STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Frontier Communications Corporation, Verizon Communications Inc., Verizon North Inc., Verizon South Inc., New Communications of the Carolinas Inc. Joint Application for the approval of a Reorganization pursuant to Section 7-204 of the Public Utilities Act the Issuance of Certificates of Exchange Service Authority Pursuant to Sections 13-405 to New Communications of the Carolinas Inc.; the Discontinuance of Service for Verizon South Inc. pursuant to Section 13-406; the Issuance of an Order Approving Designation of New Communications of the Carolinas Inc. as an Eligible Telecommunications Carrier Covering the Service Area Consisting of the Exchanges to be Acquired from Verizon South Inc. Upon the Closing of the Proposed Transaction and the Granting of All Other Necessary and Appropriate Relief.	)	Docket No. 09-0268

REBUTTAL TESTIMONY OF

DANIEL MCCARTHY

ON BEHALF OF

FRONTIER COMMUNICATIONS CORPORATION

NOVEMBER 13, 2009

PUBLIC VERSION

I. INTRODUCTION

Q. Please state your name, occupation and business address.

A. My name is Daniel McCarthy. I am Executive Vice President and Chief Operating Officer of Frontier Communications Corporation ("Frontier"). My business address is 3 High Ridge Park, Stamford, Connecticut 06905.

Q. Are you the same Daniel McCarthy who filed direct[1] and supplemental[2] testimonies in Docket No. 09-0268?

A. Yes, I am.

Q. What is the purpose of your testimony?

A. My testimony responds to Staff witnesses Samuel S. McClerren[3], Mike Ostrander[4], Rochelle Phipps[5], Qin Liu[6], Karen Chang[7] and Stacy Ross[8] and addresses the conditions that Staff is advocating for this transaction. I will also be responding to Lee L. Selwyn[9], who provided testimony on behalf of the Attorney General and the Citizens Utility Board ("CUB").

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[1] Prepared Direct Testimony of Daniel McCarthy, on Behalf of Frontier Communications Corporation, July 8, 2009, Frontier Exhibit Joint Applicants' Exhibit 1 (hereafter "McCarthy Direct").

[2] Supplemental Prepared Direct Testimony of Daniel McCarthy, on Behalf of Frontier Communications Corporation, August 13, 2009, Joint Applicants' Supplemental Exhibit 1.

[3] Direct Testimony of Samuel S. McClerren, Telecommunications Division of the Illinois Commerce Commission (Confidential Version), October 20, 2009, ICC Staff Exhibit 1.0 (hereafter "McClerren Confidential").

[4] Direct Testimony of Mike Ostrander, Financial Analysis Division of the Illinois Commerce Commission , October 20, 2009, ICC Staff Exhibit 2.0 (hereafter "Ostrander Direct").

[5] Direct Testimony of Rochelle Phipps, Finance Department of the Illinois Commerce Commission, October 20, 2009, ICC Staff Exhibit 3.0 (hereafter "Phipps Confidential").

[6] Direct Testimony of Qin Liu, Telecommunications Division of the Illinois Commerce Commission (Confidential Version) , October 20, 2009, ICC Staff Exhibit 4.0 (hereafter "Liu Confidential").

[7] Direct Testimony of Karen Y. Chang, Telecommunications Division of the Illinois Commerce Commission , October 20, 2009, ICC Staff Exhibit 5.0 (hereafter "Chang Direct").

[8] Direct Testimony of Stacy Ross, Telecommunications Division of the Illinois Commerce Commission , October 20, 2009, ICC Staff Exhibit 6.0 (hereafter "Ross Direct").

[9] Direct Testimony of Lee L. Selwyn on behalf of the People of the State of Illinois and the Citizens Utility Board, including Allegedly Confidential and Allegedly Proprietary Verizon Data, October 20, 2009, AG/CUB Exhibit 1.0 (hereafter "Selwyn Direct").

I am also responding to the direct testimonies of Randy Barber on behalf of the International Brotherhood of Electrical Workers ("IBEW")[10], Susan Baldwin on behalf of the IBEW[11], William Solis on behalf of Comcast Phone of Illinois, LLC d/b/a Comcast Digital Phone ("Comcast")[12], Dr. Michael D. Pelcovits on behalf of Comcast[13], Charles W. King on behalf of the U.S. Department of Defense[14] and Mark Schmikler on behalf of the Illinois Pay Telephone Association.[15]

Q. Can you summarize your testimony?

A. Yes. I will respond to the issues raised by Staff and the conditions they propose. Although I disagree with several of the concerns identified by Staff witnesses and the need for the conditions they advocate, Frontier can agree to several of the conditions proposed by Staff and could accept other conditions with modifications. With the inclusion of these conditions, as modified, the concerns raised by the intervenors, while not necessary, are eliminated.

In addition, in response to arguments made by the Staff and intervenor witnesses, my testimony will address the following general subjects.

- **Frontier is a financially sound operator committed to rural areas and small and mid-sized urban areas.** In terms of its financial profile and expected operating performance, Frontier will be one of the financially strongest non-Regional Bell Operating Company ("RBOC") incumbent local exchange carriers ("ILECs") in the

[10] Pre-Filed Direct Testimony of Randy Barber, on Behalf of the Communications Workers of America and International Brotherhood of Electrical Workers, Local 986, October 20, 2009, Includes Alleged Confidential and Highly Sensitive Confidential Information, IBEWExhibit 1.0 (hereafter "Barber Confidential").

[11] Prefiled Direct Testimony of Susan M. Baldwin, on Behalf of the Communications Workers of America and International Brotherhood of Electrical Workers, Local 986, October 20, 2009, Includes Alleged Confidential and Highly Sensitive Confidential Information, IBEWExhibit 2.0 (hereafter "Baldwin Confidential).

[12] Pre-Filed Direct Testimony of William Solis, on Behalf of Comcast Phone of Illinois, LLC, October 14, 2009, Confidential Version (hereafter "Solis Confidential").

[13] Pre-Filed Direct Testimony of Michael D. Pelcovits, on Behalf of Comcast Phone of Illinois, LLC, October 14, 2009, Confidential Version (hereafter "Pelcovits Confidential").

[14] Direct Testimony of Charles W. King on behalf of the U.S. Department of Defense and All other Executive Agencies, October 20, 2009, DoD/FEA Exhibit 1 (hereafter "King Direct").

[15] Direct Testimony of Mark Shmikler on behalf of the Illinois Pay Telephone Association, October 20, 2009, IPTA Exhibit No. 1.0 (hereafter "Shmikler")

country after the consummation of this transaction. The suggestion by intervenors that Frontier's business model is not sound or that Frontier is not financially fit to own and operate the business of Verizon Communications Inc. ("Verizon") in Illinois, which, along with the other Verizon operations included in the proposed transaction, I will refer to in this testimony as the Verizon Separate Telephone Operations ("VSTO"), is contrary to the evidence. Further, I will show that the leverage comparisons between the financials of VSTO and Frontier are calculated incorrectly in the testimonies of certain intervenors. I will also demonstrate that the Illinois Commerce Commission (the "Commission") should focus primarily on cash flow generation in its review of financial strength, and the evidence is clear that cash flow will be strong in the combined Frontier/VSTO properties. While certain intervenors assert that Frontier is not as financially strong as Verizon, a more careful analysis of the facts makes it clear that Frontier is among a very small number of carriers with the financial resources and the strategic will to invest capital to serve low-density areas like those in the VSTO areas. Furthermore, the Commission should understand fully that the resources of diversified carriers, such as Verizon, are or may be directed toward strategic objectives other than solely to their local exchange operations. Frontier's strategic commitment to its service areas is clear and without strategic conflicts and it will produce demonstrable public benefits for Illinois customers as set forth in my testimony.

- **Customer services will not be disrupted or adversely impacted.** The proposed transaction between Frontier and Verizon has been structured to avoid the difficulties and problems encountered by other companies such as FairPoint Communications, Inc. ("FairPoint"). Frontier will continue to utilize the same operational support systems ("OSS") and processes currently utilized by Verizon to serve customers in Illinois after the closing of the transaction. The continued use of the Verizon systems will result in at least the same quality of services and support that customers receive today.

- **Frontier will make new investments to enhance and expand its broadband network.** Frontier intends, and has the capacity, to improve investment and operations in the VSTO geographic service areas. One of the key public interest benefits of this transaction will be increased broadband deployment and subscribership in the VSTO areas. This commitment to broadband, including unserved or underserved customers in the VSTO areas, is a critical component of Frontier's business plan.

- **Frontier has a proven transactional skill set and track record.** Frontier has a history of successfully executing acquisitions and seamlessly integrating acquired operations into its existing business. As a result of its historical transactional activity, Frontier and its management team have developed the requisite competencies, and have demonstrated a compelling track record that demonstrate Frontier can execute successfully on the VSTO acquisition. The financial model for this transaction is consistent with Frontier's past experience and practices. As a result, Frontier's model is appropriate, reflecting the input of executives and senior management with many years of successful operational and transactional experience. I also note that Frontier is confident that its management team and other Frontier/VSTO personnel have the capabilities to respond to future competitive and economic challenges.

- **No conditions related to transaction approval are necessary, as the public interest benefits are demonstrable and the financial and operating risks are relatively low**. Although Frontier is willing to accede to certain Staff conditions discussed below as a means of responding to specific concerns, no conditions are necessary in this transaction. The proposed transaction will result in multiple public benefits, including new investments in network and operations. In fact, Frontier expects that the pro forma financial profile will continue to improve as a result of higher revenues and better customer relationships that result from the company's planned investment. Importantly, the pending Frontier transaction is very similar to the CenturyTel Inc. ("CenturyTel") and Embarq Corporation ("Embarq") merger (the combined company was renamed CenturyLink), which this Commission recently approved with only a limited number of conditions. In addition, as Frontier has noted in previous testimony, the proposed transaction is different in clear and fundamental ways from the combination of FairPoint and Verizon's northern New England operations ("Verizon NNE") or from the acquisition by The Carlyle Group ("Carlyle") of the Verizon Hawaii properties ("Hawaiian Telcom"). Like the CenturyLink transaction, this combination makes the post-merger company stronger operationally and financially than it was prior to the transaction, with the result that no conditions are necessary or appropriate.

II. RESPONSE TO THE ILLINOIS STAFF

Q. Has Frontier evaluated the Illinois Staff testimony?

A. Yes. It is worth noting that, while most of the intervenors seem to address the transaction on a national, holding company basis, the Illinois Staff is tasked with reviewing this transaction as it will impact the Illinois operating companies and Illinois customers. I think this approach is the appropriate one for the Commission. While I am confident, and will discuss at greater length below, that this transaction will make Frontier a stronger company across all of the states it serves, the question for the Commission to address is how this transaction will affect customers in Illinois and, specifically, the VSTO Illinois customers. In that regard, I am equally confident that the transaction not only meets the requirements of the Section 7-204, it will also benefit the current VSTO Illinois customers by introducing a provider that is focused on the rural nature of most of the VSTO Illinois properties and that has a greater commitment to bring broadband to unserved and underserved areas.

It is also noteworthy that, of the seven enumerated guidelines under Section 7-204(b), Staff witnesses find that the proposed transaction meets three of the guidelines -- 7-2404(b)(2), (3), and (6)—without conditions.[16] And while Staff's lead witness, Mr. McClerren, ostensibly opposes the transaction, Frontier understands him to say (with the support of the other five Staff witnesses) that Staff would support the transaction with the imposition of specified conditions.[17]

First, I will address the Illinois Staff's questions and concerns about operations in Illinois and, second, I will respond to their proposed conditions. After that, I will respond to the

[16] McClerren Confidential, pp. 8-14.

[17] McClerren Confidential, pp. 41-45.

issues raised by other intervenors in this proceeding.

<u>Frontier Will Not Experience The Problems Suffered By FairPoint Because This Transaction Is Fundamentally Different From The FairPoint-Verizon NNE Transaction</u>

Q. A number of parties to this docket, including Staff witness McClerren[18] (as well as Mr. Selwyn[19], Mr. Barber[20] and Mr. King[21]) have drawn comparisons between this transaction and the recent transaction by which FairPoint acquired Verizon's New England operating companies. Is that an appropriate comparison?

A. No. And I think it is important to address this distinction at the outset. Frontier is clearly distinguishable from FairPoint. In fact, FairPoint's problems which arose from its business decision to create entirely new and untested back-office operational support systems will not occur in the proposed Frontier-Verizon transaction.

Q. Please explain in greater detail why this transaction is different from the FairPoint transaction with respect to back-office software systems.

A. FairPoint chose to build "from scratch" the back-office systems that are needed to control key operational functions, which include order-taking, provisioning those orders through the company's systems, billing, maintenance and repair.[22] The newly developed and deployed FairPoint systems performed poorly due to some combination of design, integration and implementation problems, which resulted in a loss of customers and related financial problems after cutover. In essence, FairPoint's business plan caused it to spend significant funds to develop new systems, and then the company was required to spend even more in development expense when those systems proved ineffective.

In fact, the Maine Public Utilities Commission stated that "We believe that FairPoint's deteriorating financial performance is directly related to its post-cutover failure to restore itself to business as usual. We believe that failure is *directly related to the lack of a stable*

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[18] McClerren Confidential, pp. 25-31.

[19] Selwyn Confidential, pp. 19-27.

[20] Barber Confidential, pp. 10-12.

[21] King Direct, pp. 7-8.

[22] McCarthy Direct, pp. 28.

and functional OSS."[23] [Emphasis added.] Their point was that the problems occurred after cut-over to the newly-created OSS, and that the financial problems flowed from the company's inability to restore normal business operations. This assessment identifies a *root problem* for the issues experienced by FairPoint and Hawaiian Telcom that will not occur in the Frontier-Verizon transaction.

In contrast, as I explain in more detail below, Frontier will not face these issues because, upon closing, it will have working versions of both the replicated existing Verizon systems and Frontier's own scalable systems. Frontier will be using the already-proven Verizon systems for the operations acquired from Verizon in Illinois. In order to serve its Illinois customers at closing, Frontier will have no need to spend significant amounts to build and integrate new systems and incur associated software expenses similar to those incurred in northern New England by FairPoint.

Q. Did FairPoint's systems problems cause a loss of customers and revenues?

A. Yes. Although FairPoint has not reported the full extent of the costs associated with lost customers, they have made clear that the losses were meaningful.[24] In FairPoint's words,

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[23] RE: PUBLIC UTILITIES COMMISSION, Compliance with Commission Order Dated 2/1/08 in Docket No. 2007-67, Docket No. 2008-108 at 2.

[24] FairPoint Second Quarter 10-Q 2009, available at http://www.sec.gov/Archives/edgar/data/1062613/000104746909007239/a2193968z10-q.htmp,

p. 40: "Following the cutover [from Verizon's systems to FairPoint's in 2009], many of these [back-office] systems functioned without significant problems, but a number of the key back-office systems, such as order entry, order management and billing, experienced certain functionality issues. As a result of these systems functionality issues, as well as work force inexperience on the new systems, we experienced increased handle time by customer service representatives for new orders, reduced levels of order flow-through across the systems, which caused delays in provisioning and installation, and delays in the processing of bill cycles and collection treatment efforts. These issues impacted customer satisfaction and resulted in large increases in customer call volumes into our customer service centers. While many of these issues were anticipated, the magnitude of difficulties experienced was beyond our expectations. . . . Because of these cutover issues, during the three months and six months ended June 30, 2009 we incurred $8.6 million and $28.0 million, respectively, of incremental expenses in order to operate our business, including third-party contractor costs and internal labor costs in the form of overtime pay. The cutover issues also required significant staff and senior management attention, diverting their focus from other efforts. We expect to continue to incur a modest amount of incremental costs during the third quarter of 2009 as we fully complete our cutover restoration efforts. In addition to the significant incremental expenses we incurred as a result of these cutover issues, we have been unable to fully implement our operating plan for 2009 and effectively compete in the marketplace, which we believe is having an adverse effect on our business, financial condition, results of operations and liquidity, as well as our ability to continue to comply with the financial covenants in our credit agreement."

See, also, Hawaiian Telcom 2008 10-K, p, 15: "In addition to the significant expenses we have incurred, because we do not have fully functional back-office and IT systems, we have been unable to fully implement our business

"In addition to the significant incremental expenses we incurred as a result of these cutover issues, we have been unable to fully implement our operating plan for 2009 and effectively compete in the marketplace …."[25] Also, a review of the companies' operating reports indicates a sharp increase in customers lost, which I believe is materially related to the failure to provide high-quality service as those companies labored with the inadequate development of systems. By contrast, Frontier will use the existing replicated Verizon operational support systems already in operation, which means that the company will be able to operate flexibly and responsively from the first day Frontier takes ownership of the Verizon properties.

Q. Are there other significant differences between Frontier and FairPoint that mitigate the risk of Frontier experiencing the problems encountered by FairPoint?

A. Yes. Frontier is a much larger, more financially secure and more experienced provider of telecommunications services as compared to FairPoint. Table 1 provides some insight into the comparative statistics of Frontier and FairPoint.

Table 1: Company Comparison—Frontier and FairPoint (pre-transaction)

($s in millions, lines in 000s)	**Frontier**	**FairPoint**	**Ratio FTR : FRP**
Access Lines	2,254	252	9.0x
Avg. Lines per State	94	14	6.7x
Ranking Among U.S. ILECs	6th	14th	
States Served	24	18	
Largest State	NY	ME	
Lines in Largest State	684	61	11.2x
Revenues	$ 2,237	$ 263	8.5x
EBITDA	$ 1,214	$ 135	9.0x
Net Debt / EBITDA	3.8x	4.5x	
Dividend Payout Ratio	65%	87%	
Scalable Systems Platform	Yes	No	

Sources: FairPoint Presentation (January 16, 2007) (access line data as of September 30, 2006, financial data as of December 31, 2005); FairPoint 2006 10-K; 2006 USAC Appendix HC-05 (2006 Maine lines); Frontier Exhibit 2.1, New Frontier Presentation.

strategy and effectively compete in the marketplace, which has had an adverse effect on our business and results of operations. While we are continuing to work to improve the functionality of our systems and we have seen improvement, there is no certainty that these activities will be successful or when we will achieve the desired level of functionality. Until we are able to achieve this level of functionality, our lack of critical back-office and IT infrastructure will negatively impact our ability to operate as a stand-alone provider of telecommunication services, and will have an adverse effect on our business and operations." See also, p. 18.

[25] *Id*.

The data in the table summarize certain operating and financial statistics for the two standalone companies as of the announcement of their respective transactions with Verizon. Notably, Frontier and FairPoint are quantifiably very different. Frontier is substantially larger, considerably less leveraged, more conservative in its dividend policy, and, importantly, more qualified from an existing systems perspective. To be specific, at the time of the announcement of the Frontier-VSTO transaction, Frontier was serving approximately 2.254 million access lines in 24 states across the U.S. [26] (making it the sixth largest ILEC in the country). By contrast, FairPoint operated approximately 252,000 access lines[27] in 18 states, making it one-ninth the size of Frontier at the time its transaction was announced. To make the same point in different terms, Frontier's largest state currently is New York, where the company serves around 684,000 lines, or almost 3 times more lines than FairPoint's company-wide total in January 2007. FairPoint's largest single state before the Verizon NNE acquisition was Maine, where the company had operations with around 61,000 total lines - meaning that Frontier's most sizeable single state operation today is more than 11 times larger than FairPoint's largest state was pre-transaction. Similarly, Frontier's Pennsylvania operations, with around 427,000 lines, are larger than all of pre-transaction FairPoint; and the company's Minnesota operations are almost as large as total pre-transaction FairPoint. Frontier's average lines per state is today approximately 94,000, or almost 7 times larger than FairPoint's average per state operation of approximately 14,000 lines before the Verizon NNE acquisition. Quite simply, Frontier is one of the largest ILECs in the country, with existing operations that dwarf pre-transaction FairPoint. The scope and scale of the two companies at the time they announced their respective transactions is in no way comparable.

From a financial perspective, there are also meaningful differences in the nature of standalone Frontier as compared to standalone FairPoint. Just prior to the respective

[26] Frontier Exhibit 2.1, Frontier Communications Corp., "Welcome to the New Frontier" Presentation (Form 425) (May 13, 2009) (hereafter "New Frontier Presentation"). (available at: http://sec.gov/Archives/edgar/data/20520/000095015709000249/form425.htm).

[27] FairPoint Communications, Inc., Presentation to Investors, p. 15 (Jan. 16, 2007) ("FairPoint Presentation"). (available at: http://www.sec.gov/Archives/edgar/data/1062613/000110465907002499/a07-1924_1ex99d3.htm). Lines as of September 30, 2008.

transaction announcements, Frontier had a revenue base of approximately $2.2 billion,[28] more than 8 times larger than FairPoint's $263 million[29] in total revenues. Frontier was generating around $1.2 billion in EBITDA,[30] while FairPoint's EBITDA was a mere $135 million[31] – again, indicating Frontier is around 9 times larger than FairPoint. Of more interest is the fact that Frontier's pre-transaction leverage ratio (Net Debt to EBITDA) was 3.8x,[32] considerably lower than FairPoint's standalone leverage of 4.5x.[33] This lower standalone leverage allows the Frontier-VSTO transaction to be structured more favorably and potentially to attract an investment grade credit rating. FairPoint's level of leverage would not permit such a credit rating and it was unlikely that the company's credit rating would improve in the first several years of operations. Finally, Frontier on a standalone basis had a 65% dividend payout ratio, [34] a level which is clearly more conservative than FairPoint's 87% pre-transaction payout ratio.[35] Thus, Frontier has much greater financial flexibility than did FairPoint, a better standalone balance sheet, and a sustainable dividend policy.

Frontier also has a historical record to prove its ability to convert and integrate financial systems, order taking, billing, maintenance, and other operational support systems. Frontier has converted and integrated five billing systems successfully over the past five years, converting approximately 1.7 million access lines onto a single scalable company-wide platform. FairPoint possessed no similar systems integration experience or existing scalable systems platform, and decided to construct new systems entirely "from scratch," a shortcoming in terms of operational capabilities and competencies that, as I explained above, was largely responsible for FairPoint's difficulties.

[28] Frontier Exhibit 2.1, New Frontier Presentation, p. 16.

[29] FairPoint Presentation, p. 12.

[30] Frontier Exhibit 2.1, New Frontier Presentation, p. 16.

[31] FairPoint Presentation, p. 12.

[32] Frontier Exhibit 2.1, New Frontier Presentation, p. 16.

[33] FairPoint Presentation, p. 12.

[34] Frontier Exhibit 2.1, New Frontier Presentation, p. 21.

[35] FairPoint Presentation, p. 12.

Q. Do independent investment analysts agree that the proposed transaction is different from previous Verizon divestiture transactions and that Frontier's acquisition is financially sound?

A. Yes, the published response of independent research analysts to the proposed transaction generally has been positive and supportive of Frontier's ability to execute the transition effectively. For example, on June 12, 2009, Raymond James and Associates, Inc. issued a report explaining that it viewed the transaction as very different from the FairPoint transaction, and, in the analyst's professional opinion, that Frontier was making a "prudent acquisition." The report states:

> We note several significant differences between [this transaction and the FairPoint transaction]: Frontier is de-levering (not re-levering) significantly through the transaction, should be solidly in investment grade range, is proactively cutting its dividend, and plans on driving broadband penetration and availability much higher than current levels, (Verizon properties have 60% availability, Frontier's have 92%) . . ..
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> Frontier will acquire GTE's entire legacy IT systems in 13 of the 14 states, giving it the ability to run parallel systems for all products in those 13 states. This is different from a forced cutover or new systems development, which actually requires a hastened time frame and can be fraught with peril. Effectively, these are stand-alone systems with a general manager overseeing them and won't require any new systems development on the part of Frontier until management is ready to move them over . . ..
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> Overall, we believe Frontier is making a prudent acquisition, which will expand its scale, lower its leverage, and improve its dividend sustainability, thus rewarding patient investors over time.[36]

In addition, in its Rating Action placing Frontier's corporate credit ratings on review for possible upgrade following the announcement of the proposed transaction, Moody's indicated that "VZ-Spinco will be operating under independent management and operating systems prior to the merger effectiveness and will not require a timed cutover, which is expected to materially reduce the transition issues that other carriers have experienced."[37] It is also noteworthy that Fitch, in placing Frontier's credit ratings on Rating Watch Positive as a result of the proposed transaction, states that "Fitch believes

[36] Frontier Exhibit 2.2 Raymond James & Associates, FTR: Notes From the Road (June 12, 2009).

[37] Frontier Exhibit 2.3 Moody's Investors Service, Global Research Rating Action: Frontier Communications Corporation (May 13, 2009).

the execution risk is offset to some extent by Frontier's significant experience in integrating large transactions and the scalability of its existing systems."[38] Clearly, these credit rating agencies, which tend to have a conservative perspective, believe that on balance the transaction is positive for the company from a financial perspective as opposed to being a financially risky proposition.

Despite attempts by intervenors[39] to suggest superficial similarities between this transaction and former Verizon divestitures, Frontier is not FairPoint, or even similar to FairPoint, and this transaction is not the FairPoint/Verizon transaction. Intervenors' suggestions ignore the substantial evidence, supported by the independent analysts and third parties of the substantive differences between this deal and prior ones.

Quality of Service

Q. Staff witness Samuel McClerren notes that both Verizon and Frontier have missed certain service quality standards set forth in the Commission's rules, Code Part 730.[40] He expresses skepticism about whether the proposed transaction will not diminish the utility's ability to provide adequate, reliable, efficient, safe and least-cost public utility service for the VSTO Illinois properties under Section 7-204(b)(1). Can you respond to Mr. McClerren's concerns?

A. Yes. In drawing his conclusion regarding Frontier's prior service quality performance, Mr. McClerren focused on three specific service quality measures: Repair Office Answer

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[38] Frontier Exhibit 2.5, Fitch Ratings, Fitch Places Frontier Communications on Rating Watch Positive (May 13, 2009).

[39] S*ee*, for example, Barber Confidential, pp. 53-54; Baldwin Confidential, pp. 16-17; Selwyn Confidential, p. 15. However, the Morgan Stanley analyst cited by Mr. Barber does not believe that Frontier and the proposed transaction are comparable to FairPoint and its transaction:

> We continue to see significant differences in the two deals: (1) [Frontier d]eal lowers leverage by more than a turn (3.8x to 2.6x) instead of increasing it; (2) Spinco (except West Virginia with ~13% of acquired lines) will operate with a single platform on an independent basis prior to the merger while West Virginia will be integrated contemporaneously with the merger on existing Frontier systems while Fair[P]oint built new systems from scratch.
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> Frontier Exhibit 2.4, "Frontier: Merger Integration on Track; Flow Back an Overhang," Morgan Stanley Research, August 14, 2009 (hereafter "Morgan Stanley August Report").

[40] McClerren Confidential, pp. 17-18.

Time, Business Office Answer Time, and Out of Service < 24 Hours.[41] In his testimony, Mr. McClerren reviewed Frontier's performance on these measures over the period from July 2008 through June 2009. There is no question that Frontier did experience difficulties meeting these service standards during 2008 and the first quarter of 2009. However, Frontier has since addressed those difficulties and significantly improved its performance. Extending Mr. McClerren's review to include Frontier's performance through September 2009 shows a much different picture. As reflected in Frontier Exhibit 2.15, for the twelve-month period ending September 2009, Frontier has met the service quality standards for Repair Office Answer Time and Out of Service < 24 Hours. In fact, as Frontier Exhibit 2.15 shows, Frontier's performance was essentially on par with Verizon's performance for that period. Frontier's efforts to improve Business Office Answer Time took a little longer to implement, but since April 2009, Frontier has consistently met the Business Office Answer Time service standard. In fact, over the past six months, Frontier's performance on this measure has been better than Verizon's. Frontier's performance over the past twelve month period evidences its commitment to make needed improvements and do what is necessary to provide quality service.

Q. You indicate that Frontier is committed to maintaining and improving service quality, but will Frontier be able to do so? Will Frontier have the personnel and resources necessary to achieve required service quality performance in the VSTO properties in Illinois?

A. Yes. As part of this transaction, experienced and capable Verizon Illinois employees will be remaining with Frontier to continue to serve the acquired territories after the transaction. These are the same employees who have been working in these areas for years, and so are familiar with both the network and customers. This will be a seamless transition in terms of the provision of service. Indeed, Frontier intends to refocus on customer service in the acquired territories with organizational changes that will facilitate quick and local response to service issues. Also, as I mentioned in my initial testimony, Frontier's corporate focus is on service to rural and smaller urban areas.[42] Thus, Frontier

[41] McClerren Confidential, pp. 18-22.

[42] McCarthy Direct, p. 11.

will be able to devote attention and resources to these areas without competing demands from large urban service areas and nationwide wireless networks which compete for corporate resources. This transaction will increase the corporate financial strength of Frontier, making available the capital and operational resources to provide high-quality service to not only meet the Commission's service quality standards but also provide the level of service necessary to maintain and attract new customers.

Q. Chapter 730 sets out a series of service standards by which the Commission measures service quality. Do the Chapter 730 standards fully describe what Frontier considers to be "quality service"?

A. No. While the Chapter 730 standards provide certain identifiable and measurable metrics, Frontier's internal concept of "quality service" involves a higher and broader set of standards. Frontier strives to meet and exceed expectations in all aspects of a customer's experience with the company. In the mind of the Frontier team, quality service includes both the technical measures found in the Illinois service standards and the provision of services that meet a customer's telecommunications needs today and tomorrow in terms of both prices and features. Frontier is convinced that it must seek a high level of satisfaction in terms of customer care and specific services or we risk losing that customer to another provider.

Q. Can you provide some examples of the expanded vision of service quality that Frontier will bring to customers in the Verizon service areas in Illinois?

A. Yes. Frontier recognizes that customer expectations for telecommunications services run the gamut from "POTS" ("plain old telephone service") through service-offerings providing various features and toll usage up to offerings providing High-Speed Internet and other enhanced capabilities. Therefore, in order to provide high-quality service to all of these various customer types, Frontier has developed a series of offerings and bundled packages that specifically meet the desires of the individual customer. Thus, a person who uses a cell phone for the majority of his or her communications needs may want to purchase a stand-alone residential line for safety and security. Frontier will have an affordable basic single-line offering for that type of customer. Conversely, a retired couple may desire a reliable and easy-to-navigate Internet service to stay in touch with children and grandchildren in other states. Frontier will provide a variety of offerings to meet this need as well, which will provide value and "ease of use" through programs designed to help customers set up their computers and facilitate use and data backup. This includes programs such as Frontier's full-service High-Speed Internet installation and set-up designed to help customers realize the full benefits of their services. Thus, high-quality customer service and satisfaction will be judged by Frontier not only based on metrics such as those found in the Chapter 730 standards, but also on the company's ability to tailor its service offerings to meet the needs of all of its customers.

Q. Mr. McClerren also expresses some concern about the level of due diligence that Frontier applied in evaluating the terms of the transaction.[43] Is his concern justified?

A. Frontier engaged in significant due diligence in preparing for this transaction. Frontier completed a significant review of Verizon's operations using public sources and information before the two companies met and began exchanging non-public data. Beginning in March 2009, Frontier and Verizon exchanged a significant volume of data electronically. By exchanging electronic files and data, engineers quickly and effectively can discover the kinds of switches and distribution equipment, ages of plant, trouble reports (including repetitive problems), personnel needed to serve a region, and so on. This kind of information is not readily available in site visits, and site visits often are unproductive even if the engineers have a much longer period to assess the properties. During the due diligence period, therefore, Frontier and Verizon engaged in numerous conference calls between subject matter experts who relied upon and further probed the data available electronically. Frontier did not physically inspect Verizon's central offices or access facilities because its engineers and financial personnel do not gain much useful information by walking into a facility (which, in any event, would have been disruptive to Verizon's operations and could jeopardize the confidentiality of negotiations between two publicly-traded companies), and they do not typically engage in this kind of "on-the-ground" analysis prior to the announcement of transactions of this kind. Instead, in Frontier's experience, the due diligence was performed in the same manner as in virtually

[43] McClerren Confidential, pp. 36-40.

every transaction. Frontier is very comfortable that the due diligence process unfolded in a way that was consistent with industry practice and in a way that relied on exceptionally informed professionals.

Q. Mr. McClerren also expresses concern over Frontier's inability to provide him with an evaluation of the per line cost of the VSTO properties as a benchmark evaluation of the transaction.[44] Is his concern justified?

A. No. With respect to the per line cost calculation referenced by Mr. McClerren, Mr. McClerren's testimony demonstrated that the per line cost is not difficult to determine. The fact that Frontier did not engage in that rule-of-thumb calculation as it evaluated the transaction does not mean that the company did not engage in due diligence. In point of fact, per line valuation metrics are not the primary way this transaction, or any transaction, is evaluated by Frontier. Transactions are evaluated on the basis of sustainable cash flows that are generated now and into the future. The analyses require an understanding of the trends in the business, revenue per subscriber, products that are purchased, profit margins, costs that will continue into the future or that can be eliminated, capital expenditures that are required for maintenance or will be needed for expansion, and financing obligations, among others. In this transaction, Frontier is not simply acquiring access lines and assets in Illinois and the other VSTO states, but is acquiring a business that must be sustained. As explained in the testimony of Mr. Erhart, as part of this transaction, Verizon is creating a separate stand alone business – its North Central region that will operate independently from the other Verizon landline telephone business. Then the North Central region legal entities in the 14-state region constituting Spinco will be merged into Frontier. After the closing of the transaction, the Verizon ILECs in the North Central Region – including Verizon North and New Communications of the Carolinas – will be renamed and continue to operate as separate legal operating ILECs. Accordingly, because this transaction is not merely an acquisition of lines but rather of an entire functioning business unit, per line valuation calculations were not developed and utilized in determining the value of the operations to be acquired, but the

[44] McClerren Confidential, p. 39.

focus was on valuing the cash flows generated by those operations. However, it is interesting to note that Mr. McClerren computes the "per line price" of this transaction to be $1,792,[45] which is significantly less than the "per line price" that Mr. McClerren identifies for other recent transactions.[46] Based on Mr. McClerren's approach, it appears that Frontier is getting a good deal in the proposed transaction.

<u>Transition of OSS</u>

Q. Frontier will utilize replicated Verizon operational support systems to serve customers in Illinois. Can you provide additional information regarding the replicated systems to be transferred to Frontier as part of this transaction?

A. Yes. In summary, Verizon will replicate its GTE OSS and then test the systems before they are put into operation. Verizon will then use those replicated systems to serve Illinois customers. At closing, Frontier will obtain a replicated system that will have been operated by Verizon's North Central business unit for at least 60 days. The process and anticipated timing for major steps in the process are as follows:

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

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

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

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

[45] McClerren Confidential, p. 39.

[46] McClerren Confidential, p. 38.

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

As explained in the Reply Testimony of Stephen Edward Smith of Verizon, Verizon is developing the detailed testing plan for the replicated systems (Step 3 above), which will involve sample data flowing through the test environment, with results checked against the production environment results. After reviewing the Verizon testing plan, Frontier can request additional testing. Verizon will then share the test results with Frontier. Frontier will review the results of Verizon's testing both before and after the replicated systems go into production on April 1, 2010 (after Steps 1-3 above). In addition, wholesale customers will be able to test for connectivity with the replicated systems in the pre-production environment (the only changes for wholesale customers will be a modification of an e-bond with the Fort Wayne data center – and Verizon has already sent letters to these customers informing them of the changes and explaining how to establish such connectivity).

Q. Can you provide additional insights regarding replicated systems proving (Step 5) and how the process will ensure that the replicated systems actually are capable of supporting the VSTO operations?

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

Q. Can you provide more detail regarding what will happen at and after the transaction close?

A. At transaction close, Frontier takes full ownership of the replicated systems, as well as Verizon licenses to use/operate the replicated systems. Frontier will use and operate the replicated systems with more than 230 Verizon IT personnel transferring to Frontier from Verizon's North Central Area. These IT personnel have experience in operating the OSS transferred to Frontier as part of this transaction and will be fully capable of operating the systems on a day-to-day basis. In addition, Frontier negotiated a commercial arrangement with Verizon whereby Frontier has the flexibility after the first year of a five-year agreement to purchase full, partial or no maintenance services. Some of the services included in that arrangement are new releases, updates to source code, patches, and bug fixes. Optional services that Frontier can add to the arrangement include systems training and changes to the replicated systems as requested by Frontier. As a result of that flexibility, the "Maintenance Fee" can be adjusted at Frontier's option. Following the first year, Frontier can choose to handle services on its own or contract out with a different third party.

Q. Please comment on Mr. McClerren's issues concerning Frontier's explanation of its plans for transitioning from Verizon's OSS to a Frontier OSS, and particularly with

Frontier's commitment not to conduct the transition within the first year after closing on the transaction.[47]

A. I think there is some confusion about when and under what circumstances Frontier would transition from the systems it will obtain from Verizon to a native Frontier system. That confusion is only exacerbated by the speculation of many of the intervenors. As explained above, at the closing of the proposed transaction, Verizon will transfer to Frontier fully tested and functioning replicated operations support systems used by Verizon to serve its customers in Illinois. Frontier will utilize these already proven and tested Verizon operations support systems to serve its new customers after the transaction and there will be no disruption or impact on service as a result of or associated with the transaction closing. Essentially, the only impact to customers will be that the bills they receive for service will identify "Frontier" as their service provider (versus Verizon as their previous provider).

Frontier currently has no timeline for migrating services from the Verizon operations support systems to Frontier's support systems utilized in the 24 states where Frontier currently operates. Frontier has committed that it will not complete any migration from or off of the replicated Verizon operations support systems to Frontier's existing operations support platforms used to service its other 2.2 million access lines (approximately 100,000 access lines in Illinois) for a minimum of one year. In fact, the time frame for completing this integration, in all probability, will be longer than one year as Frontier has the flexibility to continue to use these wholly-owned Verizon systems and Frontier intends to evaluate the functionality and features in serving customers, before making any definitive decision regarding the timing and implementation of the system integration. Frontier's view is that systems conversions will occur if and when they make sense, but there is no plan to fix what is not broken.

Q. Will Frontier face pressure to prematurely "cut-over" from the Verizon replicated systems to its existing operations support systems?

[47] McClerren Confidential, pp. 32-34.

A. No. As Chief Operating Officer, I can unequivocally state that Frontier will not be pressured to convert from the replicated Verizon systems conveyed to Frontier as part of the proposed transaction to another system. Before Frontier will undertake any such migration, the company will be confident and fully prepared to complete the transition without customer service disruptions. Some intervenors raise a concern about the $94 million that Frontier is paying in the first year after closing for Verizon's support of the replicated systems, and they suggest that Frontier will force a premature conversion to its legacy systems to avoid this fee in the future. However, from a financial perspective, the sort of maintenance and support of the Verizon proprietary software covered by the maintenance fee is a service that would have to be provided in any event, either through an outsourced third-party or additional internal employees. Further, the maintenance fee represents less than $2.00 per line per month based on over 4 million lines that are part of the proposed transaction. By contrast, based on FairPoint's $14.2 million monthly fee (using 1.528 million Verizon access lines acquired), the cost for FairPoint of the Transition Services Agreement with Verizon was approximately $9.29 per line per month.[48] Additionally, Frontier has the flexibility to modify that maintenance fee after the first year. Therefore, Frontier has the option to avoid or reduce the fee even without engaging in a "cut-over." As a result, while Frontier eventually will be able to reduce operating costs by transitioning some or all of its operations to integrated software and systems platforms, the company certainly will not feel any undue pressure to engage prematurely in systems conversion merely to avoid less than $2 per line per month in maintenance fees.

Q. In response to concerns related to the transition from the replicated Verizon operational support systems to Frontier's operational support systems, Mr. McClerren has proposed the following condition:[49]

> **For a period of three years after the date that Frontier Communications Corporation closes this proposed transaction, before any operations support system integration between the current Verizon Illinois and**

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

[49] McClerren Confidential, pp. 43-44.

Frontier Illinois territories may occur, Frontier's management must present an operations support system integration plan to the Chief Engineer of the ICC's Telecommunication's Division for review and approval, and Frontier will not proceed with any operations support system integration effort in or for its Illinois operations until it has received the written approval of the Chief Engineer of the ICC's Telecommunication's Division. Frontier's integration plan will describe the operations support system to be replaced, the surviving operations support system, and why the change is being made. The operations support system integration plan will describe any previous experience Frontier has with integrating the operations support systems in other jurisdictions, specifying any problems that occurred in that integration process and what has been done to avert those problems in Illinois. Frontier must specify the impact on personnel levels in Illinois, where the system is currently operated from and will be operated from, as well as the name of any consulting firm assisting in the operations support system integration effort. Frontier's operations support system integration plan will also contain planned actions in the event of a "worst case" scenario, such as having to restore the previous operations support system.

Please respond to this condition.

A. As I have explained throughout my testimony, Frontier does not have a plan or timeline for integrating the Verizon operations support systems used to serve customers in Illinois with the Frontier operations support systems. Frontier has committed that this integration or transition will not occur for at least one year following the closing of the transaction. However, Frontier understands that Staff has concerns regarding the timing and process that Frontier may undertake in the future to migrate customers to Frontier's operations support systems from the replicated Verizon operations support systems that will be utilized to serve the Verizon customers at closing. As a result, Frontier can agree to the reporting requirements proposed by Staff in this condition. In the event that Frontier plans to transition from the Verizon support systems to Frontier's legacy systems, Frontier will agree for a period of three years after closing of the proposed transaction to prepare and submit a detailed operations support system integration plan to the Chief Engineer. Frontier's integration plan will describe the operations support system to be replaced, the surviving operations support system, and why the change is being made. The operations support system integration plan will describe Frontier's previous experience with integrating the operations support systems in other jurisdictions, specifying any problems that occurred in that integration process and what has been done to avert those problems in Illinois. Frontier's plan will also identify the impact on personnel levels in Illinois, where the system is currently operated from and will be operated from, as well as the name of any consulting firm assisting in the operations support system integration effort. Frontier's operations support system integration plan will also identify planned contingency actions in the event of Frontier encountering a difficulty or a "worst case" scenario, as part of the system integration process. The integration plan submitted by Frontier will address each of the areas identified by the Staff above and will be prepared by Information Technology professionals with detailed experience and knowledge regarding the systems integration process and requirements. Frontier has a significant business interest in ensuring that it properly implements the integration and transition from Verizon operational support systems to Frontier's systems. Frontier will undertake a detailed review to ensure that the transition will go smoothly and will not proceed with the integration until the company is confident that the transition can occur without disruption to Frontier's Illinois customers. Frontier will agree to meet with and discuss any concerns that the Chief Engineer may have with the plan. Frontier will also commit to provide this operations support system integration plan to the Chief Engineer of the Commission's Telecommunication's Division no less than 180 days prior to implementing the system transition. The preparation and submission of this detailed operations support system integration plan will provide the Commission with the assurance that Frontier has developed a detailed and thorough plan to mitigate the risks to Illinois consumers associated with the transition from the Verizon operations support systems to Frontier's operations support systems.

Q. Staff witness Rochelle Phipps expresses some concern about the ability of Frontier at a national level to raise capital and maintain a reasonable capital structure.[50] Do you agree?

A. No. As Frontier has affirmed repeatedly, a foundational rationale of the pending transaction for frontier is to strengthen the financial position of the company, and to sharpen the strategic focus of the combined Frontier and VSTO to serve customers in

[50] Phipps Confidential, pp. 6-10.

lower-density areas. The transaction will serve to strengthen Frontier's balance sheet in a material way and independent professional credit analysts have provided confirmation. Moody's Investors Service highlighted that the proposed transaction is actually beneficial when it put Frontier's credit ratings on review for possible upgrade: "The transaction is expected to result in significant deleveraging at Frontier, leading to a potentially improved credit profile."[51] Fitch Ratings concurred in its press release, indicating that it was placing Frontier's debt on Ratings Watch Positive, stating that, "The company to be merged into Frontier will be moderately levered, and post-merger Frontier is expected to be less levered than currently."[52] These positive ratings actions affirm the fact that the proposed transaction was structured in a way that specifically serves to enhance the balance sheet and credit quality of Frontier. Also, Morgan Stanley's senior telecommunications equity analyst wrote in a report dated August 14, 2009: "[T]he resulting entity should have investment grade-like credit metrics."[53] Finally, Frontier has stated publicly that the proposed transaction marks a shift in its perspective regarding the company's credit rating and its intention to seek an investment grade credit rating.

In addition, Frontier's investors, who are primarily professional institutions with significant knowledge of the industry, recently voted overwhelmingly to approve the transaction on October 27, 2009, indicating that they believe value will be generated by the combination both in the short term and over the longer term.[54] The opinions of independent financial analysts, credit ratings agencies, and institutional equity investors provide compelling market-based evidence that Frontier will have the ability to raise capital and maintain a reasonable capital structure.

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[51] Frontier Exhibit 2.3 (Moody's Investors Service, Global Research Rating Action: Frontier Communications Corporation, May 13, 2009).

[52] Frontier Exhibit 2.5, Fitch Ratings, Fitch Places Frontier Communications on Rating Watch Positive (May 13, 2009).

[53] Morgan Stanley August Report.

[54] Frontier Exhibit 2.6, Frontier Communications Shareholders Approve Acquisition of Verizon Wireline Operations in 14 States, Press Release (October 27, 2009)(available at:

http://phx.corporate-ir.net/phoenix.zhtml?c=66508&p=irol-newsArticle&ID=1346906&highlight).

Q. What are the most appropriate criteria for determining that Frontier is financially fit?

A. The improved financial position of the combined company is based, first, on the deleveraging of post-transaction Frontier's balance sheet. That deleveraging will assist the company in moving toward an investment grade rating. Second, Frontier will be able to generate relatively higher and more predictable cash flows through the combined business. Third, Frontier expects to have better access to the capital markets and more cost-effective pricing for financial resources in the wake of this transaction, in addition to being able to secure the financing necessary to complete this transaction.

Q. You mentioned that the proposed transaction is a deleveraging event. However, several of the intervenors have testified that the combined company will have too much debt.[55] **Can you address their concerns?**

A. Yes, I can. One of the benefits of the proposed transaction is that it deleverages Frontier and results in a post-merger company with a strong balance sheet. The Joint Applicants agreed that the leverage ratio (net debt divided by Earnings before Interest Expense, Taxes, Depreciation and Amortization or "EBITDA") to be placed on the divested Verizon operations would be only 1.7 times the EBITDA, using year-end 2008 financial data (which is below Verizon's consolidated leverage ratio of 1.8 times EBITDA as of June 30, 2009). This will result in a conservative capitalization for the combined company. Specifically, Frontier's leverage ratio is estimated to decrease from a pre-transaction 3.8 times (based on year-end 2008 financial results) to 2.6 times after the combination, before considering the benefit of expected cost savings (the 2008 pro forma leverage ratio after accounting for expected synergies is estimated to be approximately 2.2 times). As such, the transaction is expected to strengthen Frontier's balance sheet materially. And, although legacy Frontier's leverage ratio has increased slightly to approximately 3.9 times as of June 30, 2009, that does not materially change the deleveraging effect of the proposed transaction.[56] In short, while the combined company will have more debt (from an absolute dollar amount perspective) than Frontier has

[55] *See*, e.g., Barber Confidential, p. 12, lines 13-20, and p. 27, lines 3-5; Selwyn Confidential, p. 59 ff.

[56] This excludes costs related to this transaction, which are one-time in nature and were not present in the 2008 pro forma combined company leverage ratios.

currently, it will have a lower proportion of debt (from a percentage of capitalization perspective).

Q. How does Frontier's current leverage ratio and pro forma leverage ratio compare with other ILECs?

A. Frontier's leverage ratio—net debt to EBITDA—compares favorably with other major ILECs as is apparent in Table 2 which provides leverage ratios for this group of companies as of June 30, 2009.

Table 2: Net Debt to EBITDA, June 30, 2009[57]

									Pro forma FTR (2008)				
(In $mils.)	ALSK	CNSL	CTL	HTCO	IWA	OTT	WIN	FTR	w/o syn.	w/ syn.	Q	T	VZ*
Total Debt	537	881	2,920	125	490	279	5,247	4,952			14,123	76,720	64,909
Less Cash	8	20	320	11	6	19	245	454			1,796	7,348	820
Net Debt	529	861	2,600	114	484	260	5,002	4,498			12,327	69,372	64,089
Trailing 12-mo. EBITDA	118	155	1,205	30	118	43	1,563	1,150			4,404	39,850	34,321
Net Debt/EBITDA	4.5x	5.5x	2.2x	3.9x	4.1x	6.0x	3.2x	3.9x	2.6x	2.2x	2.8x	1.7x	1.8x

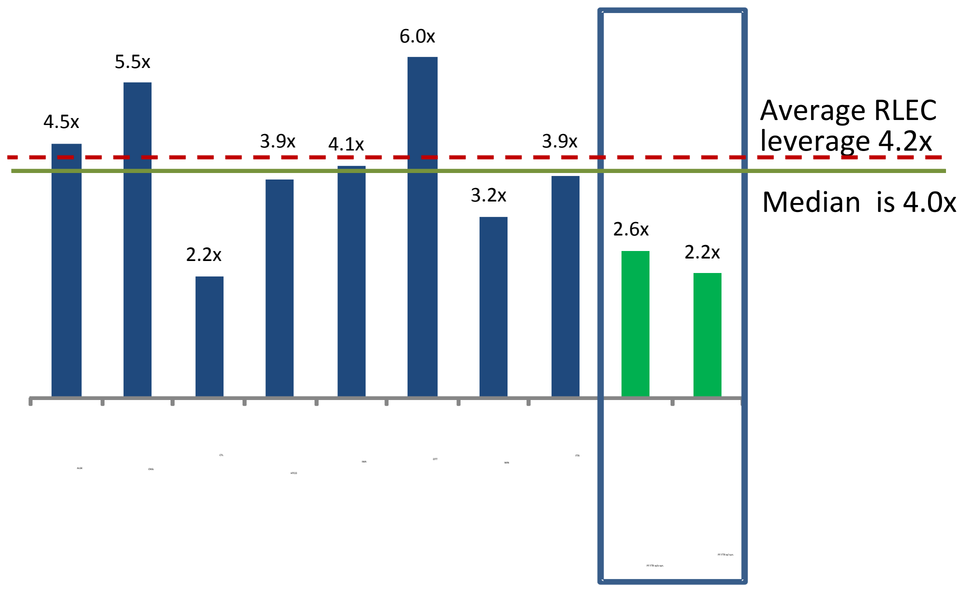
*Verizon's net debt to EBITDA is 1.9x, but after adjusting for intercompany transactions with Alltel, the adjusted leverage ratio is 1.8x.

Source: Company SEC filings of 10-Qs for period ending June 30, 2009.

The table highlights that the post-merger company is expected to have an exceptional leverage ratio compared with the leverage ratios of other rural local exchange carriers ("RLECs") and Qwest, which I believe are the appropriate comparison group of companies.

[57] ALSK = Alaska Communications Systems Group Inc.; CNSL = Consolidated Communications Holdings Inc.; CTL = Centurytel, Inc.; HTCO = Hickory Tech Corp.; IWA = Iowa Telecommunications Services Inc.; OTT = Otelco Inc.; WIN = Windstream Corporation; FTR = Frontier Communications Corporation; Q = Qwest Communications International Inc.; T = AT&T, Inc.; VZ = Verizon Communications Inc.

Figure 1: RLEC Leverage Ratios, June 30, 2009



Source: Company SEC filings of 10-Qs for period ending June 30, 2009.

Figure 1 makes the additional point that legacy Frontier has a leverage ratio that is below both the average (4.2x) and median (4.0x) of this peer group of companies, which are all companies that are providing reliable ILEC services to their customers. Further, the leverage ratios of the post-merger company (in the figure, “PF FTR”), based on 2008 financials, put Frontier in a very strong position relative to this peer group, even before the realization of synergies. With synergies, Frontier expects to have a leverage ratio that is close to the best in the group of comparable companies. This transaction positions Frontier to provide best-in-class service to rural or lower-density communities. While some intervenors assert that the appropriate financial comparison is Verizon or possibly AT&T, those carriers have different businesses, and their strategic focus is not on rural ILEC service areas. Thus, Figure 1 confirms that Frontier will be exceptionally fit and strong relative to other carriers in the industry and therefore will be in a solid position to raise capital and operate the VSTO Illinois properties.

Q. **In evaluating the impact of this transaction on Frontier, Ms. Phipps relies extensively on credit reports issued by Moody’s Investors Service, Standard & Poor’s and Fitch Ratings, each of which has commented on Frontier in the wake of the announcement of the merger. In order to ensure that the Commission continues**

to have access to this information, Ms. Phipps recommends that the Commission impose the following reporting requirement.[58]

> **Following the proposed reorganization, Frontier North, Inc. and Frontier Communications of the Carolinas, Inc. shall file with the Chief Clerk of the Commission and the manager of the Finance Department all credit rating reports published by Moody's Investors Service, Standard & Poor's and Fitch Ratings relating to changes in Frontier Communications Corporation's (and any of its affiliates' and subsidiaries') ratings outlooks or credit ratings within 10 days of their publication. Such reports shall be posted in this docket.**

Can Frontier agree to this reporting requirement?

A. Yes, although Frontier recommends that some sunset date should be assigned to this requirement so the condition does not continue in perpetuity. Because this condition relates to Ms. Phipps' concerns about the rating of Frontier's credit quality, Frontier would propose to end this condition either when Frontier achieves an investment grade rating or three years from the closing of the transaction, whichever shall first occur. I would also note that Frontier will be required to submit these reports on a Confidential basis and the reports would have to be posted in a Confidential manner because each of the credit rating agencies is a subscription service that sells its reports and would object to having the reports made public by the Commission, whether through its Clerk's office or through its website.

Q. Ms. Phipps identifies that some material elements of the proposed transaction are not currently known. Specifically, she notes that Frontier will be relying on certain debt financing to close the transaction, but that Frontier has not yet obtained the financing.[59] Can you address Frontier's need and ability to secure this financing?

A. It is true that Frontier has not yet obtained commitments for the $3.3 billion in debt that will be raised in connection with this transaction. Frontier will seek financing near the time of the consummation of the transaction, just as a buyer of a home gets financing close to the time of the actual purchase. The lenders will want to see that the regulatory processes are moving toward completion before they determine risks and rates, and they

[58] Phipps Confidential, p. 6.

[59] Phipps Confidential, p. 6.

will want to assess the condition of the financial markets at that time. However, the most direct response to Ms. Phipps' testimony is to look to the financial markets to assess their current opinion of the attractiveness of providing financing to Frontier. To my knowledge, virtually every institution important to this transaction has indicated its view that the combination will improve Frontier's access to capital. An even more compelling indicator of the financial markets' assessment of Frontier came on September 17, 2009, when Frontier was able to arrange new debt financing to raise net proceeds of $577.6 million (gross proceeds of $600 million), through 8.125% (8.375% yield to maturity) Senior Notes due in 2018. Frontier announced that the proceeds would be used, together with cash balances, to fund the proposed repurchase ("Tender") of certain of its outstanding earlier-maturity debt.[60] On October 1, 2009, Frontier announced the completion of the debt offering.[61]

Furthermore, on October 16, 2009, Frontier announced that it had successfully completed the Tender and had applied the full "Maximum Payment Amount" of $700 million toward the repurchase of its outstanding 9.250% Senior Notes due 2011 (the "2011 Notes") and 6.250% Senior Notes due 2013 (the "2013 Notes").[62] As a result, Frontier's maturities through 2013 now consist of approximately $7 million maturing in 2010, $280 million maturing in 2011, $180 million maturing in 2012, and $746 million maturing in 2013. Therefore, Frontier has already strengthened its financial condition and reduced its aggregate principal amount of debt maturing in the one year period following the closing of the proposed transaction (through 2011) to an amount that could be refinanced

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[60] Frontier Exhibit 2.7, Press Release, Frontier Communications Corporation Prices Offering of $600 Million of Its Senior Notes (September 17, 2009) (available at:

http://phx.corporate-ir.net/phoenix.zhtml?c=66508&p=irol-newsArticle&ID=1333208).

[61] Frontier Exhibit 2.8, Press Release, Frontier Communications Corporations Announces Successful Completion of Notes Offering and Acceptance for Purchase of Certain 9.250% Senior Notes Due 2011 in Cash Tender Offer (October 1, 2009), (available at:

http://phx.corporate-ir.net/phoenix.zhtml?c=66508&p=irol-newsArticle&ID=1337615).

[62] Frontier Exhibit 2.9, Press Release, Frontier Communications Corporation Announces Successful Completion of Debt Tender Offer (October 16, 2009) (available at:

http://phx.corporate-ir.net/phoenix.zhtml?c=66508&p=irol-newsArticle&ID=1343034).

primarily through surplus cash on hand or through its existing $250 million undrawn credit facility, if necessary.[63]

The recent financing activities are significant for two reasons. First, the successful debt offering in which Frontier was assigned effective rates of 8.375%, took place on the basis of its *current* credit quality even before the consummation of the Verizon transaction. With Frontier's improved credit and financial profile at the completion of the combination, the rates and terms the combined company will attract at the time of the transaction closing will likely be *at least as, if not more, favorable* than the terms that Frontier achieved in its recent financing or that it could attract at that time if the merger were not completed. Second, the recent financing was completed at a rate well below 9.5%;[64] and the Merger Agreement provides a shield if an annual rate above 9.5% would be unduly burdensome.[65] This recent successful debt offering indicates that Frontier likely will be able to finance the closing obligations at a rate below 9.5%.

Q. Are there other indications that the markets will be receptive to financing the transaction at the time of consummation?

A. Yes. The U.S. capital markets continue to improve on all major fronts as volatility subsides, equity and corporate bond valuations improve, systemic risk originating from the financial system has been greatly reduced, cash reserves held by investors are beginning to be reinvested, and economic data indicate to investors that there is "light at the end of the tunnel." Frontier's assessment is that the transaction financing is likely to be attractive to investment-grade and other investors.

[63] *Id*.

[64] Weighted average annual cash interest rate, including annual accretion of original issue discount with respect to indebtedness issued with a material amount of original issue discount, payable on the aggregate.

[65] Frontier Exhibit 2.10, Frontier Form 424B, Proxy/Prospectus (September 16, 2009) (hereafter "Frontier Proxy")

(available at: http://www.sec.gov/Archives/edgar/data/20520/000119312509194390/0001193125-09-194390-index.htm) at 90): ("Additionally, Frontier is not obligated to accept or execute documentation relating to the special cash payment financing or the Spinco debt securities if as a result thereof the weighted average annual cash interest rate (including annual accretion of original issue discount with respect to indebtedness issued with a material amount of original issue discount) payable on the aggregate of the special cash payment financing, the Spinco debt securities and any distribution date indebtedness would exceed 9.5%, unless Frontier reasonably determines in good faith that these coverage costs would not be unduly burdensome.").

Q. Why is it generally not prudent to obtain financing this far in advance of the closing?

A. It generally would not be practical or cost-efficient to secure funding many months before the consummation of the transaction. A commitment letter would be very costly, creating unnecessary expense, and would contain a wide range of interest rates which would not be capped, and hence would provide very little certainty as to interest costs. Effectively, the high cost would be harmful to the company and its customers. Notwithstanding the fact that it has not obtained a definitive financing commitment, Frontier's recent debt offering and tender offer are positive market-based indications that make Frontier confident that the required financing will be available on reasonable terms.

Q. Ms. Phipps asks to obtain additional information through the following Reporting Requirement:[66]

> **Frontier North, Inc. and Frontier Communications of the Carolinas, Inc. shall file with the Chief Clerk of the Commission copies of all documents relating to the Special Payment Financing and any Spinco Securities issued pursuant to the Distribution Agreement and the Merger Agreement within 10 days of the merger agreement's execution. The documents shall be posted in this docket.**

Can Frontier agree to this requirement?

A. Generally yes. The language in this condition refers to filing documents and information relating to the Special Payment Financing and any Spinco Securities issued pursuant to the Distribution Agreement and Merger Agreement within 10 days of "*the merger agreement's execution.*" One concern with this language is that the merger agreement has already been executed by the Applicants and therefore it is not clear when Staff is seeking to have the supplemental filing with the Chief Clerk made. Frontier is willing to comply with this condition and will agree to filing the identified information within 10 days after *closing* of the proposed transaction.

[66] Phipps Confidential, p. 6.

Q. Ms. Phipps also expresses some concern that the capital structure of the VSTO Illinois companies will not be known until after the transaction closes. For that reason, Ms. Phipps proposes Reporting Requirement 3:[67]

> **Frontier North, Inc. and Frontier Communications of the Carolinas, Inc. shall file with the Chief Clerk of the Commission a statement describing the post-merger capital structure and overall cost of capital of Frontier North, Inc., Frontier Communications of the Carolinas, Inc. and Frontier Communications Corporation. The statement shall be posted in this docket.**

Can Frontier agree to this Reporting Requirement?

A. Yes. Frontier can agree to this Reporting Requirement.

Q. Ultimately, Ms. Phipps testifies that she is not concerned about the ability of the VSTO Illinois operating companies to raise capital on reasonable terms or to maintain a reasonable capital structure under Section 7-204(b)4) because the VSTO Illinois operating companies are cash flow positive and will not need to raise capital.[68]

A. Ms. Phipps is correct in noting that the VSTO Illinois operating companies are cash flow positive. The fact that the operating companies each have a capital structure which is 100% equity with no long-term debt contributes to their strong cash flow and makes clear that nothing about the proposed transaction will negatively impact that status.

Q. Dovetailing with Mr. McClerren's concerns about Frontier's ability to maintain the service quality in the VSTO Illinois exchanges, Ms. Phipps suggests that Illinois can protect the capital structure of the VSTO Illinois operating companies by imposing two specific conditions to ensure that sufficient capital is reinvested into the VSTO Illinois properties to ensure that service quality is maintained. Those conditions are as follows:

> **Condition 1**
>
> **(a) Frontier North, Inc. and Frontier Communications of the Carolinas, Inc. (the "New Frontier ILECs") will be prohibited from paying**

[67] Phipps Confidential, p. 18.

[68] Phipps Confidential, p. 18.

dividends or otherwise transferring any Illinois jurisdictional cash balances to Frontier Communications Corporation or its affiliates through loans, advances, investment or other means that would divert the New Frontier Illinois ILECs' moneys, property or other resources that is not essentially or directly connected with the provision of noncompetitive telecommunications service if the New Frontier Illinois ILECs fail to meet or exceed the standards set forth below for a majority of the following service quality standards of 83 Illinois Administrative Code Part 730, Standards of Service for Local Exchange Telecommunications Carriers:

(i) STANDARDS:

Toll & Assistance Answer Time
(Part 730.510(a)(1)(A)): 4.05 seconds

Information Answer Time
(Part 730.510(a)(1)(B)): 4.31 seconds

Repair Office Answer Time:
(Part 730.510(b)(1)): 34 seconds

Business Office Answer Time
(Part 730.510(b)(1)): 60 seconds

Installation Requests over 5 Business Days
(Part 730.540(a)): 92%

Interruptions of Service over 24 Hours
(Part 730.535(a)): 95%

Trouble Reports per 100 Lines
(Part 730.545(a)): 1.03

In the event of failure, Frontier Illinois dividend payments or otherwise transferring cash to its parent would not be allowed until the next satisfactory annual report or the end of this condition. Additionally Frontier Illinois will provide specific plans to restore service quality levels to previous levels, and identify the incremental monies that will be invested in Illinois as a result of dividend payments and cash transfers being withheld from the parent.

(b) MEASUREMENTS: Measurements shall commence on the date that the merger closes, and recur on an annual calendar year basis.

(c) ANNUAL REPORTS: Each of the New Frontier ILECs shall file an annual report with the Chief Clerk's Office and post such annual report in this docket. The annual report will be filed by February 1 of

each year for the preceding year. Within the annual report, each of the New Frontier ILECs shall list the standard set by the Commission for each service quality measure and each of the New Frontier ILECs' actual performance for each annual period. The annual report shall present the actual performance data for every month after the date that the merger closes, with the initial month of data presented being the month in which the merger closes. The annual report shall also include an Illinois jurisdictional free cash flow calculation for the twelve months ending December 31 of each year this Condition remains in effect. The Illinois jurisdictional free cash flow calculation shall be in the same format as Joint Applicants' supplemental response to ICC Staff data request RP 3.01 and include Verifications from the financial officers of the New Frontier ILECs.

(d) DURATION OF CONDITION: Condition (1) shall remain in effect until Frontier Communication Corporation's issuer credit rating is BBB from Standard & Poor's, Baa2 from Moody's Investors Service and BBB from Fitch Ratings.

Condition 2:

Through a combination of available cash and availability under credit agreements with external financial institutions, Frontier Communications Corporation shall keep available exclusively for Illinois operations of Frontier North, Inc. and Frontier Communications of the Carolinas, Inc. (the "New Frontier ILECs"), an aggregate amount equal to the higher of $50 million or the currently approved capital expenditure budget for the Illinois operations of the New Frontier ILECs. Frontier Communications Corporation shall certify annually to the Commission that the required amount is available for Illinois operations of the New Frontier ILECs for the ensuing year. Therefore, on December 1 of each year, Frontier Communications Corporation shall file a notice with the Commission certifying that such amount is currently available and the amount of dollar commitment for the New Frontier ILECs' Illinois operations for the following year, based on their capital expenditures budget for the following year, but in no event less than $50 million.

Can you comment on these conditions?

A. Frontier does not believe these conditions are necessary and the Company has concerns with them. Frontier understands that the Commission has placed similar limitations on other companies as a condition for transaction approval.

Q. Please address Frontier's concerns with respect to the first Staff condition identified by Mr. McClerren related to limitations on the dividends issued by the two New Frontier ILECs in Illinois after the closing of the proposed transaction?

A. As a threshold matter, Frontier does not believe this type of condition is warranted. Frontier has specific concerns with two aspects of this condition. First, if the company fails to meet a majority of the standards identified in this condition, there is an unchangeable one-year lag time to subsequently address and demonstrate compliance with a majority of the service standards. As a result, a short-term performance anomaly could result in a limitation of dividends by the operating companies for one year. The ability to provide additional service quality results to the Commission on a quarterly basis to demonstrate compliance on a trailing twelve-month basis would be more appropriate.

Second, with respect to subpart C of this condition related to the duration of the condition, the duration is not fixed in time but is based on achieving investment grade credit ratings. While Frontier plans to undertake additional actions to try to move its rating toward investment grade, there are uncertainties in the financial marketplace and economy that may delay or make this objective difficult to immediately obtain. However, even without an investment grade credit rating, Frontier has been able to effectively operate its nine existing ILECs in Illinois. Instead of tying the duration of the condition to investment grade credit rate, a fixed duration of up to three years for this condition would be more appropriate.[69]

Q. Please address Frontier's concerns with respect to the second Staff condition identified by Mr. McClerren related to Frontier Communications Corporation maintaining available cash and availability under credit agreements with external financial institutions an aggregate amount equal to the higher of $50 million or the currently approved capital expenditure budget for the Illinois operations of the two New Frontier ILECs.

A. Frontier does not believe this condition is necessary because, as Ms. Phipps noted in Staff's testimony, the two New Frontier ILEC operating companies are cash flow

[69] With respect to the duration of the condition, in CenturyTel's recent March 25, 2009 Order in Docket No. 08-0645, for example, the duration of this condition was one year.

positive.[70] Frontier fully expects these companies to continue to generate sufficient cash to fund their operations and investment on a prospective basis. To the extent maintaining a credit agreement with external financial institutions is required by this condition, the requirement should be capable of being satisfied with existing or available credit lines that are available for other purposes so long as the credit availability exceeds the required financial thresholds. Also, with respect to Frontier, the company does not complete its capital budgeting process (including Board of Directors approval) until mid-December of each year and therefore Frontier would not be able to complete the Commission certification until January 15th.

Q. Staff witness Mike Ostrander discusses the proposed transaction's compliance with Sections 7-204(b)(2) and (3), which require that the proposed reorganization not result in the unjustified subsidization of non-utility activities by the utility or its customers and that costs and facilities are fairly and reasonably allocated between utility and non utility activities in such a manner that the Commission may identify those costs and facilities which are properly included by the utility for ratemaking purposes. He concludes that the proposed transaction will not negatively impact either criteria, but as a safeguard for each, asks that the Commission impose the following conditions:[71]

1. **Commission Staff will be granted access to all books, accounts, records and personnel of Frontier and all of their utility and non-utility affiliated sister and subsidiary companies, as well as independent auditor's working papers, to the extent permitted by the rules and policies of the independent auditor;**

2. **Frontier will continue to comply with 83 Ill. Admin. Code 711, Cost Allocation Rules for Large Local Exchange Carriers; and**

3. **Frontier will conduct an annual internal audit to test compliance with Section 7-204(b)(2) and 7-204(b)(3). The internal audit report will be submitted to the Manager of Accounting of the Commission by March 31st of each year and associated working papers will be available to Commission Staff for review.**

[70] Phipps, p. 2.

[71] Ostrander Direct, pp. 3-4.

> **The purpose of the internal audit will be to document the procedures performed and conclusions to determine that cost allocations between regulated and non-regulated activities are in compliance with Frontier's cost allocation manual filed with the Commission and that the cost allocation manual is correct and complete.**

Does Frontier have any objection to these conditions?

A. Frontier understands the first two conditions to reflect the rules that apply to all local exchange carriers in Illinois and therefore has no objections to them. Frontier also does not object to the third condition as a reasonable means to assure the Commission of its continued compliance with the other two regulations. We do, however, believe there should be a clear end date for this third condition and Frontier would propose that the condition remain in effect for three years after closing of the proposed transaction.

Q. Mr. Ostrander also discusses 7-204(c), which directs the Illinois Commission to rule on the allocation of any savings resulting from the proposed reorganization and whether the companies should be allowed to recover any costs incurred in accomplishing the proposed reorganization and, if so, the amount of costs eligible for recovery and how the costs will be allocated. He recommends that the Commission rule that: (1) the allocation of any savings resulting from the proposed reorganization would flow through to the costs associated with the regulated intrastate operations for consideration in setting rates by the Commission; and (2) the Joint Applicants will not be allowed to recover any costs incurred in accomplishing the proposed reorganization in future rate proceedings.[72] Do you have any response to that recommendation?

A. Frontier can accept this recommendation.

[72] Ostrander Direct, p. 10.

Q. Staff witness Qin Liu addresses Sections 7-204(b)(5) and (6), requiring, respectively, that VSTO Illinois remain subject to all applicable laws, regulations, rules, decisions and policies governing the regulation of Illinois public utilities and requiring that the proposed reorganization is not likely to have a significant adverse effect on competition in those markets over which the Commission has jurisdiction. Dr. Liu has no concern about the VSTO Illinois companies will remain subject to all applicable laws, regulations, rules, decisions and policies governing the regulation of Illinois public utilities, but she does express some concern about the extent to which each of the operating companies is currently compliant with Section 13-517 of the Public Utility Act, which requires Illinois local exchange carriers to make "advanced services" available to at least 80% of their customers.[73] She states a concern about what service type each of Frontier and Verizon is identifying as compliant with the required speeds. She also states a concern about whether Verizon South is in current compliance.[74] Please comment on her concerns.

A. As I stated in my Direct Testimony, expanding the provision of broadband -- which is what I understand Section 13-517 to mean by "advanced services" -- is a key element of Frontier's business plan.[75] Frontier intends to meet the requirements of Section 13-517, both in terms of access and in terms of the required data speeds, and over time may exceed them.

Q. Dr. Liu proposes that the Commission impose the following condition on any approval of this transaction:[76]

> **[A]s a condition of approving the transaction, [the Commission should] direct Frontier to bring NewILEC, the former Verizon South, into compliance with Section 13-517 within 24 months following the closing of the merger transaction. Furthermore, the Commission should also require that Frontier file a report with the Commission when they meet the 13-517 criteria — a report that would alert the Commission that they have reached the goal and describe in detail how the goal was met.**

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[73] Liu Confidential, p. 6.

[74] Liu Confidential, p. 7.

[75] McCarthy Direct, p. 15-16.

[76] Liu Confidential, p. 9.

Does Frontier have any objection to this condition?

A. Frontier understands Staff's position that Verizon South is out of compliance with Section 13-517. The company is concerned about its ability to complete this requirement within two years of closing. To resolve this issue, Frontier commits to put Verizon South into compliance by December 31, 2013.

Q. Section 13-517 of the Public Utility Act defines "advanced telecommunications services" to be services that support data speeds in excess of 200 kilobits per second, and requires that ILECs, like Frontier, offer or provide advanced telecommunications service to at least 80% of their customers. Does Frontier periodically submit reports to the Commission on the extent of the availability of its advanced telecommunications services, pursuant to those requirements?

A. Yes. Frontier submits reports to the Commission for each of its nine Illinois operating companies, which identify the availability of Frontier's High Speed Internet ("HSI") products. Frontier provides these HSI products using DSL technology. All of Frontier's High Speed Internet products provide for data speeds in excess of 200 kilobits per second, and thus are "advanced telecommunications services" as defined in Section 13-517. Each of Frontier's nine operating companies meets the requirements of Section 13-517 by offering advanced telecommunications services to more than 80% of its customers.

Q. In connection with the requirement that the VSTO Illinois companies remain subject to all laws, etc. affecting local exchange carriers, Dr. Liu asserts that Frontier should assume all obligations under Verizon's current interconnection agreements ("ICAs"), wholesale tariffs and other wholesale arrangements to ensure continuous, uninterrupted wholesale service.[77] Can you comment on Dr. Liu's assertion?

A. Frontier witness Ms. Kim Czak addresses this issue in detail in her Rebuttal Testimony. In general, however, I would like to make it clear again that Frontier will honor all obligations under Verizon's current ICAs, wholesale tariffs, and other existing wholesale

[77] Liu Confidential, p. 13.

arrangements, in addition to complying with the statutory obligations applicable to all ILECs. Specifically, Frontier will assume responsibility for ICAs between Verizon and other carriers that relate to service within Illinois. Frontier will also agree that, for a period of one year, it will not initiate the termination of any of the Verizon interconnection agreements for any reason other than cause. As a result wholesale customers will receive the same services, support and arrangements as those provided by Verizon prior to the transaction.

Q. Dr. Liu states a concern that Frontier could introduce instability into the wholesale market by terminating Verizon's interconnection agreements (to the extent they are in automatic renewal terms) and she proposed the following condition to avoid that concern:[78]

> **Staff believes that Frontier should further commit to a freeze for a period of three years, during which it will provide wholesale services to its wholesale customers under the same terms and conditions and at the same wholesale rates for three years following the merger. In other words, for those interconnection or wholesale agreements that would expire within three years following the merger, Frontier should commit to automatically extending those agreements until three years following the merger.**

Please respond to Dr. Liu's proposal.

A. Again, Frontier witness Kim Czak addresses the concern raised by Dr. Liu in Ms. Czak's accompanying Rebuttal Testimony. In general, as explained by Ms. Czak, Frontier can accept this condition, subject to certain clarifications, and if the duration of the condition is limited to one year.

Q. Staff witness Karen Chang addressed the criteria of Section 7-204(b) that the proposed reorganization is not likely to result in any adverse rate impacts on retail customers. She acknowledges that Frontier will assume the retail tariffs of Verizon North and has committed to file tariffs substantially identical to those of Verizon South.[79] She nevertheless states a concern about how long those retail terms would continue,[80] noting that Frontier would have the continued right to amend the tariffs

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[78] Liu Confidential, p. 3.

once it assumes or files them.[81] In order to address that concern, Ms. Chang proposes the following condition:[82]

> **I recommend a freeze on all regulated retail rates (competitive and noncompetitive) to last no less than three years. This would be a minimum freeze period designed to give the company an opportunity to actually realize all net merger costs (which, of course, could be savings). No retail rate increases could be sought before three years expire. No sooner, but anytime after three years, Frontier is free to propose noncompetitive and competitive retail rate increases. However, in doing so, Frontier must present a rate case in order to make any noncompetitive rate increases.**

Would Frontier accept this condition?

A. Frontier is concerned about the duration of this condition and the inability to seek rate changes for three years. Frontier would not object to a cap on regulated non-competitive retail rates for one year after closing of the proposed transaction. With regard to bundled rates, I understand the cap would apply only to the non-competitive elements of those bundles. In addition, Frontier does not believe it would be in the best interest of its customers to "freeze" rates where continued competition from both CLECs (including cable telephone providers) and wireless companies places downward pressure on all pricing. Finally, I would also ask that the Commission Order acknowledge that Frontier could seek relief from this condition if the FCC or Congress takes any action that significantly impacts carrier rate design, for example, through significant changes to intercarrier compensation.

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[79] Chang Direct, p. 3.

[80] Chang Direct, p. 4.

[81] Chang Direct, p. 10.

[82] Chang Direct, p. 10-11.

Q. Although Section 7-204 does not mention the transition of the 9-1-1 system, Staff witness Stacy Ross has submitted testimony seeking further clarification of Frontier's plans for assuming Verizon's 9-1-1 systems affecting the VSTO Illinois properties.[83] Does Frontier take issue with her questions?

A. No. Frontier understands that the 9-1-1 service and the E9-1-1 service that Verizon currently provides in Illinois is a critical safety issue to the people of Illinois and of utmost concern to the Commission. Similarly, Frontier views the seamless transfer of that service from Verizon to Frontier as a critical element of this transaction. In general, all of the 9-1-1 services and functions that are currently being performed by Verizon will continue to be performed after the transaction by Frontier.

Q. In her Direct Testimony, Ms. Ross raised a number of questions about how Verizon's 9-1-1 systems would be transitioned to Frontier. For example, Ms. Ross states (at 6), "I am particularly concerned that Frontier does not currently provide selective routing, 9-1-1 database services, 9-1-1 services to CLECs, wireless 9-1-1 or Private Business Switch 9-1-1 services to 9-1-1 systems in Illinois today."[84] After summarizing her understanding (at 8) about how Frontier plans to rely on Verizon's experience and resources with 9-1-1 operations and management for the transition, and how Frontier intends to retain and utilize the existing core group of Verizon 9-1-1 employees,[85] she states:[86]

> **I need to be provided more detailed information regarding 9-1-1 staffing levels prior to and after completion of the merger transaction. At this point, I cannot be certain what will happen to the current 9-1-1 employees of Verizon. There appear to be employees located around the country, some of whom work for Verizon's Verizon Business subsidiary. Frontier Response to Staff Data Request SR 1.12. I cannot be certain which company those employees will work for in the future – Frontier, New Communications of the Carolinas, or some group that serves both companies like Verizon Business. Frontier has stated repeatedly in its responses to Staff Data Requests SR 1.01-1.25 that it has no plans to**

[83] Ross Direct, p. 4 and following.

[84] Ross Direct, p. 6.

[85] Ross Direct, p. 8-9.

[86] Ross Direct, p. 9-10.

> **change staffing and locations of the Spinco employees that transfer to Frontier.**
>
> **I need specific and detailed information regarding who will perform the various operations and where they will be located. In addition, it is vital that Commission's 9-1-1 Program Manager be notified of any staffing changes regarding 9-1-1 personnel in or assigned to Illinois on a going-forward basis. Frontier should commit to notifying the Commission's 9-1-1 Program Manager of all such changes on a going-forward basis.**

Please respond to Ms. Ross' requests.

A. Ihe accompanying rebuttal testimony, Mr. Carl Erhart of Verizon confirms that all the employees listed (by title) in Ms. Ross' testimony will be transferred to Frontier at completion of the transaction.

Q. Ms. Ross also insists that Frontier notify Illinois 9-1-1 systems should problems occur that would affect those systems, during or after the transition of the database.[87] Does Frontier object to this?

A. No. Frontier will commit to keep the Commission apprised about the 9-1-1 systems in Illinois should any such problems occur.

Q. Ms Ross also asks that Staff receive a final network plan to separate the Verizon system that will be transferred with the VSTO Illinois properties, including a timeline for that plan so that Staff can be assured that such a plan has been completed ahead of execution.[88] Is Frontier willing to comply?

A. Yes. Verizon has completed the Realignment Plan that summarizes Verizon's plan to separate the Verizon systems to be transferred to Frontier with the VSTO Illinois properties. Mr. Erhart of Verizon addresses Ms. Ross' concerns in their rebuttal testimony. Frontier is committed to continuing to work with Verizon as it completes the plan to migrate 911 services for the Illinois operations to Frontier at closing.

[87] Ross Direct, p. 12.

[88] Ross Direct, p. 13.

Q. Ms. Ross raises a few other concerns with the proposed transaction and ultimately recommends that the Commission impose the following three 9-1-1 related conditions on the transactions:[89]

- **The post-merger company must inform the Commission prior to the reduction or removal of any 9-1-1 staff which are functional in providing 9-1-1 services in Illinois.**
- **Any post-merger operational changes that are made in the delivery of 9-1-1 services must be transparent to the 9-1-1 systems, as well as to the 9-1-1 subscribers.**
- **Any rate increase requested specifically for 9-1-1 network and services should not create additional profits for the post-merged company and shall be submitted to normal Commission review of proposed increases.**

Does Frontier have objections to any of these conditions?

A. No. Frontier accepts these conditions.

Q. Is Frontier aware of the Commission's statutory authority to certificate 9-1-1 carriers?

A. Yes, Frontier is aware that shortly after the Joint Application was filed in this docket, the Illinois Legislature added Section 13-900 to the Public Utility Act.[90] In essence, that Section requires new 9-1-1 providers coming into Illinois to obtain Commission certification.

Q. Does 13-900 apply to Frontier under the proposed transaction?

A. Although I would not purport to provide a legal opinion, it does not appear to apply to Verizon North because Verizon North will continue to operate under all of its current certificate authority. Section 13-900(d) "grandfathers" existing 9-1-1 carriers and Verizon North is just such a carrier.[91] New Communications of the Carolinas (the

[89] Ross Direct, p. 17.

[90] Public Act 096-0025.

[91] "(d) No incumbent local exchange carrier that provides, as of the effective date of this amendatory Act of the 96th General Assembly, any 9-1-1 network and 9-1-1 database service used or intended to be used by any Emergency Telephone System Board or 9-1-1 system, shall be required to obtain a Certificate of 9-1-1 System Provider Authority under this Section. No entity that possesses, as of the effective date of this amendatory Act of the 96th

successor to Verizon South) should also be grandfathered under that provision. Specifically, New Communications of the Carolinas will be taking over the operations of Verizon South, which are, in fact the very same operations that support Verizon North. As a result, it would appear that with the continuation of Verizon South's ILEC operations by New Communications of the Carolinas, the intent of Section 13-900 would be fulfilled. Nevertheless, Ms. Ross is of the opinion that New Communications of the Carolinas is not exempt from the Section 13-900 certification requirement.

Q. How does Frontier propose to address this issue?

A. According to the pertinent part of Section 13-900(c):

> The Commission shall approve an application for a Certificate of 9-1-1 System Provider Authority upon a showing by the applicant, and a finding by the Commission, after notice and hearing, that the applicant possesses sufficient technical, financial, and managerial resources and abilities to provide network service and database services that it seeks authority to provide in its application for service authority, in a safe, continuous, and uninterrupted manner.

Frontier believes that Mr. Erhart's explanation of the personnel who will transfer to Frontier with the 9-1-1 systems, supplemented by any necessary training of Frontier personnel who will also support the systems, demonstrates Frontier's technical and managerial capabilities and resources to meet the statutory requirements to grant 9-1-1 certificate relief. Frontier further believes that its testimony regarding the financial capacity of Frontier and the Illinois LECs demonstrates Frontier's financial capabilities and resources to meet the statutory requirements to grant 9-1-1 certificate relief. Frontier would propose to include the request for 9-1-1 certification under the final prayer for relief of the Joint Applicants, seeking "all other necessary and appropriate relief".

Q. Does Frontier have any other comments on the positions or conditions set forth in Staff's testimony?

A. As I explain above, Frontier does not agree that the conditions that Staff advocates are necessary for this transaction to meet the requirements of Section 7-204. However,

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General Assembly, a Certificate of Service Authority and provides 9-1-1 network and 9-1-1 database services to any incumbent local exchange carrier as of the effective date of this amendatory Act of the 96th General

Assembly shall be required to obtain a Certificate of 9-1-1 System Provider Authority under this Section."

Frontier has no objection to the conditions advocated and commitments requested subject to the changes I have set forth above. Moreover, these conditions and commitments should adequately address any residual concerns the Commission might have about approving this transaction and render the more extreme objections of the other intervenors entirely unnecessary for the Commission's consideration. Nevertheless, in the subsequent sections of my testimony, I will address certain claims of those intervenors.

III. RESPONSE TO INTERVENORS

Q. Mr. Selwyn on behalf of the Attorney General of Illinois ("AG") and the Citizens Utility Board ("CUB") takes issue with Verizon's stated goal to divest itself of rural access lines, arguing that the wireline telephone network is still important both to other telecommunications providers and to public safety.[92]

A. Frontier does not take issue with Mr. Selwyn's assertions in this regard. But from Frontier's perspective, this explains why the transaction is in the interest of Illinois since Frontier, in contrast with Verizon, has made the expansion of the wireline network a strategic corporate priority.

Q. Mr. Selwyn raises concerns that Frontier's current management has little direct ILEC experience and had no prior involvement in Frontier's previous acquisitions or integration into the Company's operations.[93] Is this correct?

A. Absolutely not. Frontier's senior management team has had extensive industry experience and experience in completing the integration of Frontier's operations. Each one of the members of Frontier's senior management team identified in Table 1 on page 33 of Mr. Selwyn's testimony was with Frontier and involved in the acquisition and integration of Commonwealth (over 400,000 access lines) in 2007. Each of these individuals were also with Frontier and involved in various capacities with the 2007 and 2008 operations support systems conversions for Commonwealth and Rochester. In addition, Mr. Sewelyn fails to account for both the general business experience and

[92] Selwyn Direct at 9-14.

[93] Selwyn Direct at 29.

specific communications industry experience of Frontier's senior management team. For example, prior to joining the company in November 2004, Maggie Wilderotter, Frontier's Chairman and CEO, was Senior Vice President of Worldwide Public Sector at Microsoft, responsible for strengthening customer and partner outreach in the government and education markets, as well as working across Microsoft's business divisions to develop and coordinate forward-looking strategies. Ms. Wilderotter has also served on the board of directors of more than a dozen corporations, including Proctor & Gamble, Yahoo! Inc., Xerox Corporation and Tribune Company, and on the boards of a number of non-profit organizations. In terms of communications industry experience, Ms. Wilderotter was President and Chief Executive Officer of Wink Communications Inc.; Executive Vice President of National Operations for AT&T Wireless Services Inc.; Chief Executive Officer of AT&T's Aviation Communications Division; and Senior Vice President and Regional President of McCaw Cellular Communications Inc.

Similarly with respect to Frontier's Executive Vice President and Chief Financial Officer, Mr. Donald Shassian, he was the Senior Vice President and Chief Financial Officer for Southern New England Telecommunications Corp. ("SNET"), which was a provider of communications, information and entertainment services in southern New England, with more than $2 billion in revenues and 10,000 employees. Mr. Shassian was responsible for the successful negotiation, sale and integration of SNET into SBC Communications.

In addition, Mr. Shassian has provided mergers and acquisitions consulting services to several communications companies including AT&T Inc. (formerly SBC Communications) and Consolidated Communications Inc., and was with Arthur Andersen for more than 16 years. His last position at Arthur Andersen was as the Partner-in-Charge of the Telecommunications Industry Practice in North America.

With respect to my position and responsibilities at Frontier over the last 19 years, Mr. Sewlyn is correct that I have functioned in a variety of positions and roles with the company. However, it is important to note that I was involved directly in Frontier's efforts to divest Citizens Utilities Company's ("Citizens Utilities") public sector utilities businesses and operations in the late 1990s and early 2000s. In this capacity and as part of the divestiture work, I was specifically involved in helping to ensure that the sale and transition to the acquiring companies had the necessary systems and support to ensure that the transferred electric, gas and water customers did not experience a disruption of service. I am proud to report that each of these transitions from Citizens Utilities did not result in any significant customer service disruptions or customer support systems failure. In addition, in my public service sector and more recent local exchange carrier management roles, I have gained invaluable experience in how to effectively manage the company's operations and ensure excellent customer service. I was directly involved in the acquisition of Commonwealth in 2007 and had responsibility for the Commonwealth and Rochester system conversions in 2007 and 2008.

Mr. Sewlyn seems to imply that Frontier would be more qualified to acquire the Verizon properties if all of its management had decades of experience solely in the incumbent local exchange carrier industry. However, Frontier firmly believes that the fact that its senior management team has a broad range of experience both in and outside the incumbent local exchange carrier business is a strength for the company. These experiences, especially in competitive service areas, position Frontier and its management to be more-responsive to customer service needs and to develop innovative new products and services that customers are interested in obtaining. The telecommunications industry has undergone significant changes in the last 10 years and will continue to experience dynamic technological and customer service changes in the years ahead. Frontier's senior management team's breadth of experience and expertise will position the company to adapt and respond to these changes.

Finally, it is also important to recognize, that in addition to the wealth of experience of Frontier's senior management team, Frontier has highly experienced and skilled leaders managing the day-to-day operations of Frontier's business. As I explained in my Direct Testimony, the Verizon operations in Illinois will be included in Frontier's Central Region[94], which is managed by Mr. John Lass, Regional Vice President. Mr. Lass has more than 20 years of telecommunications experience with Frontier and its predecessor,

[94] McCarthy Direct, p. 24.

and Mr. Lass and his Central Region team (including Ms. Joy Eldred and Mr. Scott Hogan) were involved with Frontier's acquisition of the GTE properties in Illinois in 2000, the eight Frontier ILECs in Illinois in 2001, the acquisition of Commonwealth (which is also part of the Central Region) in 2007, and the customer billing system conversions associated with each of these acquisitions. In addition, several other key management team members that will be involved in the acquisition and integration of the VSTO properties with Frontier have had significant ILEC responsibilities and integration experience with Frontier as summarized in the following table:

FRONTIER MANAGEMENT

Name/Title	At Frontier since	Years in ILEC mgt positions	Involvement in prior acquisitions/integration
John J. Lass Senior Vice President, General Manager	1980	28+	In addition to earlier GTE/Contel transactions and integrations, involved in the acquisition and integration of the GTE properties in Illinois and other states in 2000, the Frontier ILECs in Illinois and other in 2001, and the acquisition and integration of Commonwealth in 2007.
Joy M. Eldred Vice President, Engineering - Regional	07/1977	17	Global Crossing acquisition - Team Lead for Engineering Project Management System integration and involved with every acquisition/integration beginning with Rochester Telephone's purchase of the Centel territories of Minnesota and Iowa in 1991. Involved with each subsequent acquisition of companies that comprised the Regional Telephone Operations (RTO) including the Illinois properties that were a part of the RTO companies. Involved with Commonwealth acquisition – integration of Engineering organization, roles and responsibilities
Scott J. Hogan Director, Customer Operations - Regional	04/1979	30+	Global Crossing Transition – Project Team Lead for move to DPI systems; Commonwealth Conversion – directing efforts of Plant Conversion from CTCo systems to DPI.
Steven D. Ward Senior Vice President, Information Technology	01/2000	9+	Responsible for all the OSS conversions and integration related to the GTE/Verizon access line acquisition in 2000, the Global Crossing acquisition in 2001, the Commonwealth acquisition in 2007.

Name/Title	At Frontier since	Years in ILEC mgt positions	Involvement in prior acquisitions/integration
Richard D. Burson Vice President, Customer Support	01/1995	14+	Functional Lead responsible for customer support and billing on the following conversions: 1995 Conversion of GTE properties to CAMS; 1999 Conversion of GTE properties to DPI; 2001 integration of properties to Frontier; 2004 conversion of GTE properties from CAMS to DPI; 2007 acquisition and later conversion of Commonwealth properties to DPI; and 2008 conversion of FDPI and CARS to CDPI.
Stephen D. LeVan Senior Vice President, Carrier Sales & Service	03/1995	20	GTE acquisition – integration of sales organization, Global Crossing acquisition – integrated properties and managed field operations in NY (outside Rochester); Rochester billing system integration – took over Rochester operations following system conversion.
Kim L. Czak Assistant Vice President Carrier Services	07/1990	11	Global Crossing acquisition – Team Lead for combining Citizens and Frontier Carrier Group. Commonwealth acquisition – Team Lead for Carrier integration. 2008 Rochester billing system integration – oversight for Carrier Group.
Kenneth W. Arndt Senior Vice President, General Manager	10/2003	16	Commonwealth acquisition - VP/GM of the PA properties post acquisition. Responsible for the integration and assimilation of the Commonwealth employee and customer base. Responsible for Customer Operations during both the FDPI and Rochester billing system conversions in 2008; Accountable for customer service training on all new systems and customer interaction post conversion.
Leslie T. Wells Senior Vice President, Corporate Development	06/1995	14+	Involved in the acquisitions in 1999-2001 and responsible for setting up the following functions: (Residential Call Center, Business Call Center, Repair, Dispatch, Test board, Assignment). As RVP of East Region, operations of acquired properties in NY and PA were folded into the East Region . Commonwealth acquisition- lead the due diligence and negotiation efforts as SVP of Corporate Development. Responsible for integration efforts post close.
David P. Frezza Vice President, Customer Operations Support	03/1990	19+	Involved in the 1998-2000 integration of GTE properties - Director of Integration responsible for Field Ops including

Name/Title	At Frontier since	Years in ILEC mgt positions	Involvement in prior acquisitions/integration
			Dispatch, Repair, Assignment, Test, I&M, Central Office, Engineering and Call Center. Global Crossing acquisition/integration - Involved in the early phases and discussions. Commonwealth acquisition - Involved in due diligence as well as operations integration.
Ken Mason Vice President Regulatory	1996	13+	Wholesale and carrier organization – involved in GTE and Frontier acquisition integration. Regulatory – involved in Commonwealth acquisition regulatory oversight and implementation of integration.

Q. Mr. Selwyn and Mr. Barber raise concerns about the size and scope of the proposed transaction.[95] Should this concern the Illinois Commission?

A. No. Frontier is an experienced operator that has successfully executed many significant acquisitions. The company acquired more than 400,000 lines in 1999 through 2001 from GTE, and 1.1 million lines from Global Crossing in 2001. In fact, all of the 1.6 million lines Frontier purchased from GTE and Global Crossing in this time (with the exception of 62,200 GTE lines in Nebraska) closed from mid-2000 to mid-2001. As the Commission is aware, Frontier completed the acquisition of more than 100,000 access lines from GTE in Illinois during this time period, as well as acquiring the eight Frontier operating ILECs. Frontier has also acquired substantial properties since that time, including Commonwealth Telephone Enterprises ("Commonwealth") which involved over 400,000 ILEC and edge-out competitive lines. Frontier and its management team have extensive "real world" transactional experience and expertise. As such, Frontier is very comfortable that it has the experience and expertise to successfully complete the proposed transaction and believes that the Commission should be skeptical of speculative criticisms from intervening parties.

It is also important to note that the proposed transaction is not "unprecedented" by any means. The most comparable transaction is CenturyTel's combination with Embarq—a

[95] Selwyn Direct, p. 6; Barber Confidential, p. 43.

transaction that the Commission recently approved with only a few standard conditions (very similar to what Frontier has indicated it could agree to here).[96] The two transactions—Frontier-Verizon and CenturyTel-Embarq—are similar in size, with the CenturyLink transaction slightly larger in terms of total dollar value, target access lines to be acquired, and target states involved. In addition, on a pre-transaction basis, CenturyTel, with approximately 2.0 million access lines, was slightly smaller than Frontier, which has over 2.2 million access lines. On a relative basis, comparing the size of the target operations to the size of the acquirer, CenturyTel acquired a proportionately larger company. In terms of access lines, Embarq was 2.9 times larger than CenturyTel, while the VSTO operations are only 2.1 times larger than those of Frontier. In terms of revenues, Embarq was 2.4 times larger than CenturyTel, while the VSTO operations are only 1.9 times larger than those of Frontier. In terms of EBITDA, Embarq was 2.1 times larger than CenturyTel, while the VSTO operations are only 1.6 times larger than those of Frontier. The relative size metrics are close, with the Frontier transaction having slightly more favorable ratios (that is, "favorable" if one believes that the acquirer should be closer in size to the target). So, when Mr. Barber contends that "[t]his transaction is unprecedented in scope and size. Neither Frontier nor any other company its size has ever taken on a deal of this complexity and magnitude,"[97] it appears that for some reason he has ignored the CenturyTel acquisition of Embarq. CenturyTel was similar in size to Frontier, Embarq's operations were larger than the VSTO operations, and the scale of the two integrations is similar.

Q. What about Mr. Selwyn's contention that Frontier has made unrealistic revenue and expense projections regarding the proposed transaction?[98]

A. Frontier is a proven acquirer of local telecommunications assets. The company has successfully acquired and integrated properties over the last two decades and has had no major problems with those acquisitions. Frontier has consistently generated realistic projection models and has executed on those models with superior results. The financial

[96] *CenturyTel, Inc. and Gallatin River Communications, LLC d/b/a CenturyTel Of Illinois*, Docket No. 08-0645, Order (March 25, 2009).

[97] Barber Confidential, p. 42, lines 14-16.

[98] Selwyn Direct, pp. 56-58.

projection model provides a helpful and realistic tool. At the same time, Frontier assumes that there will be changing economic and competitive conditions. However, Frontier's management is confident in its understanding of trends and the company's ability to integrate properties, as proven by its record over the last two decades. Importantly, management also believes that Frontier is a focused operator that can respond better to market conditions than can a diversified communications entity that has many other pressing and potentially distracting strategic obligations. The uncertain future will affect Frontier and all local telecommunications carriers, including Verizon, AT&T, Qwest, and CenturyLink. Frontier's proven focus on this strategic communications industry segment makes it better prepared to respond quickly and effectively to changes in the marketplace. The projection model is informed by Frontier's experience and proven competencies, and provides a reasonable estimation of what the company expects will occur in the coming years.

Q. Mr. Selwyn references the risk factors included in the Frontier's S-4 registration statement with the SEC and concludes that these risks may result in a loss of reliable phone service.[99] Is Mr. Selwyn's conclusion correct?

A. With respect to the Risk Factors section in the S-4, it is important to understand the purpose of that document section. The SEC requires the inclusion of any and all risks to shareholders, regardless of probability, similar to those included in any public company's SEC Form S-4 or annual Form 10K. The "risk factors" represent general recitals of potential negative events, and are intended to provide legal protection to investors and to the company whose securities are publicly-traded. The disclosures are not intended to suggest that the risks are likely outcomes. In addition, it should be clear to any reader that some of these risks will be present regardless of whether the transaction goes forward.[100]

[99] Selwyn Direct, pp. 69-70.

[100] In fact, the Risk Factors in the Frontier S-4 are similar to those included in the S-4 filed by CenturyTel in conjunction with its merger with Embarq. The notable differences relate to the different forms of financial consideration and the distinct structures of the two transactions, as CenturyTel-Embarq was a stock-for-stock transaction with an ultimate price determined by fluctuations in the financial markets, while Frontier-Verizon is a Reverse Morris Trust that has tax-related risks and a collar on the price. There are also certain "risks" that were addressed by one company or the other, likely due to the advice of counsel in each case (i.e., Frontier included

More basically, the Risk Factors disclosures are analogous to warnings that are appropriate in a litigious society, and that accompany today the sale of pharmaceuticals, toys, electrical equipment, etc. Frontier and its investors recognize the potential risks and believe that they are manageable or minimal compared with the benefits to stakeholders, including to Illinois customers. In short, the risks should be assessed, but should not be assumed to connote probability of harms to ratepayers.

Mr. Selwyn also incorrectly accuses Frontier of hiding the investors' disclosures[101] that were voluntarily provided to the Staff in the form of the company's S-4, suggesting that Frontier's investors have better information about the risk to equity than the Commission. I note that those investors, even after review of the full slate of risks and being well aware of the Verizon/FairPoint experience, approved the transaction and clearly believe that this transaction will strengthen Frontier.[102] Although Mr. Selwyn argues that Verizon's customers have different risks, all of the speculative risks described by Mr. Selwyn stem from his perspective that this transaction may harm, rather than strengthen Frontier. However, sophisticated institutional investors, who undertake significant review for no purpose other than to differentiate good investment opportunities from bad investment opportunities, have indicated that they view this transaction from the perspective that it will produce a stronger Frontier; so investors with capital at risk have indicated by an overwhelming vote that they approve the combination. I contend that the independent assessment of these sophisticated investors is a more reliable indicator of the prospects for the combined company than Mr. Selwyn's speculations.

"risks" regarding the economy, the need for subsequent network upgrades, unions, etc., while CenturyTel addressed managing the expanded operations, re-branding, future dividends, and so on). The disclosures that are similar include that the merger completion is dependent on regulatory approvals; adverse conditions could cause diminished benefits or the parties to abandon merger; failure to complete the merger could negatively impact stock price and future business / financial results; the merger agreement provisions could discourage a bid from a potential competing bidder / acquirer; pendency of the merger could adversely affect business and operations; there may be substantial expenses related to integration; the combined company may be unable to integrate successfully or may not realize the anticipated benefits of the merger; if the acquirer continues to experience line losses (and related reductions in minutes of use, long-distance, and subsidy revenues) similar to the past several years, revenues, earnings and cash flows may be adversely impacted; and so on. In comparing the Risk Factor sections in the filings related to the proposed transaction to those in the CenturyTel-Embarq merger, it becomes obvious that most or at least many of the "risks" would be required to be listed for any ILEC transaction, regardless of the parties involved.

[101] Selwyn Direct at 26.

[102] Selwyn Direct at 54-60.

Q. Mr. Selwyn states that Frontier entered into the transaction with Verizon with undue haste and was negotiating in a reactive mode because key documents such as the Term Sheet, initial drafts of the merger agreement, and the tax sharing agreement were initiated or prepared by Verizon or its outside professionals.[103]

A. Mr. Selwyn is simply wrong. Frontier approached Verizon about the proposed transaction and completed significant review of Verizon's business operations using public data before Frontier and Verizon began substantive discussions. Frontier made a preliminary proposal to Verizon on March 11, 2009, pursuant to which Frontier would acquire Verizon's local exchange business in eleven states and discussed including two additional states in the proposed transaction. Throughout the negotiations related to the proposed transaction, there were proposals, counterproposals and numerous negotiations that culminated in the final Merger Agreement, Distribution Agreement and supporting documents that were executed on May 13, 2009. As I noted above, Frontier is satisfied with the level of due diligence it completed as part of this proposed transaction, which was consistent with Frontier's prior experience and standard industry practices.

Q. Can you respond to the intervenors' concerns about Frontier's strategic and financial commitment to network investment, including expanding broadband availability?[104]

A. Yes. As I have explained previously, the communications market is changing rapidly in terms of competitive pressures and services required by customers. Frontier's strategy is based on a commitment to an upgraded network that is capable of providing high-quality innovative broadband and communications services to its customer base, complemented by high-quality customer service. None of the intervenors contradicts the record that Frontier has achieved 92% broadband availability, which is proof of the company's strategic commitment. The intervenors' criticism is that Frontier has not yet articulated the specific plans and identified the definitive projects for broadband deployment in the

[103] Selwyn Direct at 48.

[104] Baldwin Confidential, pp. 46-53; Barber Confidential, pp. 44-47; Selwyn Confidential, pp. 70-81.

VSTO regions.[105] In fact, it is unrealistic to have detailed investment and deployment plans before the transaction is consummated.

Q. Is it an accurate representation that Frontier will invest less in capital expenditures in the VSTO areas than did Verizon?[106]

A. No. The record is clear that Frontier has demonstrated a commitment to broadband deployment in its legacy properties long before the announcement of this transaction. As a result of this commitment, Frontier today "stands well ahead of the national average for broadband deployment among communication service providers."[107] As of June 30, 2009, Frontier has achieved approximately 92% broadband deployment in its service areas, well above the 62.5% availability achieved by Verizon in the VSTO areas. Frontier has accomplished the indicated high level of broadband availability in its legacy regions, moreover, even though its existing services areas are more rural on average and significantly more so than many of the properties it is acquiring in this transaction. Frontier also has stated that its business objective is to bring the level of broadband deployment in the new Frontier areas in line with its existing properties over time. In its existing territories, Frontier owns and operates 330 host switches and 695 remote switches. Digital Subscriber Line ("DSL") service (referred to as High-Speed Internet or "HSI" in the Frontier product set) has been deployed in 1,017 (99.2%) of the 1,025 Frontier host and remote switches. Again, investing in broadband-capable networks is a key component of Frontier's business strategy and the company believes that this objective is fundamental to its competitive success.

[105] Barber Confidential, p. 15, lines 13-15; Baldwin Confidential, p. 47, lines 13-14; Selwyn Confidential, p. 70.

[106] Barber Confidential, pp. 44 ff.; Baldwin Confidential, pp. 65 ff.

[107] Comments of Calix, WC Docket No. 09-95 (September 18, 2009) (hereafter "Calix Comments") (available at: http://fjallfoss.fcc.gov/ecfs2/document/view?id=7020038873).

Q. Do the intervenors also question whether Frontier will have the financial capacity to accomplish its capital investment plan?

A. Yes. Mr. Selwyn raised that concern.[108] At the same time, I affirm and my testimony demonstrates that Frontier has the strategic plan, the will, and the financial capacity to meet its capital plan to expand broadband availability in Illinois.

Q. Are there other benefits that Frontier expects to realize from its broadband commitment?

A. Yes. Over time, Frontier's base of broadband subscribers has grown and its access line loss rate, which was a comparatively low 7.2% in 2008, has slowed even more to approximately 6.5% for the twelve months ending June 30, 2009.[109] Frontier believes that its more moderate line losses are a function of improved competitive positioning. Frontier is committed to bringing this same strategic focus and commitment to the properties it is acquiring here. Further, broadband attracts employers to rural areas, enables local businesses to expand, and improves the quality of life for local residents.[110] This rural economic development, in turn, creates positive effects that ripple through the local and national economies. Frontier is aware of no party that has asserted that broadband deployment in the VSTO areas would occur as quickly or as ubiquitously if the proposed transaction were not to occur. Again, while certain intervenors point to FiOS, the benefits of that service currently are concentrated in a small percentage of the population, and Verizon had never announced any plans to deploy FiOS in Illinois. In fact, Verizon's strategic focus on FiOS and its desire to divest the VSTO areas provide an indication that Verizon has determined that the VSTO areas are not appropriate for further FiOS investment in the future beyond the current commitments in franchise agreements. Simply put, this transaction will deliver concrete, transaction-specific public

[108] Barber Confidential, p. 15, lines 13-15;

[109] Frontier Proxy, p. 120.

[110] *See* Calix Comments, p. 1.

interest benefit in terms of dramatically increased broadband deployment in the VSTO areas.[111]

Q. Mr. Barber provides a brief comparison of Verizon broadband offerings in the VSTO areas to Frontier's broadband offerings and claims that the transaction will mean a step back for high-speed broadband deployment in these states.[112] **Can you address Mr. Barber's assertion?**

A. Mr. Barber's comparisons of Verizon's broadband speeds and offerings in the areas where it does offer service with Frontier's current broadband offerings miss the core benefit of this transaction. Consumers cannot buy a service that is not available in their service area. Frontier will deliver broadband to a substantial portion of those households that currently are unserved by Verizon—over time driving broadband availability much closer to the 92% level achieved in Frontier's current service areas. Mr. Barber also implies that the transaction will not improve broadband *enough*.[113] This perspective seeks to measure the transaction not against current conditions, or against conditions if the transaction does not occur, but rather against a hypothetical world of other carriers' performance in other areas outside Illinois.

Q. Please respond to Mr. Selwyn's claim that Verizon's FiOS service is superior to ADSL service.[114]

A. Verizon has not invested in FiOS in Illinois, and Verizon has indicated that it has no plans to deploy FiOS in Illinois. Accordingly, intervenor testimony that states consumers would benefit more from Verizon than Frontier in terms of their access to FiOS services is without merit. Mr. Selwyn argues that Verizon is a superior carrier because of its emphasis on FiOS deployments,[115] but he gives no consideration to the cost in the regions

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[111] *See* Comments of ADTRAN, p. 1, WC Docket No. 09-95 (September 11, 2009) ("This transaction with Verizon can only further Frontier's investment in broadband, which in turn enables new businesses to enter the marketplace and will increase capital spending with equipment vendors, which ultimately results in job creation. Given today's economy, such opportunities are welcome and necessary.").

[112] Barber Confidential, p. 15, lines 16 ff.

[113] Baldwin Confidential, p. 71, lines 5-11.

[114] Selwyn Direct, p. 66.

[115] Selwyn Direct at 10.

where it is deployed or the offsetting reduction in capital expenditures in other regions as a carrier attempts to manage its capital budget. It is not appropriate to measure the tangible benefits of the proposed transaction against a hypothetically "ideal" world.

Q. Mr. Selwyn suggests that the proposed transaction is not in the public interest.[116] To date, have other regulatory bodies approved the proposed transaction as being in the public interest?

A. Yes.[117] On October 28, 2009, Frontier received approvals of the transaction from the Public Utilities Commission of Nevada and the Public Service Commission of South Carolina. On October 29, 2009, Frontier received approvals of the transaction from the California Public Utilities Commission.[118]

Q. Mr. Barber claims to be concerned about the aggregate amount of debt Frontier will have after the closing of this transaction.[119] Can you address Frontier's aggregate leverage?

A. Yes. In assessing leverage, the absolute dollar amount of the increase in Frontier's debt ($3.3 billion) and the total debt for the pro forma combined company (over $8 billion),[120] cited by Mr. Barber as concerns,[121] are not relevant metrics in and of themselves. Although Mr. Barber is correct that Frontier is taking on just over $3.3 billion in net debt, he has omitted the important fact that annual revenues, based on VSTO 2008 figures, increase from $2.37 billion to over $6.5 billion, and EBITDA (revenues less cash operating costs) correspondingly increases from $1.2 billion to over $3.1 billion, <u>without</u> including any anticipated synergies.[122] With synergies, the combined EBITDA increases

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[116] Selwyn Direct, p. 67.

[117] Frontier Exhibit 2.11, Press Release, California, Nevada and South Carolina Approve Frontier's Acquisition of Verizon Wireline Operations in those States.

[118] *Id.*

[119] Barber Confidential, p. 27.

[120] Frontier Exhibit 2.1, Frontier Communications Corp., "Welcome to the New Frontier" Presentation (Form 425) (May 13, 2009) (hereafter "New Frontier Presentation")(available at:

http://sec.gov/Archives/edgar/data/20520/000095015709000249/form425.htm).

[121] Barber Confidential, p. 27, lines 3-5.

[122] Frontier Exhibit 2.1, New Frontier Presentation, p. 16.

to $3.6 billion, using the 2008 results.[123] As such, the dollar amount of debt provides very little insight into the credit quality of the combined company and does not provide any meaningful predictive value regarding the company's ability to maintain the given level of debt. For example, CenturyTel (now, CenturyLink) retained an investment grade credit rating after the Embarq acquisition in spite of the fact that the company increased its net debt load by around $5.8 billion, to a total of over $8.8 billion.[124] Illustrating the insufficiency of analyzing debt alone, at the end of the second quarter of 2009, AT&T had net debt of approximately $69.4 billion[125] and Verizon had just over $64 billion[126] in net debt. Yet, both companies remained solidly investment grade.

Q. Mr. Barber testifies that the VSTO properties currently have extremely low leverage compared to Frontier's leverage, both standalone and pro forma combined.[127] Is that assessment accurate?

A. Not at all. Mr. Barber presents an incomplete picture. He reports the approximate leverage of the VSTO operations alone and then compares it with Frontier's leverage as a holding company. The calculation is incorrect and results in a distorted perspective. The reality is that Verizon is a holding company, with numerous subsidiary business units and operating companies, but Verizon no longer chooses to finance through its telephone operating companies. This corporate structure, used by many companies—including Frontier—allows the holding company to issue debt, often at attractive terms, in addition to the debt that might be issued at the operating company level. To be specific, as of June 30, 2009, Verizon's total debt outstanding ($64.9 billion) was composed of approximately $21.9 billion of Verizon Wireless debt, $13.4 billion of wireline operating company debt, and $29.6 billion of holding company debt (issued by Verizon

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[123] *Id.*

[124] Frontier Exhibit 2.12, CenturyTel, Merger of CenturyTel and EMBARQ 8 (October 27, 2008), (hereafter "CenturyTel-Embarq Presentation"), p. 8 (available at http://www.centurytelembarqmerger.com/pdf/presentations/CenturyTel_EMBARQ_IR_Presentation.pdf).

[125] AT&T, Strong Wireless Growth, Continued Cost Discipline, Solid Free Cash Flow Highlight AT&T's Second-Quarter Results, Investor Briefing 3 (July 23, 2009), (available at: http://www.att.com/Investor/Financial/Earning_Info/docs/2Q_09_IB_FINAL.pdf).

[126] Verizon, Q2 Investor Quarterly 2009 15 (July 27, 2009), (available at: http://investor.verizon.com/financial/quarterly/vz/2Q2009/2Q09Bulletin.pdf?t=633904300284080415).

[127] Barber Confidential, p. 28 and Schedule 10.

Communications Inc. or NYNEX).[128] Mr. Barber is not including the Verizon holding company debt, but is referring to the VSTO operating company subsidiary debt alone. In fact, if the Commission were to look only at the debt at the VSTO operating company level, the VSTO operating company debt levels will be unaffected by this transaction.[129] The correct approach is to consider all of Verizon's debts, at the holding company and subsidiary operations, to determine the leverage levels that are supported by the combined cash flows of the subsidiary operating companies. To be clear, Mr. Barber is comparing "apples and oranges," that is, the *operating company debt* of VSTO is being compared with the total debt—*holding company and operating company*—of Frontier. As of June 30, 2009, Verizon's consolidated leverage ratio was 1.8 times.[130] So, while the VSTO operating companies may have lower leverage, they are part of the consolidated Verizon and must contribute to servicing debt that is nearly two times the consolidated EBITDA of Verizon. It is this leverage ratio that should be compared with Frontier's consolidated holding company pro forma leverage ratios, which, based on 2008 results, are 2.6 times before expected synergies and 2.2 times assuming synergies are achieved. While there will be an increase in the debt that must be supported by the VSTO operations, the increase is relatively small and is certainly well short of the figures that have been calculated by the IBEW witness.

Q. You mentioned that Frontier will generate higher and more predictable cash flows through the combination with the VSTO properties. Based on those expected cash

[128] *See* http://investor.verizon.com/income/outstanding_debt.aspx.

[129] At this time the VSTO operating companies have debt obligations of $625 million. It is anticipated that $200 million in debt due February 15, 2010 will mature and be retired prior to the merger closing date. As a result, Frontier and Verizon anticipate that the indebtedness of the VSTO operating companies will be $425 million at closing. However, if the closing occurs after June 1, 2010, $175 million in debt will mature and be retired at that time, in which case the VSTO operating companies' debt at closing will be $250 million. The direct debt obligations of the VSTO operating companies will not change or increase as a result of the closing of the transaction. The debt associated with the $3.1 to $3.3 billion financing for the special payment to Verizon will be at the Frontier Communications Corporation parent company level and will not be direct debt for the VSTO operating companies. Accordingly, the leverage ratio of the VSTO operating companies will not change as a result of the transaction.

[130] Verizon, Q2 Investor Quarterly 2009 15 (July 27, 2009), available at http://investor.verizon.com/financial/quarterly/vz/2Q2009/2Q09Bulletin.pdf?t=633904300284080415.

flow improvements, can you provide perspective regarding intervenors' concerns about the relationship between book net income and dividends?[131]

A. Yes. First of all, despite what the IBEW witness contends, dividends are not measured solely, or even primarily, against net income, nor should they be. The appropriate financial analysis, and the analysis required by the financial markets, evaluates dividend payments in relation to free cash flow. Book net income contains numerous non-cash entries, like depreciation, amortization, pension expense and income taxes (which can be positive or negative in any given period). In addition, book net income excludes capital expenditures, a major utilization of cash in the ILEC business. Free cash flow, which is calculated after all cash outflows including capital expenditures, better defines a company's ability to pay appropriate returns to its shareholders while maintaining a sustainable business.

Q. What is Frontier's outlook for free cash flow?

A. The outlook is very favorable. I have included Table 3 below, which summarizes Frontier's historical free cash flow generation, as well as pro forma free cash flow expectations for the new Frontier. Free Cash Flow is cash generated by the business after funding all operating expenses to run the business, all capital expenditures, and interest expense on the company's debt. Free cash flow here is cash generated after funding all cash operating expenses to run the business, cash taxes, cash interest expense on the company's debt, and all capital expenditures, including the network investments to expand Frontier's broadband service availability to over 92% of its current customer base in its national service territory. Free cash flow does not include funds derived from financing activities, such as loan proceeds or other borrowings.

[131] Barber Confidential, pp. 14-15, 19-22, and Schedule 4; Selwyn Confidential, p. 49.

Table 3: Frontier Free Cash Flows—Historical and Pro Forma Combined

($s in 000s)	2005	2006	2007	2008	4-yr. Total	2008 Pro Forma Pre-Syn	2008 Pro Forma Post-Syn
FCF Generation							
Free Cash Flow [1]	$ 527,971	$ 561,784	$ 528,005	$ 493,197	$ 2,110,957	$ 1,423,000	$ 1,733,000
Dividends Paid [2]	338,364	323,671	336,025	318,437	1,316,497	742,000	742,000
Payout Ratio	***64%***	***58%***	***64%***	***65%***	***62%***	***52%***	***43%***
Free Cash Flow after Dividends	**$ 189,607**	**$ 238,113**	**$ 191,980**	**$ 174,760**	**$ 794,460**	**$ 681,000**	**$ 991,000**

[1] Post-Synergies Pro Forma Free Cash Flow reflects the after-tax impact of $500 million in synergies and a 38% tax rate.
[2] Assuming Frontier issues shares at the mid-point of the collar.

Sources: Frontier 10-Ks 2006-2008; Frontier Exhibit 2.1, New Frontier Presentation.

Historically, from 2005 through 2008, Frontier generated free cash flows that ranged from approximately $493 million to $562 million annually. Notably, Frontier achieved these levels of free cash flow while simultaneously investing over $1.1 billion in its network and operations (including broadband deployment). The proposed transaction, however, is expected to increase Frontier's annual free cash flow based on pro forma 2008 results to over $1.4 billion, without synergies, and over $1.7 billion after estimated synergies are included. Importantly, the company's higher free cash flow post-transaction will be used for capital investment *and* for supporting the company's access to debt and equity financing. In recent years, as reflected in Table 2, Frontier consistently generated free cash flow after dividends at annual levels ranging from $175 million to $238 million. Post-transaction, even excluding synergies, dividends will represent a significantly smaller percentage of Frontier's free cash flow, with the result that Frontier in the post-transaction period will generate meaningfully greater annual free cash flow after dividends—$681 million without synergies, and $991 million with synergies based on the 2008 pro forma figures. Frontier's historical data demonstrate a financially sound business approach that strikes a prudent balance among funding operations, investing in the network, and providing required returns to capital providers—all while continuing to generate sufficient amounts of cash flow to provide the board and management with the financial flexibility to respond to market forces and opportunities. As such, the IBEW and AG/CUB concerns regarding dividends in excess of book net income are unwarranted.

Q. What about the argument that Frontier's dividend payments will reduce book equity to the point that the company may eventually have a negative balance?

A. Frontier's dividend payments are responsive to market requirements to attract and maintain equity financing. Equity, like debt, remains important in any carrier's capital structure. However, the concern that a company will not be financially sound if its book equity balance varies over time is not well founded.[132] For example, Embarq had a negative equity balance for most of its corporate life after the operations were spun-off from Sprint Corporation with the approval of this Commission, but it had a substantial market capitalization as the financial community valued operations, not on book equity, but on projected cash flows. Illustrating this fact, as of March 31, 2009, Embarq reported more than $500 million in negative book equity in its last independent quarterly filing with the SEC prior to the merger with CenturyTel.[133] In addition, at the time of the merger Embarq had an investment grade credit rating, indicating that the debt rating agencies were not disturbed by the company's negative book equity. Additionally, Qwest Communications had an equity market capitalization of $6.1 billion on Tuesday, November 3, 2009, but its book equity account at June 30, 2009, was a negative $1.05 billion.[134] Further, other very reliable communications companies have negative tangible book value, including Comcast Corporation, parent of intervenor Comcast Phone of Illinois, LLC ("Comcast"). Comcast, as of the end of the second quarter of 2009, had a book value of $40.450 billion but goodwill of $14.928 billion and intangible assets of $63.743 billion, so that net tangible book value was a negative $37.253 billion.[135] However, the financial markets perceive value above that negative balance and evaluate Comcast on its cash flow generation. The public market value for Comcast's equity, as of Tuesday, November 3, 2009, was $41.64 billion.[136] The short answer is that professionals in the financial markets value equity on the basis of cash flows, not on book

[132] King Direct, p. 10-11, lines 255-288.

[133] Embarq Corporation, Form 10-Q (May 5, 2009) available at: http://www.sec.gov/Archives/edgar/data/1350031/000119312509103531/d10q.htm.

[134] See Yahoo Finance; Qwest Communications, SEC Form 10-Q for the period ending June 30, 2009, available at http://www.sec.gov/Archives/edgar/data/1037949/000104746909006994/a2193752z10-q.htm

[135] Comcast Corporation, Form 10-Q for the period ending June 30, 2009, available at: http://www.sec.gov/Archives/edgar/data/1166691/000119312509166759/d10q.htm.

[136] *See* Yahoo! Finance, available at: http://finance.yahoo.com/q?s=CMCSA.

accounting entries.

Q. Should the fact that Mr. Barber cites two Wall Street analysts' projection models indicating potential negative book equity several years in the future be of concern to the Commission?[137]

A. No. Both of the analysts identified by Mr. Barber as "all-star" analysts have "Equal-Weight" or "Neutral" ratings on Frontier's stock, meaning that they do not have major concerns about the financial health of the company.[138] Both have also written generally favorable assessments about the proposed transaction and the sound financial profile of the combined company.[139] In addition, while the analysts' models show declining/negative book equity values at some point in the future, neither of the analysts sees this eventuality as enough of a concern to even mention it in their reports on Frontier. Given that the trend in book equity value does not appear to be a concern for these independent professional financial analysts, the Commission should not have any concern in this regard.

Q. The IBEW also claims that Frontier's business model is based on a transfer of wealth to shareholders rather than re-investment in the network.[140] **Can you address this "claim"?**

A. Yes. The IBEW is wrong about Frontier's business model. In fact, the financial reports of the company refute the allegation that Frontier is simply engaging in a "transfer of wealth" to shareholders and a scheme to deprive the network of investment. Frontier has invested over $1.1 billion in its network and operations since 2005, increasing broadband deployment so that high-speed availability now reaches approximately 92% of the customer base in the company's footprint. Frontier has demonstrated its commitment to investment and to customers, and competition will lead it to continue that strategic plan

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[137] Barber Confidential, p. 22, lines 9-16 and Schedule 6.

[138] Frontier Exhibit 2.13, Transcript of Deposition of Randy Barber (October 23, 2009) at pp. 59-62, Exhibit 1 and 2.

[139] See, for example, Frontier Exhibit 2.4, Morgan Stanley August Report; and Frontier Exhibit 2.14, "FTR acquires VZ lines: VZ aims for growth, FTR targets synergies," Goldman Sachs (May 13, 2009).

[140] Barber Confidential, p. 14, lines 15-16; also pp. 20-22; Selwyn Confidential, pp. 49.

without being constrained by conditions that will limit Frontier's ability to respond to market and technological changes.

Q. What about the claim that Frontier's annual depreciation is higher than annual capital expenditures and the intervenors' comments that net book fixed assets are declining?

A. Regarding Frontier's capital expenditures relative to the Company's depreciation, Frontier's ratio is consistent with the other companies in the industry. One reason that absolute levels of capital investment are lower than those in previous periods is that telecommunications electronics prices for switching and distribution equipment are falling relative to historic levels in the dedicated circuit-switched network. Further, ILECs are managing networks that are subject to competition so that the number of access lines and customers are lower. Thus, ILECs consistently are dedicating new capital investments that are 50% to 80% relative to their levels of depreciation.[141] The statistic is a signal of a changing marketplace rather than systematic underinvestment by the companies. In terms of judging the amount of necessary capital investment (and thus whether free cash flows appear sustainable), book depreciation is not the appropriate yardstick by which to determine the level of capital expenditures needed to maintain and improve ILEC networks. Depreciation is representative of the "periodic charge" for prior capital investments and is not necessarily an indicator of whether future investments should be higher or lower or the same.

Q. What about the shrinking levels of net property, plant and equipment?

A. The reasons for lower net property, plant and equipment are similar to those I just outlined. The trend of declining net fixed assets results from the fact that Frontier, like

[141] The comparable companies included in computing the capital expenditures-to-depreciation ratios were Consolidated Communications Holdings, Inc. ("Consolidated"); Embarq; Frontier; Iowa Communications Services, Inc. ("Iowa Telecom"); Otelco, Inc. ("Otelco"); Telephone and Data Systems, Inc. ("TDS"); and Windstream Corporation ("Windstream"). Averaging the companies' annual capital expenditures-to-depreciation ratios generated a relatively consistent group average of 65.4% in 2005, 69.4% in 2006, 63.3% in 2007, and 62.5% in 2008. In no instance was the ratio of capital expenditures-to-depreciation at or above 100% (in fact, the highest annual ratio calculated was just under 91%). The four-year average (2005-2008) for the companies' individual ratios ranged from a low of 51.2% for Consolidated to 81.8% for TDS. The median annual capital expenditures per line over the four years for each of the companies was $123 for Frontier, $139 for Consolidated, $125 for Embarq, $112 for Iowa Telecom, $129 for Otelco, $109 for TDS, and $117 for Windstream.

other ILECs, is prudently investing less today because of lower costs for equipment and changing industry forces. However, the company is dedicating significant capital to meet the needs of its customers, for broadband access, for transport, and for wholesale services, among others. The result of a lower requirement in terms of absolute capital commitments and a relatively higher depreciation account is that net fixed assets will decline. However, the operating import of this is not alarming, contrary to what Mr. Barber would have the Commission believe.[142] Consistent with industry practice and prudent management, Frontier is investing sufficient capital in its network for the future, and is generating sustainable cash flows.

Q. Please specifically address Mr. Barber's contention that Frontier's historic and projected capital expenditures are less than the level that Verizon has been investing in the VSTO areas.[143]

A. To accomplish its broadband expansion goals, Frontier will have to invest more, not less, in the overall network than Verizon has in the past, particularly in unserved and underserved areas in Illinois. For 2007 and 2008, Frontier's capital expenditures were approximately $126 and $123 per access line on a national basis, respectively, as Frontier invested to expand broadband deployment within its existing territories.[144] With respect to Illinois specifically, Frontier capital expenditures in 2007 and 2008 were **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]**, respectively.[145] Mr. Barber provides aggregate 14-state capital expenditures in the VSTO regions since 2005 and testifies that the annual aggregate figures each year from 2005 to 2008 were higher than the expected levels in Frontier's plan at this time.[146] However, Verizon was dedicating a very large percentage of those capital expenditures to FiOS in

[142] The precise figures are difficult to compute as Frontier has engaged in acquisitions so that the reported net property, plant and equipment are higher today than in 2005 or 2006. However, in the last year, from 2007 to 2008, the reported net property, plant and equipment declined by a mere 2.9%.

[143] Barber Confidential, p. 15, lines 5-15.

[144] Excluding non-recurring investment in information technology systems related to customer care and the conversion of back-office systems to a single platform, in 2007 and 2008, Frontier invested $112 and $113, respectively, in capital expenditures per access line.

[145] Frontier response to Data Request No. SM 2.02; per-line figures were calculated using end-of-year access lines for 2007 and 2008, as depicted in Figure 2 below.

[146] Barber Confidential, p. 45, lines 11-13.

only four of the 14 VSTO states (which do not include Illinois) to serve a very limited number of customers, and those FiOS expenditures skew the overall investment statistics. When one subtracts the FiOS expenditures, Verizon's core capital investments in the VSTO states in 2007 and 2008 averaged about $85 *per access line*.[147] A large percentage of Verizon's total VSTO capital investment was dedicated to FiOS **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL].** In the VSTO areas, Frontier estimates that it will spend approximately **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]**. This level of investment is well above Verizon's non-FiOS capital investment levels. As a result, the four-year total capital investment in the VSTO areas is expected to be just over **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]**. As such, the data clearly demonstrate that Frontier will invest more in the overall VSTO non-FiOS network in the coming years than Verizon has in the past.

Q. Why are you comparing Frontier's historical and projected levels of investment per line to Verizon's non-FiOS investment per line in the VSTO regions, instead of to Verizon's investment including FiOS?

A. I note two points about Frontier's calculations related to capital investment. First, while certain intervenors are using aggregate capital expenditures[148] to compare historical investment to planned investment, I believe that, as the number of switched access lines contracts, it is appropriate to evaluate the investment on a per-line basis rather than just assessing the total dollar amount of investment. Second, FiOS is very capital intensive as suggested by the difference between $85 per line annual investment excluding the FiOS expenditures and the higher capital expenditure figures computed by adding traditional investment and FiOS investment and then dividing by the total number of lines in the entire VSTO region. However, the distortive effect of including the FiOS investment becomes even more obvious when one realizes that FiOS is benefiting a very small

[147] *See* Declaration of Stephen E. Smith, WC Docket No. 09-95 (October 14, 2009), ¶ 22.

[148] Barber Confidential, p. 45, line 10 through p. 46, line 12.

percentage of the VSTO region. In fact, Verizon has reported 140,000 FiOS Internet customers out of the 4.5 million switched access lines in the VSTO territories as of June 30, 2009.[149] This means that Verizon's substantial investment in FiOS to-date has benefited 3.1% of the customers computed as a percentage of reported in-service access lines in the VSTO region. By contrast, Frontier intends to commit significant incremental investment in regions that are not served by FiOS, and that investment will be greater on a per line basis than the investment levels dedicated to 97% of the VSTO customers in 2007 and 2008. Frontier's network investment is expected to be significantly higher than the historical investment in underserved and unserved regions, and should be higher on average than the investment across the vast majority of the region. Such an approach to network investment is prudent and sets the entire VSTO operations on an evolutionary path toward constantly improving broadband speeds that are available to a very high percentage of customers. Thus, this transaction quantifiably will *increase* – not reduce – the funds available for network investment in unserved and underserved areas, enabling Frontier to increase broadband deployment, in direct contrast with the intervenors' claims.

Q. Will this new investment benefit Illinois customers?

A. Yes. I am confident that Illinois customers will benefit substantially. I can assure you that Frontier will move aggressively after taking ownership from Verizon. Nonetheless, while the intervenors again question whether Frontier truly is committed to investment and whether there really are benefits for Illinois consumers, their analyses are flawed. Clearly, Illinois customers are not receiving $153 in capital investment per line, which is based on the FiOS plus non-FiOS investment total capex in 2008, on an annual basis because these per line calculations include significant FiOS investment in states other than Illinois. Frontier is confident that based on its higher levels of historical and planned per-line investment, it will improve the realized benefits to Illinois customers. Figure 2[150] below highlights the discrepancy, as Verizon's annual capex per line in Illinois has

[149] Frontier Exhibit 2.10, Frontier Proxy, p. 146.

[150] The calculations in the graphic are based on end-of-year access lines for each of the companies, as Verizon has only supplied end-of-year access lines for 2007 and 2008 (in other proceedings the computations were based on

been sharply lower than both Frontier's consolidated spending per line and Frontier's Illinois spending per line over the last two years based on state-specific data supplied by Verizon and Frontier in this proceeding.

[BEGIN CONFIDENTIAL]

[END CONFIDENTIAL]

Frontier believes this comparison is most revealing as Frontier's new investment in the VSTO Illinois properties will not be conflicted by the need to direct proportionately higher capex to more densely-populated regions for fiber build outs. Frontier is confident that the per-line investment in Illinois will be significantly higher than the levels reported by Verizon, as depicted in Figure 2.

Q. Is Mr. Barber correct that Frontier has overstated revenues in its model?[151]

average access lines, which accounts for the slight discrepancies for Frontier's consolidated per line figures which were reported to be $126 and $123, respectively, using average lines).

[151] Barber Confidential, p. 32.

A. No. Mr. Barber is citing the loss of access lines and revenues between the end of 2008 and the financials reported as of the end of June 2009.[152] Obviously, the economy has been very depressed in this period and Verizon has committed to a transaction for the VSTO properties. During such a period of "limbo," it is typical that operating results will be weaker before the new carrier takes possession. In addressing the reported performance of the VSTO operations, the Morgan Stanley analyst, who is quoted by Mr. Barber and cited by Mr. Barber as an All-Star analyst, writes: "Spinco operational trends are weak, yet 2Q results exceeded management's expectations. . . . Importantly, margins are expected to be stable at +45%. . . . Revenue synergies have not been laid out, yet low broadband penetration (62% v 92% at legacy [Frontier]) points to potential revenue upside."[153] As the analyst is indicating, the recent VSTO results are in the range that the Frontier management team had assumed and, far from questioning Frontier's revenue potential (as does Mr. Barber), the analyst believes there may be an opportunity to improve revenues further. Regardless of the factors that might be affecting operations at the present, it is wrong to evaluate the potential of the VSTO properties before Frontier actually is operating the properties. Mr. Barber also notes Frontier's comments in the Frontier Proxy where the company states that it will "face further reductions in access lines and minutes of use."[154] I contend that this statement is a sign that Frontier recognizes the fundamental trends and has strategic plans to respond to those trends. The model reflects those trends and plans.

Q. Can you comment on Mr. Barber citing the "Wall Street" view that legacy Frontier will experience revenue declines on an average annual basis from 2009-2014 that are twice as great as the estimates in the Frontier model?[155]

A. Yes, I can. First, the "Wall Street" case relied upon by Mr. Barber projects annual revenue contraction of 2.8% versus Frontier's estimate of a contraction of 1.1% to 1.3% for legacy operations and 2.5% for the VSTO operations. The estimates for legacy

[152] Frontier Exhibit 2.10, Frontier Proxy, p. 146.

[153] Frontier Exhibit 2.4, Morgan Stanley August Report.

[154] Barber Confidential, p. 33, lines 9-11.

[155] Barber Confidential, p. 42, lines 3-9.

Frontier are not meaningfully different in Frontier's cases and the Wall Street case, and obviously Frontier management has more and better information regarding the specific prospects for the business on which to base its model assumptions. In addition, Frontier expects to provide additional broadband services in the VSTO properties, with the result that there is the opportunity for some growth in broadband revenues and some slowing of line loss. In short, the difference in the various revenue projection assumptions for the existing Frontier operations does not have a material impact on the financial health of the combined company and Frontier management is basing its estimates on more complete information than is available to external financial analysts.

Q. Have you had a chance to review Mr. Barber's four "sensitivity analyses" which purportedly "test" the Frontier model?

A. Yes, I have. Frontier's model is complex, and Mr. Barber's simplified sensitivity analyses cannot be readily "plugged in" to the model. First, Verizon has certain allocated costs, including software, that will disappear immediately as expense items. Second, Frontier believes that the company is capable of managing its business flexibly to respond to market conditions, and will not wait five years if there are shortfalls as is suggested in Mr. Barber's HSC-4. Third, Mr. Barber's HSC-4 provides a "cumulative" analysis which looks worse in the table than it does on an annual basis, as cumulative amounts obviously are larger on an absolute basis. Finally, and more to the point, even if we accept Mr. Barber's Base Case with no synergies analysis as plausible (which it is not), Mr. Barber is not presenting a complete picture of Frontier's financial health in the unlikely event that no synergies are achieved (or some similar shortfall in operating results occurs). Accepting even this dire scenario, Frontier's financial profile as of 2014 still shows a financially sound company. The Base Case "no synergy" projections show that the 2014 dividend payout ratio would be 68.9% and improving. In fact, Windstream, a financially-sound larger ILEC, today has a current payout ratio in the low 60% range, which is close to the extreme outcome proposed by Mr. Barber. The "no synergy" 2014 leverage ratio would be 3.2 times, which is considered reasonable in the industry and is the same as Windstream's ratio as of June 30, 2009 and would still result in a financially stronger Frontier. In addition, in terms of operating results under this scenario, EBITDA and Net Income essentially are flat in the out years, free cash flow is increasing, and the company has invested more than $3.3 billion over the projection period. Importantly, even using Mr. Barber's extreme "no synergies" assumption, Frontier generates cumulative free cash flow after dividends (and significant capital investment) of more than $1.0 billion over the projection period. So, while Frontier is confident that it can achieve and exceed its Base Case modeling, even if no synergies are assumed, the company will be financially sound and fit to own and operate the VSTO properties.

Q. Is Mr. King correct that Frontier's dividend is overly generous?[156]

A. No. Mr. King seems to be confused about the financial markets' requirement of a competitive return on capital and how that return typically is achieved by companies in the ILEC industry. In general, market-based return expectations are realized through capital appreciation (i.e., increases in share price) based on some measure of operational / financial growth, combined with direct return of capital to shareholders (i.e., through dividend payments and share repurchases). Because the local telecommunications industry is experiencing no or, at best, minimal growth currently, companies that seek capital in the public equity markets generally must meet a meaningful portion of market-based return expectations by paying competitive levels of dividends. As such, companies such as Frontier evaluate their available cash flows, capital needs, and debt service requirements, and set their dividend payout ratio (which is dividends as a percentage of free cash flow, not as a percentage of net income because, as I explain in more detail below, net income is not the appropriate measure for evaluating the payment of dividends) to provide a competitive dividend level while also funding the business and providing some discretionary cash flow "cushion." After evaluating these criteria, Frontier's Board of Directors and management have planned a dividend payout policy for the pro forma combined company (based on an annual dividend of $0.75 per share, down from the $1.00 per share paid to Frontier shareholders pre-transaction) that, in their opinion, will attract sufficient capital to fund (to the extent necessary) investment, operations, and service of other capital. In fact, Frontier's post-transaction proposed dividend payout ratio of 43% including expected cost savings (52% before these savings are achieved) is lower than that of most of other major local telecommunications carriers,

[156] King Direct, p. 10.

including Windstream, Consolidated Communications, and Iowa Telecom, and is even slightly lower than the expected pro forma payout ratio of around 50% for the newly formed CenturyLink (the recently completed combination of CenturyTel and Embarq). The market data regarding typical dividend payouts in the ILEC industry, therefore, are in contrast with Mr. King's assertions of excessive dividend payments by Frontier.

Additionally, the Frontier dividend "yield," which Mr. King reports as a "very high dividend yield"[157] is actually set by the financial markets (not by the company as with the dividend payout ratio) as the stock price rises or falls.[158] Mr. King notes that, based on Frontier's post-transaction dividend level of $0.75 and a share price of $7.42, the company's dividend yield would be "about 10 percent."[159] As is generally understood, the stock market has been under significant pressure, which has depressed prices across the entire marketplace and therefore has driven all dividend yields to relatively higher levels. So, it is important to consider Frontier's dividend yield in reference to the yields of other comparable companies in today's equity markets. A summary review of these relevant data would have revealed to Mr. King that a post-transaction yield of 10% for Frontier is in line with the yield of comparable companies such as Windstream, below the yields of Consolidated Communications and Iowa Telecom, and only slightly higher than the CenturyLink dividend yield.[160] So, the market-based data indicate that Frontier's dividend yield is consistent with comparable companies in its industry. Mr. King is incorrect that the pro forma company will pay dividends that are producing overly generous yields.

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[157] King Direct, p. 11, lines 1-2.

[158] The dividend yield is calculated by dividing the annual dividend per share by the per share price of a company's stock. Therefore, a company sets its per share dividend level, which then is a fixed numerator, while the market sets the per share price denominator which varies from day-to-day. As the per share price rises (denominator increases), the dividend yield falls, and as the share price falls, the yield rises.

[159] King Direct, p. 10, lines 266-268.

[160] For example, at the market close on Tuesday, November 10, 2009, the dividend yield of Windstream (WIN) was 9.9%, Iowa Telecom (IWA) was 13.7%, Consolidated Communications (CNSL) was 11.0%, and CenturyLink (CTL) was 8.0%

Q. Please respond to Mr. King's suggestion that Frontier should not issue dividends in excess of its net income.[161]

A. Mr. King is focusing on net income but the appropriate analysis should evaluate dividend payments in relation to free cash flow. Book net income can contain numerous non-cash entries, like depreciation, amortization, pension expense and income taxes, that make this line item a less than accurate indicator of the actual cash generated by the business. In addition booked net income excludes capital expenditures, a major utilization of cash in the ILEC business. There are better metrics to assess the ability of the business to fund, among other things, capital investment and dividends. Contrary to Mr. King's testimony, Frontier's current financial health is very sound as illustrated in Table 4 in which I demonstrate that Frontier's free cash flow generation is in excess of its dividend payments and capital expenditures. To be specific, over the period in the table, Frontier's operations have generated Free Cash Flows that ranged from $493 million to $562 million per year (these cash flows do not include funds from financing activities that were discussed above). It is important to understand that these are cash flows after network investments which, as I noted in my direct testimony, have been sufficient to allow Frontier to provide broadband service availability to over 90% of the households in its very rural national service territory.[162] Over the same period, Free Cash Flow after Dividends has ranged from approximately $190 million to $238 million, resulting in cumulative cash flow generation after dividends of almost $800 million. As a result, Frontier's dividend payout ratio (dividends paid as a percentage of Free Cash Flow) has consistently remained in the 60% to 65% range. So, when viewed properly in relation to Free Cash Flow, not in relation to book net income as Mr. King proposes, it is clear that Frontier has pursued a sustainable and conservative dividend policy relative to the industry in which it operates. Again, an objective review of the data demonstrates that Frontier is currently financially healthy and is expected to be stronger still because of this combination.

[161] King Direct, p. 11, lines 272-281

[162] McCarthy Direct, p. 12.

Table 4: Frontier Free Cash Flow Summary

($s in 000s)	2005	2006	2007	2008	4-yr. Total
FCF Generation					
Free Cash Flow	$ 527,971	$ 561,784	$ 528,005	$ 493,197	$ 2,110,957
Dividends Paid	338,364	323,671	336,025	318,437	1,316,497
Payout Ratio	***64%***	***58%***	***64%***	***65%***	***62%***
Free Cash Flow after Dividends	**$ 189,607**	**$ 238,113**	**$ 191,980**	**$ 174,760**	**$ 794,460**

Sources: Frontier 10-Ks 2006-2008.

Q. How do you respond to Mr. King when he asserts that the dividend policy must be changed or Frontier will be unable to raise further capital?[163]

A. Mr. King is entirely wrong and, his proposal would create precisely the opposite effect he advocates as his suggestion would raise rather than lower financial risk. Companies must rely on competitively-priced equity (based on total return expectations) to achieve an appropriate capital structure that balances debt and equity. If Frontier's equity value falters because the company is offering insufficient returns, the company will also lose some or all of its ability to access the debt markets, and both debt and equity financing will become more expensive. Mr. King's suggestion that Frontier should undercut its competitive returns on equity by reducing its dividend, which the company can maintain on a conservative basis as demonstrated above, would damage the balance within the capital structure, and, in fact, could put at risk the operations which serve customers.

Q. Have you reviewed the Direct Testimony filed by Mark Shmikler on behalf of the Illinois Public Telecommunications Association ("IPTA")?[164]

A. Yes. I understand that the IPTA represents Illinois pay telephone providers. The IPTA expresses concern because Verizon's obligations to pay telephone providers under applicable ICC rulemakings are different than Frontier's. In order to allay IPTA's concerns, Frontier will meet Verizon North and Verizon South's current obligations under applicable Commission rules for payphones in the current Verizon exchanges.

[163] King Direct, p. 11, lines 283-288.

[164] Direct Testimony of Mark Shmikler on Behalf of the Illinois Public Telecommunications Association, October 20, 2009.

IV. NO CONDITIONS OTHER THAN THOSE UNDER DISCUSSION WITH STAFF, ARE NECESSARY.

Q. Should the proposed transaction be subject to conditions, as suggested by several of the intervening party witnesses?

A. No, as I discussed in response to Staff above, no conditions are necessary in this transaction, as this combination will result in multiple public benefits to Illinois customers, including new investment in network and operations with no harms. In addition, the financial profile of the post-merger company will be stronger as a result of higher revenues and better customer relationships that result from the company's planned investment. Importantly, the pending Frontier transaction is very similar to the merger of CenturyTel and Embarq, which the Commission recently approved without imposition of onerous conditions that might otherwise have diminished the long-term benefits of the transaction for Illinois customers. The conditions proposed by Staff, subject to the changes suggested by Frontier, address any residual concerns. Like the CenturyTel transaction, this combination makes the combined company stronger operationally and financially than it was prior to the transaction, with the result that no additional conditions are appropriate.

Q. Do the comparisons of the proposed transaction to other transactions provide support for additional conditions, as suggested by several of the intervening party witnesses?

A. No. As Frontier has noted in previous testimony, the proposed transaction is different in clear and fundamental ways from the combination of FairPoint and Verizon northern New England or from the acquisition by Carlyle of control of the Verizon Hawaii properties. Intervenors continue to suggest superficial similarities between this transaction and former Verizon divestitures in spite of clear evidence of the substantive differences, and in spite of a clear record that the nature of the problems in those transactions can be distinguished from the characteristics of this transaction in terms of the financials, systems, and business experience.[165] Frontier was aware of and structured the transaction with Verizon to avoid these difficulties. There is no reasonable basis or

[165] *See*, for example, Barber Confidential, pp. 53-54; Baldwin Confidential, pp. 16-17; Selwyn Direct at 19-25.

need to impose conditions or requirements on Frontier as a result of the deficiencies or problems experienced by FairPoint or other carriers.

Q. What about the various proposed conditions that would require Frontier and Verizon to renegotiate the Merger Agreement?

A. Frontier objects to these types of conditions on the grounds that the risks in this transaction are not material, are highly speculative, and cannot be compared with the risks that arose in certain other telecommunications transactions that eventually failed due to newly developed insufficient back office systems. As I have discussed in detail, earlier in my Rebuttal Testimony, this transaction is most comparable in size and in financial ratios to the Century-Embarq transaction which this Commission approved without conditions. Frontier finds proposals for such conditions by interveners to be intrusive, unprecedented and unacceptable. In addition, as I explained above, the Frontier shareholders overwhelmingly approved this transaction with Verizon on October 27th, and three states, South Carolina, Nevada and California, have already issued orders approving this transaction. Requiring a renegotiation of the Merger Agreement, even if somehow feasible (which I do not believe to be the case), would not be in the public interest.

Q. Can you comment on other proposals concerning the OSS, including that the Commission should require a third-party audit of the systems integration process?[166]

A. Yes. The proposals for a third party to monitor and test the replication of systems are unnecessary and would only add to the cost of the transaction and result in unnecessary delays. First, as I have previously explained, Frontier has a highly successful track record of acquiring, operating, and investing in telecommunications properties nationally, including over 750,000 access lines purchased from Verizon/GTE, its acquisition of Commonwealth in 2007, which involved some 450,000 access lines, and its cutover of approximately 400,000 lines from Rochester Telephone. Frontier was able to successfully

[166] Baldwin Confidential, p. 103, line 13 through p. 104, line 2.

complete these conversions and none of these transactions involved a third-party monitor for systems replication and transition issues.

The audit in the case of FairPoint was directly in response to the required development of new and unproven systems. New operational support systems were created from scratch and put into operation for the very first time following the cutover to the new systems. Here, however, the Verizon operational support systems to be replicated and transferred to Frontier are not new systems. They are systems with the same features and functionality that are in place today and that have been in place for years. The replicated systems will include all operational support systems and applications that are used by Verizon in Illinois today to provide service. The transition will be entirely transparent for customers. The facts in this case are similar to those in all of the other Citizens/Frontier acquisitions or the CenturyTel acquisitions or the Alltel/Windstream acquisitions, in which a tested acquirer integrated ILEC properties using personnel and systems that were already proven.

In addition, as explained above, the operational support systems that will be transferred to Frontier at closing, will be the systems that Verizon utilizes to provide service at least 60 days prior to closing. Any type of third-party verification would undoubtedly be far less useful and reliable than 60 days of live operation in assuring the successful operation of the customer service systems that will be transferred to Frontier. Frontier has a significant business interest in ensuring that the Verizon operational support systems are correctly replicated. Frontier will undertake a detailed review and ongoing efforts to ensure that the replicated wholesale systems are working properly. Frontier will not proceed with closing of the proposed transaction unless and until the operational support systems are fully functioning and operational.

Q. What is your response to proposed conditions with respect to the combined company's debt?[167]

A. Frontier objects to the conditions proposed by Mr. Barber concerning Frontier's debt. In particular, Mr. Barber proposes a cumbersome and risky condition that Frontier should be

[167] Barber Confidential, p. 59, line 31 through p. 60 line 18.

required to seek separate and additional approvals if the interest rate at which the company is awarded debt rises above 8.5%. This sort of arrangement could create a self-fulfilling and circular risk based on the fact that, until the final terms of regulatory approvals are certain, the company will not be able to achieve optimal financing terms. The existence of such a condition could make it more likely that the threshold in the condition will be violated. The imposition of conditions that likely increase capital costs would not be in the public interest. Mr. Barber also seeks to limit the parent company's ability to pledge assets or gain access to cash flows that possibly might be needed to attract favorable borrowing rates. These sorts of conditions limiting the company's flexibility in negotiating with capital sources will restrict Frontier's ability to obtain funds at the most competitive rates, and the result of such conditions is harmful to customers in Illinois or other states. Frontier, therefore, objects to any proposed conditions that limit the company's ability to attract and obtain capital at the lowest possible rates and on the most favorable terms.

Q. What is your response to the suggested broadband conditions?

A. Frontier is committed to expanding the availability of broadband services to better serve the company's customers and to remain competitive. We have said, since the day this transaction was announced, that the opportunity for increased broadband deployment is a key benefit of this transaction for customers and for Frontier. However, such a build out should be prudent, rational and well conceived. Frontier is proud of the network it has built, and the broadband availability and penetration in its service areas, including in primarily rural high-cost areas. This growth in broadband has been accomplished without state or federal commission oversight and we expect to continue improving these services and their availability because the improvement is in the best interest of our customers, our business, and our financial stakeholders. In spite of Frontier's broadband record and clear statements to commissions and investors regarding expansion of these services, the proposed conditions look to set a pace and targets for both availability percentage and speeds. The commitment of Frontier, its track record on broadband and the likelihood that it will dedicate increased levels of capital to broadband deployment based on business and strategic imperatives should suffice to meet the standard that the public interest is served. Unrealistic broadband deployment commitments, both in terms of coverage and speed, are likely to be cost prohibitive and could force investment in services that are unable to effectively generate any return.

Q. Does this conclude your rebuttal testimony?

A. Yes, it does.