STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

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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 Section 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</td><td>)
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JOINT APPLICANTS' BRIEF ON EXCEPTIONS

Dated: March 19, 2010

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INTRODUCTION

The Proposed Order must be rejected. *First*, it is an "outlier" – it is contrary to the conclusions reached by the Staff of the Illinois Commerce Commission ("Commission Staff"), the Attorney General ("AG"), the Citizens Utility Board ("CUB"), and every party in this docket except the International Brotherhood of Electrical Workers ("IBEW"), as well as the findings of the six other state utility commissions that have unanimously approved this Transaction. *Second*, it ignores the significant public benefits the Transaction will bring to Illinois, including a specific, enforceable commitment by Frontier to deploy broadband to 85% of the households passed in its newly acquired service area – *an increase of more than 100,000 unserved and underserved households in the affected service territories* – and to expend $40 million to expand broadband services in Illinois, as well as a strong and locally focused business with innovative service offerings that will benefit consumers. And the record is absolutely clear that consumers in Illinois will *not* receive these benefits if the Transaction is denied. *Third*, the Proposed Order misapplies the law, is contrary to the record, and rejects with virtually no analysis the numerous significant conditions to which Joint Applicants have agreed with every other party to this proceeding except IBEW. In rejecting the types of conditions that this Commission has imposed and relied upon in similar transactions, the Proposed Order is inconsistent with numerous prior Commission orders. Accordingly, Joint Applicants respectfully request that the Commission reject the Proposed Order, find that the Transaction satisfies Section 7-204(b) of the Act, and approve the Joint Application.

1. The Proposed Order is an Outlier.

The Staff, the AG, CUB, the United States Department of Defense and Federal Executive Agencies ("DoD-FEA"), Level 3 Communications, Inc. ("Level 3"), Comcast Phone of Illinois

("Comcast"), and the Illinois Public Telecommunications Association ("IPTA") all agree that the Transaction, in light of the comprehensive conditions to which Joint Applicants consented, fully satisfies Section 7-204(b). The IBEW alone opposes this merger. As the Commission knows, three of these parties – Staff, AG, and CUB – statutorily represent the public interest in Illinois. These parties have for many years demonstrated their dedication to vigorously defending the interests of the public and have significant experience and expertise in evaluating transactions of the type at issue here. Indeed, Joint Applicants are unaware of any proceeding where the Commission has rejected a unanimous recommendation by that triumvirate. As Staff succinctly explained in its brief, "the very agencies charged with vindicating the public interest have determined that it is best served by approval of the transaction."[1] The other four parties – DoD-FEA, Level 3, Comcast and IPTA – are significant, sophisticated competitors and retail and wholesale customers who intervened to protect their interests and who also have concluded that the Transaction, subject to the negotiated conditions, should be approved. By rejecting the proposed transaction even with the conditions, the Proposed Order concludes that these sophisticated and experienced parties fail to appreciate (and are incapable of resolving) their own concerns.

The Proposed Order also ignores the conclusions of the six commissions in other states (Arizona, California, Nevada, South Carolina, Ohio and Oregon) that have issued approval orders on the same Transaction. Virtually all of the concerns raised in the Proposed Order were raised in these states, and in each case, the state commission found that the Transaction was in the public interest and unanimously approved it, often with conditions similar to those to which Joint Applicants have agreed here.

[1] Staff Reply Brief at 10-11.

2. The Proposed Order Ignores the Transaction's Significant Public Benefits.

The record is crystal clear that the Transaction will result in tangible, significant benefits for Illinois consumers, especially those in rural areas. First, Frontier has made an enforceable commitment to deploy broadband to 85% of the households in the affected service areas, which are predominately rural, and to expend $40 million on broadband services in Illinois. (Staff Commitment 6.)[2] This is a 25% increase in the current broadband availability, which equates to more than 100,000 additional unserved and underserved households, and is significantly more than what is required under Illinois law.[3]

And Frontier has a proven track record in deploying broadband to more rural and less dense areas: it is undisputed that Frontier's current broadband deployment rate of over 90% across its more than two million lines nationwide is *30% higher* than Verizon's deployment in the territories to be transferred based on total households passed. Frontier has made broadband available to 87% of the households in its existing Illinois service territory. Frontier has deployed broadband in over 99% of its central offices and switches across its 24 states and Frontier has deployed broadband in every one of its 138 central offices and switches in Illinois. Thus, Frontier is ready, willing, and able to significantly increase broadband deployment in Illinois. In contrast, Verizon has made the decision to exit the local wireline business in this and certain other areas in order to focus on other aspects of its business (such as wireless and global

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[2] Frontier Corrected Exhibit 8.4. A complete list of all commitments is attached as an Exhibit to this Brief.

[3] As discussed later, Section 13-517 of the Act requires certain telecommunications carriers "to offer or provide advanced telecommunications services to not less than 80% of its *customers*" (emphasis added). Frontier, however, has committed to deploy wireline broadband services to eight-five percent (85%) of the *households passed* in the territory it is acquiring. Because of competition, the households passed in the affected areas far exceed the number of customers – so Frontier' 85% commitment far exceeds Verizon's current wireline-only deployment rate to households of approximately 60%. Moreover, Frontier will not rely on wireless technology in deploying broadband – it will deploy wireline DSL service. McCarthy Rebuttal Testimony at 56.

enterprise), and has made clear that it would *not* deploy broadband in Illinois beyond its current levels even if that were not the case. Other state commissions that have ruled on the Transaction have found that similar broadband commitments will result in tangible public benefits.

Second, Frontier is a strong and capable company with both the financial capacity and operational expertise to deliver on its commitments, and brings a laser focus to serving the local market. It is the sixth largest ILEC in the country and has a strong record of successfully operating more than 2 million lines in 24 states, including 97,000 here in Illinois for the past 10 years during which its financial fitness has never been questioned. In 2008, Frontier's revenue was $2.2 billion and its net income was $182.7 million, and as one of the financially strongest ILECs, Frontier has consistently been able to raise the needed capital to invest in these operations, as evidenced by the fact that it has deployed broadband to more than 90% of the households in its existing service territories across the country and 87% of the households in its Illinois service territory. It also has significant experience in successfully acquiring and integrating local exchange companies, including 750,000 access lines from GTE and 1.1 million access lines from Global Crossing – an acquisition that almost doubled Frontier's size and that this Commission approved. Frontier also employs a proven "local decision-making" structure, which empowers Illinois-based management to meet the specific needs of their communities and to develop innovative strategies to help customers cross the digital divide – such as Frontier's promotional program, which has provided 85,000 computers to households in order to further expand broadband, promote adoption and benefit consumers.[4]

[4] *See, e.g.*, McCarthy Direct at 13-15. Frontier's programs for ensuring customers can effectively use the broadband products it offers include its "full install" program under which a Frontier technician goes to the customer's location and performs a full installation, making sure that the computer is properly set up and that the customer understands how to use the functionality. *Id.* at 14.

Third, Frontier has committed to cap all of the regulated noncompetitive retail rates (e.g., basic service rates) for the acquired service areas for three years from the date of closing of the Transaction, and after three years Frontier must present a rate case in order to increase any such rates. (Staff Commitment 7.) Thus, consumers will continue to receive quality service at the rates they enjoy today while at the same time reaping the benefit of additional broadband choices. Also, Frontier has agreed to cap certain business and wholesale service rates (e.g., DoD/FEA Condition 1), and, as discussed below, it has agreed to several commitments to ensure it provides service at or above Verizon's current levels.

The Proposed Order simply ignores these and other important public benefits that have been guaranteed by the numerous conditions – benefits that Illinois will not realize if the Transaction is denied.

3. The Proposed Order Misapplies the Law, is Contrary to the Record, and Ignores the Numerous Conditions this Commission has Imposed and Relied Upon in Similar Transactions.

The Commission must correct the Proposed Order's conclusions that three of the conditions in § 7-204(b) are not satisfied. (Attached to this brief is an appendix that includes the necessary modifications to the Proposed Order.) The Proposed Order's conclusions are, in each case, based on misapplication of the relevant legal standard and ignore the record.

First, the Proposed Order's conclusion that the Transaction fails to satisfy Section 7-204(b)(1) because it will diminish the service quality currently provided by Verizon North and Verizon South[5] is untethered to any analysis or evidence. The Proposed Order relies extensively on the direct testimony of a Staff witness regarding certain isolated issues in Frontier's levels of service for the period up through June 30, 2009, but it ignores subsequent

[5] At the close of the Transaction, Verizon South will become "New Communications of the Carolinas."

rebuttal testimony that reviewed more current service quality data and demonstrated significant improvement. Indeed, this undisputed evidence shows that for the twelve-month period ending September 2009, Frontier's performance was essentially on par with Verizon's performance, and in some measures it was *better* than Verizon's performance.

The Proposed Order also ignores the significant conditions Staff proposed and Frontier accepted that specifically address service quality – conditions this Commission adopted in similar transactions. For example, Staff Condition 1 imposes a severe penalty and restriction on cash distributions and dividends if either Verizon North or Verizon South fails to maintain service at the quality currently provided by Verizon (and in some cases at a quality better than currently provided by Verizon), and Staff Condition 2 requires Frontier to maintain at least $50 million for capital expenditures for the acquired operations and to certify annually to the Commission that the required amount is available for such operations. As Staff noted, this reserve will ensure that the affected utilities will have access to the capital needed to maintain and invest in the network as needed to keep up service quality levels.[6]

Moreover, the Proposed Order does not even attempt to explain how past, isolated issues with the Frontier operating companies would impair the acquired Verizon utilities' ability to provide adequate service. Under the Transaction, Frontier will assume control of the same two Illinois operating companies that Verizon owns today, and those companies will continue to be operated separately from the existing Frontier utilities, using the same systems and employees that will transfer to Frontier. Indeed, the parties' Merger Agreement requires Verizon to create replicas of the operational support systems it uses for its own operations and then to *actually use those replicated systems to operate Verizon North and Verizon South* for at least sixty days prior

[6] Staff witness McClerren Initial Testimony at 42-43.

to the closing of the Transaction. Frontier negotiated that provision (which Verizon has already spent hundreds of millions of dollars to implement) precisely to avoid the types of service problems experienced by other acquirers in past transactions. And as explained below, an independent third party recently certified that the pre-production testing of the systems was 100% successful, and that same third party will verify the actual operational results during the period that the replicated systems will be in use prior to closing. In addition, as part of the Transaction, the Verizon employees that are providing service in Illinois will transfer to Frontier and will continue to provide service in Illinois after the transaction closes. The fact that the lines being acquired by Frontier will continue to operate using the same systems and employees eliminates the risk that the quality of service will deteriorate. Here, too, every other state commission that has examined the Transaction has concluded that service quality will be unaffected.

Second, the Proposed Order's conclusion that the Transaction fails to satisfy section 7-204(b)(4) is based on a misreading of the statute. That section requires the Commission to find that "the proposed reorganization will not significantly impair the *utility's* ability to raise necessary capital on reasonable terms or to maintain a reasonable capital structure." 7-204(b)(4) (emphasis added). Here, that means evaluating the effect of the Transaction on the ability of Verizon North and Verizon South to raise capital, *not their parent company*. That distinction is critical because, as the Proposed Order itself observes (but then ignores), the unequivocal evidence establishes that the operations of Verizon North and Verizon South themselves "currently generate more cash than they require for capital expenditures."[7] In other words, the operations of Verizon South and Verizon North themselves provide more than the "necessary

[7] Proposed Order at 22.

capital" the utilities require *without resort to any capital from their parent company*. As a result, a change in parent company will have no effect on – and certainly will not "significantly impair" – the *utilities'* ability to raise necessary capital on reasonable terms or to maintain a reasonable capital structure.

The Proposed Order compounds its error by rejecting out of hand the Staff conditions that were designed to remedy any such concern and that have been adopted by this Commission in numerous prior orders. Those conditions (Staff Conditions 1 and 2) prevent Frontier from allowing service to degrade as a means of diverting cash from its Illinois operating companies. As Staff explained, these conditions "provide insurance that the Illinois utilities will have access to "necessary capital on reasonable terms even if, for unforeseen reasons, [they] require externally raised capital."[8] The Proposed Order contains nothing more than a conclusory assertion that these conditions are "inadequate"; it offers no explanation for this claim or why it wholly ignores the contrary conclusion reached by Staff, as well as the AG and CUB, after months of extended discovery and study.

In any case, the Proposed Order's conclusions concerning Frontier's own ability to raise capital on reasonable terms are permeated with errors and ignore the undisputed evidence. For example, the evidence shows that in September last year Frontier obtained capital on very reasonable terms when it arranged new debt financing to raise net proceeds of $577.6 million. The Proposed Order makes no mention of this fact, let alone explain how its speculative conclusion could be consistent with it. Also, numerous independent credit rating agencies and analysts with extensive financial expertise, including Moody's Investors Service, Fitch Ratings, and Morgan Stanley, have commented favorably on Frontier's post-Transaction financial

[8] Staff Reply Brief at 7.

metrics, which, again, the Proposed Order ignores. Even more remarkably, the Proposed Order baldly states that Frontier will not be financially stable after the Transaction closes because it "would be burdened with an enormous amount of approximately $3.3 billion in debt."[9] But a firm's absolute level of debt, by itself, is not indicative of its financial stability, any more than it is for an individual. The question is how that debt compares to cash flow and the resulting ability to service that debt. The Proposed Order ignores the evidence that Frontier's new debt will be more than offset by substantial incremental revenues and the cash flows of the properties it is acquiring. In fact, it is undisputed that the Transaction will be deleveraging for Frontier, meaning that its debt will *decrease* as a percentage of cash flows. The Proposed Order's failure to address this and other clear evidence on the record concerning the effect of the Transaction on Frontier's finances renders its conclusion arbitrary.

Third, the Proposed Order commits plain legal error in concluding that Verizon South's alleged non-compliance with the advanced services statute, § 13-517, provides a basis to find that Section 7-204(b)(5) is not satisfied. Section 7-204(b)(5) requires only a finding that the transferred utility will "remain subject" to all applicable laws. No one disputes that the Illinois utilities will remain subject to applicable laws, including the advanced services statute, following the Transaction. Whether or not Verizon South currently complies with that statute is not pertinent to the statutory standard.

In any case, there is no dispute that Verizon's overall operations in the state do satisfy § 13-517. All parties, including Staff, agree that on a *combined* Verizon North and South basis, Verizon already offers broadband to more than the required percentage of its local customers. Staff, however, takes the position that even though Verizon's total footprint in Illinois exceeds

[9] Proposed Order at 32.

the statutory standard, Verizon South should be analyzed in isolation because it is a separate corporate entity. In either event, Frontier has committed to ensure Verizon South is in compliance even on a stand alone basis, and, as noted, Frontier has made an *additional* commitment to increase broadband deployment significantly beyond what Illinois law requires. Given these commitments, the compliance issue is moot.

Ultimately, the Proposed Order appears to turn on the perception that Verizon, as a bigger parent company than Frontier, would present less risk. But that is not the standard set by the statute. By incorrectly converting this change of control proceeding into an exercise in picking the "biggest" parent, the framework adopted by the Proposed Order effectively precludes *any* transfer of control from a large, diversified company like Verizon to an experienced and financially fit company like Frontier. Frontier, the sixth largest wireline company in the country, has a strong record of successfully providing service in precisely the types of service territories it will be acquiring in Illinois, and its financial metrics are stronger than most of its peers. Finding that Frontier is not worthy to assume control of the Illinois ILECs would be a misapplication of Section 7-204(b).

In sum, the Proposed Order's rejection of the Transaction is based on a plethora of legal and factual errors and cannot withstand scrutiny. That is only confirmed by the fact that the Proposed Order's conclusions stand in stark contrast to those of the Staff, CUB, and AG, and the six other state commissions that have reviewed and approved this Transaction. Pursuant to 83 Ill. Adm. Code 200.830(b), Joint Applicants have attached to this brief an appendix that includes the necessary exceptions language to modify the Proposed Order consistent with the positions set forth in this Brief.[10] The Commission should therefore correct the Proposed Order and approve the Joint Application.

DISCUSSION

I. The Proposed Order Ignores the Public Interest Analysis of Staff, AG and CUB, and is Contrary to Every Other State Decision.

A. The Proposed Order is Directly Contrary to the Conclusions of *Every Party* that Intervened in this Proceeding to Protect Illinois Customers.

By siding with the sole objector to the Transaction, the IBEW, the Proposed Order rejects the position of the parties whose mandate in this proceeding is to protect Illinois consumers. As Staff explained:

> IBEW's argument must be weighted against the fact that a number of parties to this proceeding have determined that, if properly conditioned, this reorganization is indeed lawful and *in the public interest*. These parties include the Commission Staff, whose duty it is to aid the Commission in carrying out the provisions of the Public Utilities Act (220 ILCS 5/2-105(b)), the AG, the State's chief legal officer (15 ILCS 205/4), who has a statutory right to participate in Commission proceedings (15 ILCS 205/6.5); CUB, which was created to represent ratepayer interests before the Commission (220 ILCS 10/2), and the DoD, which represents the interests of the federal government, not incidentally a very substantial user of telecommunications services within the state. DoD Ex. 1 at 2. *The consensus, in other words, that all public and public-interest groups have reached here is that the Commission should approve the transaction, albeit conditionally*. The IBEW is involved in this proceeding, and quite properly so, to protect the interests of IBEW members employed by Verizon. *However,* the very agencies charged with vindicating the public interest have

[10] Joint Applicants' exceptions language addresses the specific errors identified in this Brief. However, because the current Proposed Order recommends denial of the transaction, the Proposed Order fails to incorporate Staff and Intervenor conditions related to Section 7-204 criteria where the Proposed Order finds compliance and fails to include discussions of other approvals (e.g., 13-405 and 13-406) that are necessary components of the Commission's approval of the transaction. Therefore, Joint Applicants' exceptions language includes additional explanations of positions, Commission conclusion language and additional finding and ordering paragraphs based on language originally proposed by Staff (with regard to 7-204, 6-103 and 13-900) or by Joint Applicants with regard to the other statutory sections.

determined that it is best served by approval of the transaction, and IBEW's arguments should be ignored.[11]

It is arbitrary and capricious to summarily reject the findings of experienced parties who intervened to protect the public interest and who concluded that the Transaction (with the negotiated conditions) not only meets the statutory requirements for approval but is "in the public interest". The conditions those parties negotiated and to which Joint Applicants agreed are included in the record,[12] attached to this Brief as a Conditions Appendix, and have also been added as exceptions language to the Proposed Order. The supporting parties participated here in order to protect retail and wholesale consumers, competitors, and the interests of the State of Illinois. Each now has concluded there is no reason to reject the Transaction and that the conditions address the concerns raised in their testimony earlier in the case. Specifically:

- **Commission Staff** represents the public interest and participated actively in this proceeding. Staff proposed and Frontier agreed to seven conditions and three reporting requirements resolving the concerns Staff's six witnesses raised. Also, to ensure that the Transaction will *advance* the public interest, Staff secured a formal broadband commitment from Frontier to deploy broadband facilities to 85% of the households in the Verizon service territory at speeds well in excess of Illinois' statutory requirements. As noted above, Staff has told the Commission that "IBEW's arguments should be ignored."
- **AG** and **CUB** represent the interests of Illinois and of Illinois consumers. After robustly advocating their interests, they entered into a stipulation with Joint Applicants under which Frontier agreed to an additional 22 conditions to address AG's and CUB's concerns previously raised in this proceeding, and they do not oppose the Transaction.[13]
- **DOD/FEA** intervened because it is one of the largest customers in the state and wanted to ensure that it would not be adversely affected by service quality

[11] Staff Reply at 10-11 (emphasis added).

[12] The Comcast, Level 3 and IPTA settlements are admitted as Frontier Exhibits 8.1, 8.2 and 8.3. The conditions that Staff proposed and Frontier agreed to are included in Corrected Exhibit 8.4.A. Simultaneous with their Initial Brief (on February 9, 2010), Joint Applicants moved to re-open the record so that the Administrative Law Judge could admit the settlement agreements with the AG and CUB (Frontier Exhibit 13) and with DOD/FEA (Frontier Exhibit 12). The Administrative Law Judge re-opened the record by Order dated February 16, 2010 and Joint Applicants infer that those settlements have been admitted. To date, the record has not been re-marked "heard and taken."

[13] *See* Notice in Lieu of Initial Brief filed by AG and CUB on February 9, 2010.

problems or any other potential adverse effect of the Transaction.[14] After raising the very financial concerns on which the Proposed Order relies as a basis for rejecting the transaction, DoD/FEA negotiated a condition that supplements the conditions negotiated by Staff, AG/CUB and the other parties by requiring Verizon South and Verizon North to cap their rates for various services provided to business customers.[15] Based on that condition and the conditions negotiated by other parties, the DoD/FEA "supports the proposed transaction and *urges the Commission to approve the Joint Application in all respects*."[16]

- **Comcast** and **Level 3** are competitive local exchange carriers which compete with, and which also are customers of, Verizon South and Verizon North. They intervened to ensure that the Transaction would not result in service quality problems that would harm them or their customers. These CLECs are well-represented, sophisticated companies that diligently protect their interests and the interests of their customers.[17] Based on various commitments by Joint Applicants, including commitments that will permit Comcast to test Verizon's replicated operational support systems prior to their being put into production, these CLEC intervenors withdrew their opposition to the Transaction.[18]
- **IPTA** represents payphone service providers, operator service providers, manufacturers, and distributors. It intervened to address the post-Transaction applicability of a prior Commission order on Verizon South and Verizon North. IPTA withdrew its intervention after Frontier formally agreed that the acquired utilities would be subject to the provisions of the order.[19]

In sum, Staff and each of these parties participated in this docket and negotiated comprehensive conditions for the purpose of protecting and advancing the interests of Illinois consumers and promoting competition and each concluded that the proposed conditions address *every concern they had*. The Proposed Order dismissed both their conclusions and their conditions, largely without explanation.

In rejecting and/or failing to consider the conditions that the parties negotiated, the Proposed Order appeared to accept IBEW's claim that the Commission is powerless to enforce

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[14] *See* Verified Petition to Intervene DoD/FEA (filed Oct. 15, 2009).

[15] *See* Frontier Exhibit 12 (Settlement between Joint Applicants and DoD/FEA filed on February 8, 2010).

[16] See Notice of Settlement filed by DoD/FEA on February 10, 2010.

[17] *See* Tr. at 206-207.

[18] *See* Frontier Exhibits 8.1 (Settlement Agreement with Comcast) & 8.2 (Settlement Agreement with Level 3).

[19] *See* Frontier Exhibit 8.3 (Stipulation between Frontier and IPTA).

conditions it might impose or that the conditions were inadequate to address specific statutory criteria. As just one example, Staff explained at length why Staff Conditions 1 and 2 would help ensure a continued reasonable capital structure:

> Conditions similar to Staff's proposed conditions 1 and 2 in the instant case, which specifically address the 7-204(b)(4) criterion (Staff IB at 33-35), have been adopted by the Commission previously in other reorganizations involving telephone companies. *See* Orders, Docket No. 07-0191, FairPoint Communications, Inc. et al (6/27/07); Docket No. 07-0043, Madison River Telephone Company, LLC et al (3/21/07); Docket No. 06-0683, Madison River Communications Corp. et al (11/29/06); Docket No. 05-0013, Madison River Communications Corp. et al (2/24/05); Docket No. 04-0793, Illinois Consolidated Telephone Company et al (1/20/05); and Docket No. 04-0299, FairPoint Communications, Inc. et al (5/26/04). In the instant case, unlike similar conditions adopted in prior reorganizations, there is no expiration date for the automatic reinstatement of those conditions whenever Frontier's credit rating falls below its current rating. This safeguard is designed to provide the Commission additional assurance that the proposed transaction does and will continue to satisfy the requirements of Section 7-204(b)(4) of the Act until the Commission expressly authorizes the expiration of Staff's proposed conditions 1 and 2.[20]

The Commission has specifically relied on similar conditions in past transactions to protect the public interest, and the Proposed Order's arbitrary dismissal and failure to consider of those conditions and the positions of the supporting parties constitute reversible error. The Commission should revise the Proposed Order to include and rely on these extensive public interest conditions and other conditions that the parties negotiated and which are reflected in the Conditions Appendix attached to this Brief, which are discussed in greater detail below.

[20] Staff Reply Brief at 10.

B. The Proposed Order is Directly Contrary to the Determinations of All Other State Commissions.

The Proposed Order both ignores and contradicts the findings of commissions in Arizona, California, Nevada, South Carolina, Ohio and Oregon. When presented with the same Transaction, each has issued orders approving the Transaction.[21] Virtually all of the factual issues addressed in the Proposed Order are ones that were raised in all of these states, such as Frontier's financial strength, its ability to obtain financing to close the Transaction, and the potential for problems with the operational support systems that Verizon will transfer to Frontier. While this Commission is not bound by precedent in other states, the fact that those other decisions engage the same facts and reach fundamentally different conclusions confirms that the Proposed Order is the outlier and that its findings and conclusions are arbitrary and unreasonable.

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[21] *See* Opinion and Order, *In the Matter of the Joint Application of Verizon California, Inc., Verizon Long Distance,LLC, Verizon Enterprise Solutions, LLC, Frontier Communications Corporation, New Communications of the Southwest Inc. and New Communications Online and Long Distance, Inc., for Approval of the transfer of Verizon's Local Exchange and Long Distance Business,* ACT Decision No. 71486 (February 23, 2010)("Arizona Order"); Decision, *Joint Application of Frontier Communications Corporation, New Communications Holdings, Inc., New Communications ILEC Holdings, Inc., New Communications of the Southwest Inc., Verizon West Coast Inc. (U1020C), Verizon California Inc. (U1002C), New Communications Online and Long Distance, Inc., Verizon Long Distance, LLC(U5732C), and Verizon Enterprise Solutions, LLC (U5658C) For Approval of the Sale of Assets, Transfer of Certificates and Customer Bases, and Issuance of Additional Certificates*, CPUC Docket 09-06-005, October 29, 2009)("California Order"); Opinion and Order, *In the Matter of the Joint Application of Frontier Communications Corporation, New Communications Holdings Inc., and Verizon Communications Inc. for Consent and Approval of a Change in Control,* PUCO Case No. 09-454-TP-ACO (February 11, 2010) ("Ohio Order"); Order, *Joint Application of Verizon California Inc., d/b/a Verizon Nevada ("Verizon"), Frontier Communications Corporation, and New Communications of the Southwest("New Communications") for approval of a transfer of control, the transfer of Certificate CPC2 Sub 10 from Verizon to New Communications, and the Designation of New Communications as an Eligible Telecommunications Carrier*, PUCN Docket No. 09-06005 (October 28, 2009)("Nevada Order"); Order, *Joint Application of Frontier Communications Corporation, New Communications of the Carolinas Inc., New Communications Online and Long Distance Inc., Verizon South Inc., Verizon Long Distance LLC and Verizon Enterprise Solutions LLC for Approval of the Transfer of Assets, Authority and Certificates*, SC Docket No. 2009-220-C (October 29, 2009)("South Carolina Order"); Order, *In the Matter of Verizon Communications Inc. and Frontier Communications Corporation Joint Application for an Order Declining to Assert Jurisdiction, or, in the Alternative, to Approve the Indirect Transfer of Control of Verizon Northwest Inc.*, Docket UN 1431 (February 24, 2010)("Oregon Order"). In five of the fourteen states where Verizon is transferring its ILECs to Frontier, no approvals are necessary given that the Transaction involves a holding company-level change of control that will not affect the operating companies that Frontier is acquiring. The IBEW has filed an application for rehearing of the Ohio Commission's Order which is currently pending. Commission orders remain pending in the remaining two states, Washington and West Virginia.

The stark differences between those commissions' conclusions and the Proposed Order's findings illustrate the depth of the Proposed Order's misunderstanding of the record. For example, in response to Frontier's commitment in Ohio to invest in and expand broadband (the same 85% deployment commitment Frontier makes here), the Ohio Commission stated:

> We are very pleased that Frontier North will undertake the commitment to provide broadband service to rural areas of Ohio. Without the widespread availability of broadband, Ohio cannot realize the business potential that lies dormant in its nonurban areas. Nor can rural students and teachers fairly compete with their urban counterparts. With this commitment to deploy broadband to unserved areas, we are hopeful that, ultimately, any location in Ohio will have the potential for business, learning, and communication.[22]

By contrast, the Proposed Order makes the unsupported assertion that:

> The record also does not support a finding that Frontier will be any more effective than Verizon in expanding the scope and quality of broadband services in the Illinois service areas it proposes to acquire from Verizon. To the contrary, the evidence shows that it is very unlikely that a smaller, less experienced operator would be able to support such an investment.[23]

The Proposed Order's summary rejection of Frontier's commitment not only stands in direct contrast to the Ohio Commission's praise for that same commitment, but also finds no support in the record. As discussed below, Frontier has an established track record of achieving broadband deployment levels *higher* than its commitment here in comparably rural service territories. Frontier has deployed broadband to every one of its 138 central offices and switches that serve more than one hundred communities throughout Illinois.[24] That record, coupled with conditions that among other things require Frontier to expend $40 million on broadband, deploy broadband to 85% of households, and set aside money for the express purpose of ensuring that the Illinois operating companies will have enough funds to meet their capital budgets,

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[22] Ohio Order at 28.

[23] Proposed Order at 15.

[24] McCarthy Direct testimony at 12.

demonstrate that Frontier's commitment will bring real and tangible benefits for Illinois consumers. That is certainly the conclusion of Staff and AG/CUB who obtained these commitments, and the Proposed Order offers no basis for reaching the opposite conclusion.

In all of these six states, like here, the commission staffs and the consumer advocates initially expressed concerns about the Transaction but then supported it in light of conditions to which the Joint Applicants agreed. All of the state commissions endorsed the unanimous recommendations of their staff and consumer advocates. For example, in Ohio, where all parties except the union also supported approval, the Commission stated:

> As with most mergers and changes in ownership, we find that the proposed transaction involves a level of risk. We do not find, however, that the risk level of this transaction is so great that it warrants rejection. For additional assurance, we have considered the financial aspects of this transaction and have received and scrutinized review of the Commission' own Staff and the [Ohio Consumers' Counsel]. For these reasons we conclude that the applicants have allayed the financial concerns initially raised by the application.[25]

The "risk level" here is the same as in Ohio and every other state that has approved this Transaction.[26] The difference is that the Proposed Order arbitrarily embraces the extreme rhetoric of a single party with a narrow parochial interest and ignores the mass of contrary evidence.

The fact that the Transaction will be structured similarly in all states also means that certain conditions negotiated by parties in one state will afford additional protection to others. Most of the extensive conditions negotiated by the supporting parties here in Illinois are similar

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[25] Opinion and Order, *In the Matter of the Joint Application of Frontier Communications Corporation, New Communications Holdings Inc., and Verizon Communications Inc. for Consent and Approval of a Change in Control*, PUCO Case No. 09-454-TP-ACO (February 11, 2010) at 27-28.

[26] The Proposed Order contains only one finding that is Illinois-specific – a suggestion that the service quality of Frontier's existing Illinois ILECs is below par. But, as discussed below, even if that were true (and it is not), it would have no bearing on the service quality offered by the separate acquired utilities.

to, or go farther than, the ones relied on by other commissions in approving the Transaction. However, the Ohio and Oregon commissions have imposed conditions that provide additional assurances with respect to the operational support systems Frontier will receive from Verizon. For example, under the Oregon approval order, Verizon is required to use a third party reviewer to validate the results of the functionality testing of the replicated operational support systems before they go into production:

> With respect to Retail Services, before going into production mode on the replicated systems, the Applicants commit to share the Program Test Strategy Plan and pre-production functionality tests with Staff and [consumer advocate] and show that various parameters have been validated by an independent third party. Before closing the transaction, Verizon will share production results of customer-affecting systems with Staff and [consumer advocate] and commit to meet certain benchmark data, also validated by an independent third party. Closing will not occur until all systems are certified to be working properly. [27]

The Ohio Commission likewise recognized that testing and other specific safeguards had been agreed to in a settlement with PUCO Staff and the Ohio Consumers' Counsel to alleviate concerns about the transition of Verizon North's OSS to Frontier, including the fact that an "independent third party will validate the results of the test" of the OSS transition.[28] Because Frontier will use the same operational support systems in Illinois as it does in Ohio and Oregon, Illinois will benefit from those states' additional conditions. Thus, for example, under their stipulation OAG/CUB will have access to production mode replicated test results from Oregon, Washington and Ohio. [29]

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[27] Order, *In the Matter of Verizon Communications Inc. and Frontier Communications Corporation Joint Application for an Order Declining to Assert Jurisdiction, or, in the Alternative, to Approve the Indirect Transfer of Control of Verizon Northwest Inc*., Docket UN 1431 (February 24, 2010) at 17.

[28] Ohio Order at 22.

[29] Frontier Exhibit 13 (Stipulation with AG/CUB).

II. The Proposed Order would Deny Guaranteed, Tangible Benefits to Illinois Customers.

There is no doubt that the Transaction, if approved, would provide clear, tangible benefits to Illinois consumers. As a threshold matter, Frontier specializes in, and is committed to, providing quality telecommunication services and advanced broadband services to rural and less densely populated communities exactly like those in Verizon's Illinois areas. In sharp contrast, Verizon's business interests lie elsewhere, i.e., in more urban territories, in wireless, and in global Internet-protocol services. As Staff's lead witness, Sam McClerren, testified: "If a company's management considers the rural operation to be both important to the company's long term business plan and potentially lucrative, it will likely expend both more effort and capital to properly support that area."[30]

Staff is exactly right. The undisputed evidence shows that Frontier has invested more than $1.1 billion in its operations and network over the past four years.[31] As a result, more than 90% of all households across Frontier's national footprint of more than 2 million lines have access to broadband.[32] *That deployment rate is fully 30% higher than Verizon's deployment rate in the territories subject to the Transaction*.[33] With this Transaction, Frontier will expand broadband to 85% of the households in the Verizon service territory which, as recognized by the Public Utilities Commission of Ohio, brings significant benefits to consumers and communities in the area. Thus, concrete, objective evidence supports Staff's conclusion (and the conclusions of every other party except IBEW) that Frontier will provide quality service while also significantly expanding broadband in Verizon North's and Verizon South's Illinois territories.

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[30] McClerren Initial Testimony at 16.

[31] *See* McCarthy Rebuttal at 63.

[32] *See, e.g.*, McCarthy Direct at 12; McCarthy Rebuttal at 11.

[33] *Id.*

Moreover, Frontier has been a leader in developing and implementing innovative promotions to help its customers, especially its rural customers, cross the digital divide. One is Frontier's computer promotion program, which has already provided 85,000 free computers to households subscribing to Frontier's broadband service.[34] Another is Frontier's "full install" program, which ensures customers can effectively use its broadband offerings by having a Frontier technician go to each customer's location to perform a full installation, to make sure the computer is properly set up, and to ensure the customer understands how to use the functionality.[35] Illinois consumers will receive tangible benefits from such innovative promotions and programs, as well as from Frontier's "local decision-making" structure – which will empower Illinois-based management to meet the specific needs of their communities.[36]

Importantly, Frontier has worked closely with Staff, the AG, CUB, and the other parties to develop a comprehensive list of tangible, *enforceable* commitments that ensure Illinois consumers will benefit from the Transaction. For example, under Staff Condition 6 and AG/CUB Conditions 6-7, Frontier has committed to deploy broadband to 85% of the households in the affected service areas, which are predominately rural, and to expend $40 million on broadband services in Illinois.[37] This is a *25% increase* in the current broadband availability in Verizon's service territory. This increased deployment equates to more than an additional

[34] *See, e.g.*, McCarthy Direct at 13-15.

[35] *Id.* at 14.

[36] *Id.* at 14-15; 22-23.

[37] All of the conditions to which Joint Applicants have agreed have been entered into the record as Frontier Exhibit 8.1 (setting forth conditions agreed to with Comcast), Frontier Exhibit 8.2 (setting forth conditions agreed to with Level 3), Frontier Exhibit 8.3 (setting forth conditions agreed to with IPTA), Frontier Corrected Exhibit 8.4.A, (setting forth conditions agreed to with Staff), Frontier Exhibit 12 (setting forth conditions agreed to with DoD/ FEA, and Frontier Exhibit 13 (setting forth conditions agreed to with AG/CUB). These conditions are reproduced as an appendix to this Brief.

100,000 unserved and underserved households.[38] In short, Frontier is ready, willing, and able to significantly increase broadband deployment in Illinois, whereas Verizon has made clear that it will *not* deploy broadband in Illinois beyond its current levels. Other state commissions that have ruled on the Transaction have found that similar broadband commitments will indeed result in tangible public benefits.

Moreover, Frontier has committed to cap *all* regulated noncompetitive retail rates (e.g., basic service rates) for the acquired service areas for three years from the date of closing of the Transaction, and after three years Frontier must present a rate case in order to increase any such rates. (Staff Commitment 7.) In this way, consumers will continue to receive quality service at the rates they enjoy today while at the same time reaping the benefit of additional broadband choices.

Frontier also has similarly agreed to cap numerous business and wholesale rates. For example, under the DoD/FEA Condition, Frontier will cap the rates for certain business services – Retail Flat and Measured Rate Business Services (1FB and 1MB), and PBX, Centrex, and interstate and intrastate special access services – for a period of three years after the Transaction closes. And under Staff Condition 5, Frontier has agreed to assume all obligations under Verizon's current interconnection agreements, interstate special access tariffs and intrastate tariffs, commercial agreements, line sharing agreements, and other existing arrangements with wholesale customers and to not terminate or change their rates, terms or conditions for certain periods of time. Also, Frontier will allow requesting carriers to extend existing interconnection agreements, whether or not the initial or current term has expired, until at least 30 months from

[38] Verizon North and Verizon South together have in place approximately 573,000 access lines in 413 exchanges in Illinois. Erhart Direct at 10. (Because of competition, Verizon today serves significantly fewer customers.) An increase in wireline broadband availability of 25% equates to well over 100,000 unserved and underserved households that would be capable of receiving wireline broadband services from Frontier.

the closing of the proposed transaction, or the date of expiration, whichever is later. Further, Frontier will not increase rates for certain other wholesale services – e.g., tandem transit service, any special access tariffed offerings or any intrastate wholesale tariffed offering – for at least 30 months from the closing of the Transaction.

These residential, business, and wholesale rate caps (and related conditions), like the rest of Frontier's commitments to Illinois, go far beyond what Verizon is required to do, and will constitute significant benefits to consumers and competitors. And there are many other commitments addressing enhanced reporting requirements, service quality, system changes, financing, and other issues that will further ensure the Transaction will benefit the public. The Proposed Order simply ignores these important public benefits that have been guaranteed by the numerous conditions – *benefits that Illinois will not realize if the Transaction is denied*.

III. The Proposed Order Misapplies § 7-204(b)

A. The Requirements of § 7-204(b)

Section 7-204(b) of the Act establishes seven criteria for the review and approval of the "reorganization" at issue in this proceeding. Notably, each criterion focuses on the effect of the transaction on the *utility* that is the subject of the proposed transaction, not its parent company. Specifically, this section provides that in approving any reorganization, the Commission must find that:

(1) the proposed reorganization will not diminish the utility's ability to provide adequate, reliable, efficient, safe and least-cost public utility service;

(2) the proposed reorganization will not result in the unjustified subsidization of non-utility activities by the utility or its customers;

(3) 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;

(4) the proposed reorganization will not significantly impair the utility's ability to raise necessary capital on reasonable terms or to maintain a reasonable capital structure;

(5) the utility will remain subject to all applicable laws, regulations, rules, decisions, and policies governing the regulation of Illinois public utilities;

(6) the proposed reorganization is not likely to have a significant adverse effect on competition in those markets over which the Commission has jurisdiction;

(7) the proposed reorganization is not likely to result in any adverse rate impacts on retail customers.

The Proposed Order concludes that the Transaction satisfies all these criteria except for subsections (b)(1), (b)(4), and (b)(5). As discussed in detail below, the Proposed Order misreads and misapplies these subsections, and therefore it must be revised to find compliance with these sections and to approve the Transaction.

B. The Acquired Utilities will be Able to Continue to Provide "Adequate, Reliable, Efficient, Safe, and Least Cost Service" under Frontier's Ownership, and Therefore §7-204(b)(1) is Satisfied.

Section 7-204(b)(1) requires a finding that the Transaction will not "diminish" the ability of the transferred utilities (Verizon North and Verizon South) to provide "adequate, reliable, efficient, safe, and least-cost utility service." The Proposed Order asserts that this requirement is not met because (i) a Staff witness testified that Frontier's Illinois ILECs had previously missed certain service quality metrics in the past; (ii) an AG/CUB witness initially raised concerns about the operational support systems Verizon North and Verizon South will use after close; and (iii) an IBEW witness speculated that Verizon North and Verizon South could experience service quality problems if Frontier fails to re-invest a sufficient amount of cash in their operations.[39]

[39] Proposed Order at 13-15. Notably, the Proposed Order incorrectly frames its analysis as whether "Frontier's ability" to provide telephone service will be affected (*see*, *e.g.*, *id.* at 13), not whether the ability of Verizon North or Verizon South will be affected. As discussed below, that misunderstanding of the statutory language is a contributing factor to its faulty service quality findings regarding Section 7-204(b)(1). Moreover, as discussed

The full record demonstrates that these concerns are unwarranted. Indeed, despite its extensive reliance on the initial testimony of Staff and AG/CUB and DoD/FEA about potential problems, the Proposed Order ignores their subsequent testimony and conclusions – including their conclusions that the over thirty conditions and requirements Frontier has agreed to meet fully address the very concerns that underlie the Proposed Order's finding and "resolve all issues in this proceeding."[40]

1. The Frontier Operating Companies' Alleged Service Quality Problems are Irrelevant to Whether the Transaction will Cause the Service Quality of Verizon North and Verizon South To Diminish.

The Proposed Order's application of Section 7-204(b)(1) relies extensively on the direct testimony of Staff witness Mr. McClerren regarding certain isolated issues in Frontier's levels of service for the period up through June 30, 2009.[41] It concludes that because of these past, isolated issues, the Transaction might adversely affect service quality.

There are at least three critical errors with this analysis. *First*, the Proposed Order does not even attempt to explain how those past issues with the Frontier operating companies would impair the acquired Verizon utilities' ability to provide adequate service. Under the Transaction, Frontier will assume control of the same two Illinois operating companies that Verizon owns today, and those companies will continue to be operated separately from the existing Frontier utilities, using their current assets and systems.[42] In addition, as part of the Transaction, the

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below, a similar mistake fatally infects its attempt to address the financial issues raised by IBEW under Section 7-204(b)(4).

[40] Frontier Exhibit 13, AG/CUB Stipulation at ¶ 1; Frontier Exhibit 12, DoD/FEA Settlement at ¶1; see also Hearing Transcript (01/20/2010) Staff witness McClerren at 575 (agreement that with imposition of Staff's Conditions 1 through 7 "Staff would not object to the approval of the proposed transaction.").

[41] McClerren Direct at 17-20.

[42] Control of Verizon North will be transferred to Frontier and the operating company will be renamed Frontier North Inc. The Illinois operations of Verizon South are a small portion of that operating company's total operations, the majority of which are not being transferred to Frontier. Accordingly, a newly formed Verizon affiliate named New Communications of the Carolinas Inc. will "step into the shoes" of Verizon South in Illinois, and at closing the

Verizon employees that are providing service in Illinois will transfer to Frontier and will continue to provide service in Illinois after the transaction closes.[43] Mr. McCarthy testified:

> [T]he core of Verizon employees who currently support Verizon's Illinois operations will continue to support those same ILEC operations under Frontier. In each case – Verizon North through the same corporate entity and Verizon South through a new corporate entity – virtually the same utility will have the same assets and personnel to ensure that the proposed reorganization will not diminish the utility's ability to provide adequate, reliable, efficient, safe and least cost public utility service.[44]

Following the completion of the transaction, customers will continue to receive the same regulated services, service rates, and service terms and conditions as they received prior to the Transaction.[45] The two transferred Verizon ILECs will continue to utilize the same operational support systems used by Verizon, and customer calls will be directed to calls centers staffed by Verizon employees trained on those systems who will continue employment with Frontier.[46] The fact that the two subject operating companies, Verizon North and Verizon South, will remain independent legal entities and continue to operate using the same systems and employees, undermines the reasoning of the Proposed Order and eliminates the risk that the quality of service will deteriorate. In short, any past service quality issues with the existing Frontier operating companies in Illinois have no bearing on whether the Transaction could or will diminish the ability of Verizon South and Verizon North to provide adequate quality of service.

The Proposed Order also suggests that Frontier cannot be entrusted with a large telephone operation and expresses "serious doubts as to Frontier's qualifications to step into Verizon's

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Illinois operating company will become part of Frontier Communications of the Carolinas, Inc. *See* Joint Application at 6-7.

[43] McCarthy Direct at 21; Erhart Direct at 13; *see also* Tr. at 205 (describing Verizon employees who will transfer) & 209 (explaining that virtually no employees will be required to relocate). In addition, Frontier has committed as part of the transaction that it will honor all employee collective bargaining agreements, including past practices with the IBEW and Communications Workers of America (CWA). McCarthy Direct at 21 fn. 3.

[44] McCarthy Direct at 25.

[45] *Id.* at 25, 41-42.

[46] McCarthy Direct at 26-27.

shoes as the second largest ILEC in Illinois."[47] But Frontier is not a "mom and pop" telephone company. To the contrary, Frontier trades on the New York Stock Exchange, its revenue in 2008 was $2.2 billion, and it is the sixth largest wireline telephone company in the country.[48] Frontier already is the second largest ILEC in several states, operates more than two million access lines in 24 states, and provides services in mid-sized communities and suburban areas such as Rochester, New York, the west and south metropolitan area of Minneapolis/St. Paul, and Elk Grove, California (a suburb of Sacramento).[49] Moreover, Frontier operates nine separate ILECs in Illinois.[50] Frontier initially came to Illinois in August of 2000 through the purchase of more than 100,000 access lines in 110 Illinois exchanges from GTE, pursuant to this Commission's approval Order in Docket No 00-0187.[51] In that same year, Frontier acquired Global Crossing's eight ILEC companies pursuant to this Commission's approval Order in Docket No. 00-0552.[52] Frontier has substantial managerial and technical expertise in the telephone industry and specifically in Illinois.[53]

Staff's testimony recognizes that Frontier's professional management has a demonstrated ability to successfully oversee telephone utilities:

> Both Frontier and Verizon currently have service territories in Illinois, so I already have substantial knowledge regarding certain aspects of the Illinois operations of both companies, and hence can offer some general observations. Obviously, both of these companies are generally able to

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[47] Proposed Order at 31.

[48] *See* McCarthy Direct at 33.

[49] McCarthy Direct at 5-6.

[50] McCarthy Direct at 7.

[51] McCarthy Direct at 19.

[52] *Id.*

[53] *See, e.g.*, McCarthy Direct at 3-6; McCarthy Rebuttal at 46-51.

> provide telecommunications services, and have done so for years. Both companies generally achieve reasonable levels of service quality.[54]

Nothing in the record suggests that Frontier's professional management is unable to oversee Verizon North or Verizon South or will impair the ability of either utility to continue to provide adequate, reliable, safe and least cost service as required under Illinois law.

Second, the Proposed Order fails to recognize that the service quality conditions proposed by Staff and agreed to by Frontier (Staff Conditions 1 and 2) will help to prevent any potential service quality issues for Verizon North and Verizon South. The Proposed Order dismisses the Staff's conditions, recommending a finding that "the Commission does not follow Staff's reasoning that service quality will not be diminished if conditions are imposed, when Frontier has had problems in the past in meeting key minimum standards of Part 730."[55] The Proposed Order's circular reasoning makes no sense. In fact, the conditions imposed on the two utilities require concrete steps in the event of service quality problems that will ensure the resources are available to address any service quality problems.

Specifically, Staff Condition 1 is a condition that restricts the acquired utilities' ability to pay dividends or otherwise transfer cash to Frontier in the event that specific service quality metrics are not met.[56] As Staff witness McClerren explained in his Rebuttal Testimony:

> I believe the service quality/dividend restriction condition is necessary. It is designed to make certain that Frontier maintains the level of service quality currently provided to customers in Verizon North and Verizon South territories. If it does not maintain service quality levels, Frontier will be unable to distribute dividends to its

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[54] McClerren Direct at 14-15. The Proposed Order recites this portion of Mr. McClerren's testimony (Proposed Order at 11), but ignores it (like other passages that do not fit with its conclusions) in its analysis.

[55] Proposed Order at 14.

[56] McClerren Direct Testimony at 42-43.

> corporate parent, and will be expected to use those withheld dividends to restore service quality to previous levels.[57]

In short, Staff Condition 1 imposes a severe penalty and restriction on cash distributions if either of the two Illinois ILECs fails to maintain service at the quality currently provided by Verizon (and in some cases at a quality better than currently provided by Verizon). Because Frontier would be unable to benefit from any of the profits of the Illinois operating companies until service quality was restored, Frontier would have a significant additional incentive to maintain the network infrastructure necessary to ensure quality service.

In addition, Staff Condition 2 requires Frontier to maintain the greater of $50 million or the currently approved capital expenditure budget for the Verizon Illinois utility operations for the use of those companies, at least until Frontier achieves an investment grade bond rating. That reserve will ensure that the Verizon Illinois utilities will have access to the capital needed to maintain and invest in the network as needed to keep up service quality levels. As Staff witness Mr. McClerren explained, because of these two conditions:

> If the service quality in the acquired territory diminishes relative to its pre-merger levels, monetary transfer payments from the Illinois properties to the corporate parent will be halted. In effect, if service quality is diminishing relative to pre-merger levels, additional resources are to be invested in Illinois telecommunications facilities until the service quality degradation is resolved.[58]

Staff's proposed conditions are fully responsive to the concern raised by Staff, and the Proposed Order inappropriately ignores this.[59]

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[57] McClerren Rebuttal Testimony at 7.

[58] *Id.* at 42.

[59] The suggestion (raised by IBEW and adopted in the Proposed Order) that the conditions proposed by Staff and included in the Stipulation with AG and CUB are "inadequate" to address the criterion of Section 7-204(b)(1) is baseless. Staff explained this point in detail in its Reply Brief, noting that although IBEW "raises many of the same concerns Staff discussed in its testimony and Initial Brief," the agreed upon conditions "were tailored to address concerns related to the possibility the reorganization would diminish Frontier's ability to provide service." Staff Reply Brief at 7-8.

This Commission has adopted conditions similar to Staff's Conditions 1 and 2 in other reorganizations involving telephone companies. Indeed, these two conditions have been the established Commission practice in Illinois in several recent reorganization transactions.[60] The Proposed Order also ignores this.

Furthermore, Frontier agreed to an *additional* service quality conditions in its Stipulation with the AG and CUB. This condition (AG/CUB Condition 5) provides that in the event business answer times exceed sixty (60) seconds average for a quarter, "the New Frontier Illinois ILECs will provide specific plans to the Commission Staff, AG and CUB that identifies specific actions to be taken by the New Frontier ILECs to maintain business answer times at less than sixty (60) seconds." This report must be submitted within 30 days following the end of the quarter and must summarize Frontier's plans regarding training, staffing levels and other actions Frontier will take to maintain business answer times at less than sixty (60) seconds. This condition provides additional assurance beyond the standard Staff conditions that service quality will be maintained.

In sum, consistent with the past practice in Illinois in recent telephone reorganization cases approved by the Commission, Staff's conditions 1 and 2 remove any residual concern that the transaction could negatively impact service quality, and the Stipulation with the AG and CUB provides additional service quality protections. With these conditions in place, the transaction clearly meets the requirements of Section 7-204(b)(1).

Third, even if the past, isolated issues in the Frontier ILECs' levels of service were relevant, the Proposed Order ignores Frontier's subsequent Rebuttal testimony, which reviewed

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[60] Staff Initial Brief at 10; *See, e.g.,* Orders, Docket No. 08-0645, CenturyTel and Gallatin River (issued March 25, 2009), Docket No. 07-0191; Madison River Telephone Company, LLC et al (3/21/07); Docket No. 06-0683, Madison River Communications Corp. et al (11/29/06); Docket No. 05-0013, Madison River Communications Corp. et al (2/24/05); Docket No. 04-0793, Illinois Consolidated Telephone Company et al (1/20/05); and Docket No. 04-0299..

more current service quality data through September 2009 and demonstrated significant improvement. Specifically, Frontier witness Mr. McCarthy explained that "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,[61] 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."[62] Mr. McCarthy went on to explain that, 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."[63] The record evidence shows that Frontier service quality performance in Illinois improved and was in line with Verizon's service performance.

Frontier's alleged service quality problems in the past are not relevant to whether the Transaction will cause the service quality of Verizon North and Verizon South to diminish. These companies will continue to operate separately using their current assets, systems and employees. Staff has proposed and the companies have agreed to comply with Staff's two standard conditions and the conditions agreed to in the AG/CUB Stipulation which will mitigate any potential future service quality issues for Verizon North and Verizon South.

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[61] Frontier Exhibit 2.15 is attached to McCarthy's Rebuttal Testimony, which is Frontier Exhibit 5.15.

[62] McCarthy Rebuttal Testimony at 13.

[63] McCarthy Rebuttal Testimony at 13.

2. The Record Demonstrates that the Transaction will not Result in Transition-Related Problems that Diminish Service Quality.

The next finding in the Proposed Order regarding Section 7-204(b)(1) involves concerns that service quality may diminish because of potential problems with the transition from Verizon to Frontier and with Frontier's ability to integrate the operations.[64]

First, the Proposed Order suggests it will "almost be impossible" for Verizon North and Verizon South to meet service quality requirements because Frontier's size will be "increasing from 97,000 to 670,000 lines" and because it will be "burdened with an enormous amount of debt."[65] As discussed in more detail below, the debt finding is illogical because Frontier's increased debt load will be *more than offset* by the incremental revenues, EBITDA, and cash flows it is acquiring. And the Proposed Order identifies no linkage between the increase in Frontier's size and the purported inability of Verizon's Illinois utilities to maintain service quality after the Transaction. There is nothing "unprecedented" about the size of this Transaction or the relative sizes of Frontier versus the acquired properties. Just last year this Commission approved the acquisition by CenturyTel (which had fewer lines than Frontier) of Embarq (which had more lines than Verizon is transferring to Frontier), expressly finding that the requirements of Section 7-204(b)(1) were met.[66]

Moreover, Frontier itself has extensive experience successfully acquiring telephone operations, including 750,000 access lines from GTE and 1.1 million access lines from Global Crossing – an acquisition that almost doubled Frontier's size and that this Commission

[64] Proposed Order at 14.

[65] Proposed Order at 14.

[66] Order, *CenturyTel Inc. and Gallatin River Communications, LLC Joint Application for approval of reorganization pursuant to Section 7-203 and 7-204 and for other relief*, Docket No. 08-0645 (issued March 25, 2009). *See* McCarthy Rebuttal Testimony at 51-52.

approved.[67] More recently, Frontier acquired and successfully integrated Commonwealth Telephone Company in Pennsylvania, which included over 420,000 access lines in Pennsylvania.[68] There is simply no basis to conclude that, as a result of Frontier's acquisition and operation of the Verizon Illinois ILECs, Verizon South and Verizon North – which will remain as freestanding operating companies – will be unable to maintain adequate service quality because Frontier is smaller than Verizon.

Second, the Proposed Order states that "it seems likely that Frontier will have a more difficult time meeting the minimum key standards of Part 730 due to the replication process of the operation support systems, along with other factors that come into play."[69] That claim is apparently based on concerns raised by some witnesses that Verizon North and Verizon South could encounter the same sorts of operational problems experienced by Hawaiian Telcom and FairPoint Communications after those firms acquired access lines from Verizon.[70] The Proposed Order simply *ignores* the protections which were included in the Frontier/Verizon Merger Agreement that Frontier (which obviously has a very strong interest in avoiding the problems of FairPoint and Hawaiian Telcom) negotiated with Verizon *precisely* to avoid such problems. Unlike FairPoint and Hawaiian Telcom, which experienced operational problems as a result of deficiencies in brand new operational support systems they had developed from scratch to operate the acquired assets, Frontier will operate Verizon South and Verizon North using the same systems used by those utilities prior to the close of the Transaction.[71] Frontier will ***not*** be developing operational, business and customer support systems and then cutting over to the new

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[67] *See* McCarthy Direct at 18-19.

[68] McCarthy Direct at 19.

[69] Proposed Order at 14.

[70] *See, e.g.*, McClerren Direct at 31-36; Selwyn Direct at 34-47.

[71] See, e.g., Smith Rebuttal at 5-7, 8-9; McCarthy Rebuttal at 7, 10-11. .

system to operate in Illinois.[72] Under the Merger Agreement, Verizon is required to replicate the entire suite of operational support systems used by Verizon North and Verizon South, and then to actually *use those replicated systems* in the live operations of Verizon North and Verizon South for at least sixty days prior to the close of the transaction.[73]

As explained in the testimony in this proceeding, Verizon is prepared to place the replicated operations support systems used to serve Illinois customers into production on April 1, 2010.[74] These replicated systems will then be used by Verizon to take new customer orders, to serve retail customers, business customers, and wholesale customers, and to provide customer service up until closing of the proposed transaction.[75] 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. Customers will receive bills generated from the replicated billing systems. In short, the replicated systems will be supporting the Verizon operations included in the proposed transaction starting on April 1, 2010, well before the systems are to be transferred to Frontier as part of the proposed transaction.[76]

In addition, under the Merger Agreement, the transaction will not close until the replicated systems are used and functioning for 60 days and unless and until Frontier has

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[72] McCarthy Direct at 29.

[73] *See, e.g.*, *id.* at 14-15. Verizon has substantial experience successfully performing systems replications and systems transitions. *Id.* at 12.

[74] McCarthy Rebuttal at 18.

[75] McCarthy Rebuttal at 17-19; Smith Rebuttal at 14-16.

[76] McCarthy Rebuttal at 18.

confirmed and validated that the replication process has been successful.[77] Moreover, in the settlement agreement with AG and CUB, Frontier has committed to numerous conditions regarding the operational support systems.[78] For example, the following two explicit conditions are included in the Stipulation executed by the AG, CUB, Frontier and Verizon:

> 16. The New Frontier Illinois ILECs will provide the Staff, the OAG, and CUB a copy of the report documenting the replicated systems' functionality prepared in accordance with Frontier Ex. 8.1, para. I.1.e. during the test period prior to the closing of the transaction. The New Frontier Illinois ILECs will also provide the Staff, the OAG, and CUB the reports concerning any tests of retail service provided to the Oregon, Washington or Ohio Staff as part of the proposed transaction.
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> 17. Frontier shall notify the Staff, the OAG, and CUB when the replicated operating system is put into service in Illinois. Further, Frontier will not proceed with closing of the proposed transaction unless and until it has validated that the operational support systems ("OSS") are fully functioning and operational. Frontier shall provide a report to the Commission, Staff, AG and CUB confirming that the OSS are operating in accordance with the terms of the merger agreement at least five days prior to close.[79]

The replicated systems will be put into production on April 1, 2010, and the above conditions are *already being implemented*.

The record clearly shows that the "turnkey" systems transition to be transferred to Frontier, coupled with the agreed-to conditions, specifically addresses the concerns raised about the systems transition – yet the Proposed Order inexplicably and with no analysis dismisses the replication plan as "incredibly simplistic."[80] That is not the conclusion of Staff, the AG, CUB,

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[77] *See* Smith Rebuttal at 15; McCarthy Rebuttal at 17-19. As was explained in testimony, wholesale customers will also be able to participate in system testing. McCarthy Rebuttal at 18. As discussed above, in other states, Verizon has agreed to conditions under which a third party reviewer will validate the success of the systems replication. Given that the replicated systems are a nationwide platform, those additional conditions will protect Illinois as much as they protect every other state.

[78] *See* Frontier Exhibit 13, AG/CUB Stipulation (Condition Nos. 15-22).

[79] Frontier Exhibit 13, AG/CUB Stipulation (Conditions 16 -17)

[80] Proposed Order at 15. Notwithstanding the clear differences in the systems component of the transactions, the Proposed Order implies Frontier may experience problems here similar to those experienced by Hawaiian Telcom and FairPoint. This ignores the evidence in the case. As a starting point, Frontier is not analogous to the acquirers in those transactions. Pre-transaction Frontier is a much larger company than either Hawaiian Telcom and FairPoint and has extensive experience with systems transition issues. For example, just in the past five years Frontier has

the other parties except IBEW – or any of the other six state commissions that have issued approval orders to reach a final decision on the Transaction – and it finds no support on the record.

Finally, the Proposed Order concludes that the annual fee of $94 million that Frontier will pay Verizon for maintaining the replicated systems is a concern because "there is a significant risk that problems could occur if the transition [from the replicated systems to Frontier's own systems] is made too prematurely so as to create a potential for harm to Illinois customers."[81] As an initial matter, and as Commission Staff has recognized, Frontier has agreed to continue to utilize the Verizon replicated systems for at least one year following closing.[82] Moreover, $94 million is not an "enormous" burden in the context of maintaining a nationwide platform of operational support systems for more than four million access lines. To the contrary, it is a competitive fee resulting from arms-length negotiation with Verizon that amounts to less than $2 per line, and Frontier will continue to have the ability to "shop around" for a more competitive price from a third party vendor after the first year.[83] Accordingly, if Frontier chooses to transition from the replicated systems to its existing systems, it will be under no pressure to do so "prematurely."[84]

The Proposed Order also simply assumes – without analysis and contrary to the evidence in the record – that an internal cutover from one operational support system to another is an inherently risky activity. It is not. While not simple, such cutovers occur on a regular basis in

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successfully integrated five billing systems, converting approximately 1.7 million access lines into a single scalable company-wide platform. By contrast, the acquirer of Hawaiian Telcom, The Carlyle Group, was an investor group with no prior experience in the telephone industry, and FairPoint also had far less relevant experience.

[81] Proposed Order at 14.

[82] McClerren Direct at 33.

[83] McCarthy Surrebuttal at 5-6; Smith Rebuttal at 18-19. This compares favorably to the over $9 per line paid by FairPoint.

[84] Proposed Order at 14.

the telephone industry.[85] In the past five years, Frontier has successfully converted and integrated five billing systems successfully, converting approximately 1.7 million access lines into a single, operating, scalable company-wide platform.[86] Frontier nevertheless has agreed to conditions specifically designed to avoid problems with any future transition from the replicated systems to its existing systems. In particular, one Staff condition Frontier agreed to meet prohibits it from undertaking any future cutover without first submitting a detailed cutover plan to the Commission's Chief Engineer for review, and then receiving formal approval for the plan.[87] Moreover, in the Stipulation with AG and CUB, Frontier further expanded this requirement so it would apply for five years and would require communication to Staff, the AG and CUB before Frontier subsequently migrated off the Verizon operations systems that will be used at closing to a different operations support system.[88]

The Proposed Order ignores those conditions agreed to by Commission Staff, the AG and CUB, which will mitigate the risks of harm to customer services associated with the transition of support systems from Verizon to Frontier and any subsequent transition by Frontier in the future.

3. Verizon North and Verizon South will be Able (and *Legally Required*) to Re-Invest Sufficient Funds in their Operations.

The final recommended basis for rejecting the Transaction under Section 7-204(b)(1) is that Frontier's purported "lack of financial fitness" will "jeopardize the company's ability to provide safe, reliable, efficient and least-cost service to its customers."[89] The support cited for that finding is testimony from IBEW's witness claiming that as a result of "financial constraints

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[85] Smith Rebuttal at 18; McCarthy Rebuttal at 10.

[86] *Id.*

[87] *See* Frontier Correct Exhibit 8.4.A (Condition 3). AG/CUB negotiated a condition extending this obligation from three to five years. *See* Frontier Exhibit 13, AG/CUB Stipulation (Condition No. 16).

[88] See Frontier Exhibit 13 AG/CUB Stipulation (Condition No. 18).

[89] Proposed Order at 15.

on Frontier" resulting from the Transaction, Frontier "would face strong economic incentives to cut costs," which might hurt service quality.[90]

As discussed in detail below (*see infra* Section C), IBEW's speculation is groundless because its financial analysis is unsound, it fails to consider Frontier's actual investment history and experience, and the conduct by Frontier that IBEW describes could not occur given the Staff and AG/CUB conditions Frontier has agreed to meet, as well as the Commission's vigilance regarding utilities' dividend policies. The reality is that Frontier is *already* financially stronger than most mid-sized telephone companies,[91] and it is undisputed that its financial strength will *improve* because of the deleveraging nature of the Transaction and increased cash flow. Again, this issue is discussed in detail in the following section, but it is undisputed that:

- Frontier has a strong income statement and balance sheet, and it has a record of substantially investing in its network and providing service to more than 97,000 access lines in Illinois. In 2008 Frontier had revenue of $2.2 billion, net income of $182.7 million and EBITDA of $1.2 billion.[92]

- Frontier has continued to grow its business through further expansion of broadband and value-added services (as of March 31, 2009 Frontier had approximately 600,000 High-Speed data customers and approximately 771,000 customers subscribed to a bundle or package of services), productivity improvements, and a disciplined capital expenditure program that emphasizes return on investment while delivering enhanced and broadband services to its customers.[93]

- For 2008 - Frontier's Free Cash Flow was $493.2 million, and for the period 2005 to 2008 Frontier's Free Cash Flow totaled $2.1 billion.[94]

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[90] Proposed Order at 15.

[91] See McCarthy Rebuttal at 26-27 (Table 2 comparing net debt to EBITDA of Frontier to other mid-sized ILECs).

[92] McCarthy Direct at 33-34.

[93] McCarthy Direct at 33-34.

[94] *Id*.; McCarthy Rebuttal at 63 & (Table 3)(explaining that from 2005 to 2008, Frontier generated Free Cash Flow that ranged from approximately $493 million to $562 million annually, for a total of $2,110,957 over four years. It is also important to recognize that "Free Cash Flow" is cash generated by the business after funding all operating expenses to run the business, all capital expenditures, and interest expenses on the company's debt. Free Cash Flow does not include funds derived from financing activities, such as loan proceeds or other borrowings. McCarthy Rebuttal at 62.

- Between from 2005 to 2008, after paying all salaries and wages, other operating expenses, taxes, interest on its debt, and other expenses associated with running its business, Frontier still had substantial available cash to invest over $1.1 billion cumulatively in its operations and network including the network investments that have expanded Frontier's broadband service availability to over 90% of the households in its national service territory.[95]

- And after the paying its expenses and investing in its network, Frontier was able to pay dividends to its shareholders and after paying such dividends, Frontier still consistently generated positive Free Cash Flow after dividends at annual levels ranging from $175 million to $238 million and totaling $795 million for the 2005 – 2008 period.[96]

In short, the fact that Frontier is able to pay all the costs of its operations, pay and service its debt, invest more than $1 billion in its network, pay dividends to its shareholders and then still have $175 million to $238 million in "extra" cash available each year demonstrates that the Order's fundamental premise that Frontier's lack[s] financial fitness is ***not*** supported by the record evidence.

In addition, Frontier's actual investment history and experience demonstrates Frontier's commitment to investing in its network and to expand service availability. 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.[97] With respect to Illinois specifically, Frontier capital expenditures in 2007 and 2008 were higher per access line than Frontier's national average. By comparison, excluding Verizon's FiOS expenditures, which are not applicable to Illinois since Verizon has not deployed FiOS in Illinois (and has no plans to do so), Verizon's core capital investments in the areas to be

[95] *Id.* at 63.

[96] *Id.* at 63.

[97] McCarthy Rebuttal at 67. 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.

acquired by Frontier for 2007 and 2008 averaged about $85 *per access line*.[98] A graph comparing Frontier's national and Illinois-specific capital expenditures per line to Verizon's investments in Illinois on a per line basis is included in Frontier's testimony and shows that Frontier's expenditures significantly exceed those of Verizon in Illinois.[99] Frontier's investment history shows that it is committed to making the necessary capital expenditures in its network to provide services to customers in Illinois.

Furthermore, the Proposed Order ignores the fact that Frontier agreed to Staff's proposed "fence posting" conditions, which are intended to ensure the financial integrity of Verizon North and Verizon South. Specifically, as described above, Verizon North and Verizon South are prohibited from paying dividends and transferring cash to Frontier if they do not meet minimum service quality metrics. In addition, Frontier will be required to certify annually that there is at last $50 million in backup liquidity for the utilities' operations in Illinois, which will provide additional assurance to the Commission that funds will be available, if needed, in Illinois.[100] As Staff correctly pointed out, the Commission has in the past relied on precisely such conditions to ensure that utilities re-invest sufficient amounts in their operations, can enforce such commitments (and impose penalties if necessary) under Section 5-202 of the Act, and indeed has the authority to initiate an investigation into an utility's ability to pay dividends under Section 7-103.[101] There simply can be no *bona fide* concern about the Commission's ability, especially

[98] McCarthy Rebuttal at 67-68 (citing Declaration of Stephen E. Smith, WC Docket No. 09-95 (October 14, 2009)), ¶ 22.

[99] See McCarthy Rebuttal at 70. The per line capital expenditures amounts for both Verizon and Frontier were designated as confidential but are included in Mr. McCarthy's rebuttal testimony.

[100] *See* Staff Reply Brief at 8 (discussing Conditions 1 & 2).

[101] *See* Staff Reply at 8-9.

given the agreed-to conditions, to ensure that Verizon North and Verizon South will re-invest sufficient funds to maintain adequate service quality.[102]

In summary the Proposed Order should be revised in accordance with Joint Applicants' exceptions language to find that the Transaction, subject to the conditions negotiated by Staff, AG, CUB and other intervenors, meets the criterion set forth in Section 7-204(b)(1) and to approve the Transaction.

C. The Proposed Order's Conclusion that the Transaction Fails to Satisfy Section 7-204(b)(4) cannot be Sustained.

1. Section 7-204(b)(4) is Unquestionably Satisfied because the Transaction will have no Effect on the *Utilities'* Ability to Raise Capital or their Capital Structure.

Section 7-204(b)(4) requires the Commission to find that "the proposed reorganization will not significantly impair the utility's ability to raise necessary capital on reasonable terms or to maintain a reasonable capital structure." 7-204(b)(4).[103] The Proposed Order focuses entirely on the effect of the transaction on *Frontier's* – the parent company's – ability to raise capital and concludes the Transaction will significantly impair its ability to do so.[104] As discussed below, the Proposed Order's conclusion on this score misapplies the statutory standard and is contrary to the evidence. But the Proposed Order suffers from a more fundamental flaw: it asks the wrong question. Under the plain language of the statute, the issue is not the *parent company's* ability to

[102] Proposed Order at 14. As discussed below, it is undisputed that the utilities (Verizon North and Verizon South) have sufficient cash flows to fully fund their own operations, so limiting transfers to the holding company would further ensure funds are available for operations and investment.

[103] The term "utility" does not apply to a holding company, which is why 7-204 extends to transactions impacting "ownership or control of any entity that owns or controls a majority of the voting capital stock of a public utility." With regard to telecommunications carriers, Section 13-101 of the Act (220 ILCS 5/13-101) applies the elements of the Public Utility Act relating to "utilities" only to noncompetitive telecommunications rates and services. Only Verizon North and Verizon South – and not the holding company – provide noncompetitive rates and services. For that reason, only Verizon North and Verizon South are "utilities" for the purpose of applying Section 7-204(b)(4) of the Act.

[104] Proposed Order at 29.

raise capital, but whether the transaction will significantly impair the "*utility's*" access to capital – that is, whether Verizon South and Verizon North will continue to have access to capital on reasonable terms after the Transaction.[105] The answer to that question – which the Proposed Order does not even address – is an unequivocal yes.[106]

As the Proposed Order itself observes, the unrebutted evidence on the record, including testimony from Staff witness Ms. Phipps, establishes that Verizon South and Verizon North "currently generate more cash than they require for capital expenditures."[107] In other words, the operations of Verizon South and Verizon North themselves provide more than the "necessary capital" the utilities require *without resort to any capital from their parent company*. As a result, a change in parent company will have no effect on – and certainly will not "significantly impair" – the *utilities'* ability to raise necessary capital on reasonable terms or to maintain a reasonable capital structure.[108] And because the Verizon North and Verizon South utilities will maintain

[105] The Proposed Order duplicates the error of the IBEW. As the Staff explained in its Reply Brief, "Staff's review and recommendations were limited to the effect the reorganization would have on the Illinois operations of the regulated utilities or incumbent local exchange companies ("ILECs"). The IBEW does not focus on the ILECs, but raises concerns about the parent company. Similarly, IBEW's analysis is not focused on the Illinois requirements. For example, Section 7-204(b) of the Act requires that the Commission find that the reorganization will not significantly impair the utility's ability to raise necessary capital on reasonable terms or to maintain a reasonable capital structure, whereas the IBEW's analysis addresses 'whether Frontier will be a financially sound entity.'" Staff Reply Brief at 3-4.

[106] The statutory focus on the utility rather than the parent company has a constitutional dimension. Under the Fifth Amendment, a parent company could not be required to subsidize the regulated business of its subsidiary utilities with revenue from other unregulated lines of business. *See Brooks-Scanlon Co. v. Railroad Comm'n of Louisiana*, 251 U.S. 396, 399 (1920) ("The plaintiff may be making money from its sawmill and lumber business but it no more can be compelled to spend that than it can be compelled to spend any other money to maintain a railroad for the benefit of others who do not care to pay for it."). Thus, even if a parent company has available profits or cash from other lines of business, it could not be compelled to provide that money to the utility for its capital needs. Given that, the appropriate focus must be on the ability of the utility itself to have access to capital on reasonable terms.

[107] Proposed Order at 22; *see also* Phipps Direct Testimony at 6.

[108] As the Staff's Brief summarizes: "Frontier's ability to raise necessary capital on reasonable terms is not a required factor for meeting the criteria specified in Section 7-204(b) because the New Frontier Illinois ILECs generate sufficient cash internally to fund the expenditures necessary to meet service standards. . . . Thus, if the New Frontier Illinois ILECs retain a portion of the cash they generate sufficient for maintaining adequate service, an external source of capital is unnecessary because the New Frontier Illinois ILECs will have 'the ability to raise necessary capital' (through the retention of internally generated cash) within the meaning of Section 7-204(b)(4)." Staff Brief at 23.

their same assets, operations, and capital structure after the transaction, there is no basis on the record to expect this to change in the foreseeable future. The Proposed Order, while acknowledging this evidence, then proceeds to ignore it.

The proposed conditions described by Staff ensure that the Illinois operating companies will continue to have access to necessary capital. As noted, Staff Condition 1 prohibits the Illinois operating companies from paying dividends or otherwise transferring cash to Frontier if they fail to meet certain service quality metrics. Thus, even if Frontier were to encounter financial difficulty, it could not deprive the Illinois utilities of the capital they need to maintain sufficient service quality. As a result, the Order is simply wrong in positing that Frontier might "transfer[] cash from New Frontier ILECs that is necessary for maintaining the New Frontier ILECs' service quality" in order to meet Frontier's "debt servicing obligations."[109] Staff Condition 2 goes further and provides a backup source of capital for the Illinois utilities by requiring Frontier itself to reserve funds exclusively for the Illinois utilities in an amount equal to the greater of $50 million or the currently approved capital budget for the Illinois utilities. This condition provides insurance that the Illinois utilities will have access to "necessary capital on reasonable terms even if, for unforeseen reasons, [they] require externally raised capital."[110] As Staff witness Phipps explained:

> In summary, the proposed reorganization will not significantly impair New Frontier Illinois ILECs' ability to raise necessary capital on reasonable terms or to maintain a reasonable capital structure, if the new Frontier ILECs comply with the conditions and reporting requirements set forth herein.[111]

[109] Proposed Order at 30.

[110] Staff Reply Brief at 7.

[111] Phipps Direct at 20.

The Proposed Order contains nothing more than a conclusory assertion that these conditions are "inadequate."[112] It offers no explanation for this claim or why it wholly ignores the contrary conclusion reached by Staff after months of extended discovery and study.

2. Even if the Parent Company's Access to Capital were Relevant Under Section 7-204(b), the Record Clearly Establishes that Frontier will Continue to be Able to Raise Capital on Reasonable Terms and to Maintain a Reasonable Capital Structure.

Even if the Frontier parent's own ability to raise capital were properly at issue in this proceeding, the Proposed Order's findings still would be wrong. Contrary to the claims of IBEW, the question is not whether Verizon or Frontier is the financially stronger holding company. Rather, under the statute, the relevant inquiry is whether the transaction will "*significantly* impair" the ability of the utility to gain access to capital on "*reasonable* terms and to maintain a *reasonable* capital structure." 7-204(b)(4) (emphasis added). The record evidence establishes that Frontier has raised, and will continue to be able to raise, capital on reasonable terms and to maintain a reasonable capital structure.

Frontier unquestionably has access to capital on reasonable terms today. It is among the financially strongest ILECs in the country and has a strong record of successfully operating more than 2 million lines in 24 states, including 97,000 here in Illinois for the past 10 years during which its financial fitness has never been questioned. Frontier has been able to raise the needed capital to invest in these operations – and has deployed broadband to more than 90% of the households in its existing service territories across the country (as compared to Verizon's deployment of broadband of 60% across the properties to be transferred to Frontier).[113] Indeed, as the testimony makes clear, on a per-line basis Frontier invests *more* in its operating companies

[112] Proposed Order at 32.

[113] *See* McCarthy Rebuttal at 56.

than Verizon does on telephone service.[114] That clearly would not be possible without being able to raise capital on reasonable terms.

Futhermore, as summarized above, Frontier has a strong income statement and balance sheet. In 2008 Frontier's revenue was $2.2 billion and its EBITDA was $1.2 billion.[115] For the period 2005 to 2008 Frontier's Free Cash Flow totaled $2.1 billion.[116] As a result, from 2005 to 2008, after Frontier paid all of its employee salaries and wages, its other operating expenses, taxes, interest on its debt and other expenses associated with running its business, still had sufficient cash both to invest over $1.1 billion cumulatively in its operations and network and to pay dividends to its shareholders.[117] And even after dividends were paid to shareholders, Frontier still had additional cash flow ranging from $175 million to $238 million per year, for a total of $795 million for the 2005 – 2008 period. This cash is effectively "extra" capital that has been available to Frontier after every other business obligation has been satisfied and discretionary shareholder dividends have been paid. In light of this undisputed evidence, there is no factual basis for the Proposed Order's suggestion that Frontier does not have reasonable access to capital today or is unlikely to continue to have access to capital in the future.

And while Frontier is already one of the financially strongest wireline telecommunications companies in the country, the Transaction will *further strengthen* Frontier by increasing its revenues, EBITDA, cash flow, and reducing Frontier's leverage and dividend payout ratios. The proposed Transaction is expected to *increase* Frontier's annual free cash flow, based on pro forma 2008 results, to over $1.4 billion even if no expense saving synergies are

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[114] *See* McCarthy Rebuttal at 67-68, 70.

[115] McCarthy Direct at 34.

[116] McCarthy Rebuttal at 62-63 & (Table 3)

[117] McCarthy Rebuttal at 63.

achieved and over $1.7 billion after estimated synergies are included.[118] Even assuming the payment of shareholder dividends, Frontier will generate significant extra Free Cash Flow of $681 million without synergies, and $991 million with synergies based on the 2008 pro forma figures.[119] As a result, whether the Commission considers the availability of cash of Frontier on a stand alone basis today or combined with Verizon after the closing of the Transaction, the operations will generate more than sufficient "extra" cash that will be available as capital to fund Frontier's operations and commitments in Illinois.

Independent credit rating agencies and numerous analysts have gone on record to affirm that the financial characteristics of the combined company are positive as a result of this combination. Two of the three credit reporting agencies (Moody's and Fitch) have placed Frontier's debt on Ratings Watch Positive. [120] These positive ratings actions affirm the fact that the proposed Transaction was structured in a way that specifically serves to enhance the financial capacity of Frontier.

In fact, even IBEW witness Mr. Barber acknowledged that "many [analysts and ratings agencies] have indicated a review with positive implications."[121] Further illustrating the financial community's generally positive perception of Frontier and of the transaction, industry analysts have made positive observations about the financial capacity of Frontier following the closing. Simon Flannery of Morgan Stanley explained on October 30, 2009:

> …we still believe that Frontier should emerge a stronger company. Overall, we like the sizeable cost synergy potential and believe that Spinco's low broadband penetration (62.5% vs. FTR's 92%) and relatively less crowded competitive environment could provide some revenue upside.

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[118] McCarthy Rebuttal at 39.

[119] McCarthy Rebuttal at 39.

[120] McCarthy Surrebuttal at 30.

[121] Barber Rebuttal at 6, lines 108-109.

> Dividend, both pre- and post-closing, is well supported. Post-closing, the 25% dividend cut (which would lead to a payout of FCF below 50%) along with investment grade credit-like metrics, should be supportive. Furthermore, strict cost control combined with the $500mn synergies should help FTR maintain its profitability.[122]

Similarly, Christopher King of Stifel Nicolaus, explained:

> While we have seen union posturing regarding comparisons to Verizon's divestiture of wireline assets to Fairpoint Communications, we continue to see a strong case being made in favor of approving this acquisition, from the healthy delevering at Frontier, to the reduction in the company's dividend payout, to the capital commitments that Frontier management has laid out publicly. Frontier expects to spend approximately 12% of revenues on capex in the newly-acquired properties, plus an additional $100 million per year for three years after closing for plant upgrades.[123]

The evidence establishes Frontier's ability to raise capital on reasonable terms today and demonstrates that the Transaction will financially strengthen Frontier and thereby improve its ability to raise capital going forward. Nevertheless, the Proposed Order asserts, often with little analysis, that the Transaction will significantly impair Frontier's ability to raise necessary capital on reasonable terms. Even leaving aside that the relevant question is whether the Illinois utilities, not Frontier, will have access to the necessary capital, each of the points the Proposed Order makes about the effect of the Transaction on Frontier's financial condition is contrary to the weight of the evidence on the record.

First, the Proposed Order states that it agrees with IBEW that Frontier has "relied upon aggressive revenue and expense assumptions to justify the transaction internally."[124] But the Proposed Order provides no explanation or analysis concerning what assumptions it finds overly aggressive or why. That absence is particularly glaring given that Frontier provided extensive

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[122] McCarthy Surrebuttal at 37-38 (quoting Frontier Exhibit 8.6, Simon Flannery, *3Q09 Preview: Spinco Approval Process in Focus*, Morgan Stanley Research, October 30, 2009).

[123] McCarthy Surrebuttal (quoting Frontier Exhibit 8.8, Christopher King, *Frontier Communications Corporation: Receives 3 of 9 State Approvals Needed for VZ Deal,* Stifel Nicolaus, October 30, 2009).

[124] Proposed Order at 29.

evidence explaining and justifying its assumptions.[125] For example, Frontier testified that the percentage of Frontier's customers that subscribe to Frontier's key services surpasses Verizon's in the acquired territories which presents an opportunity to increase revenues. Frontier also testified that it plans to increase broadband availability which will provide an additional and important source of revenue for the company.

Second, advancing the union's argument, the Proposed Order notes that Frontier does not have an investment-grade bond rating.[126] But this fact does not suggest Frontier will be unable to obtain access to capital on reasonable terms. With the exception of three companies (AT&T, Verizon and CenturyLink) most ILECs do not have investment grade credit ratings. The record clearly demonstrates that Frontier has been able to attract the necessary capital to make network investments even without an investment-grade bond rating. The Proposed Order's stated concern that Frontier will be unable to rollover or refinance existing indebtedness on reasonable terms is belied by the fact that Frontier did just that in September 2009, when it arranged 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, in order to fund the proposed repurchase of certain of its outstanding earlier maturity debt. [127] This successful and recent

[125] McCarthy Rebuttal at 72-73; see Barber Confidential Direct Schedule HSC-4. What is even more troubling regarding the Proposed Order's reliance on the IBEW's position is that IBEW's own witness Mr. Barber completed a review and sensitivity analysis of Frontier's financial projections through 2014 using Frontier's model. Mr. Barber made drastic changes in Frontier's assumption and effectively reduced Frontier's revenues projections and increased Frontier's expense projections by a combined aggregate amount of $500 million per year. While Frontier is fully confident in its projections and disputes the reasonableness of Mr. Barber's $500 million offset, the important point is that even after taking into account Mr. Barber's aggressive (and unrealistic) assumptions, Mr. Barber's analysis still shows that Frontier is a financially sound company and generates cumulative free cash flow after dividends (and significant capital investment) of more than $1.0 billion during the four-year period after the closing of the transaction..So even in the most dire, albeit unrealistic circumstances, projected by CWA, Frontier is still projected to generate more than enough cash to pay its expenses, maintain its operations, invest in its network, pay shareholder dividends and still have cash left over.

[126] Proposed Order at 30.

[127] McCarthy Rebuttal at 28-30.

financing at a competitive and reasonable rate makes it clear that Frontier has reasonable access to capital. The Proposed Order makes no mention of this fact, let alone explain how its speculative conclusion could be consistent with it.

Third, the Proposed Order states that the Transaction will result in Frontier incurring $3.3 billion in debt.[128] But the absolute amount of debt alone reveals little about the financial effect of the transaction. Here, the increase in debt will be more than offset by increases in Frontier's annual revenues, EBITDA and Cash Flows. The evidence in the record shows that annual revenues, based on 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, *without* including any anticipated synergies.[129] With synergies, the combined EBITDA increases to $3.6 billion, using the 2008 results.[130] Also, as summarized above, even after Frontier pays all of its expenses (including interest on the debt) and invests in its network and operations, Frontier will generate Free Cash Flow of hundreds of millions of dollars per year ($681 million without synergies, and $991 million with synergies).[131] As such, the dollar amount of $3.3 billion debt and the interest on that debt is not an "enormous" financial obligation for Frontier.

The fact that Frontier will be incurring $3.3 billion in debt itself 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. Indeed, at

[128] Proposed Order at 30.

[129] McCarthy Rebuttal at 59-60.

[130] *Id*.

[131] McCarthy Rebuttal at 63. The effect of the Transaction is the same as if a person simultaneously started a new job and bought a new car with a loan. Looked at in isolation, the car loan amount might suggest that the person's financial situation is more risky than before the purchase. But if it turned out the increased salary was significantly more than the increase in the car loan, that conclusion would be wrong. The same is true here.

the end of the second quarter of 2009, AT&T had net debt of approximately $69.4 billion[132] and Verizon had just over $64 billion[133] in net debt – although those numbers dwarf the debt of Frontier, those numbers standing alone obviously do not mean their financial condition is worse than Frontier's. Finally, the size of Frontier's debt increase here is significantly lower than the $5.8 billion increase in CenturyTel's net debt load as a result of the CenturyTel/Embarq transaction.[134] Although it references the $3.3 Billion debt as an issue, the Proposed Order fails entirely to consider these facts and issues.

Fourth, again adopting the IBEW's position, the Proposed Order claims that Frontier has a "risky business model" because it has historically paid out dividends in excess of net earnings.[135] But this conclusion is incorrect. As an initial matter, the Proposed Order ignores the appropriate financial analysis, and the analysis required by the financial markets, evaluates dividend payments in relation to free cash flow, not net income.[136] Net income reflects historical investment and depreciation rates and other non-cash adjustments going back years or even decades when capital equipment costs were higher and the number of access lines served by telephone utilities were greater. Free cash flow is calculated after all cash outflows including capital expenditures and so better defines how much cash a company has available to pay

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[132] McCarthy Rebuttal at 60 (*citing* 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)).

[133] McCarthy Rebuttal at 60 (*citing* Verizon, Q2 Investor Quarterly 2009 15 (July 27, 2009), (available at: http://investor.verizon.com/financial/quarterly/vz/2Q2009/2Q09Bulletin.pdf?t=633904300284080415)).

[134] McCarthy Rebuttal at 60; 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).

[135] Proposed Order at 30-31.

[136] *See* McCarthy Rebuttal at 62; *see also* Barbara Black, CORPORATE DIVIDENDS AND STOCK REPURCHASES § 1:3 (2004) (noting that the majority of states, including Illinois, have "focus[ed] on cash flow" in formulating solvency tests to govern dividend distributions).

appropriate returns to its shareholders while maintaining a reasonable reserve.[137] By this measure, Frontier's dividend payout ratio averaged only 62% from 2005-2008, a ratio that will improve as a result of the Transaction (on a pro forma basis) to 52% without synergies and 43% with synergies.[138] In other words, even *after* capital expenditures and other cash outflows, Frontier will retain approximately forty percent (40%) of its free cash flow as a cushion for unanticipated needs.

The Proposed Order's only response is the bald assertion that Frontier's announced plan to reduce its dividends by 25% is not "credible" because Frontier has paid dividends of $1.00 in the past.[139] This astonishing assertion finds no support in either the law or the record – indeed, even IBEW did not make such a claim. Frontier's Board of Directors has determined that upon closing of the proposed transaction, Frontier will reduce its shareholder dividends from the current level of $1.00 per share to $.75 per share.[140] Frontier's announced change in policy is not simply a casual assertion by a witness in this proceeding that the Commission is free to ignore or discount based on the witness's "credibility" – Frontier has made this corporate commitment in filings with the Securities and Exchange Commission and would be potentially subject to serious sanction if it misrepresented this fact in its filings. Frontier has also communicated its plan to reduce its dividends to its shareholders and to the public at large,[141] which further undermines

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[137] McCarthy Rebuttal at 62.

[138] *See* McCarthy Rebuttal at 63 (Table 3).

[139] Proposed Order at 31. Even if this were true – and as discussed above it is decidedly not – Frontier still would be able to fund all capital expenditures and other needs while retaining a (smaller) cash reserve. Thus, although Frontier chose to alter its dividend policy to be more prudent, even an unchanged policy would not impair Frontier's ability to obtain capital on reasonable terms.

[140] McCarthy Direct at 35.

[141] Frontier Exhibit 8.6, Simon Flannery, *3Q09 Preview: Spinco Approval Process in Focus*, Morgan Stanley Research, October 30, 2009) discussing Frontier's plan to reduce its dividend by 25%. Also, in October, Frontier shareholders overwhelmingly voted to approve the proposed transaction. The shareholder proxy soliciting the vote also described Frontier's new dividend policy of $.75/share.

any assumption that Frontier would alter its plan. The Proposed Order's offhanded dismissal of Frontier's reduction of its shareholder dividends cannot be sustained and does not provide any legal or factual basis for the Proposed Order's findings.

Fifth, the Proposed Order notes that Frontier has not yet obtained the debt financing it will need to close the Transaction.[142] But this provides no indication at all as to Frontier's ability to raise capital on reasonable terms. As it testified at the hearing Frontier will arrange for financing for the Transaction and expects to secure a portion of the financing in the immediate future.[143] The fact that Frontier has not yet secured the debt financing, by itself, should not raise any undue concern for the Commission. To the contrary, as the Public Utilities Commission of Ohio determined on February 11, 2010, when approving the Transaction, the fact that Frontier "must secure financial backing from a lender" provides "additional assurance" that the financial aspects of the Transaction "will be given prudent review."[144] Until recently, and before Frontier and Verizon obtained regulatory approval orders from six out of the nine state utility commissions required to approve the transaction, it would have been premature and imprudent for Frontier to seek terms for that debt so far ahead of closing.[145] Because lenders would face significant uncertainties about the outcome of the regulatory process if they committed to terms well before closing, the interest rates likely would be *higher*.[146] Moreover, as noted above, Frontier has already demonstrated its ability to obtain debt financing on reasonable terms as recently as September 2009. This market-based evidence provides strong indication that Frontier

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[142] Proposed Order at 31.

[143] Hearing Transcript (01/20/10) at 437-438

[144] Opinion and Order, *In the Matter of the Joint Application of Frontier Communications Corporation, New Communications Holding, Inc., and Verizon Communications Inc. for Consent and Approval of a Change in Control*, Case No. 09-454-TP-ACO (issued Feb. 11, 2010), at 26.

[145] *See* McCarthy Rebuttal at 28-29.

[146] *See* McCarthy Rebuttal at 28-31.

will be able to obtain the needed financing at reasonable rates and terms. And, in any event, as Staff witness Phipps recognized, Section 7.18 of the Merger Agreement provides additional protections including an annual interest rate protection above 9.5%, which ensures that Frontier does not have to accept unreasonably burdensome terms.[147] The Proposed Order fails to consider any of these facts which demonstrate that Frontier will continue to have reasonable access to capital.

Finally, the Proposed Order points to the experience of FairPoint as a reason to find that this Transaction fails to satisfy section 7-204(b)(4).[148] But whatever problems FairPoint may have had are irrelevant to the statutory standard here: whether the proposed Transaction will significantly impair that ability of the Illinois utilities to raise capital on reasonable terms and to maintain a reasonable capital structure. As noted above, the utilities in question here – Verizon North and Verizon South – will be able to do that based on their own cash flow and thus the ability of Frontier to raise capital is irrelevant. And, even if were, the record in this proceeding is clear that Frontier – which is much larger and has a more established track record that FairPoint – will be able to raise capital on reasonable terms and to maintain a reasonable (indeed, improved) capital structure.[149] The Order's opposite conclusion is contrary to the record, the considered determination of the Staff, AG, and CUB, and the findings of six other state commissions that have reviewed this Transaction, and cannot be sustained.

[147] Phipps Rebuttal Testimony at 5..

[148] Proposed Order at 31-32.

[149] The Proposed Order ignores the evidence that Frontier is quantifiably stronger than FairPoint. Frontier is less leveraged and more conservative in its dividend policy, and is nine times the size of FairPoint based on the number of lines. McCarthy Rebuttal at 9. More importantly, as discussed above, FairPoint's financial problems stemmed from problems with having to create new operational support systems from scratch, and Frontier specifically negotiated a "turnkey" systems transition here in order to avoid such problems.

Finally, it is important that the Commission recognize that it will also have ample opportunity to monitor Frontier's ongoing financial health. Although ignored by the Proposed Order, in the Stipulation with the AG/CUB, Frontier agreed to the following additional financial reporting conditions:

1. Beginning at the date of closing, the New Frontier Illinois ILECs must submit a quarterly report to the Commission on E-Docket in Docket 09-0268 listing the balance of the intercompany receivables and payables showing the beginning balance, the change for the quarter and the ending balance of those accounts. The New Frontier Illinois ILECs must also include in this quarterly report the dividend amount the New Frontier Illinois ILECs paid to Frontier, the parent. This report must also show the dividend payment Frontier, the parent, paid to its shareholders (in total and per share) by quarter. This Condition (1) shall remain continuously in effect until (i) at a minimum Frontier Communication Corporation's issuer credit rating meets two of the following three credit ratings: BBB from Standard & Poor's, Baa2 from Moody's Investors Service or BBB from Fitch Ratings, or (ii) for five years following the closing the proposed transaction, whichever is earlier. Condition (1), i.e., the Service Standards requirement and the prohibition on dividends or other cash transfers, shall be automatically reinstated if at any time Standard & Poor's or Fitch Ratings gives Frontier an issuer credit rating below BB or Moody's Investor Service gives Frontier an issuer credit rating below Ba2.

2. Within 30 days after the close of the transaction, the New Frontier Illinois ILECs must notify Commission Staff, OAG and CUB of the Frontier post-transaction (a) consolidated Net Debt/EBITDA on a pro forma basis as of closing and (b) the number of shares issued to Verizon shareholders at closing, the price per Frontier share used to determine transaction shares and the calculation of the share price.

3. Frontier will provide Commission Staff, OAG and CUB a copy of the opinion of the independent valuation firm provided pursuant to the terms of Section 8.1(k) of the Merger Agreement attesting to the solvency of Frontier on a pro forma basis immediately after the closing of the Transaction and reflecting the financing thereof. This solvency opinion shall be submitted to Commission Staff,

OAG and CUB within one business day of its delivery to Frontier.[150]

In short, Frontier has made a binding commitment by Frontier to provide the Commission with additional information to enable the Commission to assess and monitor Frontier's financial condition. The Proposed Order, however, ignores this.

To correct the erroneous finding and conclusion, the Proposed Order should be revised in accordance with Joint Applicants' exceptions language to find that the Transaction, subject to the conditions negotiated by Staff, AG, CUB and other intervenors, meets the criterion set forth in Section 7-204(b)(4) and to approve the Transaction.

D. The Proposed Order Misapplies § 7-204(b)(5).

The Proposed Order's final rationale for recommending disapproval is its conclusion that the Transaction does not satisfy Section 7-204(b)(5) of the Act. Section 7-204(b)(5) states that, in approving a proposed reorganization, the Commission must find that "the utility will remain subject to all applicable laws, regulations, rules, decisions and policies governing the regulation" of Illinois incumbent local exchange carriers. There is no dispute by *any* party in the proceeding that the utilities transferring to Frontier – Verizon North and Verizon South – will remain subject to "all applicable laws, regulations, rules, decisions and policies governing the regulation" after Frontier becomes their parent. Indeed, even the IBEW – the only party to oppose the transaction – does not challenge this conclusion.

The Proposed Order, however, misapplies Section 7-204(b)(5). It concludes that this section is not satisfied because Verizon South is allegedly out of compliance with a *different* section of the Act, Section 13-517, which requires certain telecommunications carriers "to offer

[150] Frontier Exhibit 13, AG/CUB Stipulation.

or provide advanced telecommunications services to not less than 80% of its customers."[151] But whether Verizon South is today in compliance with Section 13-517 (or any other law or regulation) has nothing to do with whether Section 7-204(b)(5) is satisfied; post-transaction, Verizon South will, in fact, "remain subject to all applicable laws, regulations, rules, decisions and policies," and that is all Section 7-204(b) requires.

The Commission confirmed that conclusion when it examined section 7-204(b)(5) less than a year ago and held that it was satisfied where, as here, the parties to the transaction agree that Illinois law will continue to apply to the transferred utility:

> With respect to the requirements of Section 7-204(b)(5) . . . Joint Applicants acknowledge and agree that, following the completion of the proposed reorganization, Gallatin River will continue to be subject to all applicable laws, regulations, rules, decisions, and policies governing Illinois incumbent local exchange carriers. … [T]his commitment was also viewed by staff [and provides] a sufficient basis for the Commission to find the criteria of Section 7-204(b)(5) to be met.[152]

Here, the Joint Applicants have likewise committed that Illinois law will continue to apply to the transferred utilities, and Staff has confirmed and agrees with this commitment. That is sufficient to satisfy section 7-204(b). The Proposed Order, therefore, is in error and must be corrected.

In any event, even if compliance with Section 13-517 were relevant here, Frontier has voluntarily committed to bring Verizon South into compliance (based on Staff's analysis) within 24 months of the closing date.[153] Even more significantly, Frontier has committed to provide

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[151] Proposed Order at 35.

[152] Order, *Century Tel, Inc., and Galllatin River Communications, LLC d/b/a CenturyTel of Illinois Joint Application for Approval of Reorganization Pursuant to Sections 7-203 and 7-204 and for Other Relief,* Case No. 08-0645 (March 25, 2009) at 7.

[153] Verizon does not agree that it is currently out of compliance with § 13-517. The record shows that Verizon's *total operations* in Illinois, which include both Verizon North and Verizon South, meet the 80% requirement of § 13-517. In this proceeding, however, Staff took the position that Verizon was out of compliance with § 13-517 because even though Verizon's total footprint in Illinois exceeds 80% availability based on the number of Verizon's

increased broadband services throughout the Verizon territory at a level that *far surpasses* what is required under Illinois law. As noted, Section 13-517 requires certain telecommunications carriers "to offer or provide advanced telecommunications services to not less than 80% of its *customers*" (emphasis added). Frontier, however, has committed to deploy broadband services to eight-five percent (85%) of the *households passed* in the territory it is acquiring.[154] Because of competition, the "households passed" in Verizon's service territory far exceeds the number of Verizon's current "customers." Put another way, Frontier has committed to making broadband available to 85% of the households in Verizon's territory *regardless of whether these households are current customers of Verizon.* Thus, for example, where Verizon's current network passes a household that is served by a cable company, Frontier will make that portion of the network broadband capable. In this way, consumers will have more choices in broadband providers.

Based on the undisputed record evidence, Frontier's commitment will increase wireline (DSL) broadband availability, based on households passed, *by more than 25%,* from less than 60% to at least 85% of the households passed in the Verizon Illinois service area, [155] which equates to more than an additional 100,000 unserved and underserved households. And again, this commitment applies to both the Verizon North and Verizon South areas. Moreover, Frontier made clear at the hearing that it will satisfy this commitment solely through wireline broadband

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current customers, Verizon South, standing by itself, misses that threshold by only a small margin. As noted above, this compliance issue is moot given Frontier's commitments.

[154] *See* Frontier Corrected Exhibit 8.4.A (Condition # 6); see also Tr. 403-406 (testimony of Frontier witness Daniel McCarthy).

[155] The undisputed record evidence shows that Verizon has deployed wireline broadband to 60% of the "households passed "in its Illinois service territory. (Again, this percentage does not include Verizon's *wireless* broadband deployment.) Hearing Transcript (01/20/10) at 421. Indeed, IBEW's witness acknowledged that wireline broadband deployment in Verizon's Illinois footprint, based on households passed, is less than 60% (Baldwin Direct Testimony at 52), even though Verizon has made broadband available to 80% of the current *customers* in its footprint.

service; it will not rely on wireless or satellite service.[156] Given Frontier's commitment to put Verizon South into compliance under any interpretation of the statute within twenty-four months, and given its commitment to deploy broadband services at levels far beyond what the law requires, the Section 13-517 compliance issue is moot.

Remarkably, though, the Proposed Order dismisses Frontier's broadband commitments, stating only that "it is not confident" Frontier can meet its commitments because "Verizon South, a stronger company with more resources, has yet to meet compliance."[157] This claim is not based on any evidence; indeed, it is *contrary* to all the evidence presented in testimony and at the hearing:

First, Verizon South is quite small – it serves only 19,000 access lines, whereas Frontier today serves more than 97,000 access lines in Illinois alone.[158] There simply is no evidence Verizon South is a "stronger company."

Second, based on Staff's analysis, only about 1,140 customer lines are out of compliance, a fact the Proposed Order ignores. It simply is not credible to conclude that Frontier will not be able to extend broadband to at least that many customers in twenty-four months.

Third, Frontier has a proven track record of deploying broadband. It has deployed broadband to more than 90% of the households in its current territories, whereas Verizon has deployed broadband to a significantly lower percentage (approximately 60%) in the territories Frontier is acquiring.[159] In Illinois Frontier has deployed broadband to 87% of the households in

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[156] Tr. 425 (testimony of Frontier witness Daniel McCarthy). Verizon relies, in part, on wireless service to satisfy its statutory obligation. Frontier will not.

[157] Proposed Order at 35.

[158] Erhart Rebuttal at 8; McCarthy Direct Testimony at 7.

[159] McCarthy Rebuttal Testimony at 11.

its service territory.[160] Frontier has nine ILECs operating in Illinois and every one of the ILECs has exceeded 80% broadband availability. In fact Frontier has reported that four of these ILECs have deployed broadband to more than 90% of the households in their service territories; and that one of Frontier's ILECs, Frontier Communications of Depue, has made broadband available to 100% of the households in its service territory.[161]

Moreover, in its 24 states, Frontier owns and operates 330 host and 695 remote switches, and it has deployed broadband service in 1017 (99.3%) of the 1025 host and remote switches.[162] In Illinois, 100% of Frontier's 138 host and remote wire center are equipment and offer broadband service.[163] Also, as Staff witness Qui Liu testified, "advanced services are currently available to residential customers in [only] 4 of the 43 Verizon South exchanges."[164]

In short, all the evidence proves that Frontier is ready, willing, and able to make the necessary investment to increase the availability of wireline broadband to at least 85% of the households passed in Verizon's Illinois service territory. As noted, this is a 25% increase and will enable more than 100,000 unserved Illinois households to obtain access to wireline broadband service from Frontier. Frontier has achieved this level of broadband deployment in its existing rural Illinois service area and across the county and has a proven, laser-like focus in bringing broadband to rural and less dense areas. In sharp contrast, Verizon has decided to exit

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160 Transcript (01/20/10) at 421.
161 See Direct Testimony of Qui Liu at 5. Frontier has also provided testimony that it has determined that a sizeable percentage of its rural customer base did not have a personal computer in their household. Because access to a computer is essential to using the broadband capability Frontier has provided, Frontier offers promotions enabling customers to receive a free PC or laptop in conjunction with the purchase of a bundled package for a fixed term. Over the last several years, Frontier has provided over 85,000 computers to its customers. McCarthy Direct Testimony at 13-14. Frontier has further testified that it intends to make these same types of promotions available in the Verizon service territories after the closing of the transaction, which will provide additional benefits to Illinois consumers. *Id*. at 14-15.

162 McCarthy Direct Testimony at 12.

163 *Id.*

164 Rebuttal Testimony of Qui Liu at 18.

the local wireline business in lower density areas such as those in Illinois and to focus on using its capital prudently and primarily to meet its growth initiatives in wireless, high density urban areas and the international enterprise business.[165] It is simply not part of Verizon's business strategy to invest in wireline broadband deployment in areas such as Illinois.

Fourth, Frontier is not just claiming that it will deploy broadband; rather, *it has made* a *tangible, enforceable commitment to deploy broadband to 85% of the households passed in the acquired Illinois territories, or more than 100,000 unserved and underserved households, and has committed a minimum of $40 million toward that goal.*[166] There is absolutely no basis for the Proposed Order's suggestion that the evidence does not support Frontier's ability to fulfill this commitment.

The fact that Frontier is committed to pursuing expanded broadband availability in Illinois is further solidified by Frontier's commitment in the Stipulation with the AG and CUB to provide periodic reporting and updates:

> 7. The New Frontier Illinois ILECs shall submit an initial plan for broadband deployment within 90 days of the transaction closing date. The New Frontier Illinois ILECs will consult with Commission Staff, OAG and CUB regarding the geographic scope of the broadband deployment (including the specific wire centers that will be included) and the timelines for its implementation. The New Frontier Illinois ILECs must file annual progress reports on broadband deployment with the Commission no later than May 1 of each succeeding year following the close of the merger through May 1, 2014. The annual report must contain information on a wire center basis as of December 31of the previous year including:
>
> - the total number of retail residential and business subscriber lines served by the company;
> - the total number of households in the service territory;

[165] Erhart Direct Testimony at 5.7.

[166] Frontier Corrected Exhibit 8.4.A (Condition # 6). In addition, Frontier has further committed to keep at least $50 million available exclusively for Illinois operations, and will certify each year for the duration of the commitment that $50 million or more is available for the ensuing year. Frontier Corrected Exhibit 8.4.A (Condition # 2).

- the number of broadband-capable subscriber lines by technology (DSL, FTTP and others);
- the number of broadband subscribers by technology, including both subscribers of stand-alone broadband services and subscribers of bundles that contain broadband services, and
- total expenditures associated with new broadband deployment in the previous calendar year by technology.

Given all these commitments, the Proposed Order's "concerns" about Frontier's ability to deploy broadband must be rejected.

IV. The Transaction Satisfies all Other Applicable Sections of the Act.

Of the statutory requirements that must be met for approval, the Proposed Order found that the Transaction failed to meet only Section 7-204 (b)(1), Section 7-204(b)(4) and Section 7-204(b)(5). The Proposed Order acknowledges that the Transaction otherwise meets the requirements of Section 7-204(b). Nevertheless, Joint Applicants propose exceptions language to ensure that the Commission includes the conditions language negotiated between Joint Applicants and Staff or Joint Applicants and intervenors.

The Proposed Order does not discuss the other relevant statutory requirements, but there is no dispute that they are met.

A. The Commission should Make the Required Finding Under Section 7-204(c).

Section 7-204(c) of the Act states that the Commission shall not approve a proposed reorganization without ruling on: (i) the allocation of savings from the proposed reorganization; and (ii) whether the company 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.

The Proposed Order did not address this section. Joint Applicants respectfully request the Commission adopt Staff's proposal,[167] which 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) Joint Applicants will not be allowed to recover any costs incurred in accomplishing the proposed reorganization in future rate proceedings.

Frontier witness McCarthy, in his rebuttal testimony, concurred with Staff's position.[168] No party objected to this proposal, and therefore the Commission should revise the Proposed Order consistent with Joint Applicants' exceptions language to adopt it.

B. Section 13-900 is Satisfied

Section 13-900 of the Act requires 9-1-1 a service provider that was not providing 9-1-1 service on June 30, 2009, to obtain a Certificate of 9-1-1 Service Provider Authority if it plans to provide 9-1-1 network and database services to an authorized 9-1-1 system. Verizon North was providing 9-1-1 network and 9-1-1 database service on the effective date of June 30, 2009,[169] and since Frontier is, under the terms of the agreement, acquiring Verizon North outright, the Verizon North properties transferred to Frontier are exempt from the certification requirement under this provision. Staff agrees with his position.[170]

The Proposed Order notes that "the case is different for Verizon South properties, which will be taken over by a newly-formed ILEC named New Communications of the Carolinas, which was not providing 9-1-1 network and 9-1-1 database service on June 30, 2009. It appears, therefore, that New Communications of the Carolinas is not exempt from the Section 13-900 of

[167] Ostrander's Direct Testimony at 10.

[168] McCarthy's Rebuttal at 37.

[169] Ross Rebuttal .at 2.

[170] *Id*.

the Act certification requirement."[171] But the Proposed Order goes on to explain that the Verizon employees responsible for the operation of the current Verizon 9-1-1 system in Illinois will continue as Frontier employees after closing; that Frontier intends to open a new 9-1-1 customer care center to serve states, including Illinois, where it is acquiring properties from Verizon; and that any necessary additional training of the existing workforce that supports 9-1-1 services in Illinois will be conducted by Verizon prior to closing.[172] Also, Frontier testified that it has the financial capabilities and resources to meet the statutory requirements for a 9-1-1 Certificate, and has requested that the Commission grant it a Certificate of 9-1-1 System Provider Authority in this proceeding.[173]

Given this evidence, Staff opined that New Communications of the Carolinas will, upon closing of the Transaction, possess the necessary technical and managerial resources and abilities to meet the requirements of Section 13-900(c) of the Act.[174] Staff also agreed that Frontier demonstrated sufficient financial capabilities and resources throughout its testimony in this proceeding. Therefore, Staff recommended that the Commission grant New Communications of the Carolinas a Certificate of 9-1-1 System Provider Authority subject to three conditions:

- 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

[171] Proposed Order at 42.

[172] *Id.*

[173] *Id.;* McCarthy Rebuttal at 45.

[174] Ross Rebuttal at 4.

> shall be submitted to normal Commission review of proposed increases.[175]

Frontier accepted these conditions.[176] The Proposed Order did not address this issue, but Joint Applicants request that, consistent with the exceptions language proposed by Joint Applicants, the Commission adopt Staff's proposal, which was not challenged by any party.

C. Section 6-103 is Satisfied

Section 6-103 of the Act, provides, in part, that "the capitalization of a public utility formed by a merger or consolidation of two or more corporations shall be subject to the approval of the Commission." Staff recommended that the Joint Applicants provide the Commission sufficient information to make a determination regarding the post-merger capitalization to satisfy § 6-103.[177] Since the final capital structure of the merged entity has not yet been finalized, Staff recommended that the Commission adopt Reporting Requirement 3, which requires Frontier to inform the Commission of the capital structure and cost of capital following the proposed reorganization[178] Although Frontier respectfully disagreed with the applicability of this statute, Frontier agreed with this condition.[179] The Proposed Order did not address this issue, but Joint Applicants request that the Commission, consistent with Joint Applicants' exceptions language, adopt Staff's proposal, which was not challenged by any party.

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[175] *Id.* Direct at 17.

[176] McCarthy Rebuttal at 44-45.

[177] Phipps Direct at 3.

[178] *Id.*

[179] McCarthy Rebuttal at 32.

V. The Related Relief Sought by Joint Applicants should also be Granted.

The Joint Applicants respectfully request that the Commission modify the Proposed Order to find that the Transaction all statutory requirements for approval, and to grant approval of the reorganization pursuant to Sections 7-204 of the Act. Because the Proposed Order inappropriately recommends denial of the proposed transaction, it fails to make the numerous other statutory and regulatory findings that the Commission must complete as part of merger approval. No party, not even IBEW, contested the requested findings as to any of these issues. Joint Applicants provide exceptions language to reach appropriate findings on these other statutory or regulatory requirements, including sections 13-405, 13-406, 6-103, 13-900 and designation as an eligible telecommunications carrier. Joint Applicants take exception to the omission of those findings and request that the Commission's final Order include the necessary elements as provided in Joint Applicants' exceptions language, to complete the approval of the transaction.

CONCLUSION

The Commission Staff, the AG and CUB, each charged with supporting the public interest, have each determined that the approval of this Transaction is in the public interest if conditions similar to those this Commission has commonly relied upon in prior orders are included. DoD-FEA, Comcast and Level 3, each a large and sophisticated customer of the Verizon entities that will be transferred to Frontier under the Transaction, have each concluded that the Transaction will not harm them or their customers if their negotiated conditions are included. IPTA has similarly concluded that the Transaction will not harm its members or their services if its conditions are included. Six other state commissions have unanimously concluded that this Transaction is in the public interest. Only IBEW, supporting the interests of only its union membership, opposes this transaction.

The Proposed Order recommends rejection of the Transaction without any reasoned analysis of the conditions that Joint Applicants have negotiated with all of these parties. It also does so while dismissing out of hand substantial record evidence – including uncontested record evidence – demonstrating that Frontier is exceptionally well qualified to operate the Verizon properties through the use of the same assets and support systems and in reliance on the same work force that have supported those properties for years. The Proposed Order also reaches this recommendation without any serious consideration of the significant public interest benefit to Verizon's current landline customers of Frontier's $40 million and 85% availability commitment, or more than 100,000 unserved and underserved household, to expand broadband in Illinois communities where Verizon today has an undisputed policy of no further broadband deployment.

The Proposed Order reaches the wrong conclusion through a flawed analysis of a small and skewed portion of the record. Joint Applicants respectfully request the Commission to correct the Proposed Order by finding, on the basis of an analysis of the complete record and subject to the inclusion of the conditions Joint Applicants have negotiated with Staff and each intervenor other than IBEW, that Joint Applicants meet all the criteria of Section 7-204 and that the Joint Applicants are entitled to all requested relief.

Dated: March 19, 2010

Respectfully submitted,

VERIZON COMMUNICATIONS INC.,
VERIZON NORTH INC., VERIZON SOUTH INC.
AND NEW COMMUNICATIONS OF THE
CAROLINAS INC.

By: /s/ John E. Rooney

John E. Rooney
ROONEY RIPPIE & RATNASWAMY LLP
350 West Hubbard Street, Suite 430
Chicago, Illinois 60654
(312) 447-2800
john.rooney@r3law.com

A. Randall Vogelzang
General Counsel
VERIZON GREAT LAKES REGION
600 Hidden Ridge
Irving, Texas 75038
(972) 718-2170
randy.vogelzang@verizon.com

FRONTIER COMMUNICATIONS CORPORATION

By: ______________________

Dennis K. Muncy
Joseph D. Murphy
MEYER CAPEL
PO Box 6750
Champaign, Illinois 61826-6750
(217) 352-0030
dmuncy@meyercapel.com
jmurphy@meyercapel.com

Kevin Saville
Associate General Counsel
Frontier Communications
2378 Wilshire Blvd.
Mound, Minnesota 55364
(952) 491-5564
kevin.saville@frontiercorp.com

CERTIFICATE OF SERVICE

I, John E. Rooney, hereby certify that I caused a copy of Joint Applicants' Brief on Exceptions, including appendices, to be served upon the service list in Docket No. 09-0268 via email on March 19, 2010.

/s/ John E. Rooney