators. Therefore, to the greatest extent possible, commitments should be fulfilled *before* the transaction occurs.

- Regarding post-transaction commitments, at a minimum FairPoint should submit a monthly report to the PUC and to the OCA regarding progress met, and there should be an enforcement mechanism in the event that commitments are not met.

E. Many issues in this proceeding merit Commission attention regardless of the outcome of this proceeding.

Q: Are many of the concerns and conditions that you recommend relevant regardless of the outcome of this transaction?

A: Yes. Many of the issues that my proposed conditions address exist regardless of the outcome of this proceeding. However, they are relevant to this proceeding because the transaction heightens the significance of these issues. For example, if FairPoint acquires Verizon NH's operations, its management and key resources will be focused on the transaction, leaving few resources for improving service quality, dealing with a backlog in pole removals and replacements, increasing Lifeline participation, etc.[33] FairPoint is essentially stepping into Verizon NH's shoes if the

[33] / If, however, the Commission denies the transaction, it should nonetheless address these issues in a timely manner, and where legislative initiatives are necessary, they should be pursued so that consumers have access to advanced telecommunications services and basic local telephone service at reasonable rates, installed and repaired in a timely manner.

transaction is approved and where problems already exist, FairPoint will inherit those problems and the Commission should ensure that those problems can and will be addressed by FairPoint in a satisfactory manner.

F. <u>The fact that the "starting point" for FairPoint's operation of Verizon NH's intrastate regulated business is unacceptable further complicates an already complex proceeding.</u>

Q: Ms. Baldwin, does this proceeding simply address a matter of the ownership and management of operations changing hands?

A: No. There is nothing simple about this proceeding. Although the Joint Petitioners seek to limit the scope of the proceeding, it would be a gross understatement to characterize the transaction as a simple matter of a change of hands of those holding the reins of the operations. The transaction is complicated because Verizon NH's present operations are unacceptable, and, therefore the "starting point" for FairPoint's entry under "business as usual" into New Hampshire would be unacceptable. The question of how and whether FairPoint would be able and willing to do what Verizon NH has failed to do is a strong undercurrent of the proceeding.

I do not doubt Verizon's[34] ability to improve the quality of its New Hampshire operations, but I simply doubt that the existing economic incentives would cause Verizon, left to its own, to improve the quality of its operations. It lacks not the expertise, but the willingness. By contrast, FairPoint professes to have the willingness to serve New Hampshire consumers, but its expertise is uncertain, and the risk of the highly-leveraged company being unable to provide service at affordable rates and reasonable service quality levels is high. The Commission faces a difficult

[34] / I refer here to all levels of the corporation, i.e. Verizon Communications, Verizon New England, and Verizon New Hampshire.

choice: a company that can, but does not want to serve the State, or a company that purports to want to serve the state but that has not demonstrated its ability to do so in a way that protects consumers' interests adequately and results in public benefits.

Q: In summary, Ms. Baldwin, are you recommending that the Commission approve the transaction conditioned on the commitments that you describe?

A: No. I urge the Commission to reject the transaction as proposed. As I stated at the outset, I am not aware of a set of conditions that could render the proposed transaction acceptable.

II. OVERVIEW OF PROPOSED TRANSACTION

A. <u>Verizon New England/FairPoint Agreement and Plan of Merger</u>

Q: Please describe generally your understanding of the origin of this proceeding.

A: Verizon New England and FairPoint entered into an Agreement and Plan of Merger on January 15, 2007,[35] whereby, upon completion of the transaction, the Verizon New England companies operating in Vermont, New Hampshire, and Maine would be subsidiaries of FairPoint. Verizon stockholders would own approximately 60% of FairPoint, and current FairPoint stockholders would own about 40% of the merged company.[36] Current FairPoint management would control day-to-day operations following consummation of the transaction, but Verizon would "designate up to six of the nine initial directors of FairPoint upon completion of the merger."[37]

On January 31, 2007, Verizon New England and FairPoint filed a Joint Petition seeking the PUC's approval of the proposed transaction.[38] In general, the Joint Petition seeks approval from the PUC for the transfer of Verizon New England's local exchange business and long distance business in New Hampshire to companies owned by FairPoint.[39]

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[35] / *Verizon New England Inc., Bell Atlantic Communications, Inc., NYNEX Long Distance Co., and Verizon Select Services, Inc. and FairPoint Communications, Inc.,* New Hampshire Public Utilities Commission Docket No. 07-011, Joint Application for Approval of the Transfer of Certain Assets by Verizon New England Inc., Bell Atlantic Communications, Inc., NYNEX Long Distance Co., and Verizon Select Services, Inc. and Associated Transactions, January 31, 2007 ("Joint Petition"), at 5.

[36] / "Verizon and FairPoint Agree to Merge Verizon's Wireline Businesses in Maine, New Hampshire and Vermont with Current Operations of FairPoint," joint press release of FairPoint Communications and Verizon Communications, January 16, 2007 ("Joint Press Release"), at 3-4, available at http://puc.nh.gov/Telecom/VerizonSaleToFairpoint.htm#CompanyInfo .

[37] / Joint Petition, at 7. None of the nominees can be employees of Verizon Communications, its affiliates, or Verizon Wireless or a Verizon Wireless subsidiary. *Id.*

[38] / *Id.*

[39] / *Id.*, at 2. Specifically, the Joint Petitioners seek the following approvals and authorizations from the PUC:

- The transfer of the assets, business and franchise held by Verizon New England with respect to the provision of local exchange and intrastate toll service in New Hampshire to Northern New England Telephone Operations Inc. ("Telco")

Q: Would Verizon New England transfer all of its assets to FairPoint?

A: No. The assets and liabilities that would transfer to FairPoint include those of several but not all Verizon affiliates currently operating in New Hampshire. In accordance with the Distribution Agreement, the transferred business would include all of the incumbent local exchange carrier business activities and operations of Verizon New England and its affiliates, including local exchange service; intraLATA toll service; network access service; enhanced voice and data services; DSL services and wholesale services.[40] In addition, the following activities would also be transferred:

- Consumer and small business switched and dedicated long distance service to customers located in the three states;
- Large business switched and dedicated long distance service to VSSI customers in the three states;
- Delivery of dial-up, DSL and fiber to the premises data and dedicated Internet access services by Verizon Internet Services Inc. to customers located in the three states;
- Customer premises equipment sales, and installation and maintenance services currently provided by VSSI to customers in the three states; and
- Private line services to customers currently served by VSSI provided the line originates and terminates in the three-state territory.[41]

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pursuant to RSA 374:30;

- The transfer of certain assets and intrastate interexchange telecommunications business and customer account of Bell Atlantic Communications, Inc. ("BACI"), NYNEX Long Distance and Verizon Select Services, Inc. ("VSSI") to Enhanced Communications of Northern New England Inc. ("Newco") pursuant to RSA 374:30;
- Authorization of Telco to begin business as a local exchange and intrastate toll service provider within the areas of New Hampshire currently served by Verizon New England, pursuant to RSA 374:26;
- Authorization of Newco to provide intrastate toll services within New Hampshire pursuant to RSA 374:26;
- Authorization for Verizon New England to discontinue service as a public utility in New Hampshire upon the merger pursuant to 374:28;
- The designation of Telco as an eligible telecommunications carrier for the areas of New Hampshire currently served by Verizon New England pursuant to 47 U.S.C. §254(e) and §214(e)(2); and
- Authorization of Verizon New England to relinquish its ETC designation upon the merger,

Id., at 3-4.

[40] / *Id.*, Exhibit 2: Distribution Agreement by and between Verizon Communications Inc. and Northern New England Spinco Inc. dated as of January 15, 2007 ("Distribution Agreement"), at 11. See also, Smith Direct (Verizon), at 7-8.

[41] / Joint Petition, Exhibit 2: Distribution Agreement, at 11-12. According to the January 16, 2007 Joint Press Release : "The transaction includes Verizon's switched and special access lines in the three states, as well as its Internet service, enterprise voice CPE (customer premises equipment) accounts, and long-distance voice and private line customer

The transaction does not include the services, offerings or assets of Verizon Wireless, Verizon Business (former MCI), Federal Network Systems LLC, Verizon Network Integration Corp., Verizon Global Networks Inc., Verizon Federal Inc. or any other Verizon businesses in New Hampshire, Maine or Vermont.[42] The services provided by those companies include the following:

- Wireless voice, data and other services provided by Verizon wireless and air-to-ground or rail-to-ground services offered by Verizon Airfone;
- Publishing and printing both print and electronic directories;
- Monitoring, installation, maintenance and repair of data customer premises equipment and software, structured cabling, call center solution and professional services provided by Verizon Network Integration Corp.;
- Multi-dwelling unit voice, data and video services provided by Verizon Avenue Corp.;
- Wireless services, customer premises equipment, inside wiring and cabling, and consulting services to or for federal agencies provided by Federal Network Systems LLC, and customer premises inside wiring, cabling, and consulting services to or for federal agencies offered by Verizon Federal Inc.;
- Interstate, intrastate and local exchange services offered by Verizon or its Affiliates (other than the contributing companies listed above) consisting primarily of the successors to the business of MCI, Inc.;
- Services provided generally by Verizon Business Global LLC f/k/a MCI, LLC or direct and indirect subsidiaries of Verizon Business Global, LLC;
- Consumer and small business customer premises equipment ("CPE") services (including DSL modem and router fulfillment) provided by Verizon TeleProducts;
- Long haul switching, routing and transmission and other carrier services provided by Verizon Global Networks Inc.;
- Prepaid card products, payphone dial around services and dedicated Internet access services provided by VSSI; and
- Verizon Voice over Internet Protocol ("VoIP") services generally provided by Verizon d/b/a/ Verizon Long Distance and NYNEX Long Distance.[43]

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accounts (for customer private lines with beginning and ending points within the three states) that Verizon served in the region *before the 2006 merger with MCI, Inc.*" (emphasis added). See, also, Smith Direct (Verizon), at 7-8.

[42] / Joint Press Release, at 4-5. See also, Joint Petition, Exhibit 2: Distribution Agreement, at 12-13; Smith (Verizon) Direct, at 10-11.

[43] / Joint Petition, Exhibit 2: Distribution Agreement, at 12-13. See also, Smith (Verizon) Direct, at 8, 10-11.

Q. What are the implications of the fact that the proposed transaction includes less than all of the assets and services of Verizon affiliates operating in New Hampshire?

A. Clearly, the presence of Verizon as a post-transaction competitor to FairPoint will affect FairPoint's ability to generate revenues.

B. <u>Overview of transaction</u>

Q: Please provide a brief overview of your understanding of the transaction.

A: The transaction is structured to ensure that the spin-off is tax-free for Verizon.[44] Verizon New England would transfer its assets, liabilities, and customer relationships related to local exchange, intrastate toll and exchange access services in New Hampshire, Maine and Vermont to Telco, a wholly-owned subsidiary of Verizon New England. Several other Verizon companies[45] would transfer accounts receivable and customer accounts associated with long-distance, internet services and certain CPE maintenance operations in New Hampshire, Maine and Vermont to Newco, a wholly-owned subsidiary of Spinco, itself a newly formed, wholly-owned, direct subsidiary of Verizon. Verizon New England would then transfer the stock in Telco to Spinco through several transfers resulting in Telco becoming a direct, wholly-owned subsidiary of Spinco. Verizon would distribute the stock of Spinco directly to its stockholders therefore resulting in Spinco (and thus Telco and Newco) no longer being a subsidiary of Verizon. Spinco would immediately thereafter be merged with and into FairPoint with FairPoint being the surviving company and owning all of the stock of Telco and Newco.[46] Current Verizon common stockholders would be issued a number of shares of FairPoint common stock equal to the number

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[44] / Smith (Verizon) Direct, at 3.

[45] / These Verizon companies include NYNEX Long Distance Company, Verizon Select Services, Inc., and Bell Atlantic Communications, Verizon Internet Services Inc. and GTE.net LLC. Smith (Verizon) Direct, at 7. See also, Joint Petition, at Exhibit 4: Description of the Proposed Transaction.

[46] / Smith (Verizon) Direct, at 3-4; see, also, Joint Petition, at Exhibit 4: Description of the Proposed Transaction.

of share of FairPoint common stock outstanding on the day of the merger multiplied by 1.5266 such that Verizon shareholders would own 60% of FairPoint and current FairPoint shareholders would own 40% of FairPoint post-merger.[47]

FairPoint has secured $2.08-billion in financing for the merger from a group of lenders including Lehman Brother Inc., Morgan Stanley and Bank of America.[48] The combined company would incur $1.7-billion in additional debt as a result of the merger and FairPoint estimates that it would have approximately $2.3-billion in debt immediately following the merger.[49]

Q: What approvals do the Petitioners require in order to finalize the transaction?

A: FairPoint indicates that it requires approval of the Vermont Public Service Board, Maine Public Utilities Commission and the Illinois Commerce Commission.[50] It is my understanding that the deal will not occur if any of the state regulators in the three northern New England states deny the transaction.[51]

The companies also require approval to transfer FCC authorizations from Verizon to FairPoint, and the companies filed an application for such approval with the FCC on January 31, 2007.[52]

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47 / FairPoint Communications Inc., Amendment No. 1 to Form S-4 Registration Statement Under the Securities Act of 1933, filed with the United States Securities and Exchange Commission on May 25, 2007 ("Amendment No. 1 to S-4"), at 80.

48 / Smith (Verizon) Direct, at 13.

49 / Amendment No. 1 to Form S-4, at 5.

50 / See Exhibit SMB-P-5, FairPoint response to OCA GI 1-3.

51 / See, e.g., Amendment No. 4 to S-4, at 92-93.

52 / *Application of Verizon New England, Inc., NYNEX Long Distance Company, Bell Atlantic Communications, Inc., Verizon Select Services, Inc., Verizon Select Services Inc., Verizon Communications Inc., and Northern New England Spinco Inc., Transferors, and FairPoint Communications, Inc., Transferee, For Consent to Transfer Certain Assets and Long-Distance Customer Relationships in the States of Maine, New Hampshire, and Vermont,* FCC WC 07-22, Consolidated Application for Consent to Transfer Assets, January 31, 2007 ("FCC Application"). The FCC released a Notice of March 14, 2007, setting the pleading schedule for the case. The FCC is currently reviewing the Application. The 180-day review period that the FCC has set as a goal to review and issue and order in merger proceedings suggests that the FCC will issue a decision by mid to late September. Parties filed comments/petitions to deny on April 27, 2007; responses/oppositions May 7, 2007; and replies May 14, 2007.

Additionally, the merger cannot be completed until notifications have been given to the Federal Trade Commission ("FTC") and the Antitrust Division of the Department of Justice ("DOJ") under the Hart-Scott-Rodino ("HSR") Act, and a waiting period has elapsed. Early termination was granted effective April 11, 2007 from the Antitrust Division of the DOJ. The FTC and DOJ, however, could still seek to enjoin the completion of the spin-off or merger at any time.[53]

The transaction also requires FairPoint shareholder approval. Shareholders will vote on the transaction at the FairPoint stockholder annual meeting scheduled for August 22, 2007.[54] Approval by Verizon's shareholders is not required.[55]

C. Overview of Joint Petitioners' pre-transaction and proposed post-transaction operations

Q: Please briefly describe FairPoint and its operations.

A: FairPoint is a publicly traded[56] Delaware company and its principal office is located in Charlotte, North Carolina.[57] Joint Petitioners describe FairPoint as an "experienced and respected provider of telecommunications services to rural and small urban areas, with a particular emphasis on the provision of broadband services.[58] FairPoint was incorporated in 1991 and owns thirty-one local

[53] / Amendment No. 1 to S-4, at 71.

[54] / Shareholders will vote on the transaction at FairPoint's Annual Shareholder Meeting on August 22, 2007. FairPoint Communications, Inc. *See* Form 424B3 filed with the United States Securities and Exchange Commission on July 19, 2007.

[55] / Amendment No. 1 to S-4, at 4.

[56] / As of September 30, 2006, Thomas H. Lee Equity Fund IV, L.P. and its affiliates owned 11.58% of equity in FairPoint and Wellington Management Company, L.L.P. and its affiliates owned 10.82% of equity in FairPoint. However, following the transaction, no single individual or entity is expected to own 10% or more equity in the company. FCC Application, at 8-9.

[57] / *Id.*, at 9.

[58] / *Id.*, at 17.

exchange companies in eighteen states (serving a total of 308,000 access line equivalents).[59] According to the company, FairPoint was incorporated "for the purpose of acquiring and operating incumbent telephone companies in rural and small urban markets."[60] Since 1991, FairPoint has acquired thirty-five telephone companies of which it continues to operate thirty-one.[61] Most of FairPoint's companies qualify for rural carrier status under the Telecommunications Act of 1996[62] and most of the communities served by FairPoint have fewer than 2,500 access lines.[63] FairPoint is the 14th largest telephone company in the United States based on access line equivalents as of March 31, 2007.[64]

Q: Please briefly describe Verizon New England and its northern New England operations.

A: Verizon New England is a direct, wholly owned subsidiary of NYNEX Corporation, which is a direct, wholly-owned subsidiary of Verizon.[65] NYNEX is a Delaware holding company located in New York City, and Verizon New England is a New York State company with its principal office in Boston, Massachusetts.[66] Verizon, a Delaware company with principal offices in New York, New York, is a publicly-traded company and no individual or person owns 10% or more

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59 / *Id.*; Joint Petition, at 11.

60 / Amendment No. 1 to S-4, at 11.

61 / *Id.*

62 / 47 U.S.C.A. §§ 151 *et seq.*

63 / Amendment No. 1 to S-4, at 11.

64 / *Id.*

65/ References to "Verizon" in this testimony refer to Verizon Communications.

66 / FCC Application, at 6. In addition, the other contributing companies to Newco and Spinco included: NYNEX Long Distance, which is a direct, wholly-owned subsidiary of Bell Atlantic Worldwide Service Group, Inc. which is a direct, wholly-owned subsidiary of NYNEX Corporation; BACI, which is a direct, wholly-owned subsidiary of Verizon; VSSI, which is a wholly-owned subsidiary of GTE Corporation, which is 92% directly owned by Verizon, the remainder of GTE is indirectly owned by Verizon. *Id.*, at 6-7.

of equity in Verizon. Verizon is a holding company that owns operating subsidiaries providing telecommunications services worldwide.[67] Verizon provides, through its subsidiaries, local telephone service, nationwide long-distance, broadband, video, high-capacity services, and other services and owns and operates communications networks worldwide. Additionally, Verizon is the majority owner of Cellco Partnership d/b/a Verizon Wireless.[68]

Q: Please describe the proposed merged entity.

A: FairPoint's proposed acquisition of Verizon New England's assets in Vermont, New Hampshire, and Maine would increase FairPoint's size dramatically. According to a FairPoint presentation to analysts when the merger was announced, the merger would increase FairPoint's total access line equivalents from 308,858 to 2,022,109.[69] FairPoint's residential voices lines would grow from 194,002 to 1,176,955; business voice lines would increase from 57,761 to 451,368; and FairPoint's base of high speed data subscribers would grow from 57,095 to 234,064.[70] In addition, FairPoint would acquire 159,722 wholesale access lines.[71] According to Verizon, as of September 30, 2006, it served approximately 1.5 million access lines, 180,000 DSL lines, and 600,000 long distance customers in Vermont, New Hampshire, and Maine.[72] The combined company would be the eighth largest telephone company in the United States based on access

[67] / *Id.*, at 7.

[68] / *Id.*, at 7-8.

[69]/ Investor Presentation, FairPoint Communications, Inc., January 16, 2007, at page 15 (Data as of September 30, 2006), provided as Exhibit 99.3 to FairPoint Communications Inc. Form 8-K filed with the SEC on January 16, 2007.

[70]/ *Id.*

[71] / *Id.*

[72] / Joint Press Release, at 2.

lines as of March 31, 2007.[73] Table 1 below shows the selected historical combined financial data provided by FairPoint in its Form S-4 SEC filing.

Table 1

Selected Financial Data as of December 31, 2006[74]

(dollars in millions)

	Verizon Northern New England	FairPoint	Combined Company
Operating revenue	$1,193	$270	$1459
Net Income	$32	$31	$35
Capital Expenditures	$214	$32	n/a
Access line equivalents	1,694,693	311,150	2,006,000
Residential Access Lines	1,035,515	194,119	n/a
Business Access Lines	471,129	57,587	n/a
High Speed Data subscribers	188,049	59,444	n/a

Q: Please describe FairPoint's current operations in the three northern New England states.

A: FairPoint provides approximately 64,000 access lines in New Hampshire, Maine, and Vermont.[75] FairPoint currently provides local exchange service in East Conway and Chatham, New Hampshire as well as portions of Maine and Vermont through its subsidiaries.[76] Specifically, FairPoint owns Northland Telephone Company of Maine which provides service to

[73] / Amendment No.1 to S-4, at 11.

[74] / *Id.*, at 15-19. Items denoted as n/a in the table are not provided as part of the unaudited pro forma condensed combined financial data in the S-4.

[75] / FCC Application, at 18.

[76] / *Order of Notice*, DT 07-011, February 7, 2007, at 2.

customers in the East Conway and Chatham wire centers in New Hampshire.[77] As of December 2006, Northland Telephone Company served a total of 18 business access lines and 135 residential access lines in the East Conway exchange and 22 business access lines and 209 residential access lines in the Chatham exchange.[78] FairPoint provides telecommunications services in Maine through the following companies: Community Service Telephone Company; China Telephone Company; Maine Telephone Company; Northland Telephone Company; Sidney Telephone Company; and Standish Telephone Company.[79] FairPoint provides telecommunications services in Vermont as Northland Telephone Company of Vermont.[80] The following table provides line counts for the FairPoint operating companies in New Hampshire, Maine and Vermont.

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[77] / Joint Petition, at 5. .

[78] / Annual Report of Northland Telephone Company of Maine, filed with the State of New Hampshire Public Utilities Commission, Concord, New Hampshire, for the year ended December 31, 2006 (available at http://www.puc.state.nh.us/Telecom/ilecannualreports.htm).

[79] / Joint Petition, at footnote 1.

[80] / *Id.*

Table 2[81]

Total Number of Lines Served by FairPoint in New Hampshire, Maine and Vermont

(as of December 2006)

<<<BEGIN CONFIDENTIAL

Company	Total lines

>>>END CONFIDENTIAL

Q: What percentage of Verizon New England's northern lines are in New Hampshire?

A: Table 3 below shows that 40% of Verizon New England's northern lines are located in New Hampshire, 38% in Maine, and 22% in Vermont.

[81] / See Exhibit SMB-P-6 (New Hampshire data only), FairPoint response to OCA GII 2-5(b), and Exhibit SMB-C-6, Attachment CFPNH 0264 for Vermont line data, Attachment CFPNH 0275 for New Hampshire, and CFPNH 0368-0373 for Maine.

Table 3[82]

Total Number of Access Lines Served by Verizon New England in New Hampshire, Maine and Vermont (year end 2006)

	NH	ME	VT
Single Line Business Access Lines	18,383	16,153	8,948
Multi-Line Business Access Lines	124,087	108,754	73,215
Residence Lifeline Access Lines	5,621	53,192	19,654
Residence Non-Lifeline Access Lines	382,251	316,757	191,206
Access Lines Subject To A Special Access Surcharge	461	341	965
Total Billable Access Lines	530,803	495,197	293,988
Percentage of total billable access lines served by Verizon NE	40%	38%	22%

Q: Please describe Verizon NH's operations.

A: For more than one hundred years, Verizon NH (and its predecessors) has been New Hampshire's largest local telephone company. Verizon NH serves approximately 390,000 residential lines and approximately 130,000 business lines[83] in 117 exchanges and 125 wire centers in New Hampshire.[84] The terrain that Verizon NH's telecommunications infrastructure covers

[82] / FCC Report 43-01. ARMIS Annual Summary Report. Table II. Data accessed June 19, 2007.

[83] / FCC Report 43-01. ARMIS Annual Summary Report. Table II. Data accessed June 19, 2007. See also confidential Exhibit SMB-C-7, Verizon NH's confidential supplemental reply (and attachment) to OCA GII 1-58S(a) (providing an estimate of the quantities of households in 2006 by wire center).

[84]/ See Exhibit SMB-P-8, Verizon NH response to OCA FDR II 1-7.

encompasses diverse geographic and socioeconomic regions, including the more densely populated southern part of the state and the more rural North Country. Verizon NH's intrastate regulated revenues in 2006 were approximately **<<<BEGIN CONFIDENTIAL END CONFIDENTIAL>>>**[85]

Q: How is Verizon NH regulated in each of the three northern New England states?

A: Verizon NH is regulated under rate-of-return regulation.[86] In Vermont, Verizon is subject to an alternative form of regulation.[87] In Maine, a new AFOR is being considered.[88]

D. Impacts of transaction on Verizon NH's consumers and employees

Q: Please describe the transaction's impact on consumers as described by the Joint Petitioners.

A: The Joint Petitioners assert that the transfer "will result in no net harm and will promote the public good"[89] and that FairPoint will not seek to recover transaction costs or any acquisition premium associated with the transaction through consumer rates.[90] They also assert that the

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[85]/ See Exhibit SMB-C-9, Verizon NH confidential response to OCA FDR I 1-15a (2006 earnings statement, submitted to the PUC).

[86]/ In re New England Tel. & Tel. Co., 83 NH PUC 116 (1998)(revenue reduced by $26 million); In re Verizon New Hampshire, 89 NH PUC 17 (2004)(established cost of capital of 8.2%).

[87] / Vermont Public Service Board Docket No. 6959, *Investigation into a Successor Incentive Regulation Plan for Verizon New England Inc*., d/b/a Verizon Vermont, September 26, 2005. The Order Adopting Amended Plan of April 27, 2006 ("Amended Plan") modified the settlement. Section VIII of my testimony discusses Vermont further.

[88] / Maine Public Utilities Commission Docket No. 2005-155, Investigation into New Alternative Form of Regulation for Verizon Maine Pursuant to 35-A M.R.S.A. Sections 9102-9103, Examiner's Report (Revenue Requirement and Service Quality Issues), May 9, 2007. I discuss Maine further in Section VIII.

[89] / Joint Petition, at 2. The standard for approval of the merger, which I discuss further in Section III, is public good or public interest.

[90] / *Id.*, at 10.

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transaction "will have no adverse effect on the services"[91] provided to New Hampshire consumers, and that the new company would file new tariff pages "appropriate to accomplish the adoption of the rates, terms and conditions in the tariffs under which the Verizon companies have been providing regulated telecommunications services in New Hampshire, and customers will continue receiving the same services as they were receiving before the Merger."[92] In addition to promising to maintain the rates and services offered by Verizon,[93] the Petitioners have entered into a Transition Services Agreement (TSA) under which a Verizon affiliate would provide back office services immediately following the merger for a period of time.[94]

Q: What reason does Verizon provide for selling its business in New Hampshire?

A: Mr. Smith, Vice President of Business Development for the Domestic Telecommunications Group of Verizon, states that the transaction provides "a fair value for this property to Verizon's shareowners and allows Verizon to focus more intently on its operations in other markets."[95] Mr. Smith asserts that the transaction will be good for customers as FairPoint specializes in serving midsize and smaller markets and "will focus on northern New England as a core market."[96]

Q: What benefits do the Joint Petitioners assert will result from the transaction?

A: Joint Petitioners assert several benefits of the transaction, including: increased broadband penetration; improved customer service; local focus; new investment; and new employment

[91] / *Id.*, at 2.

[92] / *Id.*, at 8.

[93] / In Section VIII of my testimony I discuss FairPoint's intention to maintain rates. I discuss FairPoint's intentions regarding services in Section VI.

[94] / Joint Petition, at 12.

[95] / Smith (Verizon) Direct, at 2.

[96] / *Id.*, at 3.

opportunities.[97] The Joint Petitioners assert that FairPoint's experience serving rural and small urban areas and its "strong knowledge of consumers' needs with substantial experience in meeting them" will enable FairPoint to provide "high-quality services, including innovative broadband services" in the three-state region.[98] FairPoint contends that, following the merger, it will increase employment and investment in Vermont, New Hampshire, and Maine.[99] Joint Petitioners assert that FairPoint will "increase broadband availability significantly"[100] within the three-state region within 12 months of merger completion. FairPoint indicates that it will establish three local service centers in New England (an Information Systems Center, an Administrative Center, and a Network Operations Center).[101]

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[97] / Joint Petition, at 3.

[98] / *Id.*, at 11.

[99] / As part of a press release, the companies stated:

> Approximately 3,000 Verizon company employees . . .will continue employment with FairPoint after the merger. Approximately 300 Verizon company employees in Maine, New Hampshire and Vermont who provide national or regional support services will remain with the Verizon company that currently employs them.
> . . .
> Subsequent to the merger, FairPoint expects to add approximately 600 positions to the current employee base serving the three states. FairPoint will also strengthen the local operational presence and create new local service centers to deliver industry-leading customer service. Additionally, FairPoint plans to significantly increase broadband availability in the region within the first 12 months after the merger is completed.
> . . .
> We believe this transaction will create an opportunity for further investment in Maine, New Hampshire and Vermont, strengthen the region's economy by creating jobs and improve service to customers through capital investment," said Gene Johnson, chairman and CEO of FairPoint.

Joint Press Release. *See*, also, Joint Petition, at 2.

[100] / Joint Petition, at 12.

[101] / *Id.*, at 13.

Q: Does FairPoint address its responsibilities in terms of regulatory agencies and maintaining the current form of regulation under which Verizon operates?

A: Yes, but only superficially. Joint Petitioners state: "FairPoint is committed to maintaining a strong and constructive relationship with regulators in the region to ensure that it meets its regulatory responsibilities as well as the needs of its customers."[102] However, as discussed in Section VI below on service quality, FairPoint will not make a commitment to meet existing PUC service quality standards.

Q. What is your opinion of the Joint Petition?

A. The Joint Petitioners assert that the information contained in the Joint Petition "demonstrates that FairPoint possesses the requisite financial, technical and managerial capability to own and operate regulated telecommunications utilities such as Telco and Newco."[103] However, as my testimony demonstrates, not only does the Joint Petition fail to provide enough information for the PUC to make an informed decision, but the testimony and discovery responses filed by the companies in this proceeding also fail to provide adequate details and support for the transaction.

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[102] / *Id.*, at 14.

[103] / *Id.*

III. STANDARD OF REVIEW

Q: How have the Joint Petitioners presented their request to the Commission?

A: The Joint Petitioners have requested a determination by the Commission that the proposed transactions are for the public good pursuant to RSA 374:30 (governing transfers of utility franchises and assets), RSA 374:26 (governing authority to operate as a public utility), and, to the extent necessary, RSA 374:33 (governing transfers of 10 or more percent of ownership of a public utility).[104] The Joint Petitioners also request that the appropriate subsidiary of FairPoint be designated an "eligible telecommunications carrier" pursuant to 47 U.S.C. §§ 254(e) and 214(e)(2) (concerning universal service assistance fund) for purposes of the affected service territory and that Verizon New England's current designation be rescinded.[105] The Joint Petitioners further request that the Commission authorize Verizon New England to discontinue service as a public utility in New Hampshire pursuant to RSA 374:28 (governing authority to discontinue providing service as a public utility).[106]

Q: What is your understanding of the Commission's standard of review for Verizon's proposed sale of its operations to FairPoint?

A: It is my understanding that the Joint Petitioners must demonstrate that the proposed transaction is in the public good or in the public interest.[107] Based upon advice of counsel, in determining whether a proposed franchise or franchise transfer is consistent with the public good under the

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104/ *Id.*, at 3-4.

105/ *Id.*, at 4.

106/ *Id.*

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applicable statutes, the Commission assesses, among other things, the financial, managerial, and technical expertise of the petitioners.[108] The "public good" standard is distinguishable from the "no net harm" standard in a separate statute, in that the Commission must find that the proposed transaction results in net benefits in this case.

Q: Based on your participation in other proceedings in which regulators were investigating other companies undergoing major changes in ownership and control, do you have any suggested approaches for assessing the merits of the Joint Petition?

A: Yes. I recommend that the Commission consider critically whether, on balance, consumers will be better off as a result of the transaction than if either the status quo ("business as usual") continued, or if the status quo continued but with PUC-directed improvements (such as to service quality). In assessing whether consumers and the public will be better off as a result of the proposed transaction, the Commission should assess critically the likelihood of purported benefits actually occurring.

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[107]/ *Order of Notice*, DT 07-011, February 7, 2007, at 1.

[108]/ *See* RSA 374:26, NH RSA 374:30, and NH RSA 374:33. See also NH Riverside Water Works, Inc., 2006 WL 3791415, N.H.P.U.C., Dec 15, 2006, (NO. 24,713, DW 06-023, ID 150219), *citing* Lower Bartlett Water Precinct, 85 NH PUC 635, 641 (2000)

Q: Do you have other observations about this transaction?

A: Yes. This transaction presents a unique challenge for the Commission, in part because this case spans a huge range of issues from ensuring reliable affordable basic local service to providing access to new technology for high speed internet access. Verizon NH and Verizon have turned their backs on New Hampshire, as evidenced by steadily declining service quality, woefully inadequate attention to pole repair and replacement, inadequate Lifeline participation, failure to deploy DSL in a reasonable and timely manner, spotty pursuit of FiOS,[109] and favoring Freedom customers at the expense of the "barebones" customers, for example. FairPoint, however, though promising attention to basic service and broadband deployment, has far less experience and resources than Verizon NH, and its ability and willingness to follow through on its promises simply have not been substantiated by the company.

The status quo is absolutely unacceptable, especially as a starting point for FairPoint: among other things, basic service quality is unacceptable; Lifeline participation is inexplicably low; poles are in disrepair and repair response rates are unacceptable; and broadband deployment leaves New Hampshire last in the country. The key question for the Commission is whether the proposed transaction represents an improvement for consumers and the public relative to the status quo and also relative to the "potential status quo." By "potential status quo," I mean that if the transaction did not occur, it is my expectation that the Commission would open another proceeding, one in which it investigated and directed remedies for critical aspects of Verizon

[109] / FiOS is Verizon's trademarked "fiber to the home" product.

NH's operations that are now sub-standard such as service quality and pole attachments, for example.

As described in my testimony and that of Mr. Brevitz, the evidence demonstrates resoundingly that the Commission should deny the transaction as proposed. The difficulty is that the Commission is then left regulating a company that has been disinvesting in the state for some time. However, the focus of this case must be on FairPoint's proposal to be the steward of the system in New Hampshire, whether it has the resources and abilities to do so, and whether approving this transaction is in the public interest.

IV. THE JOINT PETITIONERS' ECONOMIC INCENTIVES

A. The transaction poses significant risks, many of which would be borne by consumers.

Q: Ms. Baldwin, in Section II of your testimony, you refer in general terms to the financial aspects of the proposed transaction. You also indicate that Mr. Brevitz analyzes the technical elements of the financial characteristics of the proposed deal. Have you analyzed the impact of any of these elements of the transaction further?

A: Yes. In this section, I address the economic incentives of the dealmakers versus the consumers and the state as a whole. In Section VI, I discuss concerns about FairPoint's post-transaction ability and willingness to provide basic local service at affordable rates and reasonable levels of service quality; and FairPoint's ability and willingness to undertake the capital investment necessary to replace aging outside plant and to bring advanced services to rural areas.[110] In Section VII, I describe the demand characteristics of New Hampshire consumers and the related post-transaction financial pressure on FairPoint to market discretionary and bundled services to consumers, as well as the need for rate protection for non-competitive services. In Section VIII of my testimony, I address the relationship of the timing of Verizon's spin-off of its directory publishing to the Commission's imputation requirement and to Verizon's proposed sale of its northern New England operations.

Q: What do you recommend?

[110] / Mr. Brevitz addresses the specific financial characteristics of the transaction such as the capital structure of the post-transaction FairPoint and the implications of Verizon's interest in meeting the requirements for a Reverse Morris Trust.

A: Consumers, the public, and the State itself, should be protected from the significant risks that the proposed transaction poses. The best protection would be for the Commission to deny the Joint Petition. The financial, operational, and managerial risks are great, the financial cushion is inadequate, and the likelihood of employee exodus is great. The combination of these factors jeopardizes consumers' ability to obtain basic local telephone service at affordable rates with adequate service quality. The downstream impacts of the lack of affordable and adequate basic local telephone service should not be underestimated.

B. The Joint Petitioners' economic incentives diverge from those of New Hampshire's consumers and the State as a whole.

Q: Should the Commission consider the incentives of the Joint Petitioners as they weigh the risks and benefits of the proposed transaction?

A: Yes. I recommend that the Commission recognize that the Joint Petitioners' interests are not necessarily aligned with those of consumers or those of the State, and analyze the merits of the Joint Petitioners' filing through that lens. The overly optimistic view of FairPoint's post-transaction operations, which the Joint Petitioners depict, may change if and when regulators grant approval, and after the deal is irrevocably consummated.

Q. What is Verizon's interest?

A. Verizon's interest in divesting its access lines, as has been widely reported in the press, is to focus on more urbanized markets. In Verizon's words, the company seeks to **<<<BEGIN HIGHLY CONFIDENTIAL LEVEL 2**

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2>>>.[111]

Q: What are FairPoint's incentives?

A. FairPoint's incentives include bonuses and exit benefits for senior management. Also, FairPoint's post-transaction incentives will be to minimize operating expenses and to maximize revenues, which, as I discuss elsewhere in my testimony, could jeopardize service quality and create pressure for consumers to purchase additional telecommunications features and products,

Q. Have you examined FairPoint's SEC filings for details regarding bonuses for senior management?

A: Yes. FairPoint's Amendment No. 1 to S-4, filed with the SEC on May 25, 2007, details bonuses tied to completion of the proposed transaction. The five named executives stand to earn bonuses totaling $605,000 upon completion of the transaction.[112]

Q: Will other FairPoint employees earn bonuses upon completion of the merger?

A: No. The Form S-4/A only mentions bonuses for the top five executives.

Q: Does FairPoint make provisions for senior executives who leave the company due to the purchase of Verizon NH's lines?

A: Yes. The Change in Control and Severance Agreement of March 7, 2007 awards key executives exit benefits if, following a change in control, the executives are dismissed without cause, or leave due to (a) a significant or material reduction of the employee's key responsibilities or duties, (b) a reduction in the employee's overall compensation opportunities, (c) the diminishment or elimination of the employee's rights to "Severance Benefits", or (d) any

[111] / See Exhibit SMB-HCL2-10, Verizon NH response to Labor 1-13, Attachment 4(c)(13), November 3, 2005, at 13.

[112] / See Amendment No. 1 to S-4, at 170.

material breach by FairPoint of the severance agreement. The exit benefits include all unpaid base salary, a lump sum equal to two times the sum of the employee's base salary and annual bonus, medical and life insurance premium payments for 24 months, and the vesting of all non-performance based long-term incentive awards.[113] For the five listed executives, the exit benefits total at least $16 million.[114] In an interview published in the Charlotte Observer in February, 2007, CEO Gene Johnson indicated his intent to retire by year-end 2008.[115]

Q: Does the Change in Control and Severance Agreement make similar provisions for other FairPoint employees who leave the company within two years of the completion of the transaction?

A: No. The S-4 makes clear that only the five top executives are covered by the Change in Control and Severance Agreement.

Q: Are there financial consequences for FairPoint senior management if the purchase results in a poor operational or financial performance?

A: No. There appear to be no direct financial consequences for top executives if the transaction results in poor performance. Specifically, there are no "claw-back" provisions that would reclaim transaction-related bonuses in the event that the endeavor ultimately fails.

Q: What recourse will FairPoint shareholders have in the event that the transaction results in poor financial performance?

A: Shareholders can sell their holdings in the company at any time, including immediately

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[113] / *Id.*

[114] / *Id.*, at 231-234. Calculation of total figure is based on 2006 base salaries, bonuses, life insurance premiums; end of 2006 market value of non-vested, non-performance equity grants; and market value of vested equity grants.

[115] / "Who is FairPoint," *Nashua Telegraph*, June 3, 2007. Reprint of original article that ran in the *Charlotte Observer*, February 20, 2007, page 1D.

following the transaction, if they judge the performance to be sub-standard.

Q: What recourse will customers have in the event that the transaction results in poor operational performance?

A: Aside from making complaints to the company or to the PUC, consumers have little recourse if service quality or operational performance suffers as a result of the transaction. Furthermore, as my testimony and that of Mr. Brevitz demonstrate, the transaction exposes consumers to considerable risk that FairPoint will seek to raise rates in the future. Ideally, consumers would be able to turn to competitors, to "vote with their feet," but, as I demonstrate later, competition for basic (unbundled) residential local exchange service is basically non-existent. Therefore, if the Commission approves the transaction, it is must condition approval on, and enforce a system, of automatic fines for failures to meet certain benchmarks and standards.

Q: What do you recommend that the Commission infer from these differing financial stakes in the outcome of the transaction?

A: I urge the Commission to consider the financial incentives of Verizon's, Verizon NH's, and FairPoint's executive officers as the Commission contemplates the merits and implications of the proposed transaction. In November 2006, Verizon extracted $9 billion by spinning off its directory publishing, a line of business which, at divestiture, a Federal court linked explicitly to local telephone service, because it was funded with ratepayer money.[116] Now Verizon seeks to shed itself of less lucrative operations, and as its persistent flouting of PUC-established service quality standards and pole management responsibilities shows, demonstrates little accountability to New Hampshire. Verizon's shareholders, which would own shares of FairPoint, can simply sell those shares post-transaction, and, therefore, be immune from any operational and financial

[116]/ See Exhibit SMB-P-11, Verizon Communications, Inc. 2006 Annual Report, at p. 35.

difficulties that may ensue. FairPoint's executive officers gain bonuses if the transaction occurs[117] and also have a "bail-out" option.[118] If, within two years of completion of the deal, the executive team decides to leave FairPoint voluntarily, they can "take their money and run." The team of people who are "selling" the merits of this transaction to regulators lack a long-term financial interest in the post-transaction viability of FairPoint's operations in New Hampshire. Although top management has an escape clause, employees, consumers, and competitors have minimal recourse if post-transaction, things go awry.

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Q:

A:

END CONFIDENTIAL,[119] such as higher-than-expected operating expenses, lower-than-expected revenue stream, higher-than-expected cost of money, or longer-than-expected ramp-up period for running the operations.[120] By way of example, although FairPoint contemplates the TSA being available for 15 months, the financial model which supports the proposed transaction incorporates an assumption that FairPoint relies on the TSA for only six months.[121] Beginning in the 13th month, the cost of transition services will rise to

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[117] / See Amendment No. 1 to S-4, *Transaction Bonuses*, at 170. The five named executives each received half of the transaction-related bonuses in February 2007, and will receive the other half upon completion of the merger. The transaction bonuses described total $605,000.

[118] / *Id.*, *Change in Control and Severance Agreements*, at 170.

[119] / Balhoff (FairPoint) Direct, at 22.

[120] / FairPoint assumes in its financial model that retail line loss will be **<<<BEGIN CONFIDENTIAL**

END CONFIDENTIAL>>> Balhoff Direct (FairPoint), at 20-22.

[121] / See Exhibit SMB-P-12, FairPoint response to OCA GII 2-24. In response to a Staff data request regarding FairPoint's contingency plans for funding transition services, given the accelerating costs of the transition services after

$14,700,000 per month. Every month thereafter, until termination of Schedule A services, the cost rises by an additional $500,000 each month.[122] **<<<BEGIN CONFIDENTIAL**

END CONFIDENTIAL>>>[123] However, FairPoint confirmed in a follow-up data response that it did not run any sensitivity analyses for factors such as the duration of the TSA, the level of capital expenditures, DSL demand, and impact of increases in operating expenses.[124]

Q: Does FairPoint possess the same purchasing power as Verizon?

A: It seems highly unlikely that a company the size of FairPoint will be able to command the same price levels for switching equipment and other plant additions as Verizon, with its substantial economies of scale, can. The higher cost of doing business may be reflected at some point in higher rates for consumers.

Q: Does the proposed transaction present other risks?

A: Yes. In the next section I analyze managerial and operational risks, focusing primarily on the pre- and post-transaction composition of the work force.

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month 12 if it cannot complete the transition by the 12th month after closing, FairPoint stated that "[e]xcess cash flow and cash available for dividends will provide sufficient contingency in the event the TSA period lasts longer than projected. In addition, FairPoint will have up to $200 million available for borrowings under its anticipated revolving credit facility." Exhibit SMB-P-13, FairPoint first supplemental reply to Staff 1-89.

[122] / Joint Petition, Exhibit 5: Transition Services Agreement, at Article II, 2.1 Transition Services and Fees.

[123] / Balhoff (FairPoint) Direct, at 24.

[124] / See Exhibit SMB-P-14, FairPoint response to OCA FDR V-8.

V. MANAGERIAL AND OPERATIONAL ISSUES

A. The Joint Petitioners have not demonstrated that FairPoint possesses the requisite managerial and operational ability to operate Verizon NH's operations.

Q: Have the Joint Petitioners demonstrated that FairPoint possesses the requisite managerial ability to assume control of Verizon NH's operations?

A: No. In addition to failing to show that FairPoint is generally prepared and staffed to assume responsibility for the Verizon New Hampshire operations, the Joint Petitioners have also not demonstrated that they have adequately addressed the impact of the "brain drain" that has been occurring since mid-January, 2007, when the Joint Petitioners announced the transaction. This depletion of experienced work force likely will continue to occur both pre-transaction and post-transaction, and will jeopardize FairPoint's ability to offer basic local service (and expanded broadband offerings) at acceptable service quality levels and reasonable rates.

Q: Please explain your concerns in more detail.

A: A key factor that affects the merits of the transaction and whether it is in the public good is FairPoint's managerial and operational ability to operate SpinCo, which, in turn, depends critically on the composition of its salaried and non-salaried work force. After reviewing the limited information provided by the company on these matters, I recommend that the Commission examine several metrics to inform its assessment of FairPoint's access to the requisite work force:

- Quantity of SpinCo employees who, since January 15, 2007, have migrated outside of the Verizon Northern New England footprint.
- Quantity of employees eligible for regular retirement with full benefits: these employees represent experienced staff that may leave SpinCo either before or after

the transaction, due to perceived risks to benefits and retirement post-transaction, thus depleting FairPoint's number of seasoned employees.

- Quantity of employees eligible for early retirement with reduced benefits: these employees also represent experienced staff that may leave, thus further depleting FairPoint's numbers of seasoned employees.

Q: What information should the Commission consider as it assesses FairPoint's ability to operate SpinCo?

A: I urge the Commission, before rendering any final decision in this proceeding, to seek up-to-date information on the composition of the SpinCo work force.[125] This is particularly important because both the transaction and the upcoming contract renegotiation with non-salaried employees are and likely will continue to affect non-salaried work force's plans for continuing employment with Spinco.

Q: Have you analyzed any of the metrics that you recommend the Commission examine?

A: Yes. Between January 15 and May 31, 2007, <<<**BEGIN CONFIDENTIAL**

[126]

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[125] / My overarching recommendation is that the Commission reject the Joint Petition. If, however, the Commission is considering approving the transaction, I recommend that it issue a request during the hearings, presently scheduled for October 2007, seeking up-to-date information on critical aspects of SpinCo's operations including such items as the composition of Verizon NH's work force as of September 30, 2007, information about employees who have departed SpinCo since January 2007, and a detailed plan by FairPoint on how it intends to attract and retain qualified employees to fill open positions.

[126] / *See* Exhibit SMB-C-15 Verizon NH supplemental response to Staff FDR GI 1-5. *See also* Exhibit SMB- C-16, Verizon supplemental response to Staff FDR GI 1-2 for additional information about the "outward movement" from the three northern New England states between January 1, 2007 and May 31, 2007. These documents **<<<BEGIN CONFIDENTIAL**

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[127] [128] [129] **END CONFIDENTIAL>>>**

Q: Have you analyzed the retirement data?

A: Yes. **<<<BEGIN CONFIDENTIAL**

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[127]/ Joint Press Release.

[128]/ *See* Exhibit SMB-C-15.

[129]/ *Id.*

Table 4-C

Spinco Work Force May Lose Seasoned Employees

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	Number	*% of Total*	*Number*	*% of Total*	*Number*	*% of Total*
Source: Exhibit SMB-C-17, Verizon response to Staff GII 2-28.						

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Q: Do you know what percentage of employees will be eligible for full or reduced retirement as of the close of the transaction if the transaction is approved?

A: No. The OCA sought information as a follow-up to Verizon NH's response to Staff GII 2-28 regarding comparable retirement projections for (a) the projected cutover date; (b) year-end 2008; and (c) year-end 2009. Verizon NH responded that information responsive to the request was "not maintained in the ordinary course of business and is thus not available."[130]

Q: Should the Commission seek this additional information?

A: Yes. The composition of SpinCo's work force bears directly and substantially on FairPoint's technical and managerial ability to serve New Hampshire. Therefore, I recommend that the Commission direct Verizon NH to provide the information regarding retirement projections for

[130] / See Exhibit SMB-P-18, Verizon response to OCA FDR V-5.

2008 and 2009 prior to approving the transaction. Although Verizon NH may not maintain this information "in the ordinary course of business," the information is important to consider as the Commission deliberates on the merits of this transaction.

In my view, there is sufficient information in this proceeding to demonstrate that the Commission should deny the Joint Petition. Among other things, simply based on the unusually high quantity of employees who have already left SpinCo and based on year-end projections of employees eligible for reduced or full retirement, it is clear that the SpinCo work force could be depleted. However, if the Commission is contemplating approving the transaction, I urge the Commission to seek routinely updated information not only about the existing employees, but also about (1) those who have left SpinCo and (2) those who are eligible either for full or reduced retirement benefits as of year-end 2008 and year-end 2009.

B. <u>Neither of the Joint Petitioners has defined clearly what would represent departure from normal employee turnover.</u>

Q: How does Verizon NH characterize "normal" employee turnover?

A: Verizon NH, in the technical sessions, referred to its intention of turning over "business as usual" to FairPoint, and indicated that FairPoint would simply be stepping into Verizon NH's shoes. In OCA FDR V-6, OCA sought further clarification of how one might assess whether business was *not* "as usual" at the time of closing. Verizon NH explains that "[b]usiness would not be 'as-usual' when the level and types of staffing changes occurring constitute changes other than those experienced in the normal day-to-day management of the business." [131] Verizon NH, however, did not elaborate on the criteria it would consider reasonable for making that

[131] / See Exhibit SMB-P-19, Verizon NH response to OCA FDR V-6.

assessment. For the reasons discussed above, I do not consider the departure of **<<<BEGIN CONFIDENTIAL END CONFIDENTIAL>>>** employees out of approximately 3000 between January and May 2007 to be “as usual.”

Q: What criteria or benchmarks does FairPoint intend to use to assess whether it is taking over “business as usual” as it relates to the work force?

A: FairPoint does not seem to have any benchmark or criteria to assess whether the staff associated with the operations that it intends to inherit is sufficiently similar to what it contemplated when it negotiated the transaction with Verizon. FairPoint states that it “does not have any specific or enumerated criteria” and that “[n]oticeable fluctuations are topics for discussion between FairPoint and Verizon functional subject matter experts.”[132] Therefore, the questions of when these discussions will take place, and when the Commission will receive information on the outcome remain unanswered.

Q: What is your understanding of the information that FairPoint has obtained from Verizon NH regarding employees?

A: In mid-January 2007, FairPoint was provided with **<<<BEGIN CONFIDENTIAL**

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[132] / See Exhibit SMB-P-20, FairPoint response to OCA FDR V-4.

[133] / See Exhibit SMB C-21, Verizon NH response to Staff FDR GI-1, attachment a.

In May 2007, FairPoint was provided with the second employee list, which consists of an

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[134]

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Q: Please elaborate.

A: By way of example, the document may include, in one month, for a particular position, that the employee has 15 years of experience, and then, in the subsequent month the same position may show an employee with five years of experience. The burden would then fall on FairPoint to identify this change and to query Verizon further, if so inclined.[135]

Q: Did the OCA ask Verizon NH for information about the *departing* employees?

A: Yes. However, Verizon objected to the question and directed the OCA to its responses to three Staff questions (Staff FDR 1-1, 1-2, and 1-4) [136].

Q: Do the replies to Staff data requests that Verizon NH references in the data response that you quote above provide the information sought by the OCA?

A: Only in part. In addition, other responses include information about departing employees from the three northern New England states between January 1, 2007 and May 31, 2007.[137] However,

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[134] / See Exhibit SMB C-22, Verizon NH response to Staff FDR GI-1, attachment b.

[135] / See Exhibit SMB-P-20.

[136] / See Exhibit SMB-P-23, Verizon NH supplemental response to OCA FDR V-9.

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Q: Should Verizon NH provide updates to this information?

A: Yes. In light of the dynamic nature of employee turnover, Verizon NH, at a minimum, should provide the Commission, FairPoint, and the parties to this proceeding with regular updates to the information shown in SMB-15-C, because the information would assist FairPoint and the Commission greatly in assessing the extent to which SpinCo's work force may no longer be "business as usual."

Q: Has Verizon NH provided any further information about its perception of its obligation regarding the status of its work force?

A: Verizon NH has provided minimal information. In response to a data request that sought confirmation "that it is Verizon's position that it is obligated to transfer an ongoing business to FairPoint, not to ensure that current employees or others with identical skills and experience, transfer to FairPoint," Verizon NH stated that its **"**position with respect to employee matters is best formulated in Article 4 of the Employee Matters Agreement."[138]

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[137] / See Exhibits SMB-15-C, SMB-16-C.

[138] / See Exhibit SMB-P-24, Verizon NH response to Labor FDR II-14.

Q: In your view, does the referenced Article 4 respond clearly to Labor's question?

A: No. As I read Article 4 of the Employee Matters Agreement, it would seem that Verizon has no particular obligation to "ensure that current employees or others with identical skills and experience, transfer to FairPoint." This underscores further the vulnerability of FairPoint (and therefore the vulnerability of consumers) to the depletion of seasoned employees at SpinCo.

Q: Ms. Baldwin, recognizing that you recommend that the Commission deny the proposed transaction, if the Commission nonetheless considers approving the transaction, do you have any recommendations for addressing, at least in part, your concerns about the loss of experienced salaried and non-salaried personnel?

A: Yes. Verizon NH and FairPoint should develop a comprehensive plan, based on the needs of the business and the regulatory requirements, to encourage the existing work force to continue employment with SpinCo so that, post-transaction, FairPoint can provide reliable service at reasonable rates. For example, such incentives could include bonuses at increments such as 6, 12, 18 months of service after the closing. This type of approach could be more cost-effective than attracting and training new hires.

Q: Should the Commission expedite its review of the transaction in order to end the lingering uncertainty about the fate of SpinCo?

A: Absolutely not. The transaction is complex and merits careful and deliberate review by the Commission. I urge the Commission to recognize, however, that the information in the snapshots provided by Verizon NH in follow up data requests will become stale quickly, and likely the depletion of seasoned employees will continue, further jeopardizing FairPoint's ability to operate SpinCo in a manner that results in the public good.

VI. SERVICE QUALITY

A. FairPoint stands to inherit a system that has been neglected and does not meet PUC service quality standards.

Q: Ms. Baldwin, please provide an overview of your concerns related to FairPoint's proposals regarding service quality.

A: My concerns are several. First, Verizon NH has neglected its system, allowing service quality to deteriorate over the last several years. As a result "business as usual" is not an acceptable level of service quality. Second, FairPoint has not presented any plans to improve service quality, but instead states that it intends to continue operating in a "business as usual" mode. Third, in addition to its lack of plans to improve service quality, FairPoint has not demonstrated that it possesses the resources, financial and otherwise, to improve and maintain service quality levels. Lastly, FairPoint will not make any commitments to meet existing PUC service quality standards. I discuss each of these issues in detail in this section, and provide examples of ways that the Commission can address them.

Q: Please summarize your analysis of Verizon NH's "business as usual" service quality in New Hampshire as it relates to this proceeding, and as it informs your recommendations.

A: Based on my analysis of information in this proceeding, I conclude the following:

1. Service quality has been declining.

- Despite concerns expressed by Staff, the OCA and others, the quality of basic local exchange service in New Hampshire has been deteriorating for several years, and Verizon NH demonstrates no intention of achieving PUC-established service quality standards before selling its landline assets to FairPoint.[139]

- Neither Staff concerns, existing Commission standards, open dockets, nor purported competition have provided sufficient economic incentives for Verizon NH to improve and maintain its service quality.

2. Verizon NH dominates local markets.

- Competition does not yet constrain Verizon NH's dominance of the local market. Therefore, FairPoint would inherit a near-monopoly hold on the basic local exchange market. As a result, regulatory intervention is essential to protect consumers from long waits for repairs on out-of-service lines, delayed service installation, and other service quality problems.

- To the extent that competition is emerging in New Hampshire, the options are targeted to high revenue and urban customers, many of whom have cable alternatives.
- Customers of basic local exchange service and customers in less densely populated areas are particularly vulnerable to service quality deterioration.

3. FairPoint has not demonstrated its willingness and ability to improve service quality to meet PUC-established standards nor that it has engaged in sufficient due diligence to understand the extent of Verizon NH's service quality problems.

- FairPoint's testimony and data responses indicate that it may not take service quality standards in New Hampshire seriously.

- FairPoint has not demonstrated that it has an understanding of the root causes of current

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[139] / In addition to this portion of my testimony, also see the exhibits to my testimony. See, also, *Verizon's Quality of Service Performance*, New Hampshire Public Utilities Commission DT 04-019, *Order Establishing Status Conference*, Order No. 24,551, December 1, 2005 ("Order No. 24,551") and *Report on Initial Analysis for the Staff of the New Hampshire Public Utilities Commission*, by Curry & Associates, Docket No. 04-019, February 4, 2005 ("Curry Report").

service quality problems in New Hampshire or that it has a plan to address those problems.

- As the previous section of my testimony demonstrates, employee turnover at SpinCo is high, which may lead to a lack of qualified personnel, which, in turn, would jeopardize post-transaction service quality. As a result, I recommend that the Commission examine carefully the work force that would be transferred with SpinCo.

4. If the Commission approves the transaction, it must condition the approval of the transaction upon the adoption of consumer protection measures.

- Those customers who do not receive services that meet the PUC-established quality benchmarks should receive a rebate to both compensate for poor service, and to provide FairPoint with an incentive to improve service quality.

- If FairPoint does not agree to offer customer rebates, then the transaction should be modified to incorporate a provision for an across-the-board rate reduction if FairPoint fails to meet Commission-established service quality standards.

- Any approval must be conditioned upon FairPoint's agreement to be subject to automatic fines for failure to meet Commission Service Quality standards.[140]

- The Commission should not approve the transaction (or, if this transaction does not occur, any other transaction) without an enforceable plan to address the currently unacceptable levels of service quality to Commission-established standards. If FairPoint inherits a system suffering from the serious under-investment seen over the last decade, it will be very difficult for the company to bring service quality up to the standards without

[140] / Later in this section of my testimony, I describe examples of credits and other financial accountability that other states have adopted.

negatively impacting its financial health, which could result in rate increases.[141]

B. <u>FairPoint has not demonstrated its ability and willingness to first raise the level of Verizon NH's presently inadequate service quality, nor to sustain service quality that meets or exceeds Commission-established standards.</u>

Q: What standards and targets apply to FairPoint's existing operations?

A: According to FairPoint, its standards and target metrics for the first quarter of 2007 are as follows: [142] **<<<BEGIN HIGHLY CONFIDENTIAL LEVEL 1**

END HIGHLY CONFIDENTIAL LEVEL 1 >>[143]

Q: Did FairPoint provide data about its actual recent performance?

A: Yes. **<<<BEGIN HIGHLY CONFIDENTIAL LEVEL 1**

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[141] / Regardless of whether the Commission approves the proposed transaction and regardless of whether the transaction is consummated, effective service quality measures are essential. If legislative authority is necessary to establish financial accountability, I recommend that the Commission seek such authority. Absent regulatory leadership with clear costs for failure to meet standards, consumers will continue to receive a lower quality of service than they should.

[142] / It is very troubling to me that FairPoint, like Verizon, insists that service quality data is confidential. This prevents the public and policymakers from understanding how a company's service stacks up to others, and to the Commission's standards.

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END HIGHLY CONFIDENTIAL LEVEL 1>>>[144]

Q: Have you analyzed any other data regarding FairPoint's quality of service in its territories?

A: Yes. Table 5-C demonstrates FairPoint's **<<<BEGIN CONFIDENTIAL** [145]

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[143] / See Exhibit SMB-HCL1-25, FairPoint confidential first supplemental response to Staff GII 2-4.

[144] / *See Id*. at CFPNH 2049, which tracks FairPoint's quality of service on a monthly basis from January through April 2007.

[145] / *See* Exhibit SMB-C-26, **<<<BEGIN CONFIDENTIAL END CONFIDENTIAL>>>** at CFPNH 1650, 1714. While the presentation is dated July 12, 2006, the data presented included 3rd and 4th quarter of 2006. I assume that the report has been updated periodically although the report cover was not.

Table 5C[146]

FairPoint Trouble Metrics for 2005-2006

Access Lines					
	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	Total
2005					
2006					
Broadband					
	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	Total
2005					
2006					

Q:

[147]

A:

146 / *See id.*

147 / The total number of access line equivalents served by FairPoint will rise from 308,858 to 2,022,109 as a result of the transaction. Investor Presentation, FairPoint Communications, Inc., January 16, 2007, at page 15 (Data as of September 30, 2006), provided as Exhibit 99.3 to FairPoint Communications Inc. Form 8-K filed with the SEC on January 16,

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[148]

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Q: How does FairPoint describe service quality issues in New Hampshire?

A: Mr. Harrington states: "I am generally aware of issues that have been raised by some regarding Verizon's service quality in New Hampshire, to the extent those issues relate to network infrastructure. However, as the Commission is aware, there remains considerable debate and discourse regarding the service quality standards, if and how Verizon has met these standards, and what standards should be adopted by the Commission going forward."[149]

Q: What do you infer from Mr. Harrington's testimony?

A: Mr. Harrington's testimony suggests that compliance with Commission-established standards is somehow optional. By contrast, it is my understanding that unless and until the Commission revises the standards, they are applicable, and FairPoint would be required to comply with rather than engage in "debate and discourse" about them.

Q: If customers are not satisfied with the quality of service they receive can't they simply choose another provider?

2007.

148 / *See* pre- and post-transaction access lines and operating revenues shown in Amendment No. 1 to S-4, May 25, 2007, at 15-19.

149 / Harrington (FairPoint) Direct, at 15.

A: In most cases, they cannot. Most basic residential local exchange customers in New Hampshire do not have a choice of providers,[150] and, therefore, are effectively receiving "less for their money" when the ILEC fails to meet service quality standards. This points to the need, as I discuss below, for automatic penalties for failure to meet service quality standards for the company who owns the landline assets into the future.

Q: Are there other troubling implications of Mr. Harrington's testimony?

A: Yes. If the transaction occurs, his testimony provides compelling evidence of the need to have enforceable accountability to ensure that FairPoint will meet PUC-established standards *regardless of any philosophical differences it may have with these standards.* FairPoint should not be allowed to continue the status quo as it relates to the service quality consumers of Verizon NH are currently experiencing.

Q: Did FairPoint conduct any due diligence of the network assets that it proposes to acquire and the level and type of investment FairPoint will likely be required to make to meet PUC-established service quality benchmarks?

A: Yes, but only to a limited extent.[151] As shown by FairPoint **<<<BEGIN CONFIDENTIAL**

[150] / *See* Section VI of my testimony for a further discussion of choice.

[151] / *See* Exhibit SMB-P-27, response to OCA FDR I-2, in which FairPoint indicated that its due diligence was made up of three items: (1) FairPoint's review of documents in Verizon's data room; (2) the review of a select number of switches in New Hampshire; and (3) outside plant infrastructure.

[152]

END CONFIDENTIAL>>>[153]

Q: What do you conclude based on your review of this document?

A: Although I am not an engineer, **<<<BEGIN CONFIDENTIAL**

152 / Confidential Exhibit SMB-C-28, includes a copy of this memorandum (pages CFPNH 2050-CFPNH 2057.)

[154]

[153] / *See id*.

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END CONFIDENTIAL>>>

Q: Did FairPoint provide any further information about its assessment of service quality issues?

A: FairPoint stated that "[b]ased on further information provided orally by Verizon, FairPoint has concluded that the service quality issues can be addressed primarily through staffing increases at the technician level."[155] This statement is troubling for several reasons. First, this is not an acceptable level of due diligence in a transaction of this size and importance. Second, it does not reflect an adequate level of planning by FairPoint. Lastly, as the previous section of my testimony demonstrates, in the early post-transaction years, FairPoint's seasoned work force may be depleted, thus preventing FairPoint from deploying the technicians necessary to remedy the problems. In sum, the proposed solution is not adequate.

C. <u>Verizon NH's existing service quality is inadequate, in part due to reduced levels of capital expenditures in recent years</u>

Q: Did you review information about Verizon New England's historic levels of capital expenditures?

A: Yes. The following table summarizes actual data for 2004 and 2005, and estimated data for 2006 and 2007 for Verizon New England's operations in New Hampshire, Maine, and Vermont.

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[154] / *See* confidential Exhibit SMB-C-29, Exchanges with Deficient Quality of Service, for a list of such communities.

[155] / *See* Exhibit SMB-P-30, FairPoint response to OCA FDR II-4.

Table 6-HC2

Verizon New England's Capital Expenditures in the

Northern New England States: 2004 through 2007[156]

<<<BEGIN HIGHLY CONFIDENTIAL LEVEL 2

Capital Expenditures	2004A	2005A	2006E	2007E

END HIGHLY CONFIDENTIAL LEVEL 2>>> Verizon's increasing focus on FiOS has diverted capital expenditures away from the perhaps mundane, and less lucrative, yet essential task of replacing outside plant.

Q: Earlier you discussed the results of FairPoint's due diligence assessment of outside plant in some northern New England communities. Is there other evidence regarding Verizon New England's expenditures on cable maintenance?

[156] / *See* Exhibit SMB-HCL2-31, Verizon NH supplemental response to Labor GI 1-13, Northern New England Spinco Inc. Attachment 4(c)(5), at 27.

A: Yes. In response to OCA FDR I-6, Verizon NH explains that its "service improvement" category "includes expenditures required for proactive cable maintenance." Verizon New England's level of expenditures on proactive cable maintenance in the three northern New England states **<<<BEGIN CONFIDENTIAL**

END CONFIDENTIAL>>>[157]

Q: Is there evidence that suggests the Verizon NH's declining focus on plant and investing in "traditional" services infrastructure has had an effect on the quality of service that New Hampshire consumers have experienced over the last several years?

A: Yes. As I describe below, Verizon NH's performance with respect to service quality has declined because there is no incentive for Verizon NH to meet PUC-established benchmarks. If FairPoint inherits an operation that has been on the decline for several years, the Commission should ensure that there are adequate incentives in place to ensure that FairPoint invests the proper level of resources to improve and maintain service quality.

Q: Would FairPoint be taking over the "business as usual" operations of basic local exchange service with acceptable service quality?

A: No. Even if Verizon NH maintains "business as usual," that level of service quality is not acceptable. Verizon NH's service quality is well below acceptable levels, and, as a result, the many years of persistent service quality problems further complicate an already financially risky

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[157] / *See* Exhibit SMB-C-32, Verizon NH supplemental response to OCA FDR I-6.

transaction. Docket No. 04-019 ("Verizon's Quality of Service Performance") was opened by an Order of Notice on March 19, 2004,[158] to determine whether Verizon NH had been meeting the service quality standards established as a result of the approval of the merger of Bell Atlantic and NYNEX in 1997,[159] and, if not, whether Verizon NH should be fined and whether service quality standards should be revised. On April 3, 2006, the Commission determined that Verizon NH should provide a service quality status report and an action plan for addressing Staff's concerns.[160] However, there has been no activity in that docket since September 5, 2006.

Q: Have you analyzed any data and information that measure Verizon NH's service quality?

A: Yes. I have analyzed data submitted in this proceeding, which Verizon NH contends are proprietary, and I have also analyzed public FCC-reported ARMIS data.

Q: What do the publicly reported ARMIS data show about Verizon NH's service quality?

A: Exhibit SMB-12 analyzes public ARMIS data submitted by Verizon NH to the FCC regarding service quality performance, as measured by various metrics. Verizon NH service quality metrics generally improved during the period 1996 to 2000. As demonstrated by the metrics recorded after 2000, however, it is clear that Verizon NH has let customer service and quality of service deteriorate in recent years.

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[158] / *Verizon's Quality of Service Performance*, New Hampshire Public Utilities Commission DT 04-019, *Order Establishing Status Conference*, Order No. 24,551, December 1, 2005 ("Order No. 24,551").

[159] / The service quality indices were established as part of the PUC's approval of the Bell Atlantic/NYNEX merger in DR 96-220, Order No. 22,484 on January 20, 1997. *See, Order No. 24,551*, at 2.

[160] / *Id.* at 3. I reviewed non-proprietary summary materials prepared by a consultant to Staff while engaged by the OCA last year in DT 06-072, which indicated that Verizon NH was consistently failing to meet PUC-established benchmarks. *Report on Initial Analysis for the Staff of the New Hampshire Public Utilities Commission*, by Curry & Associates, Docket No. 04-019, February 4, 2005 ("Curry Report").

Q: Please summarize some of your findings.

A: Among other things, Exhibit SMB-3 shows:

- In all customer categories, the timeliness of Verizon NH's repair, as measured by the metric "Initial Out-of-Service Repair Interval," declined from its best measurements in 2000 and 2001. For residential customers the average repair interval was 35.2 hours in 2006, *more than double the wait time* experienced by households in 2000.[161]

- In 2006, residential customers in non-MSA[162] areas of New Hampshire waited *more than twice* as long as business customers in non-MSA areas for repairs to be completed (34.1 hours for residential customers vs.14.4 hours for business customers).[163]

- "Repeat Out-of-Service Repair Intervals" in Verizon New Hampshire's territory grew dramatically from 2000 to 2006. For residential customers, the length of time taken to complete a repeat repair more than doubled, from 17.4 hours in 2000 to 36.5 hours in 2006. For business customers, the interval lengthened by 45% between 2001 and 2006.[164]

- From 2002 to 2006, state complaints about residential service increased substantially for Verizon New Hampshire. In New Hampshire MSAs, residential customers made 38 complaints in 2002, a number which grew to 117 in 2006. In Non-MSA areas of New Hampshire, residential customers filed only 18 complaints in 2001. This number rose to 127 complaints in 2006.[165]

- Even more striking is the increase in the number of complaints per residential access line. After considering the reduction in residential access lines, Verizon New Hampshire's MSA-area residential complaints as a percentage of access lines quadrupled in four years, rising

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161 / FCC ARMIS Report 43-05, Table II, Row 145.

162 / MSAs, or Metropolitan Statistical Areas, are designated by the Office of Management and Budget in a list released following each decennial census. An MSA is a Core - Based Statistical Area associated with at least one urbanized area that has a population of at least 50,000. The Metropolitan Statistical Area comprises the central county or counties containing the core, plus adjacent outlying counties having a high degree of social and economic integration with the central county as measured through commuting. Non-MSA refers to all areas in a study area which lie outside of any MSA. See 65 Fed. Reg. 82228 (2000) and the FCC's ARMIS reporting instructions at http://www.fcc.gov/wcb/armis/instructions/2006/definitions05.htm#gen . There are two MSAs that cover portions of NH. The Boston-Cambridge-Quincy MSA includes Rockingham County, NH, and Strafford County, NH. The Manchester-Nashua MSA covers Hillsborough County, NH. These two MSAs include about 62% of NH's population, and about 22% of NH's land area. Population Division, US Census Bureau; US Census Bureau's City and County Databook 2000.

163 / FCC ARMIS Report 43-05, Table II, Row 145.

164 / FCC ARMIS Report 43-05, Table II, Row 149.

165 / FCC ARMIS Report 43-05, Table V, Rows 320, 321, 322, and 330.

from 0.013% in 2002 to 0.054% in 2006. In Non-MSA areas, residential complaints increased eightfold from 0.008% in 2001 to 0.067% in 2006.[166]

Q: Please discuss the alleged proprietary data submitted in this proceeding.

A: Confidential Exhibit SMB-C-33-a compares the Commission's service quality standards and Verizon NH's annual service quality performance between 1996 and 2006.[167] As Confidential Exhibit SMB-C-33-b shows: **<<<BEGIN CONFIDENTIAL**

[168]

END CONFIDENTIAL>>> The exhibits to my testimony provide community-specific information on quantities of held orders.

Q: Do you provide a more disaggregated view of Verizon NH's service quality in New Hampshire?

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166 / FCC ARMIS Report 43-05, Table V, Rows 320, 321, 322, and 330.

167 / Confidential Exhibit SMB-C-33-a, Verizon New Hampshire's Quality of Service 1996-2006, updates a table that was originally included in a 2004 memorandum in which Staff recommended that the Commission open an investigation into Verizon NH's quality of service. See Memorandum from Jody O'Marra to Commissioners, Executive Director, Telecommunications Division Director re Verizon's Quality of Service Performance, dated February 24, 2004, provided as a proprietary attachment to Verizon NH's response to NH OCA II 1-18S(b), which includes data spanning 1996 to 2003, and which I have reproduced as Confidential Exhibit SMB-C-33-b. For data between 2004 and 2007, see Exhibit SMB-C-34, Verizon NH proprietary response to OCA GII 1-9(b). Also see Confidential Exhibit SMB-C-35, Verizon NH Calendar Year Average Service Quality Metrics, which summarizes data spanning 2003 through 2007.

168 / In the exhibits to my testimony, I include community-specific data, which shows where service quality is sub-par. *See* Confidential Exhibit SMB-C-29.

A: Yes, in my exhibits I provide additional detail based on my review of proprietary service quality reports (See Exhibits SMB-C-29 through SMBC-39). Certainly, my review of FairPoint's due diligence demonstrates that it has not examined Verizon NH's service quality on a detailed basis. Performance in individual communities varies widely, as Exhibits SMB-10a-C and SMB-10b-C to my testimony demonstrate. **<<<BEGIN CONFIDENTIAL**

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Q: What significance should the Commission attribute to the service quality data you provide in your testimony and exhibits?

A: Verizon NH's service quality is indisputably in decline. As a result, simply allowing FairPoint to maintain "business as usual" isn't good enough. The deteriorating service quality is compelling evidence of the absence of any real internal *incentive* (such as executive compensation being linked to service quality) or external *incentive* (such as either market discipline or regulatory consequences) to improve and maintain service quality. In the absence of competition and in the wake of this serious decline in service quality, I urge the Commission to establish adequate financial incentives – and to seek legislative authority if necessary – for FairPoint to improve and maintain service quality. The Commission should not rely upon vague statements regarding FairPoint's more local focus to ensure improvements in service quality.[169]

D. <u>Verizon NH faults the benchmarks rather than its lack of investment or incentive for its failure to meet service quality benchmarks.</u>

Q: How does Verizon NH view the status of its service quality?

A: In response to an OCA data request seeking information about Verizon's position regarding the need for network improvement or staffing changes, and its view about what is preventing Verizon NH from meeting the PUC-established service quality standards, Verizon NH seems to fault the benchmarks, stating:

> Verizon NH concurs that its current network provides for the provision of quality service and is doing so today. While there may be room for improvement and despite some selective areas and times where certain metrics have not met the PUC established benchmark standard, Verizon NH has and continues to deliver good quality service to its customers. Verizon NH believes that *any regulatory service quality measure should accurately reflect customer expectations and the marketplace today*. The overriding *flaws and problems with the current PUC-established metrics and benchmarks is that they are static and outdated and as such fail to properly account for the changes that have occurred in technology and the marketplace. The current PUC established metrics do not accurately reflect what is important to customers or how the vast majority of customers view Verizon NH's service quality today.* Rather, these metrics reflect the service issues and technology in place in Verizon NH's public switched network as well as regulatory policy principles associated with the near monopoly local exchange environment well before 1996. As such, these metrics do not account for the

[169] / *See e.g.*, Leach (FairPoint) Direct, at 4-5.

> impact of the Telecommunications Act of 1996 (TAct); the Federal Communications Commission (FCC) and this Commission's pro-competitive policies implementing the TAct; the advent of, and significant growth in CLEC and cable competition, the deployment of cable telephony and broadband services; the explosion of the Internet and text messaging; the growth of Voice over Internet Protocol (VoIP) services and bundled service offerings, and the convergence and growth of wireless services. *All of these factors have served to undermine the very foundation and policy rationale of many of the current PUC-established metrics.*[170]

Q: How do you respond to Verizon NH's claims about service quality metrics?

A: They are extremely troubling for several reasons, especially if FairPoint plans to follow in Verizon's footsteps. First, until the Commission changes the metrics, it is my understanding that Verizon NH lacks the authority to decide unilaterally when and if it will abide by regulatory requirements. Second, I am unaware of any Verizon NH survey or data upon which it substantiates its assertion that the "current PUC established metrics do not accurately reflect what is important to customers or how the vast majority of customers view Verizon NH's service quality today." It would surprise me to learn that a rational consumer would expect competition to lead to a *decline* in service quality or that a rational customer would welcome such a decline. Third, as I demonstrate below, Verizon NH's attempt to depict a competitive landscape is unpersuasive: the vast majority of consumers of basic residential local telephone service (particularly those who do not purchase expensive bundled offerings) lack competitive choice. Long term inattention and lack of investment to improve basic service quality do not provide evidence of competition, but rather are evidence of an unregulated monopoly. FairPoint should not simply be allowed to step into Verizon NH's shoes and continue business as usual if the

170/ See Exhibit SMB-P-40, Verizon NH response to OCA FDR II-1 (emphasis added).

transaction is approved. Simply put, Verizon NH and FairPoint have not made the case that competition is flourishing in the basic local exchange market and thus service quality standards are not longer relevant.

E. Competitive forces do not yet exist to an extent that yields adequate service quality.

Q: Do you believe that the existence of competition is sufficient to provide meaningful incentives for FairPoint to meet service quality standards?

A: No. As evidenced by Verizon NH's failure to meet service quality standards, any competition that does exist does not seem to provide enough of an incentive for the company to improve service quality. My concern is that FairPoint will continue on this path.

Q Did FairPoint submit any information regarding the competitive landscape in New Hampshire?

A: Yes, the company did provide information regarding the competitive landscape in New Hampshire and the impact of FairPoint's acquisition on competition.[171]

Q: Have you reviewed these pages?

A: Yes. **<<<BEGIN HIGHLY CONFIDENTIAL LEVEL 2**

[171] / See Exhibit SMB-HCL1-41, FairPoint first supplemental reply to Staff 1-86, and attachments CFPNH HSR 0061, CFPNH HSR 0109-CFPNH HSR 0110, and CFPNH HSR 0275- CFPNH HSR 0280.

END HIGHLY CONFIDENTIAL LEVEL 2>>>

Q: Does FairPoint address competition in other documents?

A: Yes. FairPoint has consistently indicated to the investment community that rural markets have "favorable rural market dynamics" from an investment point of view because:

- there are "significant barriers to entry limit competition in our markets";

- there is "no wireline competition, no meaningful impact from wireless, majority of markets without a high speed data product from cable companies"; and
- there is a "loyal, stable customer base."[172]

In addition, FairPoint has stated that rural carriers have "[f]undamentally better wireline trends than non-rural carriers."[173] In a discussion of the proposed transaction to shareholders, FairPoint asserts that the combined company will be in a strong competitive position, based in part on the leading market share it will inherit:

> Many of the combined company's telephone companies have been the primary telecommunications provider in their respective communities for over 75 years and have leading market shares. FairPoint believes that the combined company will be able to maintain its leading market share as a result of FairPoint's and the Northern New England business's long-standing presence in the areas that they currently serve and because the low density of many of these areas is less attractive to alternative providers. FairPoint historically has also experienced less of a decline in access lines as compared to regional Bell operating companies due to the rural nature of its service areas, which have an average of approximately 13 access lines per square mile. As of December 31, 2006 FairPoint and the Northern New England business had, on a combine basis, and average of approximately 36 access lines per square mile compared to non-rural telecommunications carriers who had an average of approximately 128 access lines per square mile.[174]

According to FairPoint, **<<<BEGIN CONFIDENTIAL**

[172] / FairPoint Communications Inc., Form 8-K filed with the SEC on January 10, 2006, Exhibit 99.1: FairPoint Communications, Inc. Citigroup 16th Annual Entertainment, Media and Telecommunications Conference, January 11, 2006, presentation by Eugene B. Johnson, Chairman and Chief Executive Officer.

[173] / FairPoint Communications, Inc. Form 425 filed with the SEC on March 26, 2007, Exhibit 99.1, Presentation by John B. Crowley, Executive Vice President, Chief Financial Officer, Lehman Brothers High Yield Bond and Syndicated Loan Conference, March 26, 2007, at 8.

[174] / FairPoint Communications, Inc. Form 424B3 filing with the SEC on July 19, 2007, at 168.

END CONFIDENTIAL>>>[175]

Q: Is there public data regarding local competition in New Hampshire?

A: Yes. Viewed solely on a retail basis, Verizon NH has a 76% market share.[176] However, Verizon NH dominates the vast majority of the local market either directly through its own retail services or indirectly by leasing wholesale facilities to its competitors (*i.e.*, the non-facilities-based competition that occurs through resale, unbundled network element platform ("UNE-P"), UNE loop, and most recently, Verizon NH's Wholesale Advantage product). As Table 7 shows, Verizon NH owns or controls 91% of the end-user switched access lines in New Hampshire as of June 30, 2006 a position that FairPoint will inherit if the transaction is approved.[177]

[175] / See Exhibit SMB-C-42, FairPoint Response to Labor GI 1-13, Management Presentation, July 12, 2006, at CFPNH 1675.

[176] / Federal Communications Commission, Wireline Competition Bureau, Industry Analysis and Technology Division, *Local Telephone Competition: Status as of June 30, 2006*, (January 2007), at Table 10.

[177]/ Federal Communications Commission, Wireline Competition Bureau, Industry Analysis and Technology Division, *Local Telephone Competition: Status as of June 30, 2006*, (January 2007), at Table 10 and 11.

Table SMB-7[178]

[redacted]

Q: Please discuss the role of Verizon NH's "wholesale advantage" (previously UNE-P) in the local market.

A: Nationwide, UNE-P provision reported by ILECs declined 51% from a peak in June 2004 to June 2006.[179] In New Hampshire, CLEC-reported end-user switched access lines provided through UNEs (both UNE-P and UNE-L) declined 21% in the past year from 94,617 in June 2005 to 74,711 in June 2006.[180] The decline in competition based on UNE-P may lead to a

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[178] / Federal Communications Commission, Wireline Competition Bureau, Industry Analysis and Technology Division, *Local Telephone Competition: Status as of June 30, 2006*, (January 2007), at Table 10 and 11.

[179] / Federal Communications Commission, Wireline Competition Bureau, Industry Analysis and Technology Division, *Local Telephone Competition: Status as of June 30, 2006*, (January 2007), at Table 4. Specifically, UNE-P declined from approximately 17.1 million lines in June of 2004 to 8.4 million lines in June of 2006 nationwide. *Id.*

[180] / Federal Communications Commission, Wireline Competition Bureau, Industry Analysis and Technology Division, *Local Telephone Competition: Status as of June 30, 2006*, (January 2007) and Federal Communications Commission, Wireline Competition Bureau, Industry Analysis and Technology Division, *Local Telephone Competition: Status as of June 30, 2005*, (April 2006), at Table 11. Data is provided for all types of UNEs on a state basis. UNE-P data is

leveling off, or reversal, of the portion of the trend associated with customer migration from Verizon NH to other carriers for the provision of telephone lines. The dramatic decline in UNE-P lines contrasts sharply with UNE-P's former importance as a mode of entry for competitive suppliers. Furthermore, the position of CLECs negotiating access to UNE-P facilities is now seriously weakened due to the expiration of regulated UNE-P access in March 2006.

Data I examined in the course of this proceeding confirms the effect of the FCC's *UNE Remand Order*.[181] Verizon NH supplied **<<BEGIN HIGHLY CONFIDENTIAL LEVEL 3**

END HIGHLY CONFIDENTIAL LEVEL 3>>>[182] As Confidential Exhibit SMB-C-43 shows, Verizon NH has <<<**BEGIN CONFIDENTIAL**

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Q: Please describe other wholesale data that you analyzed.

A: As Confidential Exhibit SMB-HC3-44 shows, the total number of lines provided by Verizon NH to other carriers has **<<<BEGIN HIGHLY CONFIDENTIAL LEVEL 3**

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not available separately for New Hampshire.

[181] / *Unbundled Access to Network Elements; Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, FCC WC Docket No. 04-313; CC Docket No. 01-338, *Order on Remand*, Rel. February 4, 2005 ("UNE Remand Order" or "TRRO").

[182] / See confidential Exhibit SMB-HCL3-47.

END CONFIDENTIAL>>> Confidential Exhibit SMB-HCL3-47 shows that **<<<BEGIN HIGHLY CONFIDENTIAL LEVEL 3**

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Q: How many CLECs purchase wholesale products from Verizon NH? Has this number changed over time?

A: Between **<<<BEGIN HIGHLY CONFIDENTIAL LEVEL 3**

[183]

END HIGHLY CONFIDENTIAL LEVEL 3>>> Confidential Exhibit SMB-HCL3-48 shows the number of CLEC by mode of entry in 2007. The exhibits to my testimony provide more detail about competition in New Hampshire (See confidential exhibits SMB-HCL3-49 through SMB-HCL3-50).

F. <u>Intermodal alternatives[184] do not yet provide economic substitutes for consumers of wireline services across all market segments.</u>

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[183] / Because Verizon NH masked the identities of the CLECs, one cannot determine the extent to which this exists. Verizon NH did not provide the information requested in the OCA's request regarding common ownership of the CLECs. See Exhibit SMB-P-51, Verizon NH supplemental response to OCA FDR III-1.

[184] / Intermodal services are telecommunications services provided over alternative service platforms (i.e. non-wireline services) such as wireless and facilities based VoIP services.

ALLEGED CONFIDENTIAL INFORMATION HAS BEEN REDACTED

Q: What is your understanding of Verizon NH's view of the relationship of the evolution of intermodal alternatives to service quality standards?

A: As noted above, Verizon NH cites the presence of alternatives such as wireless and VoIP services to demonstrate why service quality standards are no longer apparently relevant.[185] However, intermodal alternatives are not economic substitutes for basic local exchange service and therefore do not constrain either the rates or quality of basic service. If FairPoint seeks to persuade the Commission otherwise, it should do so in a separate proceeding investigating competition and/or service quality standards.

Q: What is an economic substitute?

A: An economic substitute is generally considered a second product that a consumer is willing and able to buy instead of a first product, in response to a small but significant change in price of the first product. However, in the context of Verizon's statements about service quality, a substitute can also be considered a product that a consumer would buy instead of local wireline phone service from the incumbent if service quality declined.[186] The most valuable and unbiased

[185] / See Exhibit SMB-P-40, Verizon NH response to OCA FDR II-1.

[186] / The relevant question is whether a consumer has an alternative product s/he can buy if the price of the first product rises, service quality declines, or for any other reason, the consumer is unsatisfied. This possibility that the business may lose the business of a consumer is theoretically the manner in which the market disciplines the actions of the business (i.e. the business cannot let service quality decline or raise prices too much because the consumer will simply buy services from another business). In its order approving Verizon Communications Inc.'s acquisition of MCI, Inc. ("MCI"), the FCC, stated, that in considering consumer substitution possibilities: "we consider indicia of demand substitution between possible services, including: (1) the attributes and relative prices of possible competing services; (2) evidence that consumers view the possible competing services similarly, and have shifted or have considered shifting purchases between these services in response to relative changes in price or other competitive variables; (3) evidence that service providers consider the prospect of buyer substitution between services in response to relative changes in price or other competitive variables; and (4) the costs a consumer could incur to substitute between traditional services and services provided on an alternative platform." *In the Matter of Verizon Communications Inc. and MCI, Inc., Applications for Approval of Transfer of Control,* WC Docket No. 05-75, *Memorandum Opinion and Order,* Rel. November 17, 2005 ("FCC Verizon/MCI Merger Order"), footnote 251, citing *DOJ/FTC Guidelines* at § 1.11

evidence about consumers' preferences are consumers' actual purchasing decisions.[187] That a small percentage of the population may choose to abandon wireline service entirely does not change the fact that the vast majority of households, businesses, and emergency responders place a high value on the public safety characteristics of wireline telephone service and continue to be connected to the public switched telephone network ("PSTN"). Wireless, facilities-based VoIP, and "over-the-top" VoIP services do not constrain Verizon NH's prices and service quality for basic voice grade service and the Commission should not count on competition disciplining the prices or service quality of FairPoint's services if it approves the transaction.

Q: Do you view intermodal services as credible alternatives to barebones basic local exchange service?

A: No. The Commission should use caution when considering even facilities-based VoIP services (*i.e.*, cable telephony) as substitutes to wireline services for residential consumers. Currently, the competitive threat faced by the telephone companies is in the provisions of *bundles* of services (often referred to as the "triple play", *i.e*., phone, video, and Internet access).[188] Such services are usually more expensive than a single, local wireline connection that low-income or elderly consumers may require. To qualify for a rate that is more comparable to a typical

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[187] / Consumers, through their purchasing decisions, seek to maximize their utility, and in so doing show their "preferences." See generally, Mas-Colell, Andreu, Michael D. Whinston and Jerry R. Green, *Microeconomic Theory* (New York: Oxford University Press, 1995).

[188] / See, e.g., *In the Matter of AT&T Inc. and BellSouth Corporation Applications for Approval of Transfer of Control*, WC Docket No. 06-74, *Memorandum Opinion and Order,* Rel. March 26, 2007 ("FCC AT&T/BellSouth Merger Order"), at para. 102 describing intermodal competition in the following manner: "These intermodal services tend to be offered as a bundle of local and long distance services. These findings suggest that competition is increasingly occurring between bundled offerings rather than between a bundle and stand-alone local and long distance services offered by separate providers."

wireline rate, cable telephony customers typically must also subscribe to, and pay for, an entire bundle of services they may not need or desire.[189] Furthermore, even those bundled services are not yet competitive, because they are offered by a duopoly consisting of the local telephone company and the incumbent cable company.

Q: Should the Commission give weight to other intermodal alternatives such as "over-the-top" VoIP or wireless?

A: No, the Commission should not give much weight to "over the top" VoIP alternatives to basic local exchange service.[190] The product supplied by Vonage, for example, requires that subscribers provide their own broadband Internet access. In its *Verizon/MCI Merger Order*, the FCC excluded over-the-top VoIP services from the relevant product market and confirmed this decision earlier this year in its Order approving the merger of AT&T and BellSouth.[191] Wireless telecommunications services indisputably are prevalent. Yet, evidence suggests that consumers are not "cutting the cord" (i.e. subscribing to wireless service in lieu of wireline service). In its order approving the merger of AT&T and BellSouth, the FCC found that approximately six percent (6%) of households rely on wireless services for all of their telecommunications needs

[189]/ The FCC noted at footnote 268 of its *Verizon/MCI Merger Order* that the average monthly household expenditure for billed wireline local telephone service is $37. Of course, rates vary widely among states for a plethora of reasons and many households subscribe to discretionary services. A basic exchange line that provides access to the network, but no bells and whistles will be substantially less. Thus, the cable telephony option will not be price-competitive for the consumer seeking a bare-bones service that provides access to the public switched telephone network.

[190]/ "Over the top" VoIP services refer to services provided by companies such as Vonage that require users to provide their own broadband Internet access in order to use the service.

[191]/ *FCC Verizon/MCI Merger Order*, at para. 89; *FCC* AT&T/BellSouth Merger Order, at para. 94.

(*i.e.*, six percent have "cut the cord").[192] The FCC also cited its prior conclusion that "the record does not present credible evidence that mobile wireless services have a price constraining effect on all consumers' demand for primary line wireline services."[193] In addition, the Commission observed that the "average cost for mobile wireless services appears to be higher than for wireline local service"[194] which "may not make it price competitive for consumers."[195] The evidence suggests that many intermodal services act as supplements to wireline service instead of substitutes.

Q: What is your conclusion regarding assertions that the presence of competition from intermodal services obviates the need for service quality standards?

A: The decline of Verizon NH's service quality is sufficient evidence that service quality standards are still essential. There is insufficient evidence to suggest that competition from intermodal providers -- or wireline competition, for that matter -- provides sufficient competitive pressures to incent improvements to service quality. The Commission should continue to require adherence to those standards and should adopt an incentive for FairPoint to achieve those standards if it approves the proposed transaction.

G. <u>Affirmative service quality accountability is essential</u>

Q: What are the implications of Verizon NH's failure to address service quality problems in New Hampshire?

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[192]/ *FCC AT&T/BellSouth Merger Order*, at para. 96.

[193]/ *Id.*, at fn 273, citing *SBC/AT&T Merger Order* at fn 276.

[194]/ *Id.*, at para. 95.

A: Verizon NH seeks regulatory approval to sell its operations to FairPoint. Therefore, now is when Verizon and FairPoint are most likely to be responsive to strong Commission direction on service quality and other important public objectives. Once the Commission approves any transaction, particularly in the face of lackluster competition in most geographic areas, and especially for POTS customers, FairPoint's incentives for increasing its service quality will diminish.

Q: Is the current manner in which Verizon NH is held to service quality standards adequate?

A: Apparently not, as evidenced by the continued failure of Verizon NH to meet current benchmarks and the utter lack of incentive to do so. If a competitive marketplace existed, regulatory oversight of the quality of Verizon NH's basic local exchange service would be less necessary. However, precisely because mass market consumers do not select providers in a "competitive marketplace," regulatory oversight is essential as a substitute for the market. Where there is sufficient competition, customers can arguably migrate to the provider with the desired level of service quality. However, for the mass market basic exchange service customer, particularly the residential customer outside of the few marginally-competitive wire centers, such competitive options do not exist in New Hampshire at this time. Therefore, I urge the Commission to develop a meaningful service quality regime with financial accountability for FairPoint if it approves the proposed transaction.[196]

Q: Do you have specific recommendations regarding financial accountability?

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[195]/ *Id.*, at fn 275.

[196] / My recommendations regarding financial accountability for service quality could be applied to Verizon NH if the transaction is not approved.

A: Yes. As I discuss below with reference to Arkansas and Illinois, customer-specific accountability would be the best approach. In other words, rather than focus on the reporting mechanism, the Commission could focus on the customer and create financial accountability if FairPoint fails to meet specified standards. The advantage of such an approach is that there would be a clear financial incentive for meeting service quality standards. FairPoint should commit to incurring financial consequences if service quality declines and to financial consequences if it does not improve the current status of service quality in order to meet PUC-established benchmarks. However, if competitive pressures are sufficient to result in the provision of quality service at a reasonable price, then FairPoint will meet service quality standards and will not be required to pay credits to customers for poor service.[197]

Q: Please discuss the Arkansas and Illinois service quality programs that you mentioned above.

A: In Arkansas, the Public Service Commission ("PSC") approved a stipulation among Staff, the Arkansas Attorney General, and CenturyTel Northwest of Arkansas, LLC ("CenturyTel"), which

[197]/ In discussing the cap on service quality penalties in Vermont for Verizon in a 2001 Order, the Vermont PSB made the following observation:

> Finally, the debate over the size of the potential penalty amount masks the underlying goal of the service quality standards. It is the Board's strong preference that Verizon pay *no* penalty. We established these standards in 2000 and continue them now to encourage Verizon to maintain the high service quality that it had in place before the onset of incentive regulation. Verizon has shown that it can attain these standards if it chooses to deploy adequate facilities and staff. Verizon itself agreed in 2000 that these were reasonable. Large penalties only exist when Verizon fails to meet its performance expectations. Considering the availability of a waiver for unforeseeable events, this would only occur as a result of choices that Verizon itself made. Verizon has shown no reason why the risks of these choices should be removed from Verizon and passed on to its customers.

Investigation into a Successor Incentive Regulation Plan for Verizon New England Inc., d/b/a Verizon Vermont, State of Vermont Public Service Board Docket No. 6959, *Order*, September 26, 2005, at 134 (emphasis in original).

addressed matters of revenue requirement, rate design, and service quality.[198] The PSC's order describes the customer credit portion of the service quality components of the stipulation as follows:

> The Settlement Agreement provides that if CNA [CenturyTel] fails to meet the quality of [installation] service standards it will, for the following calendar quarter, provide the customer a credit in the amount of 50% of the installation charge. The Company agrees that if it fails to meet the restoration of service requirements . . . for a given calendar quarter in a specific exchange, it will provide a customer credit in the amount of a pro-rata portion (1/30th per day missed beyond a 24-hour period) of the monthly basic local exchange rate for each instance.
>
> In the Settlement Agreement CNA further agrees that if it fails to meet the restoration of service requirements . . . , it will provide a customer credit in the amount of the entire monthly basic local exchange rate for each individual instance.[199]

Q: Please describe the Illinois program you reference above.

A: In Illinois, customers also receive customer credits for poor service quality. Telecommunications carriers are required to provide customer credits for (1) out-of-service over 24 hours; (2) installation occurring after five days; and (3) missed appointments.[200] The credits are as follows:

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[198] / I submitted testimony on these issues on behalf of the Arkansas Attorney General. See Attachment A to my testimony.

[199] / *In the Matter of the Application of CenturyTel of Northwest Arkansas, LLC for Approval of a General Change in Rates and Tariffs*, Arkansas Public Service Commission Docket No. 03-041-U, *Order No. 8,* at 11-13.

[200] / 83 Ill.Adm. Code 732, effective August 1, 2001; Illinois Commerce Commission, Docket No. 98-0252, Illinois Bell Telephone Company Application for review of alternative regulation plan; Docket No. 98-0335, Illinois Bell Telephone Company petition to Rebalance Illinois Bell Telephone Company's Carrier Access and Network Access Line Rates; Docket No. 00-0764, Citizens Utility Board and the People of the State of Illinois -v- Illinois Bell Telephone Company, Verified Complaint for a Reduction in Illinois Bell Telephone Company's Rates and Other Relief, Order, December 30, 2002 ("Illinois Order"), at 196. The Illinois Commerce Commission was among the first state commissions to incorporate a "Q" factor in the initial price cap plan that governed Ameritech-Illinois. The Illinois Commerce Commission

Table 8

Illinois Credits for Out of Service for more than 24 Hours	
24 – 48 Hours	A pro-rate portion of the monthly recurring charges
48 – 72 Hours	33% of monthly recurring charges
72 – 96 Hours	67% of monthly recurring charges
96 – 120 Hours	100% of monthly recurring charges
> 120 Hours	Alternative telephone service or $20/day (customer option)

adopted a specific service quality component that added as much as two percentage points in a year to Ameritech Illinois' X-Factor if Ameritech Illinois failed to meet all of its service quality performance standards. Petition to Regulate Rates and Charges of Noncompetitive Services Under an Alternative Form of Regulation, *Order*, Illinois Commerce Commission Docket No. 92-0448/93-0239 Consol. (October 11, 1994), at 56-59.

Table 9

Illinois Credits for Delayed Service Installation	
After 5 business days	50% of installation charges
After 10 business days	100% of installation charges
Each day thereafter	Alternative telephone service or $20/day (customer option)
Missed installation and repair appointments	$50 per missed appointment (in the absence of 24 hours notice)

Q: Have other state regulators established service quality credits to protect consumers?

A: Yes. The Michigan Public Service Commission adopted new service quality rules for telecommunications on August 1, 2005.[201] Among other requirements, the comprehensive rules require providers to give customers a credit of $25 for a missed repair commitment and either a 50 percent or 100 percent waiver of installation fees, depending on the tardiness of the installation.[202]

Q: How is Verizon's service quality regulated in neighboring states?

A: In 2005, the Vermont Public Service Board ("PSB") adopted a new AFOR plan for Verizon Vermont in which it retained its Service Quality Plan.[203] Verizon Vermont had proposed to

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201 / *In the matter, on the Commission's own motion, to promulgate rules governing the quality of telecommunications services*, Michigan Public Service Commission Case No. U-14435, *Order Adopting Telecommunications Service Rules*, August 1, 2005.

202 / *Id.*

203/ *Investigation into a Successor Incentive Regulation Plan for Verizon New England Inc., d/b/a Verizon* eliminate the plan, arguing that there was a sufficient degree of competition in the market to justify such a decision. The Vermont PSB found that:

> Existing and future competition for local exchange service and other telecommunications services alone will not substitute for a regulated approach to retail service quality . . . The existence of competitive alternatives alone will not necessarily substitute for service quality standards. Moreover, Verizon's performance over the last five years belies its assertion that competition is sufficient to protect service quality. Competition has clearly increased during this period, yet Verizon's service quality performance deteriorated. Unless we accept the premise that consumers must accept lesser service quality in a competitive market, which we do not, we can only explain this dichotomy by inferring that competition does not provide adequate restraint . . . As the Department points out, most of the New England states have imposed a set of service quality standards that include predetermined penalties or customer credits for service quality failures. The Service Quality Plan that we adopt is consistent with these other programs. We conclude that Vermont's status as a relatively small part of Verizon's territory requires a service quality plan with significant penalty dollars attached in order to achieve its purpose of maintaining adequate service quality. Unless the plan contains a strong incentive for Verizon to keep its service quality high, there is too much risk that Verizon will not take steps to preserve service quality and treat the payments as a cost of doing business.[204]

Q: What form does the service quality penalty take?

A: Verizon Vermont's Service Quality Plan calculates points based on the failure of Verizon VT to meet approved metrics on a monthly basis. These points are translated into dollar amounts to assess a penalty on Verizon Vermont. The penalty is then distributed to customers and on a yearly basis in the form of a one-time rebate, or "Service Quality Compensation.[205] The total penalty, or compensation, is capped at $10,515,650.[206]

Vermont, State of Vermont Public Service Board Docket No. 6959, *Order,* September 26, 2005.

[204]/ *Id.*, at 130-131.

[205] / *Id.,* at Appendix C.

[206] / *Id.*

Q. Does Maine take a similar approach?

A: Yes. The current Service Quality Index in Maine's AFOR[207], adopted in 2001, includes a rebate mechanism similar to Vermont's. Despite granting pricing flexibility for many of Verizon Maine's retail services, the Maine Public Utilities Commission ("PUC") retained Verizon Maine's Service Quality Index ("SQI") and, in fact, increased the total number of indices and the amount of the potential penalty faced by the company.[208] The PUC found that precisely because Verizon Maine had gained a reduction in regulation, the SQI should be retained.[209]

Q: Is Verizon accountable for its service quality in Massachusetts?

A: Yes. The Massachusetts Department of Telecommunications and Energy ("DTE") adopted a service quality rebate, or credit, in 2003. Currently, the plan includes a financial penalty that is paid as a one-time credit to *all* residence and business lines on an annual basis.[210] In adopting the plan, the Massachusetts DTE stated:

> Although Verizon is no longer subject to price cap regulation, competition for some customers may introduce a financial incentive for the regulated entity to reduce costs by reducing service quality to other customers, so we conclude that

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[207] / Maine is currently examining a proposed AFOR plan for Verizon Maine. The Commission had opened a separate proceeding to examine Verizon Maine's service quality problems, but then transferred the service quality investigation to the AFOR proceeding when opening the AFOR case, stating: "The SQI has been an integral part of the AFOR since 1996." I discuss the status of this case in Section VIII.

[208] / *Maine Public Utilities Commission Investigation into Bell Atlantic-Maine's Alternative Form of Regulation*, State of Maine Public Utilities Commission Docket No. 99-851, *Order (Part 1)*, May 9, 2001.

[209] / *Maine Public Utilities Commission Investigation into Bell Atlantic-Maine's Alternative Form of Regulation*, State of Maine Public Utilities Commission Docket No. 99-851, *Order (Part 2)*, June 25, 2001, at 39.

[210] / *Investigation by the Department of Telecommunications and Energy on its own Motion into the Appropriate Regulatory Plan to succeed Price Cap Regulation for Verizon New England, Inc. d/b/a Verizon Massachusetts' intrastate retail telecommunications services in the Commonwealth of Massachusetts*, Massachusetts Department of Telecommunications and Energy Docket No. DTE 01-31-Phase II, *Order*, April 11, 2003, at 96, 100-101.

> there should continue to be some form of protection against a reduction in service quality.[211]

This is precisely the situation in New Hampshire. FairPoint will have the incentive to reduce costs to serve the basic local exchange customer and instead focus service quality efforts in competitive exchanges or in bundled services. Indeed, in Verizon Communications' second quarter 2006 Investor Quarterly, Ivan Seidenberg, Verizon's chairman and CEO is quoted as stating: "Verizon Telecom is tightly controlling costs in traditional businesses as we make the fiber network investments to accelerate growth and market expansion."[212] Despite the regulatory changes undertaken in these other states, regulators have continued to view service quality as an integral part of the regulatory regime.

H. Summary of findings and recommendations regarding service quality.

Q: Please summarize your major service quality findings .

A: Among my major findings are the following:

- FairPoint stands to inherit a system that has been neglected: Verizon NH's service quality has been deteriorating for several years, and some communities are suffering particularly poor quality of service.

- Competitive forces do not yet exist to constrain Verizon NH's service quality or provide FairPoint adequate incentives to improve and maintain service quality.

- Despite concerns expressed by Staff, the OCA and others, the quality of basic local exchange service in New Hampshire has been deteriorating for several years, and Verizon NH demonstrates no intention of achieving PUC-established service quality standards before selling its landline assets to FairPoint.[213]

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211 / *Id.*

212 / Verizon Communications, *Investor Quarterly: VZ Second Quarter 2006,* August 1, 2006, at 2.

213 / In addition to this portion of my testimony, also see the exhibits to my testimony. See, also, *Verizon's Quality of Service Performance*, New Hampshire Public Utilities Commission DT 04-019, *Order Establishing Status*

- Neither Staff concerns, existing Commission standards, open dockets, nor purported competition have provided sufficient economic incentives for Verizon NH to improve and maintain its service quality.
- It is not evident that FairPoint has the resources, the economic incentive, or the corporate interest in raising and then maintaining adequate service quality for basic local telephone service or has engaged in proper due diligence on this issue.
- Employee turnover at SpinCo is high, which may lead to a lack of qualified personnel, which in turn would jeopardize post-transaction service quality. As a result, I recommend that the Commission examine carefully the workforce that would be transferred with Spinco.
- Financial accountability is essential to protect consumers, particularly those who subscribe to POTS.

Q: What are your more detailed service quality recommendations?

- Verizon NH should not be permitted to transfer its local operations until the proposal includes a detailed plan and budget to ensure that within a specified period of time and with sanctions for non-compliance (1) PUC-established service quality standards are met or exceeded upon transfer; and (2) service quality in those communities with particularly poor service quality is raised to meet state standards.
- The Commission should adopt a system of service quality penalties and rebates or credits paid directly to consumers to provide an incentive for service quality improvement if it approves the proposed transaction.
- FairPoint should agree to financial consequences, including penalties that could include automatic customer credits, if PUC-established service quality benchmarks are not met
- Although my testimony does not address the Commission-established standards themselves (other than to recommend that these standards be met), the Commission should not make the standards any more lenient: historic data demonstrates that the standards are clearly achievable.
- FairPoint should make service quality information and reports available to the public (i.e., not filed confidentially) as is the case for the ILECs in Vermont and Maine.[214]

Conference, Order No. 24,551, December 1, 2005 ("Order No. 24,551") and *Report on Initial Analysis for the Staff of the New Hampshire Public Utilities Commission*, by Curry & Associates, Docket No. 04-019, February 4, 2005 ("Curry Report").

[214] / See, http://www.maine.gov/cgi-bin/mpuc/scorecard.pl; In Vermont, a consumer can obtain service quality

Also, FairPoint should file service quality reports, on a monthly basis and in a web-based format which can be made available directly to consumers on the PUC website.

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data by calling the Department of Public Service.

VII. BROADBAND DEPLOYMENT

A. <u>The widespread availability of affordable broadband access is critically important to New Hampshire's economy, health care system, educational institutions, and citizens.</u>

Q: Please explain the importance of broadband Internet access to New Hampshire consumers.

A: Broadband access is extremely important to New Hampshire's economy, public institutions, and citizens, and is rapidly becoming almost as indispensable as are voice telephone service, electricity, water, and gas. Broadband access enables businesses to maintain relationships with suppliers and customers, and provides consumers an efficient avenue for such daily activities as keeping in touch with friends and family, making purchases, obtaining medical care, paying taxes and fees, finding job opportunities, participating in government and civic activities, and researching school projects. The Internet is quickly becoming the first place to turn for recent or frequently updated information. Because of the increasing importance of the Internet in everyday life, those who lack speedy access to the Internet risk falling behind. Furthermore, a state that lacks an advanced "ramp" to the Internet risks its economic and social infrastructure falling behind other regions of the country.

Furthermore, as occurs with the public switched telephone network (PSTN), broadband deployment yields substantial positive "externalities" – the aggregate societal benefits of broadband interconnectedness increase exponentially as the percentage of consumers served by broadband increases.

Q: Please describe generally the regulatory framework for broadband services.

A: In 2005, the FCC adopted its *Wireline Broadband Order*, which determined that wireline broadband Internet access services were "information" services, and which sought to adopt a "consistent regulatory framework across platforms by regulating like services in a similar functional manner . . ."[215] (*i.e.*, treating cable modem and DSL services in the same manner). The FCC opted to adopt a "lighter regulatory touch" in order to "promote the availability of competitive broadband Internet access services to consumers, via multiple platforms, while ensuring adequate incentives are in place to encourage the deployment and innovation of broadband platforms consistent with [its] obligations and mandates under the Act."[216] In 2005, the FCC described the broadband Internet access market in the following manner:

> We fully recognize that not all American households can choose between cable modem and DSL-based Internet access service today. But a wide variety of competitive and potentially competitive providers and offerings are emerging in this marketplace. Cable modem and DSL providers are currently the market leaders for broadband Internet access service and have established rapidly expanding platforms. There are, however, other existing and developing platforms, such as satellite and wireless, and even broadband over power line in certain locations, indicating that broadband Internet access services in the future will not be limited to cable modem and DSL service.[217]
>
> We expect providers of both platforms will continue to invest and extend the reach of their services. We anticipate that, as the availability of cable modem and DSL broadband Internet access services grows with the modernization of network infrastructure and increased service deployment, more households will have the option of choosing between the cable and DSL broadband options. Increased intermodal and intramodal competition will continue to encourage these two broadband providers to deploy broadband Internet access services throughout their respective service areas. In addition, the threat of competition from other forms of broadband Internet access, whether satellite, fixed or mobile wireless, or

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215/ *Appropriate Framework for Broadband Access to the Internet over Wireline Facilities, Universal Service Obligations of Broadband Providers*, CC Docket No. 02-33, et al., *Report and Order and Notice of Proposed Rulemaking*, 20 FCC Rcd 14853 (2005) ("Wireline Broadband Order"), at para. 1. *See, also*, para. 5.

216 / *Wireline Broadband Order*, at para. 3.

217 / *Id.*, at para. 50 (notes omitted).

> a yet-to-be-realized alternative, will further stimulate deployment of broadband infrastructure, including more advanced infrastructure such as fiber to the home.[218]

Q: Have the FCC's expectations of "rapidly expanding platforms" been realized?

A: No. As the evidence in this proceeding clearly demonstrates, many consumers in New Hampshire still lack access to an advanced "ramp" to the Internet.

Q: If advanced services contribute to a state's economy and welfare, why hasn't the Commission simply ordered Verizon NH to deploy its DSL ubiquitously?

A: Although I am not an attorney, it is my understanding that, as a result of the FCC's 2005 decision that wireline broadband services are information services, state authority to *require* such investment is limited. As a result, ILECs' broadband commitments to regulators typically occur "voluntarily" or as conditions in proceedings in which ILECs seek alternative forms of regulation or approval of mergers.[219]

Q: How does this differ from state regulators' historic review of ILECs' network investment?

A: Historically, and with regard to the PSTN, ILECs' obligation to serve all consumers was undisputed. Rate-of-return regulation provided the FCC and state public utility commissions with the opportunity to oversee the industry's investment and to ensure simultaneously that companies would have the opportunity to earn a fair return on their investment. Also, before Verizon became a mega-company with global strategic interests, it may have been more

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[218] / *Id.*, at para. 57.

[219] / Vermont Public Service Board Docket No. 6959, *Investigation into a Successor Incentive Regulation Plan for Verizon New England Inc.*, d/b/a Verizon Vermont, September 26, 2005. The Order Adopting Amended Plan of April 27, 2006 ("Amended Plan") modified the settlement; *FCC AT&T/BellSouth Merger Order*, Appendix F ("AT&T/BellSouth Merger Conditions").

accountable to its "hometown" regions as it made infrastructure investment. For example, twenty years ago, under the jurisdiction of state regulators, Verizon (then New England Telephone and Telegraph Company) deployed digital switches not only in urban areas (where revenues from then-new features such as call waiting clearly justified the investment), but also it replaced aging electromechanical switches in rural communities (in compliance with the regulatory requirement to deploy switches capable of providing equal access to long distance carriers) more expeditiously than a strict cost-benefit analysis would have dictated.[220] Today that type of "maintenance" investment is lagging.

Q: What is the result of the regulatory "hands-off" approach to ILECs' broadband deployment?

A: Small communities in New England and across the nation are clamoring for access to broadband service, but, in the absence of adequate regulatory accountability, ILECs are selectively deploying broadband technology.[221] Despite widespread consumer demand for advanced services, the nation's advanced telecommunications network is evolving in a fragmented manner, and likely will not reach precisely those consumers who are at the greatest risk of being isolated from society's economic mainstream (such as, the unemployed, the home-bound, the disabled, and those living in remote parts of the country) in a timely, affordable, and reasonable manner

[220] / State regulators directed NET (now Verizon) to accelerate its replacement of outdated electromechanical central office switches in rural Massachusetts so that some communities would not be left behind, lacking access to touch tone, while NET advertised then-new features, such as call waiting, in urban and suburban communities. State regulators also directed NET to improve service quality in specific regions of the state where aging outside plant yielded inferior service quality. Massachusetts D.P.U. 89-300, *New England Telephone Company*, June 29, 1990.

[221]/ *See e.g.,* "In Western Mass., still using dial-up," *Boston Globe*, Business Section, D3, April 29, 2007, in which a consumer states, among other things: "[w]e are still using 56 dial-up modems (remember those?) (sic) and waiting to get the DSL lines that Eastern Massachusetts has had for more than a decade."

absent regulatory intervention.

Q: What federal efforts are underway to monitor the market for broadband access services, and to encourage broadband deployment?

A: In section 706 of the Telecommunications Act of 1996 ("1996 Act"), Congress directed the FCC and the states to encourage the deployment of advanced telecommunications capability to all Americans. [222] The FCC recently initiated three broadband proceedings, which relate to the achievement of that goal:

- In one proceeding, the FCC seeks to update its data-gathering efforts to make policy more effectively.[223]

- In another proceeding, the FCC seeks to update the definition of broadband, learn where broadband is currently deployed, and determine whether deployment occurs in a timely manner.[224] Recognizing that some areas still lack any access to broadband facilities, and that these areas are at risk of being left on the wrong side of the digital divide, the FCC seeks recommended policies to accelerate deployment of broadband to unserved areas.[225]

- In a third proceeding, the FCC is investigating market practices related to broadband access.[226] In this proceeding, the FCC seeks comments on whether it should impose a

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222 / Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 ("1996 Act"). The 1996 Act amended the Communications Act of 1934. Hereinafter, the Communications Act of 1934, as amended by the 1996 Act, will be referred to as "the 1996 Act," or "the Act," and all citations to the 1996 Act will be to the 1996 Act as it is codified in the United States Code.

223 / *In the Matter of Development of Nationwide Broadband Data to Evaluate Reasonable and Timely Deployment of Advanced Services to All Americans, Improvement of Wireless Broadband Subscribership Data, and Development of Data on Interconnected Voice over Internet Protocol (VoIP) Subscribership*, WC Docket No. 07-38, Notice of Proposed Rulemaking ("Data NPRM"), FCC 07-17, rel. April 16, 2007.

224/ *In the Matter of Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996*, GN Docket No. 07-45, *Notice of Inquiry* ("Deployment NoI"), FCC 07-21, rel. April 16, 2007.

225 / *Id.*

226/ *In the Matter of Broadband Industry Practices*, WC Docket No. 07-52, *Notice of Inquiry* ("Broadband Industry Practices NoI"), FCC 07-31 (rel. April 16, 2007).

nondiscrimination principle to guide the further development of broadband access in the U.S.[227] In addition, the FCC seeks more general information about prices for broadband access, as well as how access providers segment the market.[228]

Q: How do the FCC proceedings relate to this proceeding?

A: The broadband deployment proceeding has particular relevance to the proposed transaction, as it addresses the fact that many Americans lack broadband service. One issue discussed in the *Deployment NoI* is whether it is feasible to create a map showing what areas have broadband, and what areas do not. Such a map would allow policy-makers, consumers, and the industry itself to identify unserved areas. This would allow limited resources to be targeted to specific areas, helping to bring broadband access to more consumers in the most cost-effective manner. However, mapping alone will not bring more broadband access to New Hampshire.[229]

B. <u>New Hampshire's broadband infrastructure lags substantially behind other states.</u>

Q: What is the status of broadband deployment in New Hampshire?

A: The FCC's most recent high-speed services report indicates that as of June 30, 2006, 59% of all end-user premises in New Hampshire where ILECs (not just Verizon NH) offered telephone service had xDSL services available to them.[230] This compares to a nationwide estimate that

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227/ *Id.*

228/ *Id.*

229/ The *Deployment NPRM* makes reference to a General Accountability Office ("GAO") report that highlights a local effort to extend broadband deployment in Kentucky. The nonprofit organization ConnectKentucky, partnering with the GAO, devised a system to map actual broadband deployment throughout the state. This mapping exercise allowed the group to determine exactly where broadband facilities are deployed, and thus where broadband is actually available. As a result of this effort, and the policy initiatives that followed, broadband access in Kentucky rose from 60% in 2004 to 93% today. See *In the Matter of Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996,* GN Docket No. 07-45, *Notice of Inquiry,* Comments of Connected Nation, Inc., filed May 16, 2007, at 3. ConnectKentucky's success demonstrates that it is possible to map broadband deployment at a very local level, and to use this information to further deployment efforts. Regardless of the outcome of the proposed transaction, a similar mapping project in New Hampshire would highlight areas that are currently underserved.

230/ FCC, Industry Analysis and Technology Division, Wireline Competition Bureau, *High-Speed Services for*

79% of U.S. residential consumers have xDSL available to them where ILECs offer local telephone service.[231]

As Figure 1-C shows, according to Verizon NH's December 2006 Form 477, broadband service is available to **<<<BEGIN CONFIDENTIAL END CONFIDENTIAL>>>** of all New Hampshire households it serves,[232] which shows **<<<BEGIN CONFIDENTIAL**

END CONFIDENTIAL>>>[233]

Internet Access: Status as of June 30, 2006, rel. January 2007, at Table 14, available at http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-270128A1.docIn addition, the report indicates that 67% of residential consumers in Maine and 60% of residential consumers in Vermont have xDSL services available to them where an ILEC offers telephone service as of June 30, 2006. *Id.* The Commission typically releases new high-speed services reports in January and July. The most recent report available as of mid-July was the report released January 2007.

231 / *Id.*, at Table 14.

232 / *See* Exhibit SMB-C-52 Verizon NH response to OCA GI 1-34, sections (l) and (o).

233 / *See id.*

Figure 1-C[234]

Percentage of Homes Passed by Verizon NH DSL Facilities, 2005-2006.

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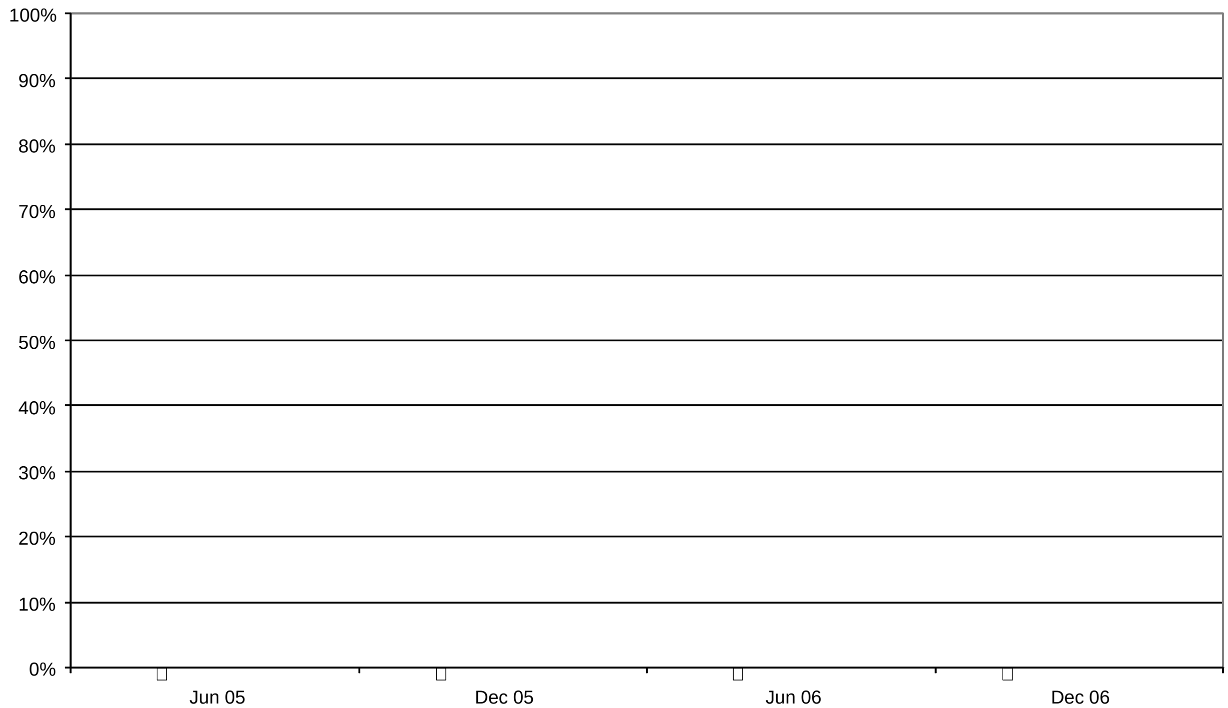

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Q: Have you reviewed the current status of broadband demand in New Hampshire?

A: Yes. Confidential Exhibit SMB-C-54 to my testimony shows the current demand for broadband in each of Verizon NH's wire centers. Of course, in some cases, DSL demand is a function of supply in that consumer demand can only be observed where DSL is supplied. Verizon indicates that it does not maintain records of consumer demand where DSL was currently not available (*i.e.* "Verizon does not track customer inquiries/requests that do not result in an order for DSL

[234] / See Exhibit SMB-C-52, question I-11. Data reported by Verizon NH. The percent of total lines "qualified" for DSL service was **<<<BEGIN CONFIDENTIAL END CONFIDENTIAL>>>** in 2003, 2004, 2005, and 2006, respectively. See Exhibit SMB-C-53, Verizon supplemental response to Staff GII 2-38.

service.”).[235]

Q: Do you have information about where Verizon NH has deployed DSL?

A: Yes. In response to Labor GII 2-22, Verizon NH provides DSL availability data on a household basis. Table 10-C summarizes Verizon NH’s response and includes data regarding the total number of DSL qualified households and the speed of services offered to those households.

Table 10-C

Household Broadband Availability

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Source: Exhibit SMB-C-55 Verizon NH response to Labor GII 2-22, proprietary attachment Labor GII 2-22.				

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Q: What are Verizon NH’s current DSL prices?

A: The following table provides “consumer annual plan” prices for DSL services (i.e. retail,

[235] / See Exhibit SMB-C-56, Verizon second supplemental response to OCA G II 1-52.

residential DSL offerings).[236]

Table 11-C

Verizon NH Consumer DSL Offerings

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Source: Exhibit SMB-C-57, Verizon response to Labor GII 2-23, and proprietary attachment.				

END CONFIDENTIAL>>>

Q: What is FairPoint's understanding of Verizon NH's current plans to deploy DSL in New Hampshire?

A: Mr. Harrington states that Verizon is "continuing to deploy DSL in its own build-out plans."[237] Verizon NH, in responding to OCA data requests, indicated that it has not suspended its DSL deployment plan and is continuing deployment planning and implementation and "business as

[236] / See also Exhibit SMB-C-58, Verizon NH's proprietary supplemental response to Labor FDR II-28 regarding DSL, FiOS and other broadband promotions that Verizon is now offering in the three northern New England states, including information about packaged and a la carte offerings.

[237] / Harrington (FairPoint) Direct, at 11.

usual" operating decisions.[238]

C. The Verizon NH network lacks ubiquitous DSL capability.

Q: What is the current status of the infrastructure that FairPoint will inherit if the transaction is approved, in terms of the percentage of embedded copper loops that currently are not considered acceptable for xDSL deployment?

A: The network that FairPoint would inherit is inadequate to provide consumers with ubiquitous broadband deployment. Loops may not be considered "acceptable" for broadband deployment because of loop distance limitations and other technical factors. Confidential Exhibit SMB-C-59 reproduces Proprietary Attachment NH OCA GII: 1-70 second errata (provided by Verizon NH in its second supplemental errata response to OCA GII 1-70 and 1-71) and provides the number of loops considered acceptable and not acceptable for DSL deployment. This Confidential Exhibit shows that **<<< BEGIN CONFIDENTIAL END CONFIDENTIAL** >>> of the copper loops in Verizon NH's territory are considered "acceptable" for DSL deployment. The information was extracted from Verizon's Loop Qualification Database. Mr. Harrington states in his testimony that the data FairPoint reviewed showed that 63% of Verizon's lines in New Hampshire are qualified to provide DSL.[239] Data provided by Verizon indicates that the percent of total lines "qualified" for DSL service was **<<<BEGIN CONFIDENTIAL END CONFIDENTIAL>>>** in 2003, 2004, 2005, and 2006, respectively.[240]

Q: What factors influence Verizon NH's determination of whether access lines are qualified for DSL?

[238] / See Exhibit SMB-P-60, Verizon supplemental response to OCA G II 1-65.

[239] / Harrington (FairPoint) Direct, at 10.

[240] / See Exhibit SMB-C-52

A: Verizon NH states that the following factors determine if a Verizon NH access line is qualified for DSL service:

- Loop length guidelines (must be less than or equal to 18,000 feet);
- Serving central office must be equipped with a digital subscriber line access multiplexer (“DSLAM”);
- RT/Overlay presence;[241]
- The line must be a Verizon account; and
- Presence/absence of interferers (Verizon will remove a load coil to support DSL if the loop is under 18,000 feet).[242]

Q: Has FairPoint indicated its criteria for qualifying loops?

A: Yes. FairPoint states that FairPoint qualifies a customer line as “DSL addressable” if it is within 15,000 feet of a DSL port.[243] FairPoint additionally states that the “maximum allowable loop length for DSL service is entirely dependent upon the gauge of the copper loop, its make-up over the length of the facility, type of DSL utilized and sustainable data speeds expected.”[244]

Q: Please provide the total capital expenditures that Verizon NH’s operations have undertaken with respect to plant maintenance and DSL buildout since 2003.

A: Verizon indicates that total expenditures for DSL-related projects for 2003, 2004, 2005 and 2006 were **<<<BEGIN CONFIDENTIAL**

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[241] / Remote terminals allow a DSL provider to install DSLAMs closer to the customers thus enabling the provider to qualify lines for DSL that were previously considering too far from the central office.

[242] / See Exhibit SMB-C-52.

[243] / See Exhibit SMB-P-61, FairPoint response to OCA GII 2-60.

[244] / *Id.*

END CONFIDENTIAL>>> respectively.[245] These amounts do not appear to include FiOS expenditures.

D. <u>FairPoint promises to roll out more broadband capability, but its promises are difficult to enforce and do not justify approval of the proposed transaction.</u>

Q: What do the Joint Petitioners state with respect to broadband deployment and the proposed transaction?

A: Mr. Leach, FairPoint's Executive Vice President of Corporate Development, asserts that one of the primary benefits of the proposed transaction is "access for more customers to advanced telecommunications and information services such as broadband Internet . . ."[246] Specifically, FairPoint has plans to "expand significantly the availability of broadband service to customers in the three-state region (primarily using DSL technology)."[247] Mr. Leach further states that FairPoint will complete a "major expansion" of broadband within the first twelve months of the closing of the merger, if approved.[248] FairPoint indicates that 92% of its customers in the three-state region of northern New England have access to broadband compared to 62% of Verizon's customers.[249] Mr. Harrington states that "one of FairPoint's top priorities will be to deploy broadband network infrastructure and provide broadband-enabled services to customers who do not have high-speed access and broadband-enabled services today."[250]

As noted by Mr. Leach, the deployment of additional broadband services "will require

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245 / See Exhibit SMB-C-62, Verizon NH supplemental response to Labor GII 2-24.

246 / Leach (FairPoint) Direct, at 6.

247 / *Id.*, at 7.

248 / *Id.*, at 7.

249 / *Id.*, at 7. See also, Nixon (FairPoint) Direct, at 7.

250 / Harrington (FairPoint) Direct, at 3.

significant incremental investment in the network," and FairPoint indicated in testimony that it had already begun to outline its broadband deployment plans.[251] Mr. Leach is correct that such expansion is "beneficial to the local economies, as broadband availability is a critical element in driving economic viability and development,"[252] but I recommend that the Commission consider two important factors as it assess the merit of FairPoint's broadband promises:

- First, even if FairPoint were to deliver broadband to consumers consistent with its promises, such deployment would not in and of itself justify the Commission's approval of the transaction.
- Second, FairPoint's promises, as structured, are entirely unenforceable.

Q: By what benchmarks, if any, does FairPoint propose that the PUC and OCA measure FairPoint's success in deploying DSL?

A: FairPoint proposes that the PUC measure success based on percent "addressability" of access lines.[253] FairPoint does not provide details about what specifically it means.

Q: Did FairPoint provide an adequate level of detail in the Joint Petition and testimony regarding its broadband deployment plans?

A: No. For instance, Mr. Harrington makes the general statement that FairPoint's goal is to "build out broadband capable infrastructure that meets customer needs and service demands."[254] Mr. Harrington further states that "[a]fter the needs are identified, we can then make the decision as

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[251] / Leach (FairPoint) Direct, at 12. FairPoint, however, did not provide its plan until June 12th, 2007. *See* Exhibit SMB-63-C, first supplemental reply to Staff GII 2-35 (CFPNH 2158-2170).

[252] / *Id.*, at 12.

[253] / See Exhibit SMB-P-63, FairPoint response to OCA II 1-35.

[254] / Harrington (FairPoint) Direct, at 3.

to the technology best suited to meet those needs. This technology decision is necessarily based on a number of factors, including service demand, customer density, quantities, cost and revenue opportunities."[255] However, FairPoint is not committing to provide DSL to particular wire centers by a set date or to pay any penalties for failure to make good on its deployment promises. Mr. Harrington indicates that as part of FairPoint's due diligence, FairPoint identified areas in which broadband could be easily and quickly deployed upon consummation of the merger.[256] He also notes that typically, FairPoint will deploy to denser areas first, in order to reach the greatest number of consumers.[257]

E. <u>FairPoint fails to substantiate its DSL projections</u>

Q: Please generally describe the financial projections that FairPoint has developed with respect to its broadband deployment plans in New Hampshire.

A: The financial model includes **<<<BEGIN CONFIDENTIAL**

END CONFIDENTIAL>>>[258]

FairPoint's financial projections include **<<<BEGIN CONFIDENTIAL**

END CONFIDENTIAL>>>[259] Mr. Leach states that FairPoint's existing broadband penetration levels are **<<<BEGIN CONFIDENTIAL END CONFIDENTIAL>>>** of voice access

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255 / *Id*. at 4.

256/ *Id*. at 13.

257 / *Id*., at 13.

258 / Leach (FairPoint) Direct, at 29-30.

259/ *Id*. at 24-25.

lines, as compared to **<<<BEGIN CONFIDENTIAL END CONFIDENTIAL>>>** for Verizon.[260] FairPoint intends to **<<<BEGIN CONFIDENTIAL END CONFIDENTIAL>>>**[261] Mr. Balhoff states that the model projects **<<<BEGIN CONFIDENTIAL END CONFIDENTIAL PROP>>>**[262] FairPoint expects **<<<BEGIN CONFIDENTIAL END CONFIDENTIAL>>>**[263]

Q: Does FairPoint provide an estimate of the investment associated with its initial build-out of DSL over the first twelve months if the merger is approved?

A: Yes. Mr. Leach indicates that **<<<BEGIN CONFIDENTIAL END CONFIDENTIAL>>>**[264]

Q: FairPoint told investors at the end of the first quarter of 2007 that it had increased

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[260] / *Id*. at 24-25.

[261] / *Id*. at 24.

[262] / Balhoff (FairPoint) Direct, at 20.

[263] / Leach (FairPoint) Direct, at 25.

[264] / *Id*. at 30.

broadband penetration for its current properties to 25% of the lines it serves.[265] **Is FairPoint's assumption that it can reach the same penetration levels in New Hampshire reasonable?**

A: No. FairPoint has failed to provide any information that supports the assumption that the results it has achieved in other regions can be achieved in northern New England or New Hampshire. At the June technical sessions, FairPoint indicated that in its current footprint, 65% of households passed have cable television and that of those households, 50% have cable modem access. FairPoint also indicated that cable penetration was higher in the New England states than nationwide averages, suggesting that DSL may have at least one competitor (cable modem service from the cable companies) in New England on a more widespread basis than FairPoint has in its current operating territories.[266] In other words, in regions where the cable industry offers an alternative "on-ramp" to the Internet (which, according to FairPoint, is more prevalent in Verizon NH's territory than it is in FairPoint's existing territory), DSL demand will be less than in those regions where DSL is the only game in town.

Q: Are there any relevant statistics on this issue that you raise?

A: Yes. Based on the most recently available data from the FCC's high speed report:

- 55.2% of residential high-speed lines are served using cable modem technology and 40.1% of residential high-speed lines are served using ADSL technology nationwide as of June 30, 2006 (fiber, SDSL and traditional wireline and all other are 0.9%, 0.2%, and

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265 / FairPoint Communications Earnings Release, "FairPoint Reports First Quarter 2007 Results: Solid Gains in Core Operations; Maine, New Hampshire and Vermont Merger Integration on Track," May 3, 2007, available at: http://phx.corporate-ir.net/phoenix.zhtml?c=122010&p=irol-newsArticle&ID=994989&highlight=.

266 / FairPoint confirmed these statistics, but did not provide a source or documentation for the statistics as requested. See Exhibit SMB-P-64, FairPoint response to OCA FDR II-14, at FPNH 0960.

3.7%, respectively).[267]

- In New Hampshire 59% of residential end-user premises have access to xDSL where ILECs offer telephone service and 83% of residential end-user premises have access to cable modem where cable systems offer cable TV service as of June 30, 2006.[268]
- There were 201,873 coaxial high-speed lines in service as of June 30, 2006 in New Hampshire and 85,247 ADSL high-speed lines in service.[269]

Q: Has FairPoint conducted any studies regarding DSL demand in New Hampshire?

A: **<<<BEGIN CONFIDENTIAL**

[270]

END CONFIDENTIAL>>>[271]

Q: Does FairPoint make any other representations with respect to DSL penetration rates?

A: Yes. Labor propounded a follow-up data request seeking an analysis of the differences and similarities between FairPoint's existing territories and Verizon's northern New England

267 / FCC, Industry Analysis and Technology Division, Wireline Competition Bureau, High-Speed Services for Internet Access: Status as of June 30, 2006, rel. January 2007, at Chart 6.

268 / *Id.*, at Table 14.

269 / *Id.*, at Tables 11 and 12.

270 / See Exhibit SMB-C-65, FairPoint response to OCA FDR II-13.

271 / *Id*.

territories with respect to factors influencing DSL demand and justification for a FairPoint's assumption that the acquired territory would exhibit similar take rates. In response, FairPoint appears to have undertaken a simplistic analysis based entirely on population density. FairPoint states:

> It is FairPoint's understanding that approximately 78% of the Verizon wire centers in New Hampshire service population centers of 5,000 or fewer access lines. Therefore, FairPoint can conclude that these are rural markets similar to those serviced by Classic FairPoint and markets that will be reached by FairPoint's broadband plans.[272]

Q: Has FairPoint provided any additional details for its broadband deployment plans since the original petition and testimony were filed?

A: Yes. During technical sessions on June 5th, Mr. Harrington indicated that FairPoint had identified 27 central offices to target and 274 remote terminals in the field. OCA received FairPoint's New Hampshire broadband plan on June 12, 2007 in the first supplemental response to Staff 2-35 (CFPNH 2158-2170).[273] I attach that first Broadband Plan that we received, as well the second supplemental data response as Exhibit SMB-HCL3-66a, which refers to the plan.

F. <u>FairPoint's broadband deployment plans are still evolving, and its most recent plan was not submitted until after the conclusion of the technical sessions.</u>

Q: Please describe FairPoint's broadband plans for New Hampshire.

A: FairPoint is proposing to **<<<HIGHLY CONFIDENTIAL LEVEL 3**

[272] / See Exhibit SMB-P-67, FairPoint response to Labor FDR II-17.

[273] / This document was not filed until June 12, 2007, after the conclusion of the technical sessions. The OCA received an updated plan in a third supplemental response on July 27, 2007, but I did not have the opportunity to review this new plan. The latest plan is attached as Exhibit SMB-HCL3-66b.

[274]

[275]

[276]

[277]

END HIGHLY CONFIDENTIAL LEVEL 3>>>

FairPoint further discusses the plan assumptions in its second supplemental reply to Staff 2-35 sent to parties on July 3rd, included in Exhibit SMB-66a-HCL3.

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274 / See Exhibit HCL3-66a.

275 / Harrington (FairPoint) Direct, at 10.

276 / See Exhibit SMB-HCL3-66a.

277 / *Id.*, at CFPNH 2159.

Q: Do you have any initial observations about the assumptions FairPoint is using to develop its broadband plans?

A: Yes. <<<**BEGIN HIGHLY CONFIDENTIAL LEVEL 3**

[278]

[279]

END HIGHLY CONFIDENTIAL LEVEL 3>>>[280]

Q: What information does FairPoint indicate it relied upon from Verizon to develop its broadband plan?

A: FairPoint indicates that it relied upon **<<<BEGIN HIGHLY CONFIDENTIAL LEVEL 3**

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[278] / See Exhibit SMB-HCL3-66a.

[279] / *Id.*

[280] / *Id.*

[281]

END HIGHLY CONFIDENTIAL LEVEL 3>>>

Q: Does FairPoint's plan constitute a formal commitment on its part?

A: No. FairPoint has represented its broadband deployment plans as fairly certain. When asked whether other projects may take priority over broadband deployment plans, FairPoint responded: "FairPoint has committed to make a significant capital investment during the first 12-18 months after close of the transaction; that commitment is not subject to other project priorities."[282] However, FairPoint has made no formal commitments. In addition, in its July 3rd second supplemental reply to Staff 2-35 FairPoint states:

<<<BEGIN HIGHLY CONFIDENTIAL LEVEL 3

281 / *Id.*

282 / See Exhibit SMB-P-68, FairPoint response to OCA FDR II-12.

END HIGHLY CONFIDENTIAL LEVEL 3>>>[283]

Q: What do you take from this response?

A. This is quite frankly alarming, and the lack of specificity at this time could have major impacts on the financial viability of the entire transaction. FairPoint's post-transaction development of more detailed "cost specifics" could either lead to a management decision to forgo (or curtail) its broadband plan. Alternatively, if FairPoint continues its broadband buildout, such an effort could lead to higher than expected costs, which could have major impacts on the financial viability of the entire transaction.

Q: Do FairPoint's broadband deployment plans suggest that it will focus first urban areas?

A: That is not yet clear. The OCA asked FairPoint to identify the criteria it uses to determine where it will deploy DSL. FairPoint responded that it "identifies sites exhibiting customer densities that would likely end in DSL take-rates supportive of deployment[284] . . . Areas not initially identified by utilizing these criteria, but receiving affirmative, quantitative customer demand for DSL, are assessed for potential deployment based upon site specific economic considerations."[285] However, when asked as a follow-up to define the specific customer density that would be supportive of DSL deployment, FairPoint stated that it does not use a specific density rate. FairPoint stated that it relies upon not only density but on whether fiber facilities

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283 / See Exhibit SMB-HCL3-66a.

284 / FairPoint did not define "take rates supportive of deployment."

285 / See Exhibit SMB-P-69, FairPoint response to OCA GII 2-36.

are available:

> Each location where placement of additional fiber cable is required must be evaluated to determine the cost of the outside plant (OSP) cable and the necessary multi service access node (MSAN) equipment. Since there are several mitigating factors involved with the placement of fiber cable, each location must be evaluated on an individual basis. However, as was discussed during the Technical Sessions, FairPoint intends to use existing embedded fiber cable to feed the proposed MSAN units during the first wave of the Broadband initiative. In cases where additional fiber placement is not necessary, the investment per customer is lower, making deployment more feasible from a pure economic perspective.[286]

Q: Have you analyzed the broadband plan that FairPoint has provided with respect to the wire centers that are not currently included in the first three phases?

A: Yes. As an initial matter, **<<<BEGIN HIGHLY CONFIDENTIAL LEVEL 3**

[287]

END HIGHLY CONFIDENTIAL LEVEL 3>>> However, Verizon indicated that **<<<BEGIN CONFIDENTIAL**

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Q: Are there areas of New Hampshire that FairPoint has indicated where it simply cannot

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286 / See Exhibit SMB-P-70. FairPoint response to OCA FDR II-10. FairPoint does not define what specific "take rates" are necessary in a follow-up request to OCA GII 2-36. *Id.*

287 / See Exhibit SMB-HCL3-66a, first supplemental reply, at CFPNH 2158 – CFPNH 2170.

provide broadband capability?

A. Staff asked FairPoint 1) whether there were areas of New Hampshire that FairPoint has identified where it will not expand broadband; 2) to identify areas of the network where broadband could not be provided for any reason; and 3) to provide the reason it could not provide broadband in any particular area. FairPoint **<<<BEGIN CONFIDENTIAL**

END CONFIDENTIAL>>>[289]

Q: Has FairPoint provided any public descriptions of its proposed locations for broadband deployment?

A: Yes. In a filing submitted July 24, 2007 to the SEC, FairPoint reproduced a press release in which it describes its plans to complete DSL in the following communities in New Hampshire by the end of 2008: Bartlett, Center Sandwich, Errol, Fitzwilliam, Jefferson, Lisbon, Lyme, Marlow, Milan, North Haverhill, North Stratford, Pike, Pittsburg, Rindge, Rumney, Twin Mountain, Warren, West Stewartstown and Woodsville.[290]

FairPoint also publicly stated its intention to extend broadband service by the first quarter of

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288 / See Exhibit SMB-C-59.

289 / See Exhibit SMB-HCL3-66a.

290/ Form 425, FairPoint Communications Inc., filed July 24, 2007 with the Securities and Exchange Commission.

2010 to neighborhoods that are presently unserved in the following communities: Ashland, Atkinson, Bedford, Berlin, Bristol, Canterbury, Center Harbor, Center Ossipee, Concord, Derry, Dover, Enfield, Epping, Epsom, Exeter, Farmington, Glendale, Hampton, Hanover, Harrisville, Hinsdale, Keene, Kingston, Laconia, Littleton, Manchester, Merrimack, Milford, Milton, North Conway, Nashua, Newmarket, Newport, Northwood, North Woodstock, Pelham, Peterborough, Plaistow, Plymouth, Portsmouth, Raymond, Rochester, Rye Beach, Seabrook, Salem, Sanbornville, Somersworth, Spofford, Sunapee, Tamworth, Tilton, Walpole, Westmoreland and Wolfeboro. [291]

Q: Does FairPoint's recent public description of its broadband deployment plans include any sanctions if it fails to follow through on these plans?

A: No. Furthermore, the public plan fails to indicate how widespread within individual communities its broadband deployment will occur, and lacks any specific information regarding the quantities of consumers who will have the option to subscribe to broadband service.

Q: Is Verizon NH continuing to deploy FiOS?

A: Verizon NH representatives at the June technical sessions indicated that Verizon NH is no longer expanding deployment of fiber-to-the-premises (FTTP) except in the normal course of business. In response to OCA G II 1-72, Verizon NH stated that it "has no plan to expand beyond the wire centers currently served."[292]

Q: What are FairPoint's plans with respect to the FiOS services that Verizon has already

[291]/ Form 425, FairPoint Communications Inc., filed July 24, 2007.

[292] / See Exhibit SMB-P-71, Verizon response to OCA G II 1-72.

deployed in southern New Hampshire?

A: FairPoint will acquire those assets if the transaction is approved and operate the FTTP network in southern New Hampshire.[293]

Q: Does FairPoint plan to use FTTP technology for broadband deployment in New Hampshire?

A: No. Mr. Harrington's testimony indicates that FairPoint does not consider FTTP technology to be a cost-effective option for broadband access provision in areas currently unserved in New Hampshire, particularly low density areas.[294]

According to Mr. Balhoff, a consultant to FairPoint, the public interest is not harmed by FairPoint's decision not to continue Verizon's FTTP deployment. Mr. Balhoff suggests that there are three reasons that FTTP may not be more desirable than DSL. First, FTTP continues to be a "high-risk proposition" requiring a very high per-line investment. Second, current FTTP projects are generally only being conducted in very dense regions. Third, investors are likely to "punish" the stock of a company that deployed FTTP in less dense regions.[295] Mr. Balhoff estimates an average cost of deployment and customer connection (if the modem is purchased by the customer) of $1,800 per home passed for FTTP versus $235 for DSL.[296]

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[293] / Harrington (FairPoint) Direct, at 11.

[294] / *Id*., at 11.

[295] / Balhoff Direct (FairPoint), at 9-10.

[296] / *Id*. at 10. *See also* Mr. Harrington's testimony stating that for initial planning purposes FairPoint intends to augment and expand Verizon's existing broadband network with DSL technology because is the most efficient way to reach most areas where availability is the lowest; DSL provides an "economically feasible" way to broaden the current broadband

Q: Please elaborate further on the implications of FairPoint's decision to discontinue further FTTP roll-out.

A: On one hand it seems that another kind of digital divide is evolving, with consumers in Verizon's footprint more likely to have access to FTTP than consumers in FairPoint's (and other small ILECs') territory. On the other hand, deploying some type of broadband to consumers who currently have no access at all to broadband is clearly essential.

At the technical sessions, FairPoint indicated that the infrastructure it would be investing in to deploy DSL would be "agnostic" in that the technology will be able to be updated to improve speeds as new broadband technologies are developed. Mr. Harrington states that DSL "will allow for future expansion into more bandwidth-intensive applications"[297] and asserts that DSL is not an "obsolete technology."[298] FairPoint plans to install or expand fiber routes to connect central offices and remotes to provide for the additional bandwidth that the broadband expansion will entail.[299]

Staff asked FairPoint whether given the expansion in use of high bandwidth applications, FairPoint believed DSL was adequate for consumers in New Hampshire. FairPoint responded that DSL is capable of various transfer speeds and that it has deployed ADSL-2+ technology capable of download speeds of approximately 25Mb. FairPoint indicates that Verizon has not

footprint; DSL is reliable and will allow for new deployment within a reasonable timeframe. *See* Harrington (FairPoint) Direct at 9.

297 / Harrington (FairPoint) Direct, at 13.

298 / *Id.*, at 12.

299 / Balhoff (FairPoint) Direct, at 12.

deployed this type of technology in northern New England.[300]

Q: Is FairPoint committed to only use DSL?

A: No. Mr. Harrington indicates in his testimony that it may not use DSL in all cases. He states that "FairPoint has, in its current operations, utilized copper, fiber, and wireless network technologies to meet its customers' broadband services needs where appropriate."[301] The OCA propounded discovery that asked whether FairPoint would commit to using alternative technologies (*i.e.*, other than DSL) to provide broadband Internet access services to households in New Hampshire that are not "addressable" by current DSL technologies.[302] FairPoint replied: "FairPoint has shown industry leadership in deploying broadband services and is committed to evaluating all technologies associated with providing broadband services to its customers. As technologies evolve FairPoint will perform an evaluation and deploy based on a positive business case."[303] The question for the Commission is whether FairPoint (or Verizon NH) is committed to addressing the lines that are not "addressable from a DSL standpoint with another broadband technology."

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[300] / See Exhibit SMB-P-72, FairPoint response to Staff GII 2-25.

[301] / Harrington (FairPoint) Direct, at 12.

[302] / *See* Exhibit SMB-P-73, FairPoint Response to OCA FDR II-36. AT&T Inc. and BellSouth made similar commitments as a condition of FCC approval of their merger last year.

[303] / *See id*.

G. The FCC recently conditioned its approval of the merger of AT&T and BellSouth on broadband pricing and deployment conditions

Q: Ms. Baldwin, has the FCC addressed broadband deployment in any recent reviews of proposed mergers or spin-offs?

A: Yes. As a result of a merger condition approved by the FCC, AT&T offers new broadband customers DSL at $10 per month and also offers a free modem. The FCC integrated broadband commitments with its review and approval of AT&T's acquisition of BellSouth, and the PUC should consider replicating this approach in its review of the pending transaction. AT&T has made specific commitments to increase the deployment of affordable retail and unbundled DSL as part of its merger with BellSouth, as well as to deploy alternative technologies as necessary to provide broadband services to unserved areas.[304]

Q: What is your recommendation regarding retail DSL?

A: New Hampshire consumers should have access to affordable retail DSL. The cost of the local loop, which provides the platform for DSL, is already recovered through intrastate and interstate regulated rates that consumers pay. DSL "rides over" this network and therefore, if the broadband market were competitive, the rates for DSL should be aligned

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[304]/ The commitments, outlined in the FCC's order approving the transaction, include the following:

- By December 31, 2007, AT&T/BellSouth will offer broadband Internet access service (*i.e.*, speeds in excess of 200 kbps in at least one direction) to 100 percent of the residential living units in the AT&T/BellSouth in-region territory.
- Within six months of the Merger Closing Date, and continuing for at least 30 months from the inception of the offer, AT&T/BellSouth will offer to retail consumers in the Wireline Buildout Area, who have not previously subscribed to AT&T's or BellSouth's ADSL service, a broadband Internet access service at a speed of up to 768 Kbps at a monthly rate of $10 per month.
- Within twelve months of and for forty-two months after the Merger Closing Date, AT&T/BellSouth will deploy and offer within the BellSouth in-region territory ADSL service to ADSL-capable customers without requiring such customers to also purchase circuit switched voice grade telephone service.
- Within twelve months of the Merger Closing Date, AT&T/BellSouth will make available in its in-region territory an ADSL service capable of speeds up to 768 Kbps to ADSL-capable customers without requiring

closely with the incremental cost of adding DSL capability. As mentioned above, as a result of a merger condition approved by the FCC, AT&T offers new broadband customers a free modem and DSL at $10 per month. Without access to cost data, one cannot asses the relationship between a similarly reduced rate in New Hampshire and the incremental cost of DSL deployment in New Hampshire. In any event, FairPoint's post-transaction incentive to maximize its DSL revenue stream would conflict with consumers' interest in obtaining DSL at reasonable rates.

H. <u>Any ILEC that serves New Hampshire should offer unbundled (stand-alone) DSL at affordable rates so that consumers can obtain access to DSL without subscribing to the ILEC's voice service.</u>

Q: If the transaction is approved, will FairPoint provide stand-alone DSL?

A: FairPoint has indicated several times that it will provide the same services at the same rates, terms and conditions that Verizon current offers its customers at the time of the merger.[305] However, FairPoint does not make any commitment regarding the duration of time that it will make any services, including stand-alone DSL available. Mr. Nixon recognized in his direct testimony that Verizon is subject to several conditions that the FCC placed upon its approval of the Verizon/MCI merger and notes that to the extent some conditions remain in effect (many are set to expire by January 2008), such as stand-alone DSL, "FairPoint would expect to review with regulators whether such conditions are merited in the context of the present transaction."[306]

Q: How does FairPoint propose to decide where in northern New England to deploy DSL?

A: In response to OCA FDR II-27, FairPoint states that it will prioritize broadband deployment

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such customers to also purchase circuit switched voice grade telephone service.

305 / FairPoint indicates that it will provide stand alone DSL. See Exhibit SMB-P-74, FairPoint response to OCA GII 2-38.

306 / Nixon (FairPoint) Direct, at 29.

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projects and capital expenditures within and between the three states "to meet service objectives of new and existing customers as required by those states . . . FairPoint will meet the highest priority projects in each state. To the extent lower priority projects are identified, FairPoint will evaluate them on a cross state basis."[307]

To the extent that the other Northern New England states have more stringent broadband deployment requirements, New Hampshire may lose out as FairPoint decides where to focus its resources.[308] At a minimum, FairPoint should commit to a "most favored nation" clause for broadband deployment to ensure that New Hampshire does not get left behind Maine and Vermont.

I. <u>FairPoint's broadband promises, even if they were enforceable, do not justify Commission approval of the proposed transaction.</u>

Q: Please summarize your major broadband findings and recommendations.

A: My general findings and recommendations are as follows:

- Expanded broadband access is a key State policy goal.

- I am skeptical of FairPoint's broadband promises and projections, and their ability to meet their promises, especially with the lack of analysis of the costs.

- FairPoint's plan is not yet final, which makes it very difficult to analyze.

- In even the most optimistic view about FairPoint's ability and willingness to deploy broadband throughout New Hampshire, such deployment does not render the proposed

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307 / See Exhibit SMB-P-75, FairPoint response to OCA FDR II-27.

308 / For example, on July 3, 2007 Verizon Maine, and the Maine Public Advocate filed a stipulation in the pending Verizon Maine AFOR case that includes and agreement that Verizon will spend $12 million annually to expand its DSL services until the FairPoint/Verizon case is either approved or terminated. Maine Public Utilities Commission Docket No. 2005-155, Investigation into Verizon Maine's Alternative Form of Regulation, Stipulation of Verizon Maine and OPA, filed July 3, 2007. The Vermont Public Service Board's approval of Verizon's alternative regulation plan included broadband investment. Vermont Public Service Board Docket No. 6959, *Investigation into a Successor Incentive Regulation Plan for Verizon New England Inc., d/b/a Verizon Vermo*nt, September 26, 2005, at 121-123.

transaction in the public interest and public good.

- I am hopeful that in some other forum the State takes affirmative steps to promote broadband service.

Q: What are your more detailed analyses and recommendations?

A: Access to advanced telecommunication services is essential so that all households and businesses can participate in mainstream economic, medical, educational, and other societal activities. However, approximately four in ten of New Hampshire's households do not have the option to subscribe to DSL service.[309] Therefore, if the Commission approves the proposed transaction, it should do so contingent upon the following conditions[310]:

- New Hampshire consumers should have access to affordable retail DSL. The cost of the local loop is already recovered through intrastate and interstate regulated rates that consumers pay, and DSL "rides over" this network. Therefore, FairPoint should commit to providing DSL at rates that reflect incremental cost.

- FairPoint[311] should offer unbundled (stand-alone) DSL so that consumers can obtain access to DSL without subscribing to the ILEC's voice service. The rates for unbundled DSL should be less than the rate charged for "bundled DSL/voice."

- Specific broadband deployment dates and locations should be established and provided to the parties in this docket, along with clearly delineated plans that set forth when and where broadband *will* be deployed, and also where it *will not* be deployed so that consumers' expectations are not unnecessarily raised and so that policy makers know

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309 / The FCC's most recent high-speed services report indicates that as of June 30, 2006, 59% of all end-user premises in New Hampshire where ILECs (not just Verizon NH) offered telephone service had xDSL services available to them. FCC, Industry Analysis and Technology Division, Wireline Competition Bureau, *High-Speed Services for Internet Access: Status as of June 30, 2006*, rel. January 2007, at Table 14.

310 / I recommend that the Commission also consider the appropriateness of these recommendations in a separate proceeding involving Verizon NH if it does not approve the proposed transaction.

311 / The PUC should pursue this condition regardless of whether the transaction is approved. Verizon NH is currently required to provide stand-alone DSL as a result of the FCC's approval of the Verizon/MCI merger. However, the condition will expire two years after the implementation date or no later than three years from the merger closing date. *In the Matter of Verizon Communications Inc. and MCI, Inc. Applications for Approval of Transfer of Control*, FCC WC Docket No. 05-75, *Memorandum Opinion and Order*, Rel. November 17, 2005 ("Verizon/MCI Merger Order"), at Appendix G: Conditions.

where alternative technologies such as WiFi may be necessary.

- Funds should be made available to deploy alternative technology to serve underserved or unserved regions of New Hampshire.

- FairPoint should agree to not oppose municipalities' wireless broadband efforts to improve the chances of unserved areas gaining broadband access.

- FairPoint should provide customer information about the deployment, pricing, rates, terms, conditions, and availability of DSL and stand-alone DSL and such information should be comprehensive, clear, and frequent.

- FairPoint should commit to provide broadband deployment data on a non-proprietary basis to, at a minimum, the Governor's office, the PUC, the Telecommunications Advisory Board, and the OCA to assist policy makers in designing and implementing broadband policy tailored to the specific needs of New Hampshire.

- FairPoint should commit to abide by the net neutrality commitment as set forth in the FCC's set of conditions that apply to AT&T, as a result of its acquisition of BellSouth.

- If Verizon NH does not provide an across-the-board credit for its spin off-of directory operations, it should instead fund a broadband program of at least $100 million, to fund reduced broadband rates for Lifeline customers and broadband deployment in unserved areas. (See Section IX for a full discussion of the yellow pages case and its implications in this transaction).

VIII. IMPACT OF PROPOSED TRANSACTION ON FAIRPOINT'S REVENUE REQUIREMENT, RATE DESIGN AND TARIFFS

A. FairPoint's plan to offer "substantially the same retail services" may change post-transaction.

Q: Have the Joint Petitioners addressed the impact of the proposed transaction on the rates, terms, and conditions of FairPoint's post-transaction offerings?

A: Yes, but only at a high level. According to FairPoint, it will "initially offer substantially the same retail services as customers receive today."[312]

Q: Did FairPoint specify the duration of the period in which it will keep today's services, rates, terms, and conditions intact?

A: No. For example, FairPoint has not specified the duration of the "initial" period to which it would commit to offer "unbundled" (*i.e.*, à la carte, stand-alone) 1ocal exchange service, but rather simply stated that it "does not have any *current* plans to eliminate the a-la-carte offerings."[313] Similarly, FairPoint has said that it does not have any current plans to increase rates, but has made no commitments to a stay-out period or a rate cap.

Q: Please describe FairPoint's plans regarding local telephone service offerings, as you understand them.

A: In response to a Staff data request, FairPoint stated that it "is evaluating the services offered by Verizon and will determine whether there are any that warrant consideration for

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[312] / Nixon (FairPoint) Direct, at 26.

[313] / See Exhibit SMB-P-76, FairPoint response to OCA GI 1-129 (emphasis added).

'grandfathering.'"[314] In the same response, FairPoint further stated that it "has agreed to maintain the charges and terms of services subject to regulation on the same terms and conditions offered by Verizon prior to closing."[315] FairPoint did not, however, indicate the duration of its agreement to maintain the existing rates, terms, and conditions for services that Verizon NH now offers, nor did it specify its time frame for assessing services that might "warrant consideration for 'grandfathering.'"

Q: As you understand FairPoint's testimony and responses to data requests, is there anything that would prevent FairPoint, post-transaction, from seeking regulatory approval to grandfather basic local telephone service or from seeking to raise rates?

A: No. If post-transaction operating expenses and capital expenditures are greater than expected, or if revenues are less than anticipated, FairPoint may seek to raise rates or grandfather basic local service at any time after the transaction is approved according to the company's filings.

B. <u>Many Verizon NH customers subscribe to "unbundled" basic local service.</u>

Q: How many residential lines does Verizon NH serve?

A: According to FCC ARMIS data, Verizon NH served 406,843 residential switched access lines in New Hampshire as of year-end 2006, of which 34,080 were additional lines.[316]

Q: Do many residential customers subscribe to Verizon NH's Freedom bundles?

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[314] / To grandfather a service would be to provide the service under a "grandfather clause" or a "clause creating an exemption based on circumstances previously existing" (Merriam-Webster Online) To grandfather a service generally means to allow current customers of the service to continue to use the service but no longer offer the service to new customers.

[315] / See Exhibit SMB-P-77, FairPoint response to Staff GI 1-114.

A: **<<<BEGIN CONFIDENTIAL**

[317]

END CONFIDENTIAL>>>[318]

Q: Is there other evidence suggesting that continuing availability of "barebones" basic local telephone service is important to New Hampshire consumers?

A: Yes. **<<<BEGIN CONFIDENTIAL**

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Q: Did you review other data about customers who subscribe only to basic local service?

A: Yes. Exhibit SMB-C-80 to my testimony, which reproduces Verizon NH's response to OCA GI 1-79, shows, separately by wire center, the percentages of residential customers who do not subscribe to any features. This exhibit further demonstrates the importance of retaining basic

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[316] / FCC ARMISReport 43-08. Table III. Access Lines in Service by Customer. Data accessed June 27, 2007.

[317] / See Exhibit SMB-C-78 Verizon NH response to OCA GI 1-75, and 1-76.

[318] / See Exhibit SMB-C-79, Verizon NH response to OCA GI 1-86 and 1-87.

local service as an option, as well as the importance of customer education so that these customers understand their options.

Q: What significance do you attribute to these patterns of consumer demand?

A: First, the data underscore the importance of retaining basic local exchange service as an option for consumers so that they are not required to purchase more telephone service than they want or need. Second, if the transaction were to occur, FairPoint likely will seek to increase the penetration of the higher-revenue bundled offerings and thus has less of an incentive to serve low-value consumers.

Q: Do you have specific public policy recommendations to address these two consequences?

A: Yes. In my view, it would be a mistake for the Commission to permit basic local exchange service to be grandfathered: customers should not be required to purchase bundled services in order to obtain a basic link to the public switched telephone network. Also, customer education is essential so that consumers make informed purchasing decisions and do not feel pressured to purchase more than they want or need.

Q: How many of Verizon NH's residential lines subscribe to Verizon NH's long distance service?

A: As Confidential Exhibit SMB-4-C to my testimony shows, **<<<BEGIN CONFIDENTIAL**

[319]

[320]

END CONFIDENTIAL>>> per month in 2003.[321]

Q: Please describe Verizon NH's business customer base.

A: Confidential Exhibit SMB-4-C to my testimony shows that as of December 2006, Verizon NH served **<<<BEGIN CONFIDENTIAL END CONFIDENTIAL>>>** business customers. Confidential Exhibit SMB-4-C to my testimony also shows that **<<<BEGIN CONFIDENTIAL**

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As Confidential Exhibit SMB-4-C shows, **<<<BEGIN CONFIDENTIAL**

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Q: Do many business customers subscribe to Verizon NH's long distance service?

A: Yes. **<<<BEGIN CONFIDENTIAL** [323]

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[319] / See Exhibit SMB-C-81 Verizon NH response to OCA GI 1-78.

[320] / See Exhibits SMB-C-79 and C-81.

[321] / See Exhibit SMB-C-82 ,Verizon NH response to OCA G1 1-69(s).

[322] / See Exhibit SMB-C-83, Verizon NH responses to OCA GI 1-91; GI FDR 1-11.

[323] / See Exhibits SMB-81-C and 83-C.

END CONFIDENTIAL>>> per month in 2003.[324]

Q: Do you draw any other conclusions from your review of demand by business customers?

A: Yes. The fact that, as confidential Exhibit SMB-4-C shows, **<<<BEGIN CONFIDENTIAL**

END CONFIDENTIAL>>> shows that these business customers, particularly those in less densely populated communities, likely lack competitive alternatives to Verizon NH's service.

Q: Are there specific issues, relating to FairPoint's revenue requirement, which pertain directly to this aspect of the proceeding?

A: Yes. For several reasons, the proposed transaction creates new and significant financial risks for consumers. The highly leveraged capital structure of the proposed new entity could raise the cost of money for New Hampshire operations. The financial precariousness of the entire transaction exposes consumers to the risk that FairPoint will not be able to deliver on its pre-transaction promises and that it may seek rate relief from the Commission. Mr. Brevitz discusses the financial aspects of the proposed transaction in greater detail in his testimony.

Q: What rates do the Joint Petitioners presently charge for residential local exchange service?

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[324] / See Exhibit SMB-82-C.

A: Verizon NH presently charges between $11.11 and $15.69, for rate groups A through E for flat rate residential service. FairPoint in East Conway and Chatham has a single rate group with a rate of $9.58.[325]

Q: Should the continued offering of stand-alone basic local exchange service be a Commission requirement?

A: Yes. Regardless of whether the transaction occurs, consumers should continue to have the option to subscribe to "unbundled" basic service.

Q: Are Verizon NH's present rates, which FairPoint intends to adopt, just and reasonable?

A: There is insufficient information in this record for me to assess whether the rates are just and reasonable, and it is my understanding that Verizon has not had a full rate case since 1989.[326] At a minimum, however, as I demonstrate in the next section of my testimony, consumers are entitled to either a monthly rate reduction or a one-time credit related to directory publishing or the equivalent. Also, Verizon NH's ubiquitous public network, which it has constructed over the years largely using consumer monies from intrastate regulated services, now, supports DSL, which yields a profitable stream of unregulated revenues. Absent a comprehensive analysis of Verizon NH's costs, it is not clear whether these profitable unregulated DSL services are bearing their fair share of the joint and common costs of the public switched network.

Q: Is there any information that indicates that Verizon NH may be overearning?

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325 / See Exhibit SMB-P-84, FPNH 0011.

326 / Re New England Tel. & Tel. Co., 76 NH PUC 150 (1991).

A: Yes. In the two other northern New England states, regulators determined in recent years that Verizon was overearning. Also, as I stated earlier, Verizon NH's rates have not been investigated since 1989.

Q; Please explain your understanding of Verizon's over-earnings in Maine.

A: In a report issued May 9, 2007, the Hearing Examiner in a major alternative regulation proceeding in Maine, determined that Verizon was over-earning by $32.4 million.[327]

Q: Please describe your understanding of the over-earnings in Vermont.

A: In a proceeding in which the Vermont Public Service Board ("Board") adopted an alternative regulation plan for Vermont, the Board found that Verizon's rates exceeded just and reasonable rates by $8.18 million. Verizon was ordered to reduce rates accordingly and to further reduce rates by $1.26 million effective July 1, 2007, and $1.80 million effective July 1, 2007, unless Verizon delivered an offsetting benefit to Vermont telecommunications consumers.[328]

Q: Please describe further the Board's rationale for its findings.

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[327] / Maine Public Utilities Commission Docket No. 2005-155, *Investigation into New Alternative Form of Regulation for Verizon Maine Pursuant to 35-A M.R.S.A. Sections 9102-9103*, Examiner's Report (Revenue Requirement and Service Quality Issues), May 9, 2007, at 274. Interestingly, the Report also addresses service quality, stating:

> We will retain 13 of the metrics from the SQI established under the Second AFOR. The benchmarks for these metrics will remain unchanged. Since Verizon's performance has degraded in several categories since 2001, revising the benchmarks based on its recent performance in effect would reward Verizon for poor performance. We retain the same benchmarks in an attempt to encourage Verizon to return its service quality to pre-AFOR standards. We will also add a new "Duration of Residential Outages" metric, as discussed earlier in this Order.
>
> As a consequence of poor service quality and the service quality index, Verizon has paid rebates ranging between $500,000 and $900,000 in each of the past five years.[327]

As I discuss in detail in Section VI, I urge the Commission not to "reward Verizon for poor performance" and to establish financial accountability.

[328] / Vermont Public Service Board Docket No. 6959, *Investigation into a Successor Incentive Regulation Plan for Verizon New England Inc., d/b/a Verizon Vermont*, September 26, 2005. The *Order Adopting Amended Plan* of April 27,

A: In approving an alternative regulation plan for Verizon Vermont, the Board stated:

> We also concur with the Department that we must consider Verizon's revenue levels at the time we evaluate the renewal (or extension) of an alternative regulation plan. Failure to make such an assessment could result in ratepayers paying higher rates under incentive regulation than they would if we resumed traditional cost-of-service regulation; this is critical to our overall determination because, unless ratepayers derive significant benefits from the alternative regulation plan, it would not promote the general good to pay higher than necessary rates.

The Board went on to develop several elements, including mechanisms for rate reductions and a requirement that Verizon reduce its annualized retail rates by $8.18 million.[329] Subsequently, the Department of Public Service and Verizon reached a settlement, which the Board approved, which set forth a specific broadband commitment instead of the rate reductions.[330]

Q: What are the broadband commitments?

A: Under the *Amended Plan*, Verizon agreed to increase broadband availability from the then-current 56% of Verizon customers, to 80% of Verizon customers by 2010. The Plan specifies intermediate goals – 65% availability by the end of 2007, 75% by the end of 2008, and 77% by the end of 2009.[331] The Plan allows the Public Service Board to terminate the arrangement on

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2006 ("Amended Plan") modified the settlement.

[329] / *See* Vermont Public Service Board Docket No. 6959, *Investigation into a Successor Incentive Regulation Plan for Verizon New England Inc., d/b/a Verizon Vermont*, September 26, 2005, at 6-7, footnotes omitted. *See also Amended Plan*.

[330] / *See Amended Plan*.

[331] / *Id.*, at 4.

December 31, 2008 if Verizon fails to meet its broadband deployment obligations, or is in violation of any other terms of the agreement.[332]

Q: What do you conclude based on your review of proceedings in Maine and Vermont?

A: If the Commission were to investigate Verizon NH's costs and revenues, it likely would find that Verizon NH's is over-earning. As I discussed in Section VII, among other things, Verizon NH's DSL is getting a "free ride" over the PSTN, with customers picking up the tab for the local loop, but Verizon NH retaining the lucrative DSL revenues on the unregulated side of its books.[333]

C. <u>Consumers should not pay for transaction-related costs.</u>

Q: Does FairPoint intend to recover transaction-related costs from consumers?

A: FairPoint indicates that it does not intend to seek transaction related costs from consumers.[334]

Q: How is FairPoint tracking costs that relate to this transaction?

A: FairPoint provided its "procedure documentation" which it uses for recording expenditures related to the proposed transaction. FairPoint indicates further that via its payroll system, FairPoint has established allocation percentages to assign and allocate the salaries and benefits of management personnel to the proposed transaction. FairPoint began recording the expenses related to the proposed transaction in a separate set of books effective January 1, 2007 [335]

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[332] / *Id.*, at 8.

[333] / I analyzed this and other cost methodology issues on behalf of the National Association of State Utility Consumer Advocates and the New Jersey Division of Rate Counsel in the FCC's proceeding on separations reform. *In the Matter of Jurisdictional Separations and Referral to the Federal-State Joint Board*, CC Docket No. 80-286, affidavit of Susan M. Baldwin, on behalf of the National Association of State Utility Consumer Advocates and the New Jersey Division of Rate Counsel, filed August 22, 2006.

[334] / Nixon (FairPoint) Direct, at 26.

[335] / See Exhibit SMB-P-85, FairPoint response to OCA GI 1-101, FPNH 0145 - FPNH 0147.

Q: Did FairPoint provide estimates of the costs to achieve the transaction?

A: Mr. Brevitz addresses this issue in his testimony.

D. <u>Efforts to improve Lifeline participation are inadequate.</u>

Q: Have the Joint Petitioners addressed adequately the under-enrollment of customers in Lifeline program?

A: No. Although Lifeline is under-enrolled in New Hampshire, neither of the Joint Petitioners addresses adequately how to improve enrollment.

Q. **Does the Joint Petition include any commitments or statements about Lifeline to increase enrollment?**

A. No.

Q. Does the Joint Petition include any statements or commitments about Lifeline/LinkUp to safeguard those currently enrolled?

A. No.

Q: Do you believe that Lifeline is under-enrolled in New Hampshire?

A: Yes. As of March 31, 2007, **<<<BEGIN CONFIDENTIAL END CONFIDENTIAL>>>** Verizon customers subscribed to Lifeline in New Hampshire.[336] FairPoint had 3 customers subscribed to Lifeline in New Hampshire for 2006, 4 for 2005 and none for 2004.[337] With approximately 63,000 households eligible in NH (see USAC chart Lifeline Support Participation Data for 2006), 10% of those households are actually enrolled.

[336] / See Exhibit SMB-C-86, Verizon NH response to OCA G IV 1-7.

[337] / See Exhibit SMB-P-87, attachment to FairPoint response to OCA GIV 4-11, at FPNH 0508.

Q: Verizon NH has designated its Lifeline information as proprietary. Is there a public source of comparable information?

A: Yes. According to ARMIS data, Verizon NH serves 5,621 Lifeline customers.[338] It is not clear to me why Verizon provides the Commission with proprietary data and supplies the FCC with public data. In the future, the Commission should require that all ILECs provide this information in a public format for use by policy makers and those helping to increase outreach and enrollment.

Q: How many existing Verizon NH customers are eligible for Lifeline?

A: Verizon NH has said that it does not know how many of its customers are eligible for Lifeline.[339] FairPoint states that the FCC estimates that approximately ten percent (10%) of the eligible Lifeline low income population actually participates in the lifeline program here in NH.[340]

Q: Is there any way to gauge whether Lifeline enrollment is comparably low in New Hampshire?

A: Yes. Among other things, one could compare enrollment across the three northern New England states. **<<<BEGIN CONFIDENTIAL END CONFIDENTIAL>>>** customers, respectively, in Maine and Vermont participate in Lifeline programs.[341] Although Verizon NH accounts for 40 percent of switched access lines in the three northern New England

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338 / ARMIS FCC Report 43-08, Table III. Residential switched access lines. As a tangential matter, I would urge the Commission to direct Verizon NH to submit quarterly public data on Lifeline enrollment.

339 / *See* Exhibit SMB-C-88, Verizon NH second supplemental response to OCA G IV-1-44.

340 / *See* Exhibit SMB-P-89, FairPoint response to OCA GIV 1-13. This data is available in Lifeline Support Participation Data at www.universalservice.org, and at www.usac.org. A map provided on the Universal Service Administrative Company ("USAC") website indicates that NH's 2006 lifeline participation rate was below 10% (http://www.usac.org/_res/documents/li/pdf/li-participation-rate-map-2006.pdf)/.

states,[342] only **<<<BEGIN CONFIDENTIAL END CONFIDENTIAL>>>** percent of the Lifeline customers in this region are New Hampshire residents.

Q: Could you provide a comparable analysis based on public data?

A: Yes. Based on ARMIS data, there are 5,621; 53,192; and 19,654 Lifeline customers in New Hampshire, Maine, and Vermont, respectively.[343] Therefore, although Verizon NH accounts for 40 percent of switched access lines in the three northern New England states,[344] only 7% percent of the Lifeline customers in this region are New Hampshire residents. In contrast, Maine accounts for 38% of access lines and 68% of Lifeline customers and Vermont accounts for 22% of access lines and 25% of Lifeline customers.

Q: Could differing demographics explain this difference?

A: Based on the widely disparate levels of enrollment, I do not believe that demographics could explain the entire difference.

Q: Should the Commission encourage efforts to increase Lifeline participation?

A: Yes. FairPoint (if the transaction occurs) should commit to comprehensive and frequent outreach efforts to increase customer participation in New Hampshire's Lifeline program. Specifically, working with PUC Staff, the OCA, and NH Legal Assistance, FairPoint should take the following steps to promote Lifeline/Link-Up, to include at least the following:

a. Include a message on disconnect notices about Lifeline and Link-Up programs;

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[341] / See Exhibit SMB-88-C.

[342] / FCC Report 43-01. ARMIS Annual Summary Report. Table II. Data accessed June 19, 2007.

[343] / ARMIS FCC Report 43-08, Table III. Residential switched access lines. As a tangential matter, I would urge the Commission to direct Verizon NH to submit quarterly public data on Lifeline enrollment.

[344] / FCC Report 43-01. ARMIS Annual Summary Report. Table II. Data accessed June 19, 2007.

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b. Include twice in twelve months a message in a monthly newsletter/communication to customers explaining the Lifeline and Link-Up programs;
c. Include a federal poverty guidelines table in the Lifeline/Link-Up brochure;
d. Include in the Lifeline/Link-Up brochure or application an explanation of acceptable documentation for determining if income is at or below 135% of the federal poverty guidelines or provide a toll free number from which a consumer could obtain such an explanation;
e. Include general educational information about the Lifeline and Link-Up programs on its website including the number to contact for further information or to request an application form;
f. Participate in outreach to social service agencies to explain the programs, including mailing brochures to social service agencies in its service territory at least twice in twelve months; and
g. Update and maintain current information about FairPoint on the Universal Service Administration Company's website.

The Commission should impose penalties for noncompliance.

E. <u>Summary of rate recommendations.</u>

Q: Ms. Baldwin, if the Commission, contrary to your recommendation, approves the transaction, are there any other specific conditions that you propose?

A: Yes. Any Commission order approving the transaction should state explicitly that FairPoint is precluded from recovering transaction-related costs from ratepayers, which include, for example, expenses incurred for legal costs, branding, and regulatory activities.[345] Furthermore, the Commission should require FairPoint to submit annual reports that track and record these costs with sufficient detail to allow for an accounting trail.

Also, FairPoint should commit to the following:

- A rate cap (or, as the following section discusses, a rate cap and a one-time rate credit for directory publishing from Verizon).

[345] / Confidential Exhibit SMB-C-85 includes page CFPNH 1813, and provides the general categories of

- To offer unbundled (a la carte, stand alone) basic local exchange service indefinitely.
- To increase participation in Lifeline/LinkUp programs.

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transaction and transition costs.

IX. DIRECTORY PUBLISHING/YELLOW PAGES

Q: Did Verizon make any changes to its lines of business in 2006 that potentially bear on this proceeding?

A: Yes. On November 17, 2006, Verizon completed the spin-off of IDEARC to Verizon shareowners. Verizon distributed a dividend of one share of IDEARC common stock for every 20 shares of Verizon common stock, and paid cash for fractional shares. Now, IDEARC owns what had been Verizon's domestic print and Internet yellow pages directory operations, which, according to Verizon, had been the principal component of its Information Services segment.[346]

Q: Ms. Baldwin, although Verizon spun off its yellow pages and directory operations, is Verizon NH still required to continue to impute directory revenues for NHPUC purposes?

A: Yes. Pursuant to a Commission Order,[347] Verizon NH continues to impute directory revenues in the earnings statement that it submits to the Commission, although Verizon has spun off its yellow page and directory operations to IDEARC.[348]

Q: Does the FairPoint financial model incorporate an imputation for the approximate $23 million for NH ratepayers associated with Verizon NH's publishing?

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346 / See Exhibit SMB-11-P at 35, which includes material related to Verizon's yellow pages spin-off from Verizon's annual report

347/ In re Verizon New Hampshire, 89 N.H. P.U.C. 382 (2004) (requiring imputation of at least $23.3 million for ratemaking purposes), *rehearing denied by* In re Verizon New Hampshire, 89 N.H. P.U.C. 582 (2004), *affirmed by* In re Appeal of Verizon New England, Inc., 153 N.H. 50, 889 A.2d 1027 (2005). The Commission fixed the amount of the imputation at least $23.3 million per year, pending the issuance of a further order in a second phase of the proceeding. Id. at 443. The Commission has yet to issue an order scheduling the second phase or delineating the scope of that inquiry. Id. at 442. Therefore, this transaction, if approved, presents the last chance for New Hampshire customers to address this issue.

348/ See e.g., See Exhibit SMB-C-9, earnings statement for 2006, submitted by Verizon NH in response to OCA FDR I-15a, which encompasses the year in which Verizon spun off its yellow pages.

A: No. Despite its position that it plans to step into Verizon New Hampshire's shoes and to adopt "business as usual" with respect to rates, terms, conditions and regulatory treatment, FairPoint states that it "does not view this issue as being applicable to FairPoint."[349]

Q: Does FairPoint, in the earnings statements that it would file post-transaction with the PUC, intend to show a $23.3 million imputation similar to that shown by Verizon New Hampshire in its earnings statements, as required by PUC Order?

A: No. FairPoint indicates that it does not plan to include a revenue imputation in the amount of $23.3 million dollars each year in its financial statements.[350]

Q: Please explain your view of the relationship of yellow pages to this proceeding.

A: FairPoint's financial position combined with Verizon's spin-off of its yellow pages raise several issues that bear directly on the proposed transaction. First, if the Commission agrees with FairPoint that this issue is not "applicable" to FairPoint, and approves the transaction without requiring the continued imputation of $23.3 million per year, New Hampshire consumers would be worse off by that amount, and would lose the opportunity to see those benefits at any time in the future. Ironically, however, if the Commission made clear to FairPoint that the Commission would not approve the transaction unless FairPoint agrees to file earnings statements that include the $23 million imputation, which would be fair to ratepayers, then the already financially precarious transaction would become even more precarious, which could harm consumers.

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[349] / See Exhibit SMB-P-90, FairPoint response to OCA FDR V-1.

[350] / See Exhibit SMB-P-91, FairPoint response to OCA FDR V-2.

Q: Would the IDEARC agreement be transferred to FairPoint?

A: Yes. IDEARC would be the official print directory publisher on behalf of FairPoint and furthermore would use FairPoint's brand in the directories.[351] As described in a recent filing by FairPoint with the SEC:

> Spinco has also agreed, as required by the terms of the publishing agreement, dated as of November 17, 2006 between Idearc Media, Verizon and Verizon Services Corp. to enter into a branding agreement with Idearc Media. Pursuant to the branding agreement, the combined company, as successor by merger to Spinco, will grant to Idearc Media a limited right, for the term of the branding agreement and on an exclusive basis, to use certain marks of the combined company in connection with publishing print directories in the wireline local exchange areas in the former Spinco territories and identify itself as the official print directory publisher for these areas. Idearc Media may terminate the branding agreement at any time. The combined company may terminate the branding agreement with respect to any of the service areas in the former Spinco territories if Idearc Media fails to correct a deficiency in its use of any of the combined company's marks after the combined company has given notice of the deficiency. If Idearc Media or any of its subsidiaries directly or indirectly engages in the provision of telecommunications services or video services in any of the service areas in the former Spinco territories, the combined company may terminate the branding agreement with respect to the affected service area. If, however, an owner of an affiliate of Idearc Media is a provider of telecommunication services outside of these service areas, the combined company may not terminate the branding agreement, so long as Idearc Media's owner or affiliate does not provide telecommunications services in connection with Idearc Media's directory products in any of the service areas in the former Spinco territories. If the combined company has terminated the branding agreement with respect to 20% or more of its subscribers in the service areas in the former Spinco territories, it may then terminate the branding agreement in its entirety.[352]

Q: Why might it harm consumers if FairPoint were to impute $23.3 million post-transaction?

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[351] / Confidential Exhibit SMB-C-92 reproduces in pertinent part Verizon NH errata response to OCA GI 1-42 (Publishing Agreement among SpinCo, SpinCo Subsidiary and IDEARC Media Corp), at 10. **<<<BEGIN CONFIDENTIAL**

END CONFIDENTIAL>>> *Id* .

[352] / FairPoint Communications, Inc. Form 424B3 filing with the SEC on July 19, 2007 ("Form 424B3"), at 132.

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A: Apparently, FairPoint did not anticipate the $23.3 million imputation when it negotiated the agreement with Verizon, despite the fact that the Commission's Order and the Supreme Court's decision in the case is in the public record. As a result of this failure, all else being equal, FairPoint would have $23.3 million less to spend on much-needed service quality improvement and promised broadband deployment than it had planned.

Q: What is your recommendation to the Commission if it approves the proposed transaction?

A: The Commission can determine an appropriate credit or rebate that Verizon owes to consumers based on the sale of its directory publishing line of business. Until the Commission can confirm that Verizon NH's ratepayers were compensated properly for the spin-off, it should not approve the pending Joint Petition.[353]

Q: Why are ratepayers entitled to a credit?

A: State regulators have traditionally imputed the profits related to directories publishing to intrastate regulated operations and also have concluded that the value of directories businesses are derived from the incumbent's historic monopolistic position vis-à-vis its customer base (a position that the courts have upheld). Verizon's publishing has historically enjoyed a unique benefit by virtue of the fact that it has been associated with Verizon. Before 1984, Verizon New Hampshire's predecessors, including New England Telephone, "compiled, published and distributed telephone directories 'in house' and Yellow Pages operations and revenues belonged

[353] / Regardless of the outcome of the proposed transaction, I recommend that the Commission investigate Verizon's IDEARC spin-off in a separate proceeding concerning Verizon NH.

entirely to the regulated telephone company."[354] In other words, ratepayers bore the costs associated with publishing the Yellow Pages as well as enjoyed the profits from the sale of the advertising within them. By the early 1980s, at least, the Yellow Pages business "had become a highly profitable business."[355]

Q: Didn't Verizon NH dispute the PUC's imputation requirement?

A: Yes. On December 28, 2005, the New Hampshire Supreme Court upheld the PUC order requiring Verizon NH to impute directory income to its rate base.[356] In that Opinion, the Court found that the New Hampshire PUC "selected imputation as a reasonable means of making the Telephone Company's ratepayers whole"[357] and upheld the PUC's conclusion that the telephone

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354/ Re Verizon New Hampshire, 89 N.H. P.U.C. 382, 422 (2004).

355/ Re Verizon New Hampshire, 89 N.H. P.U.C. 382, 422 (2004). In 1984, when the Bell Operating Companies (BOCs) were divested from AT&T, Judge Harold Greene for the District Court for the District of Columbia:

> removed the previously announced prohibition on the BOCs' publication of the printed Yellow Pages directories because he concluded that such prohibition would not serve the public interest. The ruling caused the Yellow Pages print business to remain with the BOCs, such as [Verizon New Hampshire's predecessor, New England Telephone], instead of being transferred to AT&T (Id.)

Judge Greene noted "All parties concede that the Yellow Pages currently earn supra-competitive profits." Among the reasons Judge Greene gave for the decision, he said that

> Yellow Pages provided a large "subsidy" to local telephone rates which would most likely continue if the BOCs were permitted to publish the Yellow Pages, and the loss of the "subsidy" would result in large rate increases. He said this could reduce the number of homes with telephones and increase the disparity, in terms of the availability of telephone service, between low income and well-off citizens, a result "clearly contrary to the goal of providing affordable telephone service to all Americans." (Id.)

As the PUC has recognized in its order requiring imputation of Yellow Pages revenues,

> In effect, [Judge Greene's order] recognized the value of the Yellow Pages enterprise to the BOCs and established [Verizon New Hampshire's predecessor,] NET's rights to the revenues derived from the Yellow Pages business subject to supervision and regulation by the states . . . when the [Court] required AT&T to turn over its Yellow Pages operations to the [BOCs], [it] assumed that the revenues from directory advertising would continue to be included in rate base of the Operating Companies …(Id.)

356 / Appeal of Verizon New England, Inc. d/b/a Verizon New Hampshire, 153 N.H. 50 (2005).

357 / *Id*.

company could not “unilaterally relinquish the value derived from Yellow Pages or the right to contribution arising therefrom on behalf of itself or its ratepayers.”[358]

Q: How does this history relate to this proceeding?

A: Verizon is now “cashing in” this extremely lucrative line of business, which Verizon NH has agreed is a “legacy of the monopoly position of the regulated telephone companies,”[359] and consumers should now benefit by receiving a one-time credit for the sale (since imputation will no longer be an option if the transaction is approved).

Q: Have you quantified the magnitude of the credit which you contend should be given to New Hampshire consumers?

A: Yes. I computed the present value of a stream of annual payments based on the $23.3 million imputation required by the Commission.[360]

Q: What level of consumer credit do you compute?

A: Table 12 below shows that New Hampshire consumers are entitled to per-line credits of between approximately $340 and $600, and on an aggregate basis are entitled to between approximately $200 and $360 million as a result of the spin-off. The present value methodology that I use to compute the consumer credit is consistent with prior Commission precedent regarding the

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[358] / *Id.*

[359] / Re Verizon New Hampshire, 89 N.H. P.U.C. 382, 422 (2004) (citations omitted).

[360] / In its notes to its consolidated financial statements in its 2006 annual report, Verizon states the following: “In connection with the spin-off, Verizon received approximately $2.0 billion in cash from the proceeds of loans under an Idearc term loan facility and transferred to Idearc debt obligations in the aggregate principal amount of approximately $7.1 billion thereby reducing Verizon’s outstanding debt at that time.” Verizon Corporate 2006 Annual Report, at 51. See also Exhibit SMB-11. Also, Verizon’s “Consolidated Statement of Changes in Shareowner’s Investment” shows a “contributed capital” amount of $8.695 billion associated with the IDEARC spin-off. Verizon Corporate 2006 Annual Report, at 45.

imputation of revenues, and corresponds with the monies that consumers would otherwise receive in future years. The discount rate that is used also affects significantly the present value calculation, and, for this reason, I use two different discount rates in my calculations. Before Verizon NH is permitted to sell its operations to any other entity, it should provide that credit to New Hampshire ratepayers. Failure to do so means that the state's consumers will never receive the value of the sale of assets that were developed utilizing ratepayer funds.

Q: Please describe your calculation based on the present value of the imputation further.

A: Table 12 uses two different discount rates (5% and 10%) and two different periods of time (a twenty-year span and a thirty-year span) to compute the present value of a multi-year stream of annual payments of $23.3 million. A time period of 30 years corresponds with the initial duration of Verizon's existing IDEARC agreement.[361] Assuming, for example, a 10% discount rate, this methodology yields a per-line one-time credit of between approximately $340 and $380 (and aggregate credits of between approximately $200 and $220 million).

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[361] / IDEARC 2006 Annual Report, available at www.idearcmedia.com. See also Exhibit SMB-92, Verizon NH errata response to OCA GI 1-42 (Publishing Agreement among SpinCo, SpinCo Subsidiary and IDEARC Media Corp), at 10. **<<<BEGIN CONFIDENTIAL** **END CONFIDENTIAL>>>**

Table 12
Calculation of consumer credit for Verizon's IDEARC spin-off
(based on present value of $23.3 million imputation[362]

Time Period	**Discount Rate**	
	5%	10%
20 years	$290,369,501	$198,366,035
30 years	$358,178,109	$219,647,107
Per line calculation	5%	10%
20 years	$500.14	$341.67
30 years	$616.93	$378.32

Q: Verizon states that it has not actually "sold" its directory publishing. Does that change your recommendation?

A: No. Verizon's financial statements clearly show that it has gained a one-time $8.695-billion in capital as a result of the IDEARC spin-off.[363] To distinguish a spin-off from a sale is semantics.

Q: Ms. Baldwin, are you aware of any cases in which state utility commissions have dealt with the sale of the incumbent's directory business?

A: Yes. Qwest Communications International, Inc. ("QCI" or "Qwest") entered into purchase agreements in August 2002 to sell its Qwest Dex, Inc. ("DEX") directory publishing business to

[362] / Sources: Imputation of $23.3 million from Re Verizon New Hampshire, 89 N.H. P.U.C. 382, 443 (2004); Verizon NH total switched access lines used in per line calculation (580,580) from FCC ARMIS Report 43-08, Table III (accessed 6/28/07).

[363] / See Exhibit SMB-11, Verizon Communications 2006 Annual Report, at 45.

an unaffiliated business, “Dex Holdings, LLC.” Dex Holdings, LLC was formed by two private investment firms (Carlyle Group and Welsh, Carson, Anderson & Stowe) to buy Qwest’s directory business for $7.05 billion.[364] In its filings with state utility commissions regarding the sale, Qwest asserted that to avoid bankruptcy, it had agreed to sell Dex.[365]

Q: Were any of the state proceedings in that case relevant to this proceeding?

A: Yes. For example, Qwest agreed to credit ratepayers as part of the sale. On August 1, 2003, the Washington Utilities and Transportation Commission (“WUTC”) approved a Settlement Agreement that provided direct credits on customers’ bills of $67-million which translated into $29.87 per access line.[366] In addition, the settlement included 15 years of revenue credits whereby in the first five years $110 million would be added to Qwest’s Washington intrastate regulated revenues and $103.4 million would be added for the following ten years. Directory revenues would no longer be imputed for the purposes of rate cases.[367] As part of the settlement, Qwest also agreed not to petition to remove customer-specific service quality remedies contained in its tariffs for two years[368] and to “improve customer access” to Washington’s Telecommunications Assistance Program and Lifeline/Link-Up.[369]

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364 / In the Matter of the Application of Qwest Corporation Regarding the Sale and Transfer of Qwest Dex to Dex Holdings, LLC, a non-affiliate, Washington Utilities and Transportation Commission Docket No. UT-021120, Tenth Supplemental Order: Approving and Adopting Settlement Agreement; Granting Application and Accepting Notice, Subject to Conditions, August 1, 2003, at paras. 10-11.

365 / *Id.*, at para. 40.

366 / *Id.*, at para. 27.

367 / *Id.*, at para. 28.

368 / *Id.*, at para. 29.

369 / *Id.*, at para. 30.

In Utah, the Public Service Commission ("Utah PSC") approved a stipulation that provided for a one-time credit to retails customers totaling $22-million.[370] In addition, parties to the stipulation agreed not to seek changes in the price cap index or consumer prices based on the sale.[371] The credit was estimated to translate to approximately $32.91 per customer account.[372]

Q: Please summarize your recommendations regarding yellow pages.

A: Verizon NH should not be permitted to sell its operations to any entity unless and until it compensates consumers for the value of its spin-off of its operations.[373] As an alternative to directly compensating consumers, the Commission could investigate other ways to utilize those funds, such as investments in broadband access.

Q: If Verizon NH agreed to compensate consumers for its IDEARC spin-off, would that justify the transaction?

A: No.

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[370] / In the Matter of the Petition of Qwest Corporation for Declaratory Ruling or, in the Alternative, for Approval of the Sale of the Utah Assets of Qwest Dex, Inc., Public Service Commission of Utah Docket No. 02-049-76, Report and Order, March 11, 2003, at 1. Consumers received $34.25 per account as a credit after the sale was final. Utah PSC Press Release: "Qwest Customers Will Receive Phone-Bill Credits," dated September 26, 2003.

[371] / *Id.*, at 6.

[372] / *Id.*, at 5.

[373] / Furthermore, regardless of the outcome of this proceeding, the Commission should investigate Verizon NH's IDEARC spin-off and direct a consumer credit.

X. WHOLESALE OPERATIONS

Q: Please briefly explain the impact of wholesale operations on consumers.

A: FairPoint's proposed management of complex wholesale operations impacts consumers in three general ways. First, FairPoint likely will focus substantial resources pre- and post-transaction on integration and transition issues relating to wholesale operations, which, in turn, will minimize the resources available for addressing service quality problems and broadband deployment. Second, FairPoint's ability to manage wholesale operations affects the ability of other telecommunications providers to offer competitive alternatives to consumers. Third, the challenge of running a wholesale operation, which is a new line of business for FairPoint due to its history as a rural company, has the affect of placing significant doubt on its ability to undertake the proposed transaction.

Q: Are there reasons to be concerned about the challenge of this aspect of the transaction?

A: Yes. If the transaction occurs, FairPoint will need to create from the ground up an organization to manage and operate the wholesale line of business. Unlike Verizon NH, FairPoint does not have the resources, nor any demonstrated experience in running wholesale operations. FairPoint's total lack of managerial, operational and technical experience in this line of business and its limited financial resources raises significant doubt about its ability to accomplish a smooth and seamless transition from Verizon NH's current wholesale operations. FairPoint has not demonstrated its ability to take over Verizon NH's complex wholesale operations.

Q: Have other state regulators expressed concern about the complexity of re-establishing back office functions?

A: Yes. In the sale of Verizon Hawaii assets, the Hawaii Public Utilities Commission ("PUC") stated, among other things:

> The commission is also concerned about Carlyle's ability to re-establish all necessary back office functions within the projected nine (9)-month timeframe. Re-establishment of the back office functions that Verizon Hawaii affiliates currently provide is, in our view, extremely difficult and complicated as evidenced, in part, by the enormous amount of documentation on the transition from Verizon-to-Hawaiian Telecom filed in the record.[374]

Q: But didn't the Hawaii PUC nonetheless approve the transaction, with conditions intended to offset these wholesale risks as well as other risks?

A: Yes, and the transaction has resulted in major problems.[375] One of the Commissioners dissented, stating, among other things:

> The proposed Transfer of Control does not seem to present an improvement over the finances and services of the existing Verizon Hawaii ownership. Instead, I believe that the components of the transaction impose new and substantial risks

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[374] / Hawaii Public Utilities Commission Docket No. 04-0140, *In the Matter of the Application of Paradise Mergersub, Inc.,GTE Corporation, Verizon Hawaii Inc. Bell Atlantic Communications, Inc. and Verizon Select Services Inc. for Approval of a Merger Transaction and Related Matters,* Decision and Order No. 21696, March 16, 2005, (footnote omitted).

[375] / Soon after celebrating a smooth "phase one" of the transition from Verizon back office systems to its own, the company announced that it was having trouble converting about 100,000 email accounts from the verizon.net domain to hawaiiantel.net. Then inclement weather and subsequent flooding caused massive service outages. These two problems led to a barrage of calls to customer service, which overwhelmed the call centers for several days. (Pacific Business News (Honolulu), "Hawaiian Telcom enters final transition," April 10, 2006.) After completing the second and final phase of the transition, the company learned from customers that bills included erroneous charges. Furthermore, many bills for April were sent out two weeks late, leading to the May bills that included charges for two months. Customers confused about their bills again overwhelmed customer service lines. (Honolulu Star Bulletin, "Billing woes overwhelm Hawaiian Telcom systems," June 21, 2006.) In response, Hawaiian Telecom replaced the consulting firm hired to build and integrate the back office support systems. (Associated Press, "Hawaiian Telecom hires firm to improve customer service," February 9, 2007.) The Hawaii Public Utilities Commission opened a investigation into service quality earlier this year. (Nashua Telegraph, "FairPoint working hard to avoid phone problems that occurred with sale in Hawaii," July 1, 2007).

> on residential, commercial, retail and wholesale ratepayers statewide – now and for many years to come.[376]

Q: Do you have other concerns about the transition to FairPoint's wholesale operations?

A: Yes. On behalf of Verizon Communications **<<<BEGIN HIGHLY CONFIDENTIAL LEVEL 2**

[377]

END HIGHLY CONFIDENTIAL LEVEL 2>>>

Q: Do you have other concerns about the transition to FairPoint's wholesale operations?

A: Yes. The wholesale system appears to be extremely complex.[378] In Verizon NH's response to NECTA/CPNH G III FDR 1-6, Verizon NH provides information about the 600 Verizon systems that Verizon provided to FairPoint, and on the approximate 130 "gold" systems that "run" Verizon's business, which provide further evidence of the complexity of the wholesale

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376 / Hawaii Public Utilities Commission Docket No. 04-0140, *In the Matter of the Application of Paradise Mergersub, Inc.,GTE Corporation, Verizon Hawaii Inc. Bell Atlantic Communications, Inc. and Verizon Select Services Inc. for Approval of a Merger Transaction and Related Matters,* Decision and Order No. 21696, March 16, 2005, Dissenting Opinion of Wayne H. Kimura, Commissioner, at 2.

377 / See Exhibit SMB-HCL2-93, Verizon NH supplemental response to Labor GI 1-13, Northern New England Spinco Inc. Attachment 4(c)7, at 18.

378 / See my discussion (and exhibits referenced therein) in Section VI of the volume and composition of Verizon NH's wholesale business.

operations. We have not yet seen assurance, or a clear plan from FairPoint that they are ready and able to make this transition to serving CLECs.

Q: What do you propose?

A: I anticipate that the CLECs that are participating in this proceeding may raise specific concerns. On a more general level, the complexity of the wholesale operations, and FairPoint's lack of relevant experience in this area provide additional compelling reasons for denying the proposed transaction.

XI. OTHER ISSUES

Q: Does the transaction affect New Hampshire's economy?

A: Yes. The health of the state's local and ubiquitous telecommunications infrastructure bears directly on the health of the state's economy. The proposed transaction is risky and therefore jeopardizes consumers and the State, which in turn, jeopardizes the health of the state's economy.

Q: Doesn't FairPoint promise to add 675 new jobs across the 3 northern New England States?

A: Yes. However, at this point, despite press releases and media reports, we have not received answers to data requests seeking more specifics on these commitments.[379] In addition, these promises are unenforceable. Furthermore, as I discuss in Section V above, many seasoned employees may leave SpinCo between now and the closing of the deal if it is approved. Both open and new positions may be filled by less experienced employees, and, therefore, on balance, it is not evident that SpinCo's labor force post-transaction will be as experienced as the current labor force. In addition, these new positions are necessary to simply replace Verizon back office functions that are provided in other states, and therefore aren't new positions that will address any of the existing issues such as service quality. In any event, the 675 new positions across the three states do not justify the approval of the transaction.

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[379] / "FairPoint Announces Plan for 675 Jobs, New England Broadband Expansion Strategy." FairPoint's press release states, " FairPoint intends to create approximately 250 new positions in New Hampshire, with approximately 190 jobs in Manchester, 50 jobs in Littleton and the remaining jobs being located throughout the state as appropriate. The 190 new jobs in Manchester will involve opportunities in business and wholesale sales, accounting, marketing, engineering, risk management, and staff support. The 50 new jobs in Littleton will be in the areas of outbound telemarketing, credit and collections activities and marketing. A few positions have already been filled, but the bulk of the hiring will occur over the last quarter of 2007 and the first quarter of 2008." http://phx.corporate-ir.net/phoenix.zhtml?c=122010&p=irol-newsArticle&ID=1021323&highlight= site visited June 29, 2007.

Q: Please address generally the impact of the transaction on E911.

A: The state's E911 system is clearly critically important to the safety and well-being of the state. Therefore, at a minimum, I assume that the PUC, in conjunction with the E911 Commission, must assess FairPoint's ability to operate and provision E911, as well as the costs to do so.

Q: Have you analyzed FairPoint's ability in that regard?

A: No. That is not within the scope of my testimony. It may be prudent, however, for the Commission to seek comment from the Enhanced 911 Commission with regard to any concerns or potential impacts on the operation of the statewide E911 system.

XII. CONCLUSION

Q: Please summarize your analysis and recommendations.

A: The transaction as proposed poses substantial risks to New Hampshire consumers and to the New Hampshire economy. The benefits described by Joint Petitioners are speculative, and largely unenforceable. I cannot conceive of enforceable commitments that would counterbalance these risks, and, therefore, I recommend that the Commission deny the transaction.

I recognize that the Commission may, nonetheless, approve the transaction. If it does, I urge the Commission to condition such approval on specific, enforceable commitments by the Joint Petitioners. I discuss such commitments in Section I of my testimony, while reiterating that these commitments do not justify approval of the proposed transaction, and making clear that they should apply to any company that owns and operates the assets at issue in this case.

Q: Are the conditions that you describe in Section I, the only ones that are relevant?

A: No, other parties may propose conditions that merit consideration. However, without seeing these proposals, the OCA can not express an opinion as to whether the condition should be imposed.

Q: Ms. Baldwin, several of the commitments that you propose appear entirely unrelated to the proposed transaction. If this is true, why then, do you propose them in this proceeding?

A: The transaction exacerbates existing market imperfections (such as deteriorating service quality, poles issues, low Lifeline participation, inadequate broadband deployment) because it will absorb substantial management attention, human resources, and capital. For these reasons, the conditions are entirely appropriate. Without explicit enforceable commitments, the transaction likely would divert FairPoint's resources away from critical consumer issues. Therefore, strong enforceable conditions are essential to ensure that FairPoint follows through on its pre-transaction promises. I summarize my proposed conditions in the first section of my testimony on page 11.

Q: If the Commission denies the proposed transaction, do you have any other recommendations?

A: Yes. As I discuss at the outset of my testimony, this complex proceeding has diverted important regulatory attention away from important matters, such as service quality, Lifeline participation, poles management, and directory credits. Therefore, I recommend that the Commission return to these pressing matters with a renewed focus and in a timely manner. Consumers have been held hostage by this transaction and denied the benefit of the Commission's deliberation on major matters of importance to consumers and to the New Hampshire economy.

Q: Does this conclude your testimony?

A: Yes, at this time. However, I reserve my right to see permission to supplement my testimony based on my review of recently filed and forthcoming responses to data requests, and other relevant information.

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